CUSTOMER OWNED BANKING ASSOCIATION

www.customerownedbanking.asn.au

LEVEL 11, 35 CLARENCE STREET, SYDNEY NSW 2000 GPO BOX 4686, SYDNEY NSW 2001

10 February 2017

Manager
Banking Statistics
Australian Prudential Regulation Authority
GPO Box 9836 Sydney NSW 2001

Email: statistics@apra.gov.au

Dear Sir/Madam,

Consultation on residential mortgage lending reporting requirements for ADIs, October 2016

Thank you for the opportunity comment on this discussion paper.

COBA is the industry association for Australia's customer-owned banking institutions (COBIs) – mutual banks, credit unions, and building societies. Collectively, the sector we represent has $103 billion in assets and more than 4 million customers. These institutions make up more than 70 per cent of APRA's domestic ADIs.

APRA's decision to extend residential mortgage reporting to ADIs with less than $1 billion housing will result in around 60 COBIs undertaking new reporting processes. The customer owned banking sector will bear most of the reporting burden of these new requirements. Within our sector, this burden will fall most heavily onto the smallest ADIs.

Some COBIs are already reporting at least some of this data to APRA. These COBIs agree that a D2A process will reduce their reporting burden, assuming:

- that ad-hoc reporting discontinues, and
- they already collect the required data.

To reduce the overall reporting burden, COBA asks APRA to:

- push back the implementation date to 31 December 2018 to align with the timeframes required for system changes
- reduce the retrospective coding of existing loan portfolio stocks
- reconsider loan to income ratio reporting.

Push back the implementation period by one year

ARS 223 introduces additional reporting requirements for outstanding balances and new loans. This requires changes to core banking and reporting systems. Examples of reporting that requires system changes include impaired customer credit history, loan to income ratios and secured by unit/apartment. The proposal states that ADIs will need to report under ARS 223 for the first period ending 31 December 2017.

Some COBIs are able to utilise internal resources to change their systems to meet the end of 2017 date. However, other COBIs will need to discuss and agree on changes for implementation by external suppliers and this could take at least a year. If ADIs cannot finalise changes by the proposed reporting date, they will have to collect this data through costly manual processes rather than automated reporting processes.

For institutions already reporting data on an ad-hoc basis, continued manual reporting should be relatively straightforward, assuming they already collect the required data.

However, for institutions not currently reporting this information, any manual reporting will create an additional compliance burden. One member estimates that this additional ad-hoc reporting would cost $30,000 per year.

This manual reporting cost comes on top of the already significant costs of system changes. COBA members estimate the system costs to be $20,000 to $100,000 depending on the required level of work.

COBA requests that APRA extend the reporting deadline by one year. This provides enough time for all ADIs to implement automated reporting systems and avoid costly manual reporting. An extended deadline also aligns system upgrades with changes that may arise from APRA's Economic and Financial Statistics consultation, which may create efficiencies.

Under this approach, entities that are already reporting can use the certainty of a final ARS 223 to transition systems ahead of the deadline. This allows them to realise any ARS 223 reporting efficiencies as soon as possible.

Recommendation 1
COBA recommends that APRA extend the reporting timeframe to "reporting periods ending on or after 31 December 2018" to minimise the manual reporting burden.

Reduce the retrospective coding of existing loan books

ARS 223 changes existing reporting requirements for loan portfolio stocks. If ADIs already collect this information then these changes are not materially significant.

Some COBIs note that some of this information is not currently collected or is classified under a different definition. In particular, ADIs classify investment lending 'by loan purpose' in line with ARS 323 but the proposed ARS 223 asks ADIs to classify 'by security usage'.

To meet these requirements, ADIs need to gather additional information. Putting the cost of changing loan origination systems aside, this is straightforward for new loans. However, for existing loans it requires reviewing individual loan files. Given the age of some loans, it may be difficult to get some of this information. COBA members estimate that this recoding and review work could cost $25,000 to $45,000 for their institutions and take up to 6 months. It is unclear what differences arise from the two classifications, and if there is a net benefit in reclassifying on a 'by security' basis.

One option to reduce this burden is allowing ADIs to retain their 'by purpose' definition for loan portfolio stocks and new loans. If APRA insists on retaining a 'by security' definition, another option is to allow ADIs to report existing loan portfolio stocks as of the implementation date as 'by purpose'. These ADIs would then report new loans 'by security'. Over time, as loans amortise or refinance, the existing loan portfolio will turn over and most loans will be classified under the 'by security' definition.

Member feedback notes that the retrospective reclassification of loan portfolio stocks has been a significant reporting burden in the past.

Recommendation 2
COBA recommends that APRA take steps to minimise the recoding of existing loan portfolio stocks, particularly under the proposed investment lending definition.

Reconsider loan to income ratio reporting

ARS 223 requires ADIs to report new loans by loan to income ratio (LTI) (items 10.1.3-4 and 10.2.3-4).

APRA defines the LTI as:

> *"the ratio of the originated loan amount to the borrower's total gross annual allowable income, as defined by the ADI's serviceability assessment policy. Allowable income is the total of the borrower's main pre-tax income and any other pre-tax income, for example, overtime, rental income and dividends, to the extent that the ADI takes such income into account, in whole or in part, in its serviceability assessments."*

ADIs do not commonly use gross LTI ratios, as it is not a commercially relevant measure. It is an abstract measure—as borrowers do not pay mortgages out of their pre-tax income.

Many ADIs do not calculate this ratio and need system changes in order to do so. In some cases, ADIs do not capture all the information required for loan to income ratios.

In addition, the supervisory value of these ratios is uncertain given APRA has publicly noted *"[LTIs] come with some definitional challenges, so they should be treated as approximations".*[1]

COBA members prefer that APRA does not introduce LTI ratio reporting. However, if APRA persists then it should consider defining LTI with net income measures. ADIs commonly report net income in their loan systems as it is a superior measure of borrower serviceability. This ensures that reported information is useful to both industry and the regulator.

Recommendation 3
COBA recommends that APRA reconsider its proposal to introduce loan to income ratio reporting.

Further comments

Classification by security usage when there are multiple securities

COBA seeks clarification on how to treat a loan secured by both an investment <u>and</u> an owner-occupied property. Under a 'by purpose' classification, loans generally have a single purpose. However, under a 'by security' classification, there could be multiple securities with different usages. ARS 223 instructions state that *"Where there is doubt or ambiguity over whether a loan is secured by either investment property or owner-occupied property, report the loan as investment."* It is unclear what happens when secured by both types of property.

[1]Heidi Richards, A prudential approach to mortgage lending, Macquarie University Financial Risk Day, Sydney, 18 Mar 2016

Definition of primary security

COBA seeks guidance on what APRA considers to be a 'primary security'. For items 3.9 and 10.10, ADIs must report balances and new loans where the primary security is a unit or apartment. There is currently no definition of primary security in the reporting instructions or additional guidance. COBA believes many factors such as security value, seniority and underlying security could determine whether a property is the primary security.

COBA would welcome the opportunity to further discuss APRA's proposed ARS 223. Mark Nguyen, as the relevant Policy Adviser for this matter (mnguyen@coba.asn.au or 02 8035 8443), will contact you shortly to arrange a time to discuss ARS 223.

Yours sincerely

LUKE LAWLER
Head of Public Affairs