OPENING STATEMENT

WAYNE BYRES

Chairman
Australian Prudential Regulation Authority

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By: Mr Wayne Byres, Chairman, APRA
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OPENING STATEMENT TO THE SENATE ECONOMICS LEGISLATION COMMITTEE
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I would like to make a short opening statement to bring the Committee up to speed on two issues of priority for APRA at the present time: our actions to reinforce sound lending practices in the housing market, and our preparations to take over responsibilities for the prudential regulation of private health insurance.

Let me first discuss lending for housing. As you would be aware, APRA wrote to all authorised deposit-taking institutions (ADIs) in December emphasising the need to maintain sound lending standards in residential mortgage lending. This was done against a backdrop of historically low interest rates, high household debt, subdued income growth and rising unemployment, significant house price growth, and strong competitive pressures. Our letter highlighted three areas that would be a particular focus of our supervisory activity in early 2015: higher risk lending (such as significant and growing volumes of lending at high loan-to-value and high loan-to-income ratios); strong growth in investor lending; and serviceability measures. In the latter two cases, we set out some benchmarks that would act as triggers for more intensive supervisory review. We indicated that as our supervisors reviewed plans and lending practices in early 2015, we would consider the need for a proportionate increase in regulatory capital requirements for individual lenders.

It is important to highlight a few points about what our work is - and is not - designed to achieve:

- First, our approach involves benchmarks, not hard limits. Operating beyond these benchmarks is not a breach of a regulatory requirement. Rather, the benchmarks are designed to provide guidance to lenders about how APRA supervisors will be approaching the task of making assessments in this area in 2015. That said, the guidance is not intended to be dismissed lightly, and any recipients of subsequent supervisory action have no right to claim they weren't warned.

- Our approach is forward-looking, and transparent. It focusses on how ADIs plan to go about lending for housing in 2015 (not what they have done in years prior), and it gives ADIs time to consider their plans and lending standards - and adjust them if necessary - before APRA considers whether any action is needed.

- Our approach is not expected to be unduly restrictive. Most ADIs are already operating within the benchmarks in our letter - across the system, the investor lending portfolio has been growing at around 10 per cent, and many lenders were already using serviceability measures that were at or above the benchmarks we set - so we do not foresee that our approach should have a severe impact on the flow of credit to housing. First and foremost, it will guard against any deterioration of lending standards, and further growth of imbalances in the market, in the future.

- Our approach is targeted. We have not loaded higher capital requirements on all ADIs, or imposed other across-the-board restrictions. The intention is to target those ADIs pursuing higher risk practices. Many ADIs, if they maintain their current path, will be unaffected by our heightened scrutiny.

For the sake of clarity, let me conclude on this topic by stressing our objective is not to target a particular level of house prices. That is not a task that is within our mandate. Our goal is more modest – to make sure that, however the housing market evolves, housing finance remains sensibly founded on sound lending standards.

Turning to private health insurance, the transfer to APRA of responsibility for health insurance prudential regulation is scheduled for 1 July this year. APRA has been working hard in preparation for its new duties, and we and the various other parties involved – including, critically, the Private Health Insurance Administration Council (PHIAC) – are well on track to meet this date. This has involved a lot of time and effort in planning, logistics, training, and communication.

The approach we are taking is intended to minimise the disruption to industry and the risks to sound supervision. We have indicated that we intend to maintain the current regulatory framework and supervisory approach pretty much as is for at least the first year. In simple terms, the health insurance industry will wake up on 1 July and notice very little difference. The staff will be largely the same (and on day one the PHIAC supervision team will remain in place), the rules and standards will be substantively the same and the approach to supervision consistent with that experienced under PHIAC. In other words, private health insurers who are compliant with the current prudential framework will not need to take any steps at all in order to be compliant when the new prudential framework begins. As a result, there will be very little preparation for the change that will be required of the industry.

This outcome is being facilitated by the proposed legislation under which APRA will supervise the industry, and the intended approach for transferring PHIAC rules and standards to APRA standards. The draft bill sets out the prudential supervision framework, which - with some exceptions - will be the same as the existing prudential framework. The exceptions include aligning certain provisions to APRA's existing supervision regime: this alignment will help us to remain efficient and cost-effective across all our operations. Some re-writing of existing prudential rules and standards will also be necessary to ensure they align with the bill, but again this is being done with the objective of ensuring that their substance does not materially change. Assuming the bill progresses as planned, we will be consulting on these changes in the next couple of months.

As I have said, good progress has been made in facilitating this transfer, and we think it important that the transfer of responsibilities occurs on 1 July as planned. From the perspective of the industry's interests, this will ensure certainty in the regulatory framework into the future, and a regulator that is not distracted by uncertainty of direction and decisions. From an APRA perspective, it ensures momentum is not lost, and minimises any doubling-up of work that will come with a delay. To their great credit, PHIAC staff have been preparing themselves for the transfer with genuine goodwill and commitment – we also do not wish this to be lost by any delay in the effective date.

So in summary, APRA will continue to work closely with all parties involved to ensure the transfer takes place successfully on 1 July this year, as we think this will provide the best outcome for everyone.