Regulation Impact Statement

Residential mortgage reporting requirements for authorised deposit-taking institutions

(OBPR ID: 2016/21302)

Introduction

1. This Regulation Impact Statement (RIS) has been prepared by the Australian Prudential Regulation Authority (APRA). Its purpose is to assist APRA in making a decision on the implementation of proposed new reporting requirements for specified authorised deposit-taking institutions (ADIs) to report information regarding residential mortgage lending to APRA. The proposals would require locally-incorporated ADIs to report information on both existing and new loans for each calendar quarter.

2. APRA has prepared a standard-form RIS as the Office of Best Practice Regulation (OBPR) considers that the proposals are likely to have a measurable but contained impact on ADIs. The issues addressed in this RIS were considered as part of APRA's decision making process relating to these measures. This RIS follows a 'preliminary assessment' RIS submitted to the OBPR and takes account of the OBPR's feedback on this document. The RIS has been prepared in accordance with the *Australian Government Guide to Regulation* and relevant guidance notes.

3. The issues raised in this RIS were considered by APRA at each major decision point. The need for regulatory action, proposed solution, industry feedback, estimates of regulatory burden and alternative options were considered by APRA throughout the development and consultation process.

Background

APRA's supervisory framework

4. APRA's mandate is to ensure the safety and soundness of APRA-regulated institutions so that they can in all reasonable circumstances meet their financial promises to depositors, policyholders and fund members within a stable, efficient and competitive

financial system. APRA carries out this mandate through a multi-layered prudential framework that encompasses authorisation and supervision of institutions. APRA is empowered under the *Banking Act 1959* (the Banking Act) to issue legally binding prudential standards that set out specific requirements with which ADIs must comply. APRA also publishes prudential practice guides (PPGs), which clarify APRA's expectations with regard to prudential matters.

5. A key component of delivering APRA's mandate is the use of data analysis for identification of key entity risks and for analysis of broader industry trends. APRA relies on data regularly provided by ADIs. These data provide detail on areas such as financial strength, performance and operations. The resulting analysis is in an assessment of a regulated entity's financial position and emerging trends or potential issues that should be monitored or followed up with the entity. These are critical inputs into APRA's supervisory assessment and supervisory action plans. The depth of financial analysis and areas to be reviewed depend on the nature and operations of the regulated entity, its size, complexity and risk profile. Appropriate supervisory actions are taken where a deterioration in financial performance or stability becomes evident.

APRA's reporting framework

6. The *Financial Sector (Collection of Data) Act 2001* (FSCODA) enables APRA to collect information from the institutions it regulates. Under this Act, APRA may determine reporting standards that require regulated institutions to provide information about their businesses and activities. These powers assist APRA in the prudential regulation of the financial sector and enable APRA to collect data on behalf of some other government bodies such as the Reserve Bank of Australia (RBA), the Australian Bureau of Statistics (ABS) and other financial sector agencies, thus improving the efficiency of reporting for the financial sector.

7. FSCODA is the legislative foundation of APRA's program to streamline and harmonise its data collection systems. FSCODA sets out requirements for the review, internal governance and external audit of information reported to APRA, to ensure its reliability. It is an offence for an ADI to breach a reporting standard and ADIs typically apply robust governance procedures to ensure compliance.

APRA's current data collections on residential mortgages

8. One key data source for APRA's monitoring and supervision of residential mortgage lending is *Reporting Standard ARS 320.8 Housing Loan Reconciliation* (ARS 320.8). ARS 320.8 was introduced in 2008 and has not been changed since. It requires ADIs with more than $1 billion in housing loan assets to report 99 data items each quarter. ARS 320.8 is a dual-purpose data collection: APRA uses these data to support its supervisory role, and the RBA uses these data to perform its role.

9. Other key data sources regarding the stock of an ADI's housing loans, including owner-occupied and investor loans, include *Reporting Standard ARS 320.0 Statement of Financial Position (domestic book)* (ARS 320.0) and *Reporting Standard ARS 323.0 Statement of Financial Positon (licensed ADI)* (ARS 323.0). All ADIs are required to report on either ARS 320.0 or ARS 323.0. These two collections only include limited detail on the stock of housing loans, and no risk information. The concepts and definitions in ARS 320.8 are consistent with ARS 320.0 and ARS 323.0.

10. To assist its recent work on residential mortgage lending, APRA has supplemented data from ARS 320.8 with requests for additional information from all ADIs that undertake residential mortgage lending.

