28 February 2022

Mr [redacted]
General Manager - Policy
Policy and Advice Division
Australian Prudential Regulation Authority

Via email: [redacted]

Dear Mr [redacted]

Macroprudential policy: consultation

COBA welcomes the opportunity to comment on APRA's proposed *APS 220 Attachment C – Macroprudential policy: credit measures.*

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has more than $150 billion in assets and more than 4.5 million customers. COBA represents our member customer-owned banks who have a wide range of business models and service many different demographics including those originating from employee groups (e.g. essential workers) or specific regional areas.

Welcoming increased transparency on macroprudential measures

COBA welcomes the increased transparency on APRA's macroprudential policy measures. This consultation, APRA's recent Macroprudential Information Paper and explanations of its recent buffer have greatly increased transparency on APRA's macroprudential framework. This transparency provides more certainty to ADIs as to what to expect when APRA applies these credit- and lending standard-related measures that have significant impacts on how our members operate their businesses. We note that APRA's approach is to formalise measures stating that "this package does not change the potential macroprudential tools APRA may use, or provide APRA with additional powers". This additional transparency may also increase an ADI's ability to implement these measures at a shorter notice than in the absence of such a policy.

We also support APRA's increased transparency around its decision to recently increase the interest rate buffer to 3.0 per cent, particularly regarding its consultation with other CFR agencies and the ACCC and its regard to the "impact on different borrower cohorts, credit risk, loan growth and competition".[1] In the past, poorly constructed limits have caused competitive issues with limits based upon existing portfolios potentially locking in market shares. In 2018, the ACCC found a clear impact on competition from APRA's macroprudential measures and that the "lack of sensitivity to scale in the design of these regulatory measures has given a competitive advantage to the large banks."[2]

COBA acknowledges that APRA's credit-based macroprudential measures aim to moderate higher risk lending to change the flow of credit in the economy through a policy intervention (compared to the counterfactual of no change). This means that they are intended to have certain consequences on

[1] APRA Letter to ADIs: Strengthening residential mortgage lending assessments, 6 October 2021

[2] ACCC Residential mortgage price inquiry: Final Report November 2018, page 10

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lending activities. However, these consequences must be intended and are clearly articulated to be intended. It is critical to avoid any harmful unintended consequences.

Clarifying the forward-looking nature of macroprudential measures

COBA seeks confirmation that any macroprudential measures applied under APS 220 para 111 and APS 220 Attachment C relate to loan growth rather than existing loan stocks. This would allow ADIs to focus limited resources on pre-positioning regarding new loans. COBA believes this is implied given that para 111 on macroprudential measures does not refer to portfolio limits.[3]

Embedding flexibility for different limits

COBA believes that the Attachment C should reflect APS 220 para 111 and make it clear that APRA may set different limits for different classes of ADIs. This would allow APRA to set different limits for different groups of ADIs. For example, this could be through higher limits or longer 'rolling periods' for restrictions.[4] This clarity would allow APRA to provide flexibility for smaller ADIs which are likely to have more difficulty managing limits compared to the major banks given they can be subject to higher levels of lending volatility due to their smaller size, lower growth bases as well as spill-over effects when larger ADIs pull back lending.[5]

Given their macroprudential nature, by default these measures start off as one size fits all. However, this may not be appropriate as there are significant variations in ADI size across the financial sector. As noted above, these size differences can make it harder to operate within these limits. There are also a wide range of business models and risk appetites across the customer-owned banking sector. Some COBA members may be overweight in certain demographics such as essential workers, geographical regions, first home buyers, particular partnerships with State & Federal Governments[6] and particular products such as construction loans. These demographic niches may mean they are more or less likely to breach any system-wide macroprudential limits. There is also a 'small numbers' issue where percentage-based limits that grow off smaller bases are more difficult to comply with for smaller ADIs. This issue occurs because smaller ADIs will have smaller aggregate limits but the size of individual housing loans do not change with ADI size and remain relatively constant. APRA should be cognisant of this when setting and enforcing any limits.

