



20 August 2020

General Manager,
Policy Development Policy and Advice Division
Australian Prudential Regulation Authority
by email: ADIpolicy@apra.gov.au

Dear General Manager,

Consultation on Treatment of Loans Impacted by Covid-19

Thank you for the opportunity to comment on the Australian Prudential Regulation Authority (APRA) consultation on the treatment of loans impacted by COVID-19. The Financial Rights Legal Centre (**Financial Rights**), Consumer Action Law Centre (**Consumer Action**), CHOICE and Financial Counselling Australia have been on the frontline of the Covid-19 crisis providing advice, support and assistance to a large number of Australians facing financial hardship during this difficult period. We think it is critical that APRA consult with consumer representatives with respect to the capital treatment of loans given the direct impact this will have on millions of Australians' lives and the country's economic well-being.

Background

The Covid-19 crisis has had a huge impact on the financial lives of Australians. Over 896,000 loans have been deferred,¹ including home loans, personal loans and credit card payments with banks. The ABA has said that 96,000 households, or 1 in 5, who deferred their home loans are facing financial difficulties.²

Many Australian households entered this crisis over-indebted with high levels of household debt. For many, this crisis has deepened financial vulnerability and hardship. Industry and regulators will need to examine the unquestionable role irresponsible lending practices and poor product design have played in exacerbating these outcomes during the crisis.

¹ APRA, Treatment of loans impacted by COVID-19, Letter, 9 July 2020

² AFR, One-in-five home loan deferral customers in strife, 15 June 2020

Around 20% of customers who asked for a deferral have continued to make payments, either in full or in part.³ This is in part evidence of the evolving nature of the government response, with some people accepting deferrals prior to the full extent of government support and its impact being known. It is also evidence that the vast majority of borrowers want to pay and will do so if they possibly can.

Covid-19 recovery: principles of financial hardship

To ensure that Australians hit hard by this crisis are treated fairly by lenders and that there is an appropriate balance struck between meeting ADI capital requirements, prudential standards, and the needs of everyday Australians, a number of principles need to be applied to the handling of financial hardship during the recovery period. These principles are:

- **Respect and kindness.** Treat people with respect and kindness.
- **Proactive.** Banks need to be proactive in identifying and then assisting people who may be experiencing financial hardship.
- **Tailored.** Banks need to tailor their responses to cohorts of customers based on information from customers themselves and data indicating their level of hardship.
- **Best interests.** Hardship arrangements should be based on what is in the best interests of the customer, rather than the bank's commercial interests.
- **Affordability.** Banks need to ensure that arrangements are realistic and affordable.
- **Continuing assistance.** The length of hardship assistance should match the time that a person needs it to get back on their feet. This will in many cases be longer than six months.
- **Keep people living in their homes.** As far as practically possible, people should not be removed from their homes through foreclosure. Should it be in an owner's interests to sell up, this should be their choice.
- **Fair treatment of unsecured debt.** Hardship measures should ensure fair treatment of people with unsecured debt, not just mortgages.
- **Fair credit reporting.** A customer's credit report or credit score should not be unfairly impacted if they adhere to hardship arrangements.
- **Interest rates.** Existing customers should receive the same interest rates offered to new customers. Penalty interest rates should not be applied to people in hardship.
- **Resourcing and training.** Hardship teams should be adequately resourced and trained to respond to the depth of the crisis.
- **Clear communications.** There must be clear and ongoing communications including in writing, at all stages, so that customers understand what their arrangements mean, that they should maintain repayments where they are affordable, and any implications if they fail to comply.

³ As above

- **Independent advice.** People should be referred for independent advice, for example, from a financial counsellor if that would be helpful. This includes when a customer has limited ability to self-advocate, is dealing with multiple creditors, or is considering a serious step, such as an asset sale.
- **Small business specialist assistance.** Some small business owners need specialist assistance. Small business owners frequently execute personal guarantees using their homes as security. Again, banks need to keep people in their homes as far as practically possible.

Banks should take a proactive, cohort-based approach to identify and assist groups of people who are in financial hardship, prioritising those most vulnerable or at risk of disadvantage. This should include banks not only interrogating their own account data to identify these cohorts but also potentially seeking input from their customers in efficient, automated interactions. The banks should offer tailored assistance - including conversations, not just digital interactions - to these people until they get back on their feet.

Cohorts who should receive tailored assistance include customers who:

- have suffered a significant drop in income;
- receive JobKeeper or JobSeeker payments (where this can be identified);
- are dependent on Centrelink payments as their main source of income;
- had persistent debt before COVID-19 began or were already experiencing financial hardship;
- have negative equity on their mortgage; or
- are vulnerable or struggling financially for other reasons known to the bank.

People who are able to pay should be assisted to start making their repayments at a level they can afford if they have not already.

