

28 June 2019

General Manager  
Policy Development  
Policy Advice Division  
Australian Prudential Regulation Authority

Email: ADIpolicy@apra.gov.au

Dear Sir/Madam

**Comments on APRA 'Proposed revisions to credit risk management framework for authorised deposit-taking institutions' issued in March 2019**

**Introduction**

The Small and Medium Enterprise Committee of the Business Law Section of the Law Council of Australia (**SME Committee**) makes these comments on the Australian Prudential Regulation Authority (**APRA**) consultation paper 'Proposed revisions to credit risk management framework for authorised deposit-taking institutions' (**ADIs**) issued in March 2019 (**Consultation Paper**).

The SME Committee has as its primary focus the consideration of legal and commercial issues affecting small businesses and medium enterprises (**SMEs**) in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SMEs.

Please note that the SME Committee's submission may differ from those made by other Committees of the Law Council because of our Committee members' perspectives and experiences as advisers to SMEs.

**Response and feedback**

Thank you for the opportunity to provide comments on the Consultation Paper. We have sought to respond below to each of the questions listed in the Consultation Paper.

The SME Committee recognises that the Consultation Paper is considering appropriate updates to APRA APS 220 *Credit Quality* including re-naming it to APS 220 *Credit Risk Management (RG 209)* to:

- cater for a new accounting standard ASB 9 that uses a forward-looking approach to provisioning;
- updated Basel supervisory guidance associated with the new accounting standard on sound credit practices and asset classifications; and
- make other changes following the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**).

APS 220 sets out APRA's prudential standard with which the credit risk frameworks of ADIs must comply and is adhered to by banks (ADIs) in managing their credit risk frameworks including when assessing applications for loans and credit.

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The SME Committee notes that APS 220, both in its current form and as proposed, deals with an ADI's own credit risk position. It also includes processes at a borrower level where an ADI is expected to exercise prudent credit judgement commensurate with the nature, size and complexity of the transaction when approving new loans and credit and when reviewing and refinancing existing exposures.

The proposed updates to APS 220 list in paragraph 44 criteria ADIs must consider when a new loan or credit is to be provided to an individual as a borrower, and in paragraph 45 additional criteria to those in paragraph 44 to be considered when the borrower is not an individual.

Consequently, the SME Committee notes that the criteria to be applied under APS 220 for new loans and credit to SMEs includes the same criteria in paragraph 44 as is applied to individuals in addition to the criteria in paragraph 45.

Whilst the criteria list in paragraph 44 appear to the SME Committee to reflect the requirements of the Australian Securities and Investments Commission (**ASIC**) in RG 209, which sets out guidelines for credit providers to meet their obligations under the *National Consumer Credit Protection Act 2009 (NCCP)*, the Committee notes that neither the NCCP nor RG 209 apply to loans or credit provided to SMEs. Aside from the provisions of the *Australian Competition and Consumer Act 2010* that prohibit misleading and deceptive conduct and unfair contract terms, there is no equivalent regime for SMEs to that of NCCP for consumers.

However, despite this, and because there are no guidelines from ASIC or APRA on responsible lending practices where the customer is an SME, the SME Committee is aware that it is (particularly since the Royal Commission) often the current practice of ADIs to seek to apply to SME customers who apply for loans or credit the responsible lending guidelines set out in ASIC RG 209 as applicable for consumers.

The inclusion of the same criteria as proposed by APRA in paragraph 44 of APS 220 will require ADIs to similarly apply those criteria to SMEs for new loans or credit in order to comply with their own obligations under APS 220.

The SME Committee is strongly of the view that the responsible lending guidelines for consumers are not appropriate to be applied when an ADI assesses the ability of an SME to service debt or repay any new loan or credit, and that the proposed update to APS 220 should not require the criteria in paragraph 44 to be applied to SMEs in addition to the criteria in paragraph 45.

Likewise, the SME Committee notes that the NCCP, and thereby the responsible lending obligations of ACL holders and ADIs under RG 209, only applies to new loans issued from 1 July 2010, or to extensions of credit under loans existing as at 1 July 2010. The SME Committee is aware that ADIs are currently applying their responsible lending obligations under RG 209 to borrowers who already held loans as at 1 July 2010, even where no new loan or extension of credit under those pre-existing loans is applied for.

The SME Committee appreciates that both with SMEs and customers with pre-existing loans, APRA has in recent years required ADIs to strengthen for reporting to APRA their understanding of their internal credit risk being taken on board. APRA has in the past, in APS 220, referenced ASIC RG 209 as providing processes for responsible lending that ADIs could utilise to assist them in assessing their internal credit risk. It would appear that ADIs are justifying their application of RG 209 obligations to both SMEs and pre-existing loan customers on this basis. It is the position of the SME Committee that RG 209 should not apply to SMEs or borrowers who already held loans as at 1 July 2010, even where no new loan or extension of credit under those pre-existing loans is applied for.

In this regard, the SME Committee considers that the responsible lending obligations set out in RG 209 and the proposed criteria to be included in paragraph 44 of APS 220 are not appropriate for the assessment of the credit risk to the ADI on loans and credit provided to SMEs. ADIs should, and should already have been, assessing their internal credit risk on loans and credit to SMEs based upon the credit assessment information relevant to any particular SME, and which can vary considerably due to the differences in circumstances between SMEs.

The SME Committee further also considers that those RG 209 obligations and the proposed criteria to be included in paragraph 44 of APS 220 should not be applied by ADIs for their own internal credit risk assessment of customers with pre-existing loans unless the customer has applied for an increase in credit under that loan. The SME Committee recognises particularly that customers with loans pre-existing as at 1 July 2010 are already in the ADI's credit risk profile and, unless additional credit is provided, the risk assessment under that profile shouldn't change.

The SME Committee therefore calls on APRA, as a matter of urgency, to clarify that for SME borrowers and borrowers who already held loans as at 1 July 2010, unless a new loan or an extension of credit under pre-existing loans is applied, the prudential standards to be complied with by ADIs under their own credit risk frameworks should not include, as proposed, the criteria in paragraph 44 of APS 220 being the responsible lending obligations in ASIC RG 209. These criteria are not appropriate to apply, and should not be applied, by ADIs to assess applications for loans or credit from SME customers, nor should they be applied to borrowers who already held loans as at 1 July 2010, unless a new loan or an extension of credit under pre-existing loans is applied for.

### **Consultation Questions**

The SME Committee is not in a position to provide the practical responses required to the three consultation questions.

### **Options**

The SME Committee, subject to the comments and suggestions it has made above, supports APRA adopting Option 3 as being the most appropriate to reflect credit risk management current best practice for ADI credit risk frameworks.

### **Further discussion**

The SME Committee would be happy to discuss any aspect of this feedback. Please contact Coralie Kenny, member of the SME Committee, on 0409 919 082 if you would like to do so.

Yours sincerely,



**Rebecca Maslen-Stannage**  
**Chair, Business Law Section**

