



# INFORMATION PAPER

## Macroprudential Policy Framework

11 November 2021

## **Disclaimer Text**

While APRA endeavours to ensure the quality of this publication, it does not accept any responsibility for the accuracy, completeness or currency of the material included in this publication and will not be liable for any loss or damage arising out of any use of, or reliance on, this publication.

### **© Australian Prudential Regulation Authority (APRA)**

This work is licensed under the Creative Commons Attribution 3.0 Australia Licence (CCBY 3.0). This licence allows you to copy, distribute and adapt this work, provided you attribute the work and do not suggest that APRA endorses you or your work. To view a full copy of the terms of this licence, visit <https://creativecommons.org/licenses/by/3.0/au/>

# Contents

---

<b>Executive summary</b>	<b>4</b>
<b>Chapter 1 - Macroprudential objectives</b>	<b>7</b>
<b>Chapter 2 - Macroprudential toolkit</b>	<b>13</b>
<b>Chapter 3 - Policy implementation</b>	<b>19</b>
<b>Annex A - Macroprudential instruments</b>	<b>24</b>

# Executive summary

---

This Information Paper sets out APRA's framework for macroprudential policy, building on experience in Australia and lessons learned from other peer jurisdictions. It covers APRA's objectives, the scenarios in which macroprudential policy could be applied, the toolkit of options and key considerations in implementation.

## APRA's purpose

APRA's macroprudential framework is founded on the *Australian Prudential Regulation Authority Act 1998* (APRA Act, section 8), which establishes APRA's purpose. The APRA Act mandates APRA to pursue a financial safety objective, balanced with considerations of efficiency, competition, contestability and competitive neutrality. Importantly, APRA is required by the APRA Act to balance these considerations in a manner that promotes financial system stability in Australia.

This explicit direction to promote financial stability in pursuing its objectives, coupled with the fact that macroprudential tools are within APRA's discretion to deploy, gives APRA a central role in the determination and implementation of macroprudential policy in Australia.

## Objectives

The objective of macroprudential policy is to mitigate risks to financial stability at a system-wide level. Macroprudential policy measures are typically temporary and counter-cyclical in nature; they seek to build additional resilience or reduce excessive risk-taking during an upswing in the financial cycle, and can provide flexibility for the financial sector in supporting the economy during a downturn.

Macroprudential policy is an important complement to traditional microprudential requirements, which are focused on maintaining the financial safety of individual entities, and held steady through the cycle. Macroprudential policy reduces financial stability risks through its direct impact on risk taking, and by strengthening the financial resilience of the system when needed. It can also have an indirect impact on the broader economy, such as on asset prices.

In Australia and overseas, macroprudential measures have typically been deployed through the banking system given the critical role that leverage plays in the financial cycle, although that need not always be the case. In 2018, APRA was also given new powers to apply macroprudential measures to non-APRA regulated lenders, where these lenders are materially contributing to financial stability risks.

## Risks and tools

Central to APRA's macroprudential policy framework is the identification and assessment of systemic risks at an early stage. While APRA monitors a range of risks, four main indicators are used to identify emerging threats to financial stability: credit growth and leverage; growth

in asset prices; lending conditions; and financial resilience. These have been shown empirically to provide an indication of emerging systemic risks.

APRA has a broad range of macroprudential tools that can be used to mitigate financial stability risks. Where possible, APRA would seek to implement measures that best target the nature and source of concern. For example, in an upswing it could be appropriate for APRA to implement measures that would seek to limit excessive risk-taking by APRA-regulated entities. On the other hand, in a downturn, APRA could use tools such as the Countercyclical Capital Buffer (CCyB) to provide banks with additional flexibility to maintain their lending.

## Implementation

Decisions on changes to prudential requirements are ultimately for APRA to determine, However, where changes are being made for macroprudential purposes, the Council of Financial Regulators (CFR) has an important role in assessing the level of systemic risk and coordinating regulatory responses across agencies.<sup>1</sup>

The monitoring and review of any macroprudential measures is a critical part of implementation, given the need to assess whether measures should be adjusted or removed as risks to financial stability evolve. As with the initial implementation of macroprudential measures, APRA would seek the input of the CFR on any subsequent adjustments.

APRA's success measure for any macroprudential policy response would be a reduction in risks to financial stability. This may be evident, for example, in a moderation in higher risk lending during an upswing, the continued supply of credit to sound borrowers during a downturn, and ultimately the maintenance of financial system stability through the cycle.

## APRA's framework

This Information Paper outlines APRA's framework for macroprudential policy. Chapter 1 provides a summary of the objectives, scenarios and key indicators. Chapter 2 sets out the toolkit of options, including capital, credit, liquidity and other measures. Chapter 3 concludes with an overview of the key implementation considerations.

---

<sup>1</sup> The CFR is the coordinating body for Australia's main financial regulatory agencies: APRA, the Australian Securities and Investments Commission, the Reserve Bank of Australia and the Treasury.

