11 August 2017

The Manager
Banking, Insurance and Capital Markets Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: lenderrules@treasury.gov.au

Dear Sirs,

New APRA Powers to Address Financial Stability Risks – Non-ADI Lender Rules

Background

The Government announced in the 2017-18 Budget that it would act to ensure that the Australian Prudential Regulation Authority (APRA) is able to respond flexibly to financial and housing market developments that pose a risk to financial stability, by providing APRA with new powers in respect of the provision of credit by entities that are not authorised deposit-taking institutions (non-ADI lenders), to complement APRA's existing powers in respect of ADIs.

This written submission is in response to the draft ***Treasury Laws Amendment (Non-ADI Lender Rules) Bill 2017*** (the draft Bill) released by Treasury for public comment on Monday, 17 July 2017.

Extract from Federal Treasurer's Media Release on Monday, 17 July 2017

In setting the context for this written submission, I have repeated below a direct extract from Federal Treasurer, Mr Scott Morrison's, media statement in response to the draft Bill, as follows:

"However, APRA does not have powers over the lending activities of non-bank lenders, even where they ***materially*** *contribute to financial stability risks.*

Today, the Turnbull Government is releasing draft legislation for public consultation that will provide APRA with these new powers.

- *APRA will be able to issue rules relating to lending practices of non-bank lenders, where it considers that they* ***materially*** *contribute to financial stability risks.*
- *These new rules will be backed by appropriate enforcement mechanisms. If a non-bank lender fails to comply with a rule, it will be directed by APRA to comply. If it fails to comply with an APRA direction, the non-bank lender will face appropriate penalties.*
- *The legislation also enhances APRA's ability to collect data from non-bank lenders, so it can better tailor the use of these new powers.*

These new powers will allow APRA to manage the financial stability risks posed by the activities of non-bank lenders, complementing APRA's current powers over ADIs.

*The Turnbull Government's practice is to approach financial risks **with a scalpel rather than a chainsaw** – this measure provides APRA a new scalpel to deal with risks specific to non-bank lenders.*

APRA will use its independent judgement to determine how and when to use this tool, in consultation with the Council of Financial Regulators".

Detailed Comments and Observations

As the former long-term CEO of one of Australia's largest non-bank mortgage lenders, Pepper Group Limited, I have been publicly vocal in my opposition to what I regard as potentially unnecessary intervention by APRA in the day-to-day regulation of non-bank ADI's which are currently supervised and regulated by the Australian Securities & Investments Commission (ASIC).

I believe, however, that there are genuinely positive changes being recommended in the draft Bill which will provide APRA with better insights into the financial stability of the Australian market, including the housing market. Specifically, I applaud the initiative to extend APRA's ability to collect and monitor data from non-bank lenders under the auspices of the *Financial Sector (Collection of Data) Act 2001*.

Beyond this, I have a number of concerns with the draft Bill as follows:

- The draft Bill is so broad and vague in its drafting that it is highly likely to have far-reaching and unintended consequences. APRA chairman, Wayne Byres, has publicly sought to assuage concerns about regulatory overreach, telling a Senate committee on May 30 the new law over shadow banks will merely provide a "reserve power" and that it would not be APRA's intent "to ensure the safety of every 'shadow bank'".
- To the contrary, the draft Bill has the very real and strong potential to be anti-competitive, giving ASIC unbridled and far-reaching rule-making powers to shut-down any and all non-bank lender activities without notice. There are no protections in the draft Bill which would prevent a future APRA chairman choosing to interpret the legislation as providing him or her with a much broader remit, beyond Wayne Byers' "reserve power" interpretation.
- It will potentially jeopardise investor confidence in the asset-backed securitisation markets (ABS and RMBS) if there is a risk that the originating non-bank lender, and most likely servicer, of the underlying loan assets can be unilaterally shut down by APRA without notice.
- This effectively makes APRA the regulatory super power over bank and non-bank financial institutions; ASIC only needs to be "consulted" but the legislation gives ASIC no power to prevent APRA imposing previously unforeseen 'rules' on the non-bank sector.
- In doing so, it blurs the lines of regulatory responsibility between APRA and ASIC for the non-bank sector, thereby having the potential to create significant uncertainty for non-ADI lenders and other market participants.
- Simply relying on the Council of Financial Regulators to act as a quasi-umpire between APRA and ASIC to resolve jurisdictional matters arising from this draft legislation is simply not good enough. The legislation needs to be far more prescriptive around where APRA's powers of regulation over non-ADI lenders begin and end. Only then will market participants have a clear understanding of the different roles being played by each regulator.
- The draft Bill, in my opinion, results in regulatory over-reach and a sledgehammer to a nut in the context of non-bank lender market share in residential mortgages and consumer finance in Australia. On an aggregated basis, non-bank lenders comprise less than 5% of the Australian mortgage lending market.
- This approach clearly contradicts the Federal Treasurer's statement that "*The Turnbull Government's practice is to approach financial risks with a scalpel rather than a chainsaw – this measure provides APRA a new scalpel to deal with risks specific to non-bank lenders".*
- As mentioned above, the legislation (as drafted) is too vague and too broad as to APRA's driving purpose to promote financial stability. It should be more prescriptive about what this means - is it the ability to extend macro prudential controls to the non-bank sector, is it to regulate responsible lending practices, is it to intervene in product pricing?

