

17 March 2022

Mr Gideon Holland
General Manager - Policy
Policy and Advice Division
Australian Prudential Regulation Authority

Via email: ADIPolicy@apra.gov.au

Dear Mr Holland

APRA consultation on capital framework prudential practice guides (APG 110 and 112)

COBA welcomes the opportunity to comment on APRA's draft capital framework prudential practice guides (PPGs) (APG 110 and APG 112).

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has over \$150 billion in assets and more than 4.5 million customers. Customer owned banking institutions are simple retail banking businesses, and all are subject to the standardised approach to credit risk. Our member institutions range in size from less than \$200 million in assets to over \$15 billion.

Given the current size of individual COBA members, it is unlikely that any of our members will become internal ratings-based (IRB) ADIs in the foreseeable future. Most COBA members are likely to be subject to the simplified capital framework in the long term. However, we expect that there may be a number of SFIs customer-owned banks in 2023 pending prospective mergers.

Welcome APRA's engagement on capital framework implementation

COBA welcomes APRA's engagement on the capital framework implementation. The capital framework implementation project is a significant project for all ADIs. We appreciate APRA's time to support the customer-owned banking sector with our questions and understanding of elements of the incoming capital framework through workshops held so far and those to be held in future.

COBA supports the development and publishing of any FAQs that may be necessary after the finalisation of these practice given more issues. We expect more issues and queries to arise as ADIs get further into the detail and implementation of these prudential standards. We also look forward to the release of the draft capital framework reporting standards. Similar to above, we expect more queries on treatments and definitions to arise once these standards are released and ADIs continue the classification task.

Please find attached some comments on currently identified queries on the prudential standards and draft PPGs in **Attachment A**. If you wish to discuss any aspect of this submission, please contact Mark Nguyen (mnguyen@coba.asn.au).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Michael Lawrence', with a stylized flourish at the end.

MICHAEL LAWRENCE
Chief Executive Officer

Attachment A – Prudential Practice Guide Comments

Clause(s)	Description	COBA comments
APS 110 / APG 110		
Reductions in Capital APG110 para 13.	APG 110.13 states that “Although decisions to reduce capital can be time sensitive, a prudent ADI would ensure it allowed sufficient time for the supervisory review of the proposal in its planning.”	COBA seeks information as to what is considered to be “sufficient time” for the supervisory review of a proposal.
Designating an ADI as a SFI or a ‘part SFI’. APG 110 paras 46-51.	Under APG 110.48 & 110.51, APRA has the ability to determine an ADI as a SFI or remove an exclusion for one or more risk areas for a non-SFI business. This would increase the prudential and/or reporting requirements on an individual ADI.	COBA’s view is APRA’s exercise of this power should be on a ‘no surprises’ basis. These ADIs should have sufficient lead time to implement these additional requirements. These lead times should be determined in consultation with the ADI as some requirements may be easier or more difficult to implement depending upon specific requirements (e.g. any risk management requirements under APS 117 could be more difficult) or need for system changes (e.g. reporting changes).

Clause(s)	Description	COBA comments
APS 112 / APG 112		
<p>Risk weight multiplier for certain exposures with currency mismatch</p> <p>APS 112 Attachment A paras 43-44.</p>	<p>COBA members request clarity in the practice guide on whether this mismatch check is an ongoing requirement or only at serviceability.</p>	<p>COBA understands that APRA’s current intention is that an ADI would apply this test at loan origination and during any subsequent serviceability assessment.</p> <p>COBA suggests the practice guide be amended to reflect this expectation.</p>
<p>Land acquisition, development and construction (ADC)</p> <p>APS 112 Attachment A paras 27-30.</p>	<p>COBA members query how a loan secured against a not-yet-completed duplex residential property should be classified under new APS 112 if the borrower was going to live in one duplex and rent out the other (e.g. ‘ADC’ or ‘owner-occupied’).</p>	<p>COBA notes that property exposures are exempt from ADC treatment if the “property will be the primary residence of the borrower” (APS 112.28(b)). However, it is not clear how this works in the duplex scenario.</p> <p>COBA understands that APRA is considering the appropriate treatment of these exposures through the review of APG 112.</p>
<p>Land acquisition, development and construction (ADC)</p> <p>APS 112 Attachment A paras 27-30.</p>	<p>COBA members note that our land and construction home loans for investment are typically for ‘mum & dad investors’ who are buying a block of land to construct a house with the intention to rent out for investment purposes.</p> <p>COBA members query how to treat these types of loans given they are considered to be ADC loans.</p>	<p>COBA members note that these loans will not be able to meet the requirements of APS 112.29(b) and APS 112.29(d) as this type of policy is not applicable for these loan types.</p> <p>Given the above, we assume that these loans are subject to the higher risk weighting of 150%.</p> <p>We also query whether an ADI who does not provide total exposures greater \$5 million to a</p>

Clause(s)	Description	COBA comments
		<p>borrower would be required to have qualifying pre-sales policy given this is not necessary in this situation (29(d) is contingent of being greater than \$5 million).</p>
<p>General corporate – unrated small- and medium-sized enterprise exposures APS 112 Attachment B, para 22.</p>	<p>COBA members query whether the \$75 million revenue threshold for general corporate SME is based on origination revenue or ongoing revenue.</p>	<p>COBA understands that APRA’s intent is that the \$75 million threshold applies on an ongoing basis in an addition to at origination.</p> <p>COBA suggests the practice guide be amended to reflect this expectation.</p>
<p>Use of term deposits as security</p>	<p>COBA members notes that a borrower may offer as security a term deposit that fully covers the value of the loan as a guarantee.</p> <p>In these cases, the ADI would lock the term deposit for processing for the period of the loan and customer cannot break the term deposit.</p>	<p>APG 112.15 notes that “When determining the loan amount for the purposes of calculating LVR, deposit accounts that meet the requirements of APS 112 (Attachment H) can reduce the loan amount. Offset accounts would not meet the requirements for this purpose.”</p> <p>COBA notes that we would expect that the LVR for the loan in this example to be calculated as nil or no exposure rather than incurring an 80% or 100% LVR. The credit risk in this scenario for the ADI is nil given it is fully backed by a term deposit.</p> <p>Is this correct?</p>

Clause(s)	Description	COBA comments
<p>Loans to individuals security by motor vehicles</p>	<p>COBA members query whether loans to individuals secured by motor vehicles would be classified as 'other retail' under new APS 112.</p>	<p>COBA understands that this a loan to an individual secured by a motor vehicle would be treated as 'other retail' based on the 'immovable real property' definition.</p> <p>COBA suggests the practice guide be amended to reflect this expectation.</p> <p>COBA also notes the increasing potential of 'tiny homes' and other alternative forms of housing that may not fit neatly into the prudential framework.</p> <p>COBA suggests that APRA keep this in mind regarding its prudential framework modernisation project.</p>