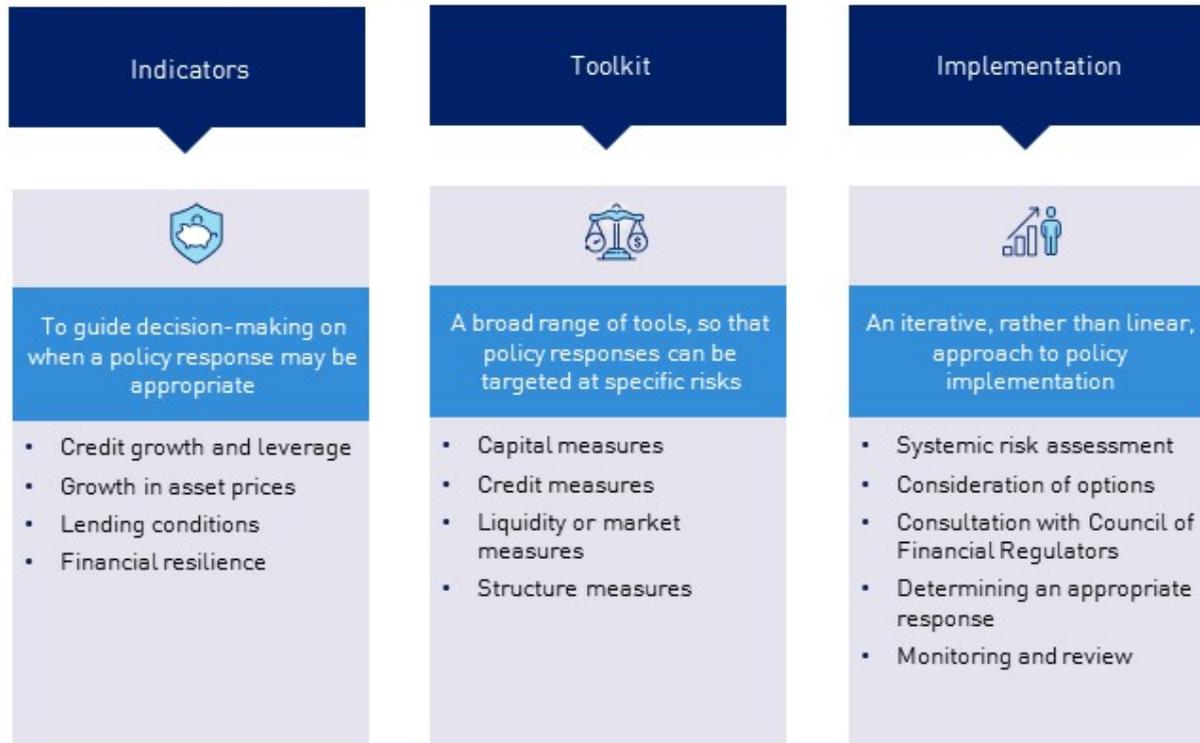


## Objective

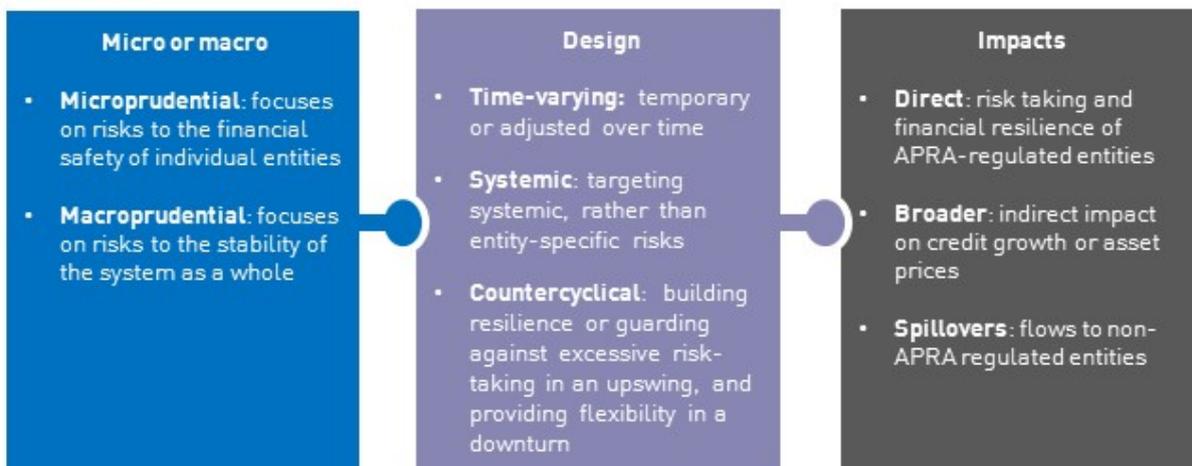


Promote financial stability by adjusting prudential requirements in response to the financial cycle

## Key elements of the framework



## Features



# Chapter 1 - Macroprudential objectives

---

This chapter outlines the objectives of macroprudential policy, with examples of the scenarios in which measures may be used in Australia. It sets out the key indicators that APRA monitors to assess the need for a macroprudential policy response.

## Objective

APRA's objective in using macroprudential policy is to promote financial system stability. Macroprudential policy complements and reinforces existing microprudential requirements, which are primarily focused on maintaining the financial safety of individual institutions.

What makes macroprudential policy different to other prudential policy, however, can be characterised by the following key considerations:

- **Time-varying:** macroprudential measures are typically either temporary or adjusted over time, in response to changes in the financial or economic cycle.<sup>2</sup> While core prudential requirements are risk-sensitive and can also be varied, they typically apply through the cycle on a permanent basis. In contrast, macroprudential measures would only come into effect or be varied in periods of heightened systemic risks, and would be adjusted or removed as these risks subside.
- **Systemic:** macroprudential measures target systemic rather than entity-specific risks, and would therefore be calibrated on an industry-wide or cohort basis. As these measures are used in response to heightened risks, there is typically also a greater need for more prescriptive requirements, rather than principles-based rules.
- **Countercyclical:** macroprudential measures aim to operate countercyclically, building additional resilience and guarding against excessive risk-taking in periods of potential exuberance. They can also provide flexibility in times of stress. The CCyB, for example, can be reduced in an economic downturn, to ensure that the banking sector can absorb losses and continue to lend to support households and businesses when they most need it.

