CUSTOMER OWNED BANKING ASSOCIATION

7 November 2019

Ms Katrina Squires
Acting General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority
SYDNEY NSW 2001

Via email: ADIpolicy@apra.gov.au

Dear Ms Squires

Consultation on the capital treatment of mortgages under the First Home Loan Deposit Scheme

COBA welcomes the opportunity to comment on APRA's proposed capital treatment of mortgages under the First Home Loan Deposit Scheme (FHLDS).

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has $121 billion in assets and 4 million customers. We lend over $90 billion for Australians to purchase homes, with the vast majority going to owner-occupiers.

Several COBA members are likely to participate in the current NHFIC procurement process. Many more have expressed interest in this scheme. COBA believes that this scheme is likely to improve a first home buyer's ability to purchase their first home more quickly without the cost of lenders' mortgage insurance. Any scheme features must not unfairly discriminate against smaller lenders.

In making these comments, COBA acknowledges that "APRA intends to release… additional information on implementation for participating ADIs, as soon as practicable after the consultation period." We believe that this additional information can resolve our outlined issues.

Strong support for proposed APRA capital treatment

COBA strongly supports APRA's proposed capital treatment.

APRA proposes to allow ADIs to treat eligible FHLDS loans comparably to mortgages with a loan-to-valuation ratio (LVR) of 80 per cent. This approach will reduce FHLDS loan capital requirements in line with the risk of these loans and recognise the value of the NHFIC guarantee (relative to a mechanical application of APS 112).

Aspiring first home buyers will be the beneficiaries of this approach as their mortgages with standardised ADIs will be subject to a lower cost of funds due to the lower relative capital requirements. This will also reduce the capital advantage of advanced ADIs (and non-ADIs) relative to standardised ADIs. These three groups are likely to compete against each other for NHFIC's 'non major bank lender' sub-panel allocation.

One area needing clarification is that this 80 per cent LVR capital treatment extends beyond the existing APS 112 and 1 January 2022 when an updated APS 112 will be in place. COBA assumes that

post-2022 these exposures are treated under the revised APS 112 as an 80 per cent LVR loan in the "owner-occupied principal and interest mortgages" category (suggesting a 35 per cent risk weight based on current proposals) [1].

A need to exempt FHLDS loans from high LVR reporting

COBA believes that flexibility around the high LVR status of these loans for reporting purposes is needed. This will help promote competition in line with the Government's intentions regarding smaller lenders and the FHLDS as well as showing adequate consideration of competition in line within APRA's mandate. COBA believes that APRA should exempt these loans from high LVR reporting. Given these are recognised as lower risk for capital purposes, it should follow that they should be for reporting purposes as well.

Some COBA members have raised concerns about the treatment of these loans for prudential reporting and how this would interact with existing internal limits. The uncertainty around this treatment has reduced their appetite to participate in this scheme.

At face value, these loans are high LVR loans (with an LVR between 80 to 95 per cent) that have a NHFIC guarantee to reduce potential losses to the lender.

COBA notes that New Zealand has set a precedent for exercising flexibility regarding Government-supported guarantee schemes for high LVR lending measures.[2] RBNZ excludes the Welcome Home Loan scheme from its macroprudential measures. The rationale is outlined below.

> Exemptions will be permitted for high-LVR lending under Housing New Zealand's Mortgage Insurance Scheme (MIS), including the Welcome Home Loan scheme and Kainga Whenua program. MIS loans are intended to meet government housing policy objectives and present minimal risks to financial stability, as any bank losses are either underwritten or guaranteed by Housing New Zealand.[3]

Given the size of Australia's FHLDS, it is unlikely that this scheme would pose a material risk to financial stability. The FHLDS is intended to meet government housing policy objectives.

COBA acknowledges that there are no APRA-prescribed macroprudential measures in place to prevent ADIs from taking on additional owner-occupied principal and interest high LVR loans (the type of lending underpinning the FHLDS). However, at a minimum, there needs to be clarity for FHLDS panel lenders (and prospective lenders) around how they can set their internal LVR limits regarding FHLDS loans. Otherwise an ADI could undertake the work to be on the panel, without being able to maximise the benefits. As mentioned, at one extreme, this may discourage smaller ADIs from applying to be on the FHLDS panel. COBA believes it would be simpler if APRA exempts these loans from high LVR reporting. COBA also notes that an inflexible approach provides a free 'leg-up' for any non-ADIs on the FHLDS panel compared to their ADI peers — a factor to be considered in the context of APRA's interpretation of its competition mandate

In any case, any panel ADI must ensure that taking on these FHLDS loans is within their own risk appetite. Any APRA flexibility regarding FHLDS loans for reporting purposes would not be a green light for ADIs to ignore any potential risk implications.

COBA acknowledges that high LVR loans with LMI may not currently be excluded from high LVR reporting. However, we believe that flexibility with the FHLDS loans is consistent with this approach

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[1] See draft APS 112 Capital Adequacy: Standardised Approach to Credit Risk, Attachment A - 12

[2] RBNZ, 2018, Framework for Restrictions on High-LVR Residential Mortgage Lending Prudential Supervision Department (Document BS19) Online.

[3] RBNZ, 2013, A new macro-prudential policy framework for New Zealand – final policy position Online.

given that there is a distinction between private and public guarantee providers. A similar approach is taken by RBNZ. RBNZ includes private LMI loans in its high LVR reporting but excludes publicly guaranteed loans noting that: "In the event of a severe systemic shock, the resilience of private insurance can be severely tested, as was illustrated in the United States, with mortgage insurers not having adequate capital to meet claims".[4] In contrast, the resilience of a guarantee from a Government-owned provider (NHFIC in Australia & Housing New Zealand in New Zealand) is theoretically less likely to be tested due to the explicit Government guarantee.

Another necessary consideration is the highly cyclical nature of FHLDS loans. It is likely that FHLDS panel lenders will receive a substantial flow of these loans as a one-off each financial year (e.g. at some lagged time after the FHLDS allocations are released). APRA must consider this FHLDS feature in their supervision of FHLDS panel lenders, particularly smaller ADIs where this flow will be more evident. Selected smaller ADIs may receive flows above their existing market share given the Government's proposed pro-competitive construction of the FHLDS sub-panel allocations.[5]

Thank you for the opportunity to comment on APRA's proposal. Please contact [redacted] on [redacted] or [redacted] to further discuss any matter raised in this submission.

Yours sincerely

MICHAEL LAWRENCE
Chief Executive Officer

[4] RBNZ, 2013, Response to submissions received for the consultation on macro-prudential policy instruments and framework for New Zealand. Online.

[5] See NHFIC Draft Investment Mandate