Policy problem and need for intervention

Importance of reliable information on residential mortgage lending

11. Residential mortgages as a proportion of ADIs' lending exposures has increased over the past few years, currently standing at more than 60 per cent of total loans. Given the significance of the concentration in residential mortgage lending, a build-up of risks in this segments has the potential to pose significant prudential and financial stability risks. Potential risks in residential mortgage lending can be heightened by economic and market conditions. The current environment in which there is a high and increasing level of household indebtedness, interest rates have been at historical lows for a long period of time, wage growth is subdued and house prices high. In such circumstances, households, individual ADIs and the broader banking sector are vulnerable to economic shocks such as a fall in house prices or a rise in unemployment.

12. In response, APRA, the RBA and other regulators have increased their focus on residential lending practices, which requires access to robust data about various aspects of ADIs’ lending practices and activities, including loan purpose, counterparty and other risk indicators. Analysis of this information has underpinned a series of measures APRA has taken to help contain the risks associated with ADIs’ residential mortgage portfolios. These measures include strengthening lending standards and practices, establishing benchmarks to moderate particular types of lending and increasing some capital requirements.

13. Misreporting, poor data quality, data gaps and other ambiguities thus affects APRA’s ability to properly monitor and assess risks in the housing market at both individual entity and systemic levels.

Existing collections of mortgage lending data not fit for purpose

14. Since 2008 when ARS 320.8 was introduced, there have been changes in the residential mortgage lending industry, the economic environment, APRA’s supervision practices and the need for more granular data. Some of the data items on ARS 320.8 are no longer relevant to supervision and many of the loan characteristics that are a factor for assessing credit risk today are not covered. Further, smaller ADIs are not subject to ARS 320.8.

Data quality problems for existing collections

15. The structure of current forms and the quality of the related instructions do not always facilitate high-quality reporting. For example, related information on some concepts is spread across multiple forms in the collection, making consistent reporting and reconciliation difficult. Feedback from ADIs indicates that the current instructions are often insufficiently detailed and, at times, ambiguous and/or inconsistent, making it difficult for reporting institutions to report and for APRA to draw meaningful analysis from responses. These limitations mean approximately two full time employees of effort is required within APRA for inquires and analysis of restatements arising due to poor reporting. Additional effort is also often required from the ABS or RBA.

16. Some concepts on ARS 320.8, ARF 320.0 and ARF 323.0 are not adequately defined, leading to inconsistent reporting. This limits the usefulness of the data for supervision, and creates a costly burden on ADIs to restate misreported data.

Limitations of ad hoc information requests

17. Unlike data submitted under reporting standards, supplementary data are collected on a 'best endeavours' basis via spreadsheets. These data are not subject to the strict reporting requirements of FSCODA and are of varying quality, timeliness and usability. An ADI is more likely to be required to resubmit incorrect data. APRA's assessment and requests for resubmitted data require the equivalent of approximately 1.5 full time employees to administer on an ongoing basis.

18. One small ADI estimated the costs of such reporting as more than $30,000 per year, while costs to restate misreported data are often well in excess of this figure. Industry representatives have expressed a preference for reporting requirements to be collected under reporting standards through APRA's 'D2A' data collection system wherever possible in preference to spreadsheets, and for all reporting requirements to include a clear purpose and instructions. This gives industry greater certainty of ongoing reporting requirements, allowing for higher quality reporting as well as streamlining of entity's reporting processes. For example, ADIs can make minor amendments their processes to ensure relevant loan information is captured at the source, removing the need for manual file reviews.

The new ABS/RBA Economic and Financial Statistics data collection

19. On 23 August 2017, APRA, the RBA and the ABS finalised a proposal to update a suite of ADI data collections, known as the Economic and Financial Statistics data collection (EFS).[1] This proposal sought to modernise the data collection, to ensure that the data collected meet the needs of the ABS and RBA while not imposing unnecessary burden on reporting institutions and improving data quality. The EFS will cease 17 forms, including ARS 320.0 and ARS 323.0, and introduce 23 new reporting forms that will include new concepts and definitions. The development of the EFS data collection was the product of several rounds of informal and formal consultation with industry, representative bodies and other interested parties.