Consistent with APRA's mandate, macroprudential policy can either strengthen the resilience of entities to risks in the financial system, or moderate their risk taking. In some jurisdictions, macroprudential policy has been used explicitly to target broader economic or

---

<sup>2</sup> The financial cycle is a term used to describe the commonly observed cycle in financial system variables, and in particular credit growth and asset prices (such as property prices). An upswing in the financial cycle has often been observed to presage an economic downturn, as household, business or banking leverage can become stretched and reach unsustainable levels. The financial cycle may coincide with an economic or business cycle, but its length, timing and amplitude can differ.

social objectives, such as to dampen house price growth. For APRA, high and rising house prices would be an important risk factor that could signal that risks in the financial system are building, but financial stability, rather than housing affordability, would be the objective of any macroprudential policy measures.

## Scope

The scope of macroprudential policy is deliberately broad. It can be deployed through the APRA-regulated banking, insurance and superannuation sectors and, in certain cases, it can be extended to non-APRA regulated lenders.

Traditionally, macroprudential policy has been deployed through the banking sector; this is consistent with the critical role that leverage plays in the financial cycle. However, this need not always be the case. For example, during the COVID-19 pandemic in 2020, APRA set an expectation that banks and insurers would limit discretionary capital distributions so that they could maintain capacity to continue to lend and underwrite insurance in a period of heightened uncertainty.

## Non-ADI Lenders

APRA also has powers that can be used to extend macroprudential policy to non-APRA regulated lenders, in certain circumstances.<sup>3</sup> Under Part IIB of the *Banking Act 1959*, APRA has powers that can be used to extend macroprudential policy to non-ADI lenders where their provision of finance is materially contributing to risks of instability in the Australian financial system.<sup>4</sup>

APRA's objectives for non-ADI lenders are narrower than for APRA-regulated entities. In implementing macroprudential policy for non-ADI lenders, APRA would be seeking to reduce the contribution of these entities to financial stability risks; for APRA-regulated entities, APRA would also be concerned with entities' own resilience, consistent with existing prudential requirements.

In determining whether to apply macroprudential measures to non-ADI lenders, APRA would take into account a number of factors, including:

- the overall size of the non-ADI lender sector, with a particular focus on market shares in higher risk lending segments;

---

<sup>3</sup> Non-ADI lenders provide loans to households and businesses. They are not required to hold an ADI licence unless they meet the criteria to be classified as an ADI (including, for example, specified deposit-taking activities).

<sup>4</sup> Subsection 38C(1) *Banking Act 1959*.

- the lending practices of non-ADI lenders, to assess whether they are contributing to downward pressure on industry-wide standards;
- potential spillover effects, given the possibility that a reduction in higher-risk lending at APRA-regulated entities could flow to non-ADI lenders, reducing the effectiveness of macroprudential measures at the system level; and
- insights from other regulators, including in particular the Australian Securities and Investments Commission (ASIC) given its role as the primary regulator of non-ADI lenders.<sup>5</sup>

In most cases, APRA expects that any macroprudential measures relating to lending would typically apply in the first instance only to APRA-regulated entities. For non-ADI lenders, there would usually be a two-step process:

- APRA would subject non-ADI lenders to heightened oversight to gain better visibility of risks in the sector, alongside (or prior to) the implementation of any macroprudential measures for ADIs. This could include enhanced data collections for non-ADI lenders.
- If APRA subsequently determined, in consultation with ASIC and other CFR agencies, that non-ADI lenders are also materially contributing to financial stability risks, APRA could apply the same (or similar) credit measures to non-ADI lenders as applied to ADIs.

## Scenarios and indicators

Unlike other prudential requirements, macroprudential policy would only be implemented where there are heightened risks to financial stability. Given the forward-looking nature of such an assessment, determining when a macroprudential policy response may be appropriate is necessarily based on judgement, informed by consultation with the CFR and a range of key indicators.

While risks to financial stability can come from a range of sources, they can be categorised according to the point in the financial cycle during which they emerge: either during an upswing in the cycle or a downturn.

### Upswing scenario

An upswing in the financial cycle is generally associated with rising asset prices and credit growth. These trends can have a significant positive impact on economic growth, but can also create risks to financial stability if not managed prudently. For example, growth in lending that materially outpaces borrowers' repayment capacity can lead to future vulnerabilities.

---

<sup>5</sup> Under Part IIB of the *Banking Act 1959*, APRA must also consult with ASIC before making a non-ADI lender rule, or varying or revoking a non-ADI lender rule.

Growth that is fuelled by higher risk appetites or looser standards can also lead to significant risks, as evidenced during the 2008 global financial crisis.