While it is not practical to set individual limits for individual entities, Attachment C should make it clear that APRA has the ability to set different limits for different classes of ADIs. This would not be a new policy position but rather reiterating what is already articulated in APS 220 para 111 which states: "APRA may set limits on particular types of lending, including but not limited to, the share of lending or growth rate of lending, to be **complied with by all ADIs or a specified class of ADIs." (COBA emphasis)**

Clarifying definitions – debt-to-income ratios

COBA's view is that definitions used across industry must be as consistent as possible to limit distortions from applying macroprudential limits. Inconsistent definitions may advantage or disadvantage individual ADIs that have taken different views of the various definitions. Given APRA is the only entity with visibility across the industry and these definitions exist as APRA prudential or reporting requirements, APRA is best placed to identify issues and provide guidance to promote consistency. COBA members also note that for consistency purposes that we support using the same definitions and interpretation for macroprudential limits as those used in APRA's prudential reporting

[3] In contrast to APS 220 para 110 which refers to individual ADI limits

[4] For example, in [RBNZ's Framework for Restrictions on High-LVR Residential Mortgage Lending (page 3)] which notes "restrictions will normally apply over a three-month rolling period for banks with new mortgage lending flows of more than $100 million per month, and a six-month rolling period for other banks".

[5] Limits also create overflow onto smaller ADIs from the majors – you can be heading in the right direction, but then hit by a wave of loans flowing from majors.

[6] For example, State or Federal Government shared equity, land rent and deposit guarantee schemes.

(e.g. ARS 223 Residential Mortgages). COBA notes that definitional changes to address consistency issues may also require additional time to adjust systems.

The loan-to-valuation ratio (LVR), interest-only status and investment definitions are relatively straightforward given their more common usage and APRA's previous use of these definitions for past macroprudential measures.[7] However, this may be not the case for debt-to-income (DTI) ratio definitions.

Debt-to-income ratio definition

Unlike the other measures in para 5,[8] debt-to-income ratios have not been used in previous macroprudential measures and there is significant scope for interpretation as a ratio of two subjective measures of borrower income and borrower debt. In particular, there are questions to the extent that Buy Now Pay Later (BNPL) products and HECS loans are included as debt. BNPL products can vary in size and may be harder to detect despite being credit-like products. HECS loans are income contingent and are not exposed to interest rate movements.

COBA members also highlight a number of issues when it comes to interpretating DTIs. In some cases, ADIs may only verify income to the extent that it meets their legal obligations so DTI may be overestimated in these cases. Given the blunt nature of DTI figures, COBA members suggest that APRA work through the different impacts on different cohorts of borrowers before applying these particular DTI limits.

Implementation issues

Lending standards

COBA member feedback notes that it is most straightforward to adjust interest rate buffers than implement credit-related measures. Any increased buffers are assessed at the approval stage at an individual loan level so ADIs will know when they are compliant with any macroprudential measures. This also reduces impact on the customer experience given the restriction is assessed up front.

Credit-related measures

COBA notes that there are difficulties with managing pipeline loans when applying macroprudential measures. These loans would be approved but not funded. Under the credit-related measures, we understand the limits are assessed at the funding stage. COBA member feedback notes that there may be potential customer experience issues where ADIs have to curtail lending to meet recently imposed limits as ADIs work to clear out the previously approved pipeline loans. If ADIs have to manage disappointed customers due to regulatory interventions, this could promote unhelpful public debate and interest from political stakeholders.

Minimum notice periods

COBA suggests that APRA outline an indicative notice period to help ADIs understand the approximate time they have to go from pre-positioned to implementing these measures. Para 8 states that APRA would notify ADIs of the date from which its limits would apply with APRA's letter only outlining that this would be "ahead of the date". As an example, RBNZ outlines indicative notice periods on its website[9]. COBA notes that period of 4-6 weeks may be appropriate to allow ADI to manage pipelines and implement any potential pricing changes. COBA member feedback suggests that it may take up to 90 days to clear existing loan pipelines that may have been approved before the APRA's announcement of any macroprudential measures.

