Australian Banking Association

21 June 2019

General Manager
Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority
Email: ADIPolicy@apra.gov.au

Dear General Manager

Consultation on revisions to prudential practice guide APG 223 residential mortgage lending

Thank you for the opportunity to make a submission on the proposed revisions to the Prudential practice guide APG 223 Residential Mortgage Lending contained in your letter to ADI's on 21 May 2019[1].

With the active participation of 24 member banks in Australia, the Australian Banking Association (ABA) provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services.

The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and community. It strives to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

The ABA welcomes APRA's revision of the current buffer and floor limits set in December 2014. We agree that the economic environment has since that time changed which warrants a review. In particular, making sure the floor is appropriate when determining serviceability requirements for customers, given the low interest rate environment. Revising the floor downwards will mean that customers meet serviceability requirements more easily and could help more customers achieve home ownership. Depending on the approach taken to the floor, the proposed 2.5 per cent buffer may become the determining factor in serviceability assessment.

If a serviceability floor is required, banks are concerned that allowing self-determination of the floor interest rate in the absence of guidance on the approach to be taken could lead to reduced credit quality over time and increase regulatory uncertainty. This is for two reasons:

- Banks may face short term internal incentives to review floor rates downwards which does not reflect the long-term risk. This could lead to reduced credit quality like that requiring intervention in December 2014[2]. This intervention in residential mortgage lending coincided with a decline in economic conditions.
- Increased regulatory uncertainty amongst banks on how to set a correct and appropriate rate is costly. Banks need to make a number of assumptions about APRA's requirements to ensure compliance. Working this out through consultation with APRA supervisors over time and internal review is costly and can result in inconsistency across lenders thereby

[1] https://www.apra.gov.au/sites/default/files/letter_consultation_on_revisions_to_prudential_practice_guide_apg_223_residential_mortgage_lending.pdf

[2] https://www.apra.gov.au/sites/default/files/141209-Letter-to-ADIs-reinforcing-sound-residential-mortgage-lending-practices.pdf

increasing regulatory risk. Further it could slow down implementation which has greater economic impacts.

If a serviceability floor is required, the ABA is proposing that APRA continue to set the floor or alternatively provide clear guidance on the approach to be taken. However, both the floor rate and buffer rate would need to be reviewed regularly by APRA to ensure the rates are in line with economic conditions. The review would be transparent and would take into consideration the current interest rate environment and input from the Council of Financial Regulators (CoFR).

The benefits of the ABA proposed approach are as follows:

- Assures positive customer outcomes and that credit quality is maintained across the industry. This is likely to reduce the risk of regulatory interventions during an economic downturn.
- Allows the proposed amendments to be quickly implemented (after the announcement of the rate by APRA) which could improve some customer's ability to meet serviceability requirements.
- Reduces the regulatory costs for banks from developing a floor and determining its compliance.
- Reduces the supervisory costs to APRA. APRA would not need to evaluate the methodology of each bank to ensure its consistency with the guidance.

Further, the ABA would like to see these requirements extended to the non-ADI residential mortgage lenders. Non-ADIs do not need to meet this mortgage guidance and therefore can offer greater loan amounts to their prospective borrower. This gives non-ADIs a distinct advantage when competing with ADIs as a result of regulation and could also result in unfavourable customer outcomes. Coordination with ASIC may be required to ensure industry-wide consistency in applying these responsible lending obligations to both the ADI and non-ADI sectors

In addition, APRA needs to supervise the growing risk to financial stability that these providers increasingly represent. Despite only representing 5.7 per cent of outstanding loans and advances, non-bank financial institutions accounted for 12.5 per cent of growth in lending over the 12 months to March 2019.

Yours faithfully

Karen O'Brien
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