1 In developing the EFS, the agencies engaged the OBPR, which determined that a RIS was not required.

Policy options and comparative net benefit

20. APRA has identified three options for improving ADI's reporting of residential mortgage lending:

    Option 1: retain the existing requirements without revision;

    Option 2: introduce a new data collection, *Reporting Standard ARS 223.0 Residential Mortgage Lending* (ARS 223.0) based on the existing reporting requirements; or

    Option 3: introduce ARS 223.0 aligned with the forthcoming EFS.

Option 1: Status quo option

21. The status quo option is to maintain the existing reporting requirements under ARS 320.8 and continue to supplement these as required.

Option 2: Formalising existing reporting through a new ARS 223.0

22. To better enable APRA's supervisory monitoring and oversight of residential mortgage lending this option would involve APRA implementing a new reporting standard, ARS 223.0, and ceasing ARS 320.8. The new ARS 223.0 would require all locally incorporated ADIs to report information on both the portfolio stock and new lending activity each quarter.

23. Under this option, APRA would introduce ARS 223.0 based on the loan classification and definitions based on APRA's prudential needs. This is the approach APRA proposed in its initial discussion paper (see 'Consultation' section below).

24. Under this option, ARS 223.0 would meet APRA's needs for high quality data on residential mortgage lending, covering a range of risk information that is not currently collected under FSCODA. Data reported under ARS 223.0 would not have the same ambiguities and quality concerns as existing reporting, due to clearer instructions and detailed reporting guidance. ADIs would be less likely to be asked for supplementary information.

Option 3: Introduce a new reporting standard that aligns with the EFS

25. Under this option, APRA would introduce ARS 223.0 as per option 2, except with key reporting concepts aligned with the EFS data collection. This alignment would reduce the compliance cost for industry and reduce duplication. As with option 2, ARS 320.8 would cease.

What is the likely net benefit of each option?

Net benefit of option 1—status quo

26. Under option 1, the existing issues of poor data quality and inconsistent reporting would continue, and ADIs may be asked for supplementary information to inform APRA's supervisory activities and work addressing residential mortgage lending practices across the Australian banking sector.

27. The *status quo* option would also lead to duplication of reporting and inadequate definitions given that the EFS data collection includes definitions that do not align with the ARS 320.8 requirements. This duplication would impose unnecessary regulatory burden and complexity, leading to costs for ADIs and less reliable information for APRA.

Net benefit of option 2—introduce a new ARS 223.0

28. Under option 2, APRA would amend the reporting framework by introducing a new reporting standard, ARS 223.0, improving data quality and extending the scope to include all ADIs that provide residential mortgage lending. However, duplicate reporting effort would persist as definitions would not be aligned between ARS 223.0 and the EFS data collection.

29. Adopting option 2 would require ADIs to modify information systems to classify new loans and to reclassify existing loans. Feedback from consultation indicate that this would impose significant costs to industry.

30. The average annual regulatory costs from option 2 are shown below. These costs are calculated based on information provided by ADIs and industry bodies in consultation (see below), including estimates of system set-up costs, the cost of reclassifying loans to new definitions and ongoing marginal reporting and audit costs, offset by estimated reduction in costs due to the reduction of *ad hoc* information requests. These costs are averaged over ten years, and pro-rated across all relevant ADIs based on the size of current mortgage portfolios. No other ongoing impacts are expected.

	Business	**Community organisations**	**Individuals**	**Total costs**
Total, by sector	$5.7 m	$0	$0	$5.7 m

Net benefit of option 3–reporting aligned to ABS/RBA Economic and Financial Statistics

31. Under option 3, data quality would improve as definitions would be more clearly articulated, and duplicate reporting effort for ADIs would reduce as definitions would be aligned between ARS 223.0 and the EFS data collection.

32. Credit risk data collected under FSCODA would increase to the same extent as in option 2. ARS 223.0 would better meet APRA's needs for information to asses key entity risks and for analysis of broader industry trends. This stability would allow ADIs to invest in streamlining their internal reporting processes.

33. Aligning definitions with the EFS collection and removing ARS 320.8 would obviate the need for ADIs to retain the existing inadequate definitions and loan classification approaches in their information systems.

34. APRA, the RBA and ABS have collaborated to ensure the minimum amount of duplicated reporting as possible, for example, by not collecting certain information in the EFS forms that may be collected on ARF 223.0.

35. Under Option 3, concepts and definitions would be aligned between EFS and the proposed ARS 223.0, to allow ADIs to streamline their internal reporting processes.

