



19 August 2021

TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

GUIDANCE ON CREDIT RISK MANAGEMENT

APRA has today released final guidance for credit risk management. *Prudential Practice Guide APG 220 Credit Risk Management* (APG 220) is new APRA guidance to assist ADIs in making prudent lending decisions and meeting their requirements under the new prudential standard, *APS 220 Credit Risk Management* (APS 220). APG 220 incorporates examples of better practices that APRA has identified in recent supervisory reviews.

Finalised guidance (APG 220)

In December 2019, APRA released a draft APG 220 for consultation. APRA received four submissions from ADIs and industry associations. Non-confidential submissions have been published on APRA's website. In response to feedback, APRA has provided further clarity regarding APRA's expectations for:

- the role of the Board in managing credit risk, aligning with the requirements in APS 220;
- sound credit assessment and approval processes, including providing examples where some additional flexibility could be considered prudent; and
- the use of automated valuation methods, including examples for the prudent development of scorecards and use of risk controls.

The attached guidance, APG 220, has been finalised. It has been published in advance of finalising the standard to assist ADIs in meeting their requirements, and in response to feedback from industry that earlier sight of the final guidance would support implementation.

Update on the prudential standard (APS 220)

In December 2020, APRA consulted on potential changes to the new APS 220, which would be contingent on the Government's proposed changes to consumer credit laws passing as legislation.¹ This included:

- a drafting amendment that would require ADIs to assess an individual borrower's repayment capacity without substantial hardship. This requirement is similar to the Government's proposed requirements of non-ADI lenders; and
- closer alignment between the implementation date of the Government's proposed consumer credit reforms and the new APS 220, if Government's reforms come into effect

¹ In September 2020, the Government announced a series of proposed reforms to consumer credit laws. This included that ADIs would no longer be subject to the Responsible Lending Obligations, which had been administered by the Australian Securities and Investments Commission. See the following link for further details: <https://treasury.gov.au/consultation/c2020-124502>

before 1 January 2022. APRA remains committed to ensuring there is appropriate alignment between the new ADI and non-ADI lenders' regimes. The new APS 220 will be implemented on 1 January 2022, or earlier if the Government's proposed reforms are passed as legislation. In this event, APRA will provide an update to ADIs at the time.

APRA expects that prudent ADIs would already be meeting the requirements of the new APS 220. In particular, given APRA's focus on reinforcing sound lending practices, and in light of the current risk outlook, APRA would be concerned if ADIs were not already meeting the core requirements for prudent loan origination standards.

Next steps

In the current environment, APRA expects Boards to have a strong focus on credit risk management, particularly for residential mortgage lending. APG 220 sets out examples of better practice to assist ADIs in maintaining sound lending practices and managing their credit risk, including during periods of heightened risk. It would be prudent for ADIs to review closely the examples of better practice in APG 220 against their current credit risk management practices, and make changes where appropriate.

Yours sincerely,

John Lonsdale
Deputy Chair