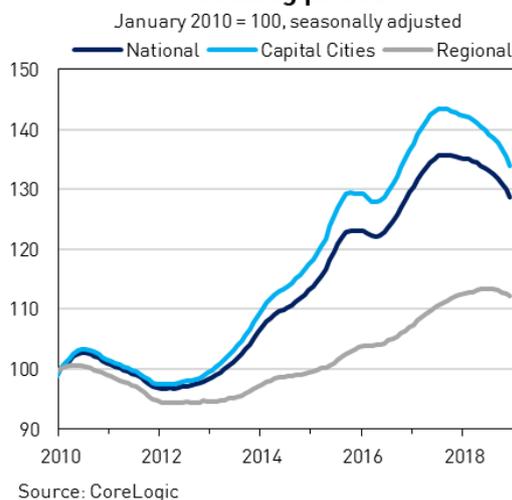
APRA's measures to reinforce sound residential mortgage lending practices in 2015 and 2017 were applied during an upswing in the financial cycle. As illustrated in the charts below, the environment was characterised by high and rising housing prices and household indebtedness, subdued income growth and low interest rates. APRA's concern was that bank lending practices, in aggregate, were amplifying these risks, reflected in systemic weaknesses in serviceability assessments and strong growth in higher-risk lending. Throughout this period, APRA introduced measures which limited growth in banks' lending to investors and the concentration of interest-only loans in new lending. While these temporary benchmarks were in place, APRA also strengthened the rigour of banks' underlying serviceability assessment standards.

### Rising macro risks...

**Household debt to annual disposable income ratio**

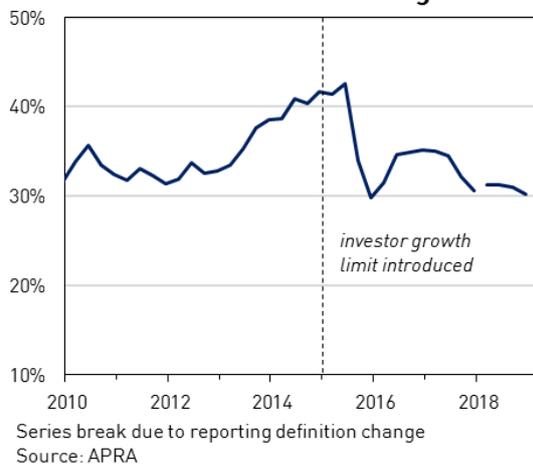


**Housing prices**

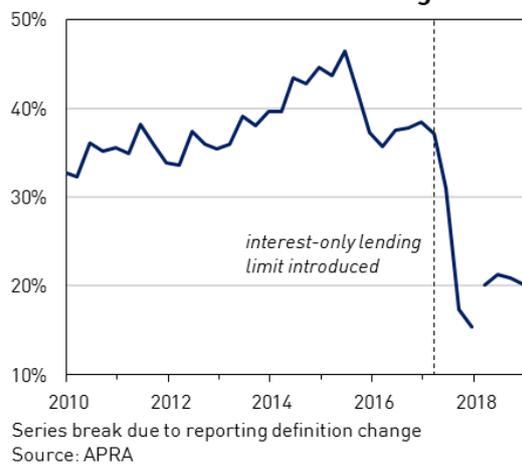


### accompanied by growth in higher-risk lending...

**Investor loans, share of new lending**



**Interest-only loans, share of new lending**

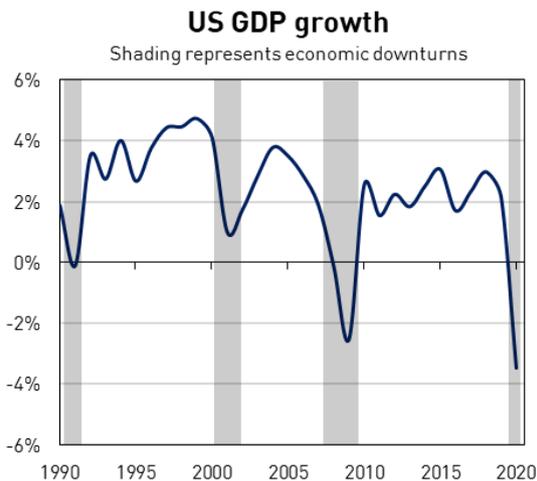


## Downturn scenario

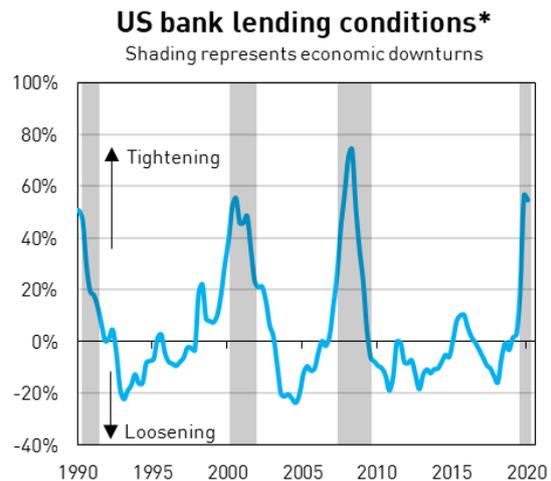
Just as APRA-regulated entities can amplify risks to financial stability during an upswing, they can also exacerbate risks during a downturn. For example, when economic conditions are deteriorating, there can be a tendency for banks and insurers to conserve capital by constraining credit or limiting the underwriting of new business to preserve capacity to absorb expected losses. However, excessive risk aversion has the potential to worsen the impact of any initial stress by restricting activities critical for economic recovery.

In 2020, APRA implemented measures to provide banks and insurers with additional flexibility during a period of heightened financial stress. APRA announced temporary changes to expectations on bank capital benchmarks and bank and insurer capital distributions, in response to concerns over the impact of COVID-19 on economic activity. These changes provided additional flexibility for entities to use capital buffers to absorb losses, while continuing to lend and underwrite insurance to support the economy.

