

21 August 2017

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To The Manager  
Banking, Insurance and Capital Markets Unit  
Financial System Division  
The Treasury  
Langton Crescent  
Parkes ACT 2600  
By email: [lenderrules@treasury.gov.au](mailto:lenderrules@treasury.gov.au)

Dear Sir

### **New APRA powers to address financial stability risks: non-ADI lender rules**

We act for Qualitas Property Partners Pty Limited (**Qualitas**).

We refer to the call for comments on the draft Treasury Laws Amendment (Non-ADI Lender Rules) Bill 2017 (**Exposure Draft**) published by the Government on 17 July 2017, and to Qualitas' meeting with Treasury and APRA in Sydney on Friday 11 August 2017. Qualitas also refers to the information that it provided to Treasury and APRA at that meeting, and does not repeat any of that information in this submission.

On behalf of Qualitas, we welcome the opportunity to make a submission on the Exposure Draft.

Qualitas believes there are two separate and distinct elements of the Exposure Draft that warrant comment, and further consideration by the Government in terms of the design of the legislation.

#### **Registration and data**

Qualitas recognises the need for the proper and complete collection of data in relation to the finance provided by non-ADI lenders, and therefore supports in substance the provisions in the Exposure Draft which clarify the concept of "registrable corporation".

However, Qualitas believes that the legislation, as drafted, is too broad in scope and will catch what is essentially the same finance provided by a number of parties, whether in a corporate group, in the chain of funding activities conducted by a non-ADI lender or by separate financiers in relation to the same underlying property (such as development finance, and subsequently acquisition finance for the same property). Only the final stage of the "lending finance" needs to be the subject of the new reporting requirements in order for APRA to have clarity on the amount of credit being originated in the economy.

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In the attachment to this letter, Qualitas makes a number of comments that are designed to address this concern.

Qualitas also believes that APRA should consult widely with each category of non-ADI lender and agree the exact data sought by APRA in respect of the lending activities of the non-ADI lenders. It is only after that consultation is completed that the data reporting obligations should commence. The Exposure Draft should also provide that it is only the registration and data collection provisions that are enlivened at the time that the legislation receives Royal Assent – this will provide the market and investors with certainty that the immediate priority of APRA is the collection of data, and not the application of any potential rule to non-ADI lenders.

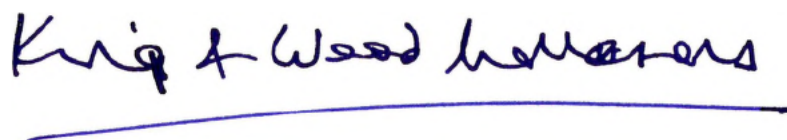
### **Rule-making**

While Qualitas agrees that financial stability can be affected by activities undertaken outside of the traditional banking sector, it also needs to be acknowledged that there are fundamental differences between ADIs and non-ADI lenders. A non-ADI lender does not have the same broad functions in, or influence over, the financial system as that of an ADI. It follows that any regulation of non-ADI lenders should not have any prudential characteristics, should be limited to exceptional circumstances, and should be limited in scope to the specific activities of lending finance of the specific category or sector of non-ADI lenders that are creating the risk of financial instability, and their scope of application, terms and duration should be clear and applied only after extensive consultation with the relevant non-ADI lenders who could be affected by the rule.

In the attachment to this letter, Qualitas makes a number of comments that are designed to address these concerns.

Qualitas would welcome the opportunity to discuss this submission further with members of the Banking, Insurance and Capital Markets Unit, and are very happy to assist should there be any queries arising from this submission. In that event, please contact Diana Saw, Director, Risk Management at Qualitas, on (02) 8073 0013 or [diana.saw@qualitas.com.au](mailto:diana.saw@qualitas.com.au) at first instance.

Yours faithfully

A handwritten signature in blue ink that reads "King & Wood Mallesons". Below the signature is a horizontal blue line.

