BANKING

QUESTION

Capland is a first world country with a fully developed financial marketplace.

Roger Munie is the Capland Treasurer. He is an actuary and former very senior retail banking executive in the UK. He has cabinet responsibility for the Capland banking system. Roger has become concerned about the level of risk being accepted by Capland banks.

After returning from a recent international banking conference, his level of concern has increased with his exposure to the experience in other relevant countries e.g. Australia, Kingsland – a neighbouring country of Capland - and some European countries. His concerns have also been confirmed in discussions with cabinet colleagues and, particularly, the Capland Banking Regulator. These concerns have been reinforced when he reviewed the trends in the most recent data.

He has further noted the major run of increases in housing prices driven principally by overseas investors coming into the Capland market. This has caused a significant change in the Capland housing market. In earlier years the vast majority of housing was owned by occupiers rather than being owned by investors and rented. Until 5 years ago buying houses by overseas investors was prohibited. This was changed with a view to increasing the housing supply. The outcome was only a modest increase in supply over the five years (5% p.a. on average) but a significant increase in prices (15% p.a. on average). The proportion of rented properties rather than owner-occupied has steadily increased.

You are the senior partner in Australia's Best Banking Actuaries ("ABBA"). The Treasurer has approached you to provide advice as to the best method of dealing with the problem of the increasing risk being accepted by the Capland banks.

In the briefing he has pointed out the major differences between the Capland housing market and the Australian market

- a historically higher proportion of owner-occupiers
- generally lower loan to valuation ratios
- only recent opening up of the market to overseas investors
- better default experience, especially among owner-occupiers
- lack of any very large banks – the 12 largest banks, all of similar size, have an 80% market share
- extreme competition between banks for housing loans
- given the level of competition, informal pressure from the Regulator has little impact
- all individual bank deposits are specifically guaranteed by the government up to $250,000 per individual (C$1 is approximately A$1)
- no banks require lender's mortgage insurance for loans with high loan to valuation ratios

© 2018 Actuaries Institute

The advice requested was set out as follows:

- Provide a set of well justified and detailed recommendations to reduce and manage the additional risk being taken on by Capland banks
- The following options have been identified by the Treasury department
    - Increase capital for investor loans
    - Change the overall structure for capital
    - Give the Capland Banking Regulator legislative power to impose conditions
- Other relevant options should be examined
- Comparison with Australia would be helpful, provided that the differences in Capland are specifically recognised

Task

Prepare your report

Attachments

A: Capland Bank Capital Rules
B: Housing Loan Data
C: Owner-Occupier Data
D: Interest Only Loan Data

© 2018 Actuaries Institute

Attachment A: Capland Bank Capital Rules

The minimum capital required is determined as the following percentages of assets:

Government bonds	nil
Secured housing loans (owner-occupier and investor) - depends on the loan to valuation ratio (LVR) as follows	
loans with a LVR of 50% or less	4%
loans with a LVR over 50%	4% + ((loan/valuation) – 0.5)/10 (e.g. if LVR is 0.7 then capital is 6%)
Other loans	
Secured	8%
Unsecured	10%

© 2018 Actuaries Institute

Attachment B: Housing Loan Data

LVR Proportion (new loans by amount)

LVR	2012 %	2017 %
< 0.2	20	10
0.2 – 0.4	20	16
0.4 – 0.6	25	19
0.7 – 0.8	30	40
> 0.8	5	15

Default Rates (by amount)

Year	Owner-Occupier	Investor
2012	0.15%	0.30%
2013	0.18%	0.40%
2014	0.16%	0.53%
2015	0.19%	0.62%
2016	0.21%	0.79%
2017	0.25%	1.03%

© 2018 Actuaries Institute

Attachment C: Owner-Occupier Data

(new loans by amount)

Year	% Owner-Occupier
2012	80
2013	78
2014	75
2015	73
2016	68
2017	60

Attachment D: Interest Only Loan Data

(new loans by amount)

Year	% Owner-Occupier	% Investor
2012	5%	3%
2013	8%	4%
2014	7%	15%
2015	9%	20%
2016	12%	35%
2017	16%	53%

END OF QUESTION

© 2018 Actuaries Institute