### International data indicates a tendency for banks to tighten lending standards in downturns...



Source: The World Bank



Source: Federal Reserve

\* Net percentage of respondents tightening standards for commercial and industrial loans

## Key indicators

With these two scenarios in mind, APRA monitors a range of key indicators to determine whether risks to financial stability are heightened. This includes four main indicators that have been shown empirically to provide an indication of emerging systemic risks: credit growth and leverage; growth in asset prices; lending conditions; and financial resilience.



There is no mechanical link between any indicator and APRA’s decisions on macroprudential measures. In combination, however, the indicators help to inform APRA’s judgements on the outlook. For example, strong growth in asset prices alone could present limited risks to financial stability where lending standards remain prudent and the banking sector is strongly capitalised. In contrast, growth that is driven by weak lending standards or higher risk loans would likely be a strong indicator that risks to financial stability are rising.

# Chapter 2 - Macroprudential toolkit

This chapter sets out APRA’s core macroprudential tools, together with a comparison of measures used by international peer regulators. The choice of macroprudential policy tool will always depend on the risk to financial stability that APRA is seeking to mitigate.

## Macroprudential tools

International experience has shown that a wide range of macroprudential tools can be used to address risks to financial stability. These tools are also likely to evolve as the structure of the financial system changes and new threats to financial stability emerge. To date, international macroprudential tools have typically been deployed through the banking sector, given the critical role leverage plays in the financial cycle.

A snapshot of macroprudential tools that have been used internationally is provided below.<sup>6</sup>

Capital	Credit	Liquidity or market	Structure
 <ul style="list-style-type: none"> <li>• Countercyclical capital buffer</li> <li>• Dynamic provisions</li> <li>• Restrictions on capital distributions</li> <li>• Time-varying leverage ratio caps</li> <li>• Sectoral capital requirements</li> </ul>	 <ul style="list-style-type: none"> <li>• Lending limits for higher risk loans</li> <li>• Minimum lending standards, such as serviceability assessment criteria</li> </ul>	 <ul style="list-style-type: none"> <li>• Reserve requirements</li> <li>• Caps on loan-to-deposit ratios</li> <li>• Time-varying net stable funding ratio requirements or liquidity coverage ratios</li> <li>• Margin requirements</li> </ul>	 <ul style="list-style-type: none"> <li>• Exposure limits, such as interbank</li> <li>• Concentration limits to particular counterparties</li> </ul>

In establishing a macroprudential policy toolkit, flexibility is important; the most appropriate response will always depend on the particular risks at the time. However, there are benefits in establishing a ‘core’ set of tools, *ex ante*. Requiring entities to be pre-positioned for certain core measures can materially improve the timeliness and effectiveness of any future macroprudential policy response.

As set out in the table below, APRA’s existing core macroprudential toolkit has primarily focused on capital and credit measures that can be deployed through the banking sector. For example, under APRA’s existing capital requirements, ADIs are subject to the CCyB, which

<sup>6</sup> See RBA, *Financial Stability Review* (RBA, October 2021) <https://www.rba.gov.au/publications/fsr/2021/oct/mortgage-macroprudential-policies.html>

can be varied according to changes to the systemic risk outlook. APRA also has the ability to apply limits to higher-risk lending under its credit risk prudential standards. Through prudential guidance, APRA has adjusted its expectations for prudent serviceability assessment criteria to be used in new residential mortgage loan approvals.

Macroprudential tool	Instrument*	Summary
<b>Capital-based</b>		
Countercyclical capital buffer (CCyB)	APS 110	Additional capital requirement to reinforce bank resilience, which can be relaxed during stress.
Capital distribution constraints	APS 110	Restrictions on capital distributions
<b>Credit-based</b>		
Lending limits	APS 220	Limits that moderate growth in higher-risk lending during periods of heightened systemic risk.
Lending standards	APG 223	Guidance for prudent settings in credit origination, including the serviceability buffer.

\* *Prudential Standard APS 110 Capital Adequacy; Prudential Standard APS 220 Credit Risk Management; Prudential Practice Guide APG 223 Residential Mortgage Lending.*

To improve the effectiveness of future macroprudential policy responses, APRA plans to embed further measures within its banking prudential standards; this will ensure that a broader range of tools can be implemented in a timely, consistent and enforceable manner. While these tools will be initially focused on certain capital and credit measures (as set out below), APRA will continue to update the core toolkit as risks to the financial system evolve over time. This could also include embedding measures in prudential standards for other APRA-regulated industries.

APRA's core macroprudential tools are explained in further detail below. While some tools could in theory be applied on a regional basis, or to a specific cohort of ADIs, such considerations would depend on the risk APRA is seeking to mitigate. For example, concerns about borrowers overstressing in an environment of low interest rates would unlikely be unique to a particular region or to a particular group of ADIs; in this instance, it would be appropriate to apply macroprudential tools uniformly. A more uniform approach would generally be less likely to create competitive distortions between affected ADIs.

## Capital measures

When deployed for macroprudential purposes, capital measures seek to strengthen the financial system's resilience as systemic risks are building, and to provide additional flexibility to support economic activity in a downturn. In an upswing, capital measures focus on building broad-based resilience to withstand the eventual impact of stress, rather than directly preventing risks from building. As noted by the Reserve Bank of Australia (RBA),

evidence from empirical studies suggests that increases in capital requirements are unlikely to be an effective tool in leaning against the financial cycle.<sup>7</sup>

By supporting the drawdown of capital buffers as economic conditions deteriorate, APRA can also provide the financial system with greater flexibility to absorb, rather than amplify, the impact of shocks. For ADIs, APRA's primary capital-based macroprudential measure is the CCyB.