Application of these principles to APRA's temporary capital treatment of loans impacted by Covid-19

In order that these principles are met by ADI's, it is important that APRA's approach to the capital treatment provides a framework that does not hamper an ADI's ability to proactively tailor their response and work in the best interests of their customers, but encourages and assists ADI's to do so. In this spirit we provide the following comments:

Tailoring outcomes for borrowers

We strongly support APRA's statement to banks in its letter to ADIs dated 9 July 2020:

Regardless of the capital treatment, it is the responsibility of ADIs to determine the most appropriate response when borrowers encounter a period of financial hardship. APRA does not preclude or require a particular period of deferral or other form of loan modification or restructuring. Regulatory capital requirements do not affect an ADI's obligations when offering hardship arrangements.

This supports and encourages an appropriately tailored approach and sends, ADIs the message to work with borrowers to produce outcomes in their best interest. In our experience ADIs tend to interpret capital requirements as restrictions on what they can offer individual borrowers, or as dictating what they have to report on a consumer's credit report – that repayment history information, for example, should match arrears reporting to APRA when these systems serve totally different purposes and are subject to different requirements.

In implementing APRA's approach, ADIs will have to place borrowers into certain categories as outlined in the Draft Prudential Instrument – that is those who receive further deferrals, those whose loans will be restructured in accordance with the APS 220, Attachment A, section 8 definition, and those who may be provided 'other' forms of hardship assistance. In so doing, some ADIs may take an approach that is not necessarily in the best interests of the individual borrower and their particular situation, including putting up unnecessary barriers to "other hardship assistance", or determining that other hardship assistance is automatically a less deserving form of hardship which may have different consequences (for credit reporting purposes for example). What is required is good communication and discussions between ADIs and their customers to reach an understanding and an outcome appropriate to the circumstances, not putting customers in artificial categories.

It is therefore important to make clear that while banks may have categories for APRA reporting and capital treatment, this should not drive individual consumer outcomes on the ground. Ideally ADIs should work with the customer to come to an appropriate arrangement, and then categorise the arrangement for capital requirement purposes and to meet their disclosure obligations, not the other way around. Such a case-by-case, best interests approach is consistent with the additional guidance recently issued by ASIC about their expectations regarding lenders treatment of borrowers at the end of the current deferral periods.⁴ It also aligns with the promises ADI's make in relevant industry codes of conduct.⁵

Further, we support Clause 7 of the draft instrument which states:

For the purpose of this Prudential Standard, a deferral period, extension of maturity or capitalisation of interest that results solely from implementing an eligible repayment deferral is not a restructure.

⁴ ASIC, 20-184MR [ASIC publishes expectations of retail lenders when loan repayment deferrals end](#), Thursday 13 August 2020

⁵ Banking Code of Practice cl 167:

"We will work with you to help you respond to financial difficulty

167. With your co-operation, we will work with you to help you find a sustainable solution to your financial difficulties. Any help we can give will depend on your individual circumstances. We provide help to customers on a case-by-case basis."

Customer Owned Banking Code of Practice cl 24:

24. If you are in financial difficulties

24.1. We will work with you in a constructive way if you experience genuine difficulties meeting your financial commitments to us. With your agreement and commitment, we will try to assist you to overcome those difficulties.

This measure will allow ADIs to be flexible with capitalisation of interest and extensions of loan term unless consumer wants to catch up faster to save money.

Treatment of some common scenarios

Clause 5 of the draft instrument states:

For all COVID-19 loans that have been granted an eligible repayment deferral, an ADI must resume the counting of arrears for prudential purposes at the end of the deferral period from the number of days past-due at the time the initial deferral was granted, unless the loan is modified in accordance with paragraph 8 of this Attachment.

A common scenario that will arise is the situation where borrowers have made payments during the deferral period but may be a few payments behind at the beginning of the period. It is not clear how this scenario should be treated under this clause.

Hard deadline

We note that APRA have imposed a hard deadline of 1 April 2021 for the treatment of loans as impaired following restructure.

While we generally support the principles enunciated in the instrument we are concerned that this hard deadline to achieve a restructure (and thus favourable treatment) may drive ADI's to put in place permanent restructuring arrangements prematurely. This has the potential to push some borrowers into early default on such arrangements because they are not suitable. This is particularly the case given the obvious volatility in the ongoing impact of COVID-19 situation on the economy.

While we appreciate the temporary relief cannot be open ended, some flexibility on timing is warranted given the many unknowns in the current circumstances and differences between states. Such flexibility – combined with the retention of the condition that proposed restructure relief can only be used once for any particular facility would strike a balance between limiting the relief timeframe and recognising the reality of this unstable period.

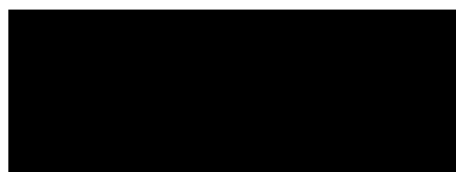
Concluding Remarks

Thank you again for the opportunity to comment. If you have any questions or concerns regarding this submission please do not hesitate to contact Drew MacRae, Policy and Advocacy Officer, Financial Rights on [REDACTED]

Kind Regards,



Karen Cox
Chief Executive Officer
Financial Rights Legal Centre



Gerard Brody |
Chief Executive Officer
Consumer Action Law Centre



Erin Turner
Director – Campaigns & Communications
CHOICE



Fiona Guthrie
Chief Executive Officer
Financial Counselling Australia