Deloitte.

MACROPRUDENTIAL POLICY: Credit Measures

Response to APRA consultation

25 February 2022

Executive Summary

Deloitte welcomes the opportunity to respond and provide feedback on APRA's industry consultation on its steps to formalise and embed credit-based macroprudential policy measures within its prudential standards.

We note that APRA's aim is to balance macroprudential policy considerations *in a manner that promotes financial system stability in Australia* and we have therefore focused on two areas where we believe it is unclear that the proposed requirements align to APRA's goal.

The first of these is the balance between regulatory prescription and the need for strong risk cultures in the banks where they are committed to meeting the requirements of all their stakeholders. APRA will recognise the greater the level of detail supplied, the potential that this may lower the incentive for banks to invest in their own risk analysis and mitigation strategies. Deloitte agrees that the characteristics listed in the proposed annex align fairly well to higher-risk mortgage lending. However, this list is more detailed than other prudential standards and may not strike the balance as intended.

The second potential area of misalignment is the characterisation of commercial property lending as a second potential source of system-wide instability. While this sector is notoriously cyclical, the diversity of funding sources available to it may mean that the risk is lower than it has been during past property crashes. More significantly, however, emphasising an historical threat may reduce appetite to contemplate new potential sources of risk to financial system stability, such as the sector's exposure to high greenhouse gas emitting industries.

Macroprudential Policy: Credit Measures Considerations

Deloitte acknowledges the standard formalises the measures APRA has implemented[1,2] (and subsequently lifted) since the financial crisis to curb excessive systemic risk in the housing market. Allowing for an explicit provision for macroprudential credit measures provides the banks with more certainty on the broad structure of the binding regulatory measures and a clearer visibility of APRA's expectations. Consistent with APRA's broader Macroprudential Policy Framework[3] well-deliberated and strategically timed lending limits and lending standard measures are useful tools in mitigating systemic risks in the market.

Risk Culture

Although we acknowledge and support the intention of introducing the document, we however, would highlight the formalisation of such prescriptive supervisory measures may be counter-productive to the banking industry's on-going investment in enhancing their internal risk management capabilities and risk culture. Over the last decade banks have invested significant resources to strengthen their own risk management tools. APRA should uphold the credibility of the banks sophisticated risk management tools. Macroprudential constraints may inadvertently act as disincentive to the industry to continue their endeavours in improving their own risk management processes as banks may consider their efforts as "poor investment" as they can be overridden any time at APRA's discretion via imposition of lending limits and lending standards.

Risk Management tools: APRA may wish to provide guidance on how the banks should recalibrate their risk management settings to avoid lending limits and lending standard measures. APRA should provide indication on circumstances under which APRA would accept an ADIs internal forecast and analysis. Such a pre-emptive approach may incentivise banks to further boost their risk analytics and stress testing capabilities, instead of acting as an impediment to further development of more sophisticated risk management tools.

Industry readiness: APRA has noted it expects the industry to have already put in place core measures ahead of any emerging risks. It is expected banks will utilise controls put in place while operationalising APRA's lending limits and lending standards. We encourage APRA to provide guidance on additional controls an ADI should build in their existing risk management framework.

Policy as a complementary tool: APRA may wish to demonstrate that the limits are warranted in addition to any countercyclical buffer (CCyB) imposed on the major banks. A combination of CCyB and credit measures may put bigger banks at competitive disadvantage compared to other lenders only subject to the credit measures. APRA should ensure the macroprudential policy doesn't act as micro prudential policy for the selected few banking entities.

---

[1] Investor lending limits – 2014 https://www.apra.gov.au/news-and-publications/apra-outlines-further-steps-to-reinforce-sound-residential-mortgage-lending
[2] Interest-only lending limits – 2017 https://www.apra.gov.au/news-and-publications/apra-announces-further-measures-to-reinforce-sound-residential-mortgage
[3] Information paper - Macroprudential policy framework November 2021 https://www.apra.gov.au/macroprudential-policy-framework

Broader Financial Stability

APRA has had a longstanding supervisory focus on the relatively risky and high leverage profile of commercial property lending in Australia; predominantly attributable to poor underwriting standards, monitoring and control of these assets. To this end APRA has mandated a series of risk management measures including, but not limited to, risk management processes (in recently implemented APS 220 credit risk management) and collateral haircuts and capital floors. Industry has been working with APRA to strengthen their commercial lending risk management practices and uplifting of risk analytics capabilities.

Deloitte would encourage APRA to continue to foster a culture of controlled risk for commercial real-estate rather than placing limits on the exposures. In setting limits, there should be an awareness of potential unintended secondary effects at a systematic or idiosyncratic level. Some of these may include reduced capital supply through reduced earnings, reduction of access to certain sub segments of customers, or potential creation of secondary concentrations as banks look to replace lost returns through new segments.

It is our view that the document would be stronger if the reference to commercial property were replaced with a more general commitment that APRA identify portfolios of system-wide concern each year, potentially sharing their concerns via feedback on bank CPS 220 risk management declarations.

Key authors and contributors

Mike Ritchie
Lead Client Service Partner
[redacted]

Will Chan
Partner, Risk Advisory
[redacted]

Edmund Bosworth
Principal, Risk Advisory
[redacted]

Jonathan Sykes
Partner, Audit & Assurance
[redacted]

Ricky Arjuna Sharma
Senior Manager, Risk Advisory
[redacted]