## The Countercyclical Capital Buffer (CCyB)

Under *Prudential Standard APS 110 Capital Adequacy*, ADIs must hold an additional amount of capital as an extension to the capital buffer range through the CCyB. The CCyB is held in the form of Common Equity Tier 1 capital. At the individual ADI level, the CCyB requirement will depend on where the entity operates, as it is weighted by an ADI's total credit exposures in different jurisdictions.<sup>8</sup>

In 2015, APRA published an information paper outlining its approach to implementing the CCyB.<sup>9</sup> This paper detailed the objectives of the buffer, the approach to decision-making, indicators of the financial cycle, and communication plans. APRA's approach aligns with guidance on operating the buffer set out by the Basel Committee on Banking Supervision, including the use of the credit-to-GDP indicator as a guide, rather than a determining factor, in setting the CCyB level.

APRA would publish any decision to set, or increase, the level of the CCyB up to 12 months before the date from which it applies. Decisions to lower the buffer would apply immediately upon announcement. APRA publishes its assessment on the appropriate level of the CCyB on an annual basis through an information paper, although changes could be made at any point in the year should circumstances warrant it.

---

<sup>7</sup> See RBA, *Different approaches to implementing a countercyclical capital buffer* (RBA, September 2020) <https://www.rba.gov.au/publications/bulletin/2020/sep/different-approaches-to-implementing-a-countercyclical-capital-buffer.html>. This is because at this stage of the financial cycle, lending is usually highly profitable and so banks generate internal capital to meet any increased regulatory requirements, and can reduce management buffers rather than moderate lending. The notice period given to banks can also slow the rate at which capital needs to increase.

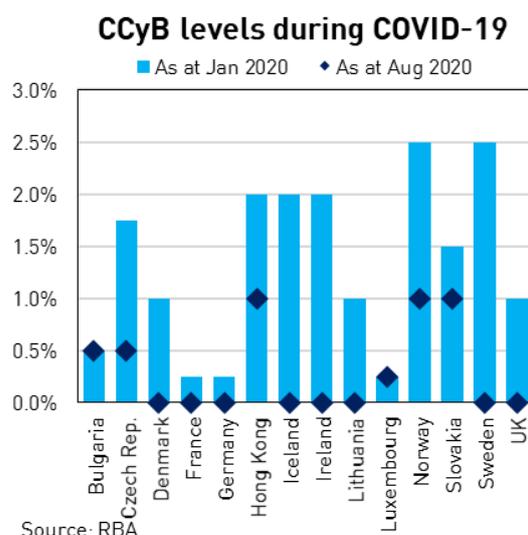
<sup>8</sup> Some international jurisdictions have applied the CCyB on a sectoral basis (to particular credit portfolios). The benefits of a sectoral CCyB are limited in Australia given banks' concentrated portfolios (above 60 per cent in residential mortgages). In an economic downturn, there would be limited benefit in releasing capital on a sectoral basis, as concerns around lending supply and loss absorption are unlikely to be portfolio specific.

<sup>9</sup> See APRA, *The countercyclical capital buffer in Australia* (Information Paper, December 2015) [https://www.apra.gov.au/sites/default/files/151217-CCyB-Information-Paper\\_FINAL.pdf](https://www.apra.gov.au/sites/default/files/151217-CCyB-Information-Paper_FINAL.pdf)

## Enhancing the CCyB

Through reforms to the ADI capital framework, which will come into effect from 2023, APRA will enhance the effectiveness of the CCyB as a macroprudential tool.

In recalibrating the capital framework, APRA plans to set a 'normal' level for the CCyB at 1.0 per cent of risk-weighted assets. This will provide greater built-in flexibility in capital buffers, which can be used if needed during stress. This is consistent with the approach some other jurisdictions have taken, as shown in the chart opposite. To provide further flexibility, APRA also plans to widen the range for the CCyB, to between 0 and 3.5 per cent.



## Credit measures

There are two key complementary sets of credit-based macroprudential measures: *lending limits* that would operate at a portfolio level at each bank, and *lending standards* that would be applied by banks to individual loans at origination.<sup>10</sup> These credit measures could also apply to non-ADI lenders, should circumstances warrant it.

### Lending limits

The purpose of macroprudential lending limits would be to restrain certain types of higher-risk lending, where these are contributing to risks to financial stability. Lending limits are generally targeted responses to specific risks, and would serve to improve the risk profile of credit portfolios.

Given the nature of Australian ADIs' balance sheets, limits would typically be applied to lending secured by property, although they could be extended more broadly. Collectively, residential mortgage and commercial property loan portfolios accounted for more than 70 per cent of banks' total credit exposures in 2021.

Under *Prudential Standard APS 220 Credit Risk Management*, APRA has the ability to apply lending limits on an industry-wide basis or for a cohort of ADIs, if there is an excessive

---

<sup>10</sup> Alongside this Information Paper, APRA is consulting on steps to more formally embed specific credit-based macroprudential measures in the prudential standards. This is intended to provide greater transparency on likely credit measures that APRA could apply in the future. These changes would also bring together APRA's credit-based macroprudential measures into a single attachment to *Prudential Standard APS 220 Credit Risk Management* (APS 220).

concentration or growth in higher risk lending. Limits for higher-risk lending would typically be measured as growth in total loans outstanding or as a share of new lending.