- In my view, the draft Bill needs to be more prescriptive, mainly to ensure that it does not result in regulatory over-reach when, now or in the future, APRA decides to apply a broader reading to its rule-making powers, beyond say extending ADI-style macro prudential controls on investor lending or interest-only lending to the non-bank sector.
- This could be particularly damaging to the non-conforming mortgage sector which typically has a broader credit appetite in areas such as debt consolidation, borrowers requiring alternative-income verification, borrowers with past adverse credit histories, and self-employed borrowers. Non-conforming lenders provide access to borrowers who would not otherwise have access to mortgage credit from traditional lenders such as the major Australian banks.
- We need to avoid "best intentions" drafting which may result in future "scope creep" in terms of APRA's powers over the non-bank sector.
- Finally, I come back to the relative market share of the non-banks in both residential mortgages and consumer finance, relative to the ADIs. Is it necessarily a threat to Australia's financial stability if a particular non-bank lender underwrites 50% of its mortgage volume in interest-only loans, relative to ADIs which might have a 10% macro prudential cap, if that non-bank represents less than 0.5% of the Australian market?

As a final observation, I note there has been almost no consultation to date by either Treasury or the Federal Government with representatives of the non-bank, non-ADI lenders currently operating in the Australian market. In the absence of direct consultation, there seems to have been a tendency, perhaps inadvertently, to overstate the significance of the non-bank lending sector in the context of the overall Australian housing market.

On this basis alone, the draft Bill fails the "pub test" when it refers to APRA having concerns with *"an activity or activities engaged in by one or more non-ADI lenders in relation to lending finance (which)* ***materially*** *contribute to risks of instability in the Australian financial system".*

I sincerely hope that the comments and observations made in this written submission are accepted in good faith and viewed by Treasury as being both constructive and practical, particularly given that they are made by a long-term CEO with direct experience in leading a large non-bank ADI and an organisation with a long and successful track record in issuing RMBS in the global debt capital markets – a key source of funding for the non-bank sector which facilitates healthy competition in the Australian residential lending market.

Yours sincerely,

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About the Author - Patrick Tuttle

Patrick Tuttle is the former Group Managing Director & CEO and Co-Group Chief Executive Officer of ASX-listed, Pepper Group Limited, from February 2008 to March 2017.

Mr Tuttle was instrumental in leading the Company's Initial Public Offering in July 2015, becoming a substantial public shareholder whilst remaining in his capacity as Co-Group CEO.

Following his departure from the Company in March 2017, Mr Tuttle remains as a substantial individual shareholder.

At the time of his departure from the Company on 31 March 2017, Mr Tuttle was Pepper Group's longest, continuously serving Executive Director (16 years) and longest-serving CEO, having continuously served in this capacity for nearly 10 years.

He was appointed Co-Group Chief Executive Officer in October 2013 reflecting his responsibilities for executing strategy and leading the Pepper Group's operating businesses in Australia, Asia (South Korea) and Europe (United Kingdom, Ireland and Spain).

Mr. Tuttle was appointed Managing Director & CEO of Pepper Australia Pty Limited ("Pepper") on 1 February 2008. He is a banking, capital markets and financial services specialist with extensive experience in leading consumer lending and asset management businesses.

During the period from February 2008 until January 2011, Mr Tuttle had sole responsibility for overseeing all aspects of Pepper's Australian strategy principally steering the business during the Global Financial Crisis by pivoting the Company's strategy towards 3rd party loan servicing at a time when it was forced to limit its mortgage lending activities.

As Co-Group CEO, Mr. Tuttle was responsible for all aspects of the Pepper Group's performance, including the development of the Company's short and long term strategic direction, creating and implementing the business plan and achieving targeted profitability.

Mr Tuttle was CEO for Pepper's Australian operating business. The country heads responsible for Pepper's European and Asian businesses, located in London, Dublin, Shannon, Madrid and Seoul also reported directly to Mr Tuttle in his capacity as Co-Group CEO. He was also Co-Chairman of Pepper's Global Executive Committee from October 2013 to March 2017.