Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

2016 - 2017

Department/Agency: Australian Prudential Regulation Authority
Question: 193
Topic: Tracker Home Loans
Reference: Written
Senator: Ketter, Chris

Question:

1. During the recent House of Representatives banking hearings the banks in their evidence expressed a range of opinions on tracker loans – including some that implicate tracker loans (?) in the 2007 financial crisis. Does APRA have a view on the provision of tracker loans?
2. Would there be risks to Australia's banking and financial system if banks were to provide tracker loans.

Answer:

1. APRA's role is focussed on the overall financial safety of individual entities and the stability of the financial system, and generally does not seek to prescribe the products, or specific product features, offered by an authorised deposit-taking institutions (ADI). Rather, APRA seeks to ensure the risks of the products offered are appropriately managed by the ADI including that the capital held is adequate. For lenders, tracker loans clearly involve greater risks – relative to current standard home loan products - which need to be carefully managed. However, APRA has no in-principle objection to the provision of tracker loans.

2. Tracker loans, particularly those tied to the official cash rate, involve additional risks to lenders as they limit the lenders' ability to protect themselves against changes in funding costs. APRA would expect ADIs offering these products to have very sound techniques for managing the risk of changes in the basis (differential) between the tracker rate and the bank's cost of funds. This basis risk is difficult to hedge, and asymmetrical given customers can typically pre-pay residential mortgage loans, including as a result of re-financing. This asymmetry adds complexity to the lender's ability to appropriately manage risk. Should the additional risks be unable to be adequately hedged, additional capital support would be likely to be needed. The cost of hedging and/or higher capital requirements would mean that, all other things being equal, tracker loans would likely be priced higher than other similar products.

   In limited amounts, tracker loans should not pose material risks to the viability of the banking system. APRA would, however, be opposed to any proposal to oblige ADIs to offer tracker loans if they did not wish to do so.