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[7] APRA announces further measures to reinforce sound residential mortgage lending practices

[8] APS 220 Attachment C

[9] RBNZ Macro-prudential policy FAQs

COBA believes that APRA will also need to provide additional flexibility where it prescribes limits involving non-specified loan types. ADIs may not be appropriately pre-positioned for any non-specified loans.[10] COBA welcomes APRA's intention to consult ahead of adding any new loan types. In all cases, COBA notes that ADIs would prefer it if APRA consulted on new loan types before introducing any limits on these new loan types.

Flexibility regarding particular types of loans

APRA should have explicit power to exclude certain types of loans from its macroprudential limits where appropriate. As a precedent, RBNZ excludes a number of special cases such as repair work, bridging finance, refinancing, certain Government-backed scheme loans and construction loans.[11] While COBA acknowledge that RNBZ's macroprudential measures are relatively strict, we believe the case still stands for special consideration of certain loans.

COBA believes the following loans should have particular consideration:

- First Home Loan Deposit Scheme loans – these loans are in limited quantity across the system due to place limits, have a Government-backed guarantee, align to specific Government goals and have unique timing considerations.
- Bridging loans – while these loans can have high DTI ratios at origination, the DTI decreases within a short timeframe (<1 year).
- Construction loans – while these loans are considered to be interest-only at origination, this reverts to P&I within a short timeframe (<1 year), these also support economic growth and housing supply.

COBA acknowledges that at present these loan types may not be readily reportable using existing APRA prudential reporting. However, COBA understands that future data collections are likely to contain elements that would allow the reporting of these loans.

Understanding public disclosure

COBA seeks more information as to which circumstances that APRA would require an ADI to publicly disclose lending levels under para 10. As unlisted and smaller entities, mutual ADIs do not have the reporting resources of larger listed ADIs so it is critical to understand the circumstances where this would occur. COBA members note there may be some commercial sensitivities with disclosing this information so there would need to be public interest case. Given APRA's expectation on ADIs, we suggest that APRA disclose aggregate system lending against these limits as well for transparency purposes. While APRA's Quarterly ADI publications may provide some information, they may not have the sufficient level of detail or context for macroprudential monitoring.

COBA notes that it may be worthwhile for APRA to prominently publish any macroprudential measure parameters on its website given APRA has now made this buffer more explicitly amendable and APRA will introduce a default non-zero countercyclical buffer from 2023. This will ensure that these key parameters are easily accessible by all stakeholders alongside the latest relevant information, including APRA's latest systemic risk assessment.

Applying macroprudential measures to non-ADI lenders

COBA welcomes APRA's references to applying macroprudential measures to non-ADI lenders. Non-ADI housing lenders are direct competitors to our sector. The application, or non-application, of macroprudential measures on non-ADIs can impact the competitive dynamics between non-ADIs and our sector. COBA supports APRA applying these measures to non-ADIs where they contribute to risks of instability in the Australian financial system. We welcome APRA's continuing assessment and transparency on the risks that the non-ADI pose to broader financial stability.

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[10] i.e. loan types not in para 5-7 of APS 220 Attachment C

[11] See RBNZ's Framework for Restrictions on High-LVR Residential Mortgage Lending (page 10)

APRA’s macroprudential paper states that the overall size of the non-ADI sector is a factor in determining policy action on non-ADIs. APRA’s recent announcement of ADI measures excludes non-ADIs on the basis that “Non-ADI lenders currently account for a quite small share (<5 per cent) of total housing lending”. COBA members have noted that the customer-owned banking sector is a similar size. While we acknowledge that as ADIs, this may limit our ability to be exempt from APRA’s measures, we believe this supports a case for differentiated measures and flexibility in their application.

If you wish to discuss any aspect of this submission, please contact [redacted]

Yours sincerely

[redacted]

MICHAEL LAWRENCE
Chief Executive Officer