For key types of higher risk lending that could be subject to such limits, it is important that ADIs are appropriately pre-positioned to be able to control growth and the composition of lending, if needed. Some lending limits can be operationally complex to deploy, and APRA expects ADIs to have addressed any impediments for implementing core measures, well in advance of risks emerging.<sup>11</sup>

## Lending standards

Industry-wide settings for banks' lending standards are an important part of the macroprudential toolkit. These measures could include, for example, a minimum setting for the serviceability buffer. Such measures would be applied on an individual loan basis, rather than at the portfolio level.

Adjustments to lending standards can provide a targeted response to financial stability risks. For example, in October 2021, APRA adjusted upwards its expectation for a sound serviceability buffer in housing lending to mitigate risks from borrowers overstretching in an environment of low interest rates and rising house prices. A higher serviceability buffer increases the resilience of households to future shocks, by building additional conservatism into banks' serviceability assessments.

## Other measures

APRA also has other macroprudential measures within its toolkit, such as liquidity and market-based measures. For example, APRA could adjust banks' minimum liquidity requirements through the cycle, similar to the operation of the CCyB. APRA could also introduce temporary limits on exposures to certain counterparties, should this be considered necessary to reduce financial stability risks. Based on the current structure and risk profile of the financial system, APRA considers these measures to be less likely in the near term, and has not required regulated entities to formally pre-position for their use.

## International comparison

In determining the core set of macroprudential measures, APRA has reviewed capital and lending measures used internationally. The table below provides a snapshot of measures that have been used by certain international peer regulators. There is significant overlap between APRA's core toolkit and those deployed by other regulators.<sup>12</sup>

---

<sup>11</sup> For residential mortgages, the key metrics would include lending at a high debt-to-income ratio, high loan-to-valuation ratio, interest-only, or investment lending.

<sup>12</sup> The key tools used overseas but not domestically are a sectoral CCyB, dynamic provisioning and limits on debt payments to income. While limits on debt payments to income can provide a similar constraint to debt to income, they can be more complex to calibrate and can be less effective in an environment of very low interest rates.

Measure	Countries
<b>Capital-based</b>	
Countercyclical capital buffer	Denmark, France, Germany, Hong Kong, Ireland, Norway, Sweden, Switzerland, UK
Dynamic provisioning	Spain
Capital distribution constraints	UK, US, New Zealand, Canada, Sweden, Switzerland
<b>Lending limits</b>	
Lending at high loan-to-valuation ratios	Ireland, Israel, New Zealand, Norway, Sweden
Lending at high debt- or loan-to-income multiples	Ireland, New Zealand <sup>13</sup> , Norway, UK
<b>Lending standards</b>	
Maximum debt payments to income	Israel
Minimum interest rate buffers	Canada, New Zealand <sup>13</sup> , Norway, UK
Maximum amortisation periods	Norway, Sweden

---

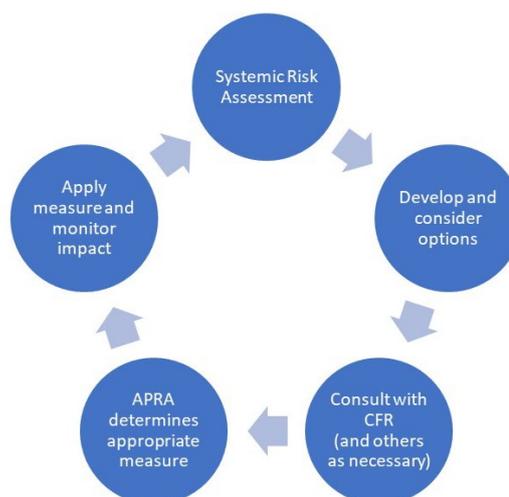
<sup>13</sup> See RBNZ, *Debt serviceability restrictions added to policy toolkit* (June 2021) <https://www.rbnz.govt.nz/news/2021/06/debt-serviceability-restrictions-added-to-policy-toolkit>. The RBNZ has been discussing with industry the feasibility of implementing a debt-to-income limit and other debt servicing restrictions as part of its financial stability toolkit.

# Chapter 3 - Policy implementation

This chapter sets out APRA's approach to implementing macroprudential policy. Macroprudential policy is distinct in several ways: by virtue of the temporary and targeted nature of macroprudential interventions, it requires regular monitoring of systemic risk indicators to ensure settings are adjusted appropriately over time. Given the focus on cyclical factors at the macro level, there is also a need for close engagement with other CFR agencies.

## Policy cycle

The chart opposite summarises APRA's approach to implementing macroprudential policy. Macroprudential policy involves an iterative cycle rather than a linear process. This cycle comprises ongoing monitoring of systemic risk and the assessment of options, engagement with other CFR agencies, and regular monitoring of the effectiveness of any actions.



## Systemic risk assessment

APRA closely monitors the systemic risk environment to inform decisions on macroprudential policy. As set out in Chapter 1, this includes the analysis and assessment of key indicators such as credit growth and leverage, growth in asset prices, lending conditions and financial resilience. To inform APRA's assessment of the risk outlook, APRA draws upon data reported by regulated entities, supervisory and market intelligence, and the views and analysis of other members of the CFR.