**QUALITAS' RESPONSE TO THE PROPOSED TREASURY LAWS AMENDMENT (NON-ADI LENDER RULES) BILL 2017**

Subject	Response
<p>Scope of legislation – who is a registrable corporation and who is a non-ADI lender</p>	<ul style="list-style-type: none"> <li>• The current draft captures a wide range of entities across the capital markets.</li> <li>• This scope is beyond the stated intent of the Government’s proposed regulatory framework.</li> <li>• We support the objective of relevant data collection to facilitate a greater understanding of the non-ADI lending market and lending practices.</li> <li>• This should confirm the small market share of the financial system of the non-ADI lending sector and the resultant lack of need to increase regulation of this, or parts of this, sector.</li> <li>• We would discourage additional compliance costs and administrative burden for non-ADI lenders where information collected will not identify material and systemic risks of instability in the financial system.</li> <li>• Data collection requirements should take into account the relatively small size, both in terms of profit and employees, of certain segments of the non-ADI lending sector.</li> </ul>
<p>Circumstances for making a rule – lending activities that “materially contribute to risks of instability in the Australian financial system”</p>	<ul style="list-style-type: none"> <li>• The role of non-ADI lenders in promoting competition and liquidity in the Australian property finance market, and thereby encouraging financial stability, is widely acknowledged and should continue to be encouraged.</li> <li>• Particularly in a downturn situation, alternative capital provides a floor to asset prices as it can purchase or finance assets during times of volatility.</li> <li>• Over-regulation or untargeted and unfocused regulation (including adopting regulatory considerations formulated for ADIs) will have negative consequences for the property sector and the overall economy, eg. reduction in construction and housing supply.</li> <li>• In formulating any regulatory approach, it is important to distinguish between different types of lending activities and different segments of the lending and financial markets.</li> <li>• Any rule made by APRA should be limited to the specific activities of lending finance that</li> </ul>

	<p>have in APRA's view materially contributed to the risks of financial instability, and should not extend any further.</p>
<p>Scope of the rule-making power – lending activities that “materially contribute to risks of instability in the Australian financial system”</p>	<ul style="list-style-type: none"> <li>• Qualitas has a diverse range of funding capability across the capital stack from first mortgage investment finance, mezzanine debt and senior construction finance, to preferred equity and ordinary equity.</li> <li>• Qualitas only engages in responsible lending practices.</li> <li>• Qualitas' implements investment-grade internal processes and governance to continually assess a borrower's ability to repay its obligation through sources over and above the primary security.</li> <li>• Security is taken to provide a secondary exit in the event of default and never as a primary exit strategy.</li> <li>• Qualitas participates in investment activity that may appear debt in form but is in fact equity in substance. In particular, Qualitas invests in preferred equity transactions, and may at times take a mortgage and an agreed preferred coupon prior to a sharing of ordinary profit. Such features are to provide priority on receipt of cash flows from the projects and thereby provide some differentiation from ordinary equity. Returns from such investments are equity based and recognise the equity risk characteristics of the investment.</li> <li>• Qualitas does not raise deposit capital or receive the benefit of government guarantees.</li> <li>• Qualitas raises unlevered capital from wholesale and sophisticated domestic and foreign high net worth or institutional investors. Such capital is 'patient' equity capital.</li> <li>• Losses suffered in respect of lending activities are absorbed by the sophisticated capital providers, not the broader financial system.</li> <li>• The sophistication of the investors ensures that lending activities in this sector of the financial system is essentially self-regulating. Losses by a particular non-ADI lender will discourage investor participation in that non-ADI lender's lending activities.</li> <li>• Qualitas raises funds on a thematic investment approach. It analyses the market supply and demand net absorption capital flows and determines that a reasonable risk-adjusted return exists for investors.</li> </ul>

	<ul style="list-style-type: none"> <li>• The broad scope of the rule-making powers should be narrowed to reduce the potential for investor uncertainty in the non-ADI sector.</li> <li>• The retail property markets should be distinguished from the commercial property markets.</li> </ul>
Process for rule-making	<ul style="list-style-type: none"> <li>• Any new rules should not apply retrospectively.</li> <li>• There should be consultation with non-ADI lenders like to be affected by a rule before that rule is made.</li> <li>• There should be a transition period, that takes into account a non-ADI lender's existing commitments, before any rule becomes effective.</li> <li>• A rule should be revoked once APRA is satisfied that the relevant risk of instability has ceased.</li> </ul>
Consequences of breach	<ul style="list-style-type: none"> <li>• APRA should not determine a rule in relation to the way the business affairs, operations or activities of a non-ADI lender are to be conducted or not conducted, other than in respect of the relevant lending finance activity.</li> <li>• APRA should not affect any existing transaction or funding programme.</li> </ul>