36. The average annual regulatory costs from option 3 are shown below. These costs are calculated based on information provided by ADIs and industry bodies in consultation as with option 2. The costs for option 3 are far less due to the use of loan definitions that are consistent with EFS. The costs associated with option 3 include estimates of system set-up costs which are offset by the estimated reduction in costs due to the reduction of *ad hoc* request. No other ongoing impacts are expected.

	Business	**Community organisations**	**Individuals**	**Total costs**

Total, by sector	$1.7 m	$0	$0	$1.7 m

Consultation

37. APRA has developed the proposals and preferred option after extensive informal and formal consultation with ADIs, industry representative bodies, the ABS and RBA. Consultation with the ABS and the RBA is ongoing, with regular meetings at senior levels and frequent correspondence between the three agencies.

38. The first round of industry consultation consisted of an informal consultation with a small number of large ADIs in the first half of 2016. APRA sought feedback on proposals to improve the reporting of residential mortgage lending information, including: the feasibility of reporting proposed data items; the basis of the reporting (definitions); alignment with other existing regulatory data; and suggestions on how to streamline reporting requirements.

39. APRA's formal public consultation on the specific proposals commenced on 24 October 2016, with the release of a consultation discussion paper and a draft of the proposed ARS 223.0.[2] The aim of this consultation was to obtain feedback on all aspects of the proposed changes from any interested stakeholders. The formal consultation package reflected Option 2, that is, a new reporting standard that reflected APRA's prudential requirements but did not align with the EFS reporting collection. APRA issued a media release[3] and sent an email to subscribers to its email alert service and to representatives from each ADI. Written submissions were invited by 10 February 2017.

40. APRA requested that respondents provided an assessment of the impact of the proposed changes and, specifically, the marginal compliance costs ADIs are likely to face. Respondents were also requested also indicate whether there are any other requirements

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2 http://www.apra.gov.au/adi/PrudentialFramework/Pages/residential-mortgage-lending-reporting-requirements-ADIs-Oct16.aspx

3 http://www.apra.gov.au/MediaReleases/Pages/16_41.aspx

relating to ADI reporting that should be improved or removed to reduce compliance costs.

41. APRA also requested feedback on the ability of ADIs' data source systems to align to the concepts and definitions in the proposed data requirements. APRA sought suggestions for changes to definitions that will improve data quality and reduce reporting burden. Specifically, APRA sought feedback on the proposed definitions in the reporting instructions for owner-occupied loans, investor loans, household trusts and newly originated loans.

42. APRA received six submissions in response to the October discussion paper, two non-confidential submissions from industry associations and four confidential submissions from ADIs and one other interested party. No submissions objected to the proposal. No respondents provided the detailed breakdown on costs as requested by APRA. Respondents did, however, provide high-level estimates of costs.

43. APRA considered the feedback received and responded with updates to the proposed ARS 223.0. Several of the key concerns related to alignment with the EFS collection, and to address these APRA's updated proposal was Option 3. APRA's proposed response to submissions, including revisions to ARS 223.0, were publicly released on 23 May 2017.[4]

44. The changes to the proposal addressed the key concerns:

Concern	Response
Objections to the proposal for the first reporting period to be the quarter ending December 2017 imposing unnecessary costs and not giving adequate time for ADIs to implement automated reporting systems.	APRA extended implementation timelines for three months for ADIs with more than $1 billion in housing loans and for nine months for all other ADIs. This deferral allows ADIs time to implement automated reporting systems and reduce

[4] http://www.apra.gov.au/adi/PrudentialFramework/Pages/Response-to-submissions-New-residential-mortgage-reporting-requirements-for-ADIs.aspx

	the need for more costly manual reporting.
Reporting owner-occupied and investor loans based on loan security added additional burden as this was inconsistent with the approach taken by the EFS data collection.	APRA has aligned to the EFS collection.
Reporting information on 'household trusts' was unfeasible as this classification is not widely used within industry.	APRA has removed this proposal.
The large effort required to reclassify existing loans per the new reporting framework, specifically classifying loans by security.	APRA's alignment to EFS classifications has reduced this need for reclassification.

45. APRA also sought feedback in the May 2017 response on a proposal to include additional data items in the proposed reporting requirements, most notably debt to income ratios. APRA sought feedback on the costs of reporting these additional data items.

46. APRA received six submissions in response to the May 2017 letter, one from an industry association and five confidential submissions from ADIs. No submissions objected to the proposals, but some did suggest minor changes or sought minor clarification of reporting requirements. Some submissions stated the additional data items could be implemented with negligible cost, others made no comment. No cost estimates were provided by respondents.

