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Consultation on treatment of loans impacted by COVID-19

Thank you for the opportunity to provide a submission in relation to the draft prudential instrument, *Attachment E – COVID-19 Adjustments*.

ARCA is supportive of the intent of the prudential instrument. Although the prudential treatment of hardship loans (including “COVID-19 loans”) does not necessarily dictate the contractual repayment relationship between the ADI and customer (which is then reflected in the reporting of repayment history information (“RHI”)), the draft prudential instrument allows for a consistent approach to be taken to prudential reporting and contractual/RHI reporting. That is, (subject to the terms of the instrument) an ADI may treat a loan as up-to-date for prudential purposes which facilitates the ADI treating the loan as up-to-date for contractual/RHI reporting purposes.

As a result, during the initial period of COVID-19 assistance, many ADIs have offered assistance arrangements that have involved a contractual variation of the customer’s repayments (often to \$0), which has then been reflected on the customer’s credit report, i.e. the customer’s credit report will continue to show RHI=0 during the period of no payments.¹ This contrasts to ordinary hardship arrangements offered by many ADIs that initially do not involve a contractual variation to the customer’s repayment and may result in the customer’s RHI being “suppressed” (i.e. not reported) during the arrangement given the RHI would ordinarily reflect the contractually missed payments.

The approach to reporting RHI was understandable in the circumstances that existed in the early days of the pandemic given the inability of ADI’s to undertake conventional assessment

¹ We note that, while this has been a common assistance offering, other forms of assistance have also been offered (particularly in relation to unsecured credit).

of assistance requests. Fundamentally however, in the absence of some way to identify those consumers receiving assistance (as proposed in the “hardship” legislation before the Senate), it is not a good outcome for the credit reporting system to be unable to distinguish between those consumers actually making repayments and those who are not. With so many ‘false positive’ records of payments being made in the system, the effectiveness of credit reporting will be diminished well into 2021. This will impact the ability of credit providers to support the recovery of the economy as both consumers and small businesses seek credit. Over the coming months and into 2021, lenders will be unable to efficiently distinguish between applicants who were able to maintain repayments during the pandemic and customers who were not (where the latter customers may require a higher level of inquiry and verification by the credit provider before lending).

To support the recovery of the Australian economy, it is important that the credit reporting system return to normal in the near future. In line with the expiration of the prudential instrument, ARCA expects that from 1 April 2021 a payment history record of RHI=0 should reflect the payment of a genuine contractual repayment amount. In the absence of some other form of indicator in the credit reporting system, customers who remain on a form of hardship assistance from that date should not have a payment history of RHI=0 recorded.²

We also provide the following drafting comments in relation to the prudential instrument:

- **Paragraph 2(a):** the treatment is limited to borrowers that are a “natural person” or a “small- to medium-sized enterprise (SME) with less than \$10M in total debt facilities outstanding”. It is not clear that the concept of an “enterprise” will include some relevant non-natural person borrowers, such as corporate trustees.

Recommendation 1: the prudential instrument should make it clear that it applies to relevant non-natural person borrowers, including corporate trustees.

Recommendation 2: the prudential instrument should clarify that it applies if at least one borrower on a multi-borrower loan satisfies the criteria in paragraph 2(a).

- **Paragraph 2(b):** at the start of the pandemic, ADIs generally granted assistance to customers who requested assistance due to a self-disclosed COVID-19 impact. This was generally taken at face value without the ADIs seeking evidence to support the claim. It has now become clear that many customers who sought assistance may not have ultimately required that assistance (although they may have nevertheless taken advantage of the reduced repayment amounts). Based on the current wording of this paragraph, the prudential treatment may not apply to those customers.

Recommendation 3: paragraph 2(b) be amended to say “the ADI had reason to believe the borrower’s ability to repay according to the original loan terms has been was or would be affected by the COVID-19 pandemic”.

- **Paragraphs 3 and 5:** these paragraphs allow for an ADI to pause the past due status of a COVID-19 loan. However, we are concerned that they may be taken by some stakeholders as a ‘requirement’ to pause the past due status for any customer impacted by the COVID-19 pandemic.

² Depending on the ADIs internal processes, and in accordance with the permitted exception under the *Principles of Reciprocity and Data Exchange*, the payment history for such customers may continue to be suppressed.

Recommendation 4: the explanatory material to the prudential instrument clarify that paragraph 3 and 5 permit the ADI to pause the past due status, but not require or place an expectation on the ADI to do so.

Recommendation 5: paragraph 5 be amended to say "...an ADI must resume the counting of arrears for prudential purposes at the end of the deferral period from no less than the number of days past-due at the time the initial deferral was granted...".

- **Paragraph 7:** the special ability to restructure is stated to apply to a "deferral period, extension of maturity or capitalisation of interest that results solely from implementing an eligible repayment deferral". This wording appears to be somewhat vague and, potentially, too limiting. For example, an extension of maturity following a deferral may potentially happen because the customer cannot otherwise afford the higher payments that would be required if the loan maturity date were to stay the same. Therefore, the extension of maturity is required because of the deferral and the customer's pre-existing financial situation (although the customer was able to afford the original repayments prior to COVID-19).

Recommendation 6: APRA should clarify (either within the draft instrument or in explanatory materials) that the wording of paragraph 7 is not intended to limit the application of the paragraph in the way described above.

If you have any questions about this submission, please feel free to contact me [REDACTED] or Michael Blyth [REDACTED]

Yours sincerely,

[REDACTED]

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