AUSTRALIAN
RETAIL
CREDIT
ASSOCIATION

General Manager
Policy Development
Policy and Advice Division
Australian Prudential Regulatory Authority

12 March 2020

By email

Dear Sir/Madam

Draft Prudential Practice Guide APG 220 Credit Risk Management

Thank you for the opportunity to provide a submission in response to the draft APG 220.

ARCA is the peak industry association for businesses using consumer information for risk and credit management. Our Members include Australia's leading banks, credit unions, finance companies, fintechs, and credit reporting bodies. Collectively, ARCA's Members account for well over 95% of all consumer lending in Australia.

Our comments in respect of the draft APG 220 are directed to the guidance in relation to the 'Credit assessment and approval process' and 'Non-performing exposures' sections of APS 220 as it applies to the provision of credit to individuals (particularly credit that is regulated by the *National Consumer Credit Act* (NCCP)).

ARCA's earlier submission in relation to the draft APS 220 noted our concern that the revised prudential standard could restrict innovation and competition by imposing inflexible obligations on ADIs which are not 'scalable'. We welcome the confirmation provided in the final revised APS 220 and draft APG 220 of the continued relevance of 'scalability', including the:

- small – but important – changes that have been made to the final revised APS 220 (in particular paragraph 44);

- the clarification (para 42, APG 220) that "[n]ot all aspects of the criteria in paragraphs 44 and 45 of APS 220 would be relevant to certain credit products and activities";
- the statement (para 43, APG 220) that "[s]ome credit products and activities may warrant a streamlined credit assessment which may not be fully consistent with a traditional credit assessment"; and
- the recognition (para 45, APG 220) that there are various ways of assessing an individual's capacity, including looking at a borrower's regular savings pattern.

We also welcome the retention of the 6-month probation period as provided for in paragraph 94 of APS 220.

We have the following specific feedback:

i. In relation to the statement (para 48, APG 220) that, "Interest rate buffers would also be applied to any other existing debts of the borrower", we suggest that the practice guide clarify/recognise that:
   a. It is not necessary to individually apply a buffer on each obligation of the borrower. A more broad-based approach to providing for a buffer on other debts may be taken.
   b. The approach to buffers on other obligations should be designed considering the consumer's overall financial position and their overall level, and types, of debt. For example, in relation to credit cards, there is already an implicit buffer given the NCCP obligation to assess capacity to repay the full balance over three years (even though a very small proportion of credit card holders would ever draw the full balance and take three years to repay).
   c. The above expectation does not apply to fixed rate obligations of the borrower;

ii. In relation to the statement (para 48, APG 220) that "APRA does not expect that buffers would be adjusted on an individual basis to approve an exposure that otherwise would not meet the ADI's credit assessment and approval criteria", we note that an ADI may utilise a process of "dual buffers" whereby a consumer who satisfies the higher of the buffers is not required to undergo additional verification steps. However, a consumer who fails serviceability based on the higher of the buffers is put through additional verification steps and will be approved if, following that additional verification, they are deemed to satisfy serviceability based on the lower buffer. We recommend that the practice guide recognise that the use of "dual buffers" as a 'scalability' tool is acceptable.

iii. In relation to paragraph 50, we note that the draft practice guide currently infers that the ADI *must* use the borrower's declared expenses (when they are greater than calculated benchmarks) and that there is no room for the borrower to reduce those expenses in order to afford the loan. We recommend that the practice guide recognise that expense reduction is possible as reflected in ASIC's RG 209 (at RG 209.194 onwards).

iv. In relation to paragraph 53, we note that Perram J in *Australian Securities and Investment Commission v Westpac Banking Corporation (Liability Trial)* [2019] FCA 1244 recognised that, for the purposes of the NCCP responsible lending assessment, it is an impossibility to assess the borrower's capacity to pay the principle and interest repayments that 'will' be due at the end of the interest only period as that figure is an unknown. While it may be APRA's expectation that the ADI should apply reasonable assumptions as to the interest rate and balance of the account at the end of the interest only period, we recommend that the practice guide also recognise that the ADI may apply reasonable, data-driven assumptions as to the potential for increases in income of the borrower (or, in the case of an investment property, the rental return) over that period. Likewise, where a borrower's expense figure has been temporarily increased (e.g. due to being a first home owner), it should be permissible for the ADI to assume a reduction in those expenses when calculating capacity at the end of the interest-only period. [1]

v. The requirements of paragraph 44 of APS 220 and the expectations in paragraphs 45 – 52 of the draft APG 220 are stated to apply to all credit to "individuals". We note that ASIC, in its recent update to RG 209, recognised the need to clarify that the requirements of the NCCP responsible lending obligations (as expanded upon in RG 209) do not apply to loans for commercial purposes (including to individuals). Similarly, we are concerned that the requirements of APS 220 could be considered to apply equally to consumer and commercial lending to individuals. We recommend that the practice guide explicitly recognise that, given the regulatory regime applying to consumer credit, an ADI may take a different approach to the requirements of APS 220 for commercial lending to individuals, compared to consumer lending.

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

Yours sincerely,

Mike Laing
Chief Executive Officer
Australian Retail Credit Association

[1] An ADI would, of course, also be expected to calculate the borrower's immediate capacity to repay the interest-only repayments based on current income and expenses.