47. Throughout each round of consultation and incremental change to the proposals, APRA has also consulted with the ABS and RBA. As feedback from submissions raised concerns with lack of alignment with the EFS data collection, discussions with ABS and RBA representatives helped to amend the proposals to create alignment. Through this collaboration, the ABS and RBA shared their experience and findings in the consultation on the development of the EFS data collection.

Conclusion and recommended option

48. The following table provides a summary of the costs and benefits of each option against the key criteria discussed in this RIS.

	Option 1: Status quo	**Option 2: Formalising existing reporting under a new ARS 223.0**	**Option 3: Formalising existing reporting under a new ARS 223.0, aligned with EFS**
Ongoing compliance costs	Moderate net cost as ARS 320.8 is retained, classifications not consistent with EFS.	Moderate net cost, classifications not consistent with EFS.	Lower net cost
Set-up costs including reclassification of existing loans	No change. Inconsistent reporting will continue through retention of ARS 320.8.	Substantial costs for reclassification of existing loans, minor costs for system set-up. Inconsistency with other regulatory data.	Minor costs for system set-up. Less effort required for reclassification of loans as EFS concepts are used.
Addresses limitations of existing reporting	Does not meet criteria	Meets this criteria through clearer expectations placed on ADIs, clearer definitions and improved quality control.	Meets this criteria through clearer expectations placed on ADIs, clearer definitions, improved quality control and alignment with existing reporting requirements.

Reduces reliance on *ad hoc* requests	Does not meet criteria. *Ad hoc* request will continue	Meets this criteria. APRA's data needs primarily met through ARS 223.0.	Meets this criteria. APRA's data needs primarily met through ARS 223.0.
Overall	**No net benefit**	**Likely no or low net benefit**	**Positive net benefit**

49. Option 3 is the preferred option as APRA considers that this option responds to feedback received through industry consultation and will yield the greatest net benefit. It addresses the limitations of existing reporting, reduces the reliance on *ad hoc* requests while introducing only marginal regulatory costs.

50. Option 3 will impose an additional regulatory burden on industry; however, this burden is expected to be relatively minimal and largely incurred during implementation, and will be offset by a reduction in *ad hoc* requests and ceasing ARS 320.8. This nets to an average regulatory cost of $1.75 million per year compared to the status quo option. APRA has also endeavoured further reduce regulatory burden by, for example, deferring implementation of new reporting by up to nine months and accepting reporting on a 'best endeavours' basis for the first two reporting periods.

51. Option two is not preferred as the additional set-up costs lead to a net increase in average regulatory costs of $5.72 million per year compared to the status quo option.

Implementation and review

52. APRA will give effect to the proposed reporting requirements by determining ARS 223.0 under FSCODA.

53. Reporting will commence with the reporting period ending 31 March 2018 for ADIs with more than $1 billion in housing loans and the reporting period ending 30 September 2018 for all other ADIs.

54. APRA has offered to discuss any difficulties in meeting the reporting requirements with impacted ADIs. APRA will accept reporting on a 'best endeavours' for a transition period of six months, granting relief from specific audit requirements.

55. As delegated legislation, reporting standards impose enforceable obligations on affected ADIs. APRA monitors ongoing compliance with its reporting framework as part of its supervisory activities. APRA has a range of remedial powers available for non-compliance with a reporting standard, including issuing a direction requiring compliance, breach of which is a criminal offence.

56. APRA regularly reviews its prudential and reporting framework as part of APRA's policy development process. Such reviews would consider whether the requirements continue to reflect good practice or impose undue regulatory burden. Such a review is likely to coincide as part of APRA's implementation of the Basel Committee on Banking Supervision's capital framework reforms (commonly known as Basel III), currently anticipated to come into force from 2021. APRA is also undertaking a Data Modernisation programme, which will substantially overhaul the technology through which APRA collects data from regulated entities, and makes it available to the public.

57. APRA will also take action within a shorter timeframe where there is a demonstrable need to amend a reporting requirement. Such a need could be identified through APRA's ongoing engagement with ADIs as part of its supervisory activity, regular stakeholder surveys, or internally within APRA.

58. As legislative instruments, reporting standards are also subject to sun-setting requirements after 10 years.

Regulatory offset

59. A regulatory offset has not been identified. However, APRA is seeking to pursue net reductions in compliance costs and will work with affected stakeholders and across Government to identify regulatory burden reductions where appropriate.