To provide transparency of its systemic risk considerations, APRA publishes an annual information paper each year.<sup>14</sup> This information paper has historically focused on systemic risk implications for the setting of the CCyB. However, from 2022, this information paper will have a broader focus, assessing the implications of systemic risks for macroprudential policy.

---

<sup>14</sup> APRA, *Countercyclical capital buffer* [Information Paper, December 2020] <https://www.apra.gov.au/countercyclical-capital-buffer-1>

## Considering options

In considering an appropriate macroprudential response, APRA's primary objective is financial stability. Depending on the risks, certain tools may be more appropriate than others; for example, credit-based measures may be more effective at reducing excessive risk-taking, while capital-based measures would provide greater flexibility in a downturn.

The APRA Act (section 8) requires APRA to balance its financial safety objectives with considerations of efficiency, competition, contestability and competitive neutrality, and in balancing these objectives, promote financial stability. In determining an appropriate macroprudential response, APRA assesses the impact of its actions on these considerations.

To demonstrate how these sometimes competing objectives are balanced, the Box below sets out APRA's approach to assessing competition impacts as part of its 2015 and 2017 implementation of macroprudential measures for higher-risk residential mortgage lending.

### Box A. Competition considerations within macroprudential policy decision-making

Macroprudential policy can have both positive and negative competition impacts. For example, where there is excessive risk-taking, APRA's actions may seek to reduce competitive pressures in the short term. However, over the longer-run, a resilient financial system – the ultimate objective of macroprudential policy – is likely to be conducive to promoting more sustained competition.

Furthermore, there can often be multiple policy options available for tackling a particular threat to financial stability. The nature, structure and calibration of these options can have different competition impacts. In choosing between options, APRA will – consistent with its statutory mandate – generally seek to limit any adverse outcomes in relation to competition.

Following the implementation (and subsequent removal) of housing lending benchmarks in 2015 and 2017, APRA published an *Information Paper: Review of APRA's prudential measures for residential mortgage lending risks (2019)*.<sup>15</sup> In relation to competition, the information paper noted:

---

<sup>15</sup> APRA, *Review of APRA's prudential measures for residential mortgage lending risks* (Information Paper, January 2019) [https://www.apra.gov.au/sites/default/files/review\\_of\\_apras\\_prudential\\_measures\\_for\\_residential\\_mortgage\\_lending\\_risks\\_-\\_january\\_2019.pdf](https://www.apra.gov.au/sites/default/files/review_of_apras_prudential_measures_for_residential_mortgage_lending_risks_-_january_2019.pdf).

- APRA's serviceability measures resulted in a more level playing field for ADIs' borrower risk assessments. However, the industry-wide benchmarks on lending to investors and interest-only tended to constrain significant shifts in market share during the temporary period that the benchmarks were in effect.
- In light of the potential competition impacts, APRA considered applying the benchmarks only to the largest ADIs, given that the activity of smaller lenders was unlikely to influence the overall risks in the system. However, this would have resulted in higher risk lending simply spilling over to the smaller ADIs, leading to a concentration of risks in smaller entities less equipped to manage them. Indeed, APRA did observe this spillover effect to some degree when the benchmarks were initially introduced.
- As it was, many smaller ADIs found themselves with an unanticipated surge in demand for credit that in some cases was difficult to manage. APRA sought to address concerns about smaller ADIs' ability to compete by adopting a more flexible approach to the application of the benchmarks for these ADIs, especially in the early stages. As a result, the market share of small ADIs grew through the period.

The ACCC also analysed the pricing impacts of the measures, in its 2018 Residential Mortgage Price Inquiry, given that many ADIs used interest rates as a key control lever to limit the flow of lending and stay within APRA's benchmarks. The ACCC noted that, although APRA's interest-only lending limit only applied to new lending, ADIs typically applied higher rates to existing loans as well.<sup>16</sup>

## CFR consultation

The CFR serves as a discussion and information-sharing forum for its four members: APRA, ASIC, RBA and Treasury. It plays a key role in coordinating policy responses by regulatory authorities in Australia, especially where there are matters of common interest to member agencies' mandates. In particular, the CFR seeks to

---

<sup>16</sup> See ACCC, *Residential mortgage price inquiry* (Final Report, November 2018) <https://www.accc.gov.au/publications/residential-mortgage-price-inquiry-final-report>; and ACCC, *Residential mortgage price inquiry* [Interim Report, March 2018] <https://www.accc.gov.au/focus-areas/inquiries-finalised/residential-mortgage-products-price-inquiry/interim-report>. The ACCC also noted in these inquiries that certain prudential interventions can have differential impacts for competition, even if applied uniformly.

*'facilitate cooperation and collaboration between member agencies, with the ultimate objectives of promoting stability of the Australian financial system, and supporting effective and efficient regulation by Australia's financial regulatory agencies.'*<sup>17</sup>

As a non-statutory group, the CFR has no formal regulatory or policy decision-making powers: those powers reside with its members under their respective Acts. Nevertheless, given its objectives, the CFR is an important forum for assessing systemic risks, sharing analysis and market intelligence, and discussing the need for policy responses, including in relation to macroprudential policy measures.

While the key tools for macroprudential policy are for APRA to deploy, APRA views consultation with the CFR as an essential prerequisite for initiating any actions. The purpose of consultation is to:

- ensure there is alignment on the assessment of the risk outlook and the need for action;
- challenge and review the options; and
- ensure effective coordination of any other actions by other agencies.

Depending on the nature of the measures being proposed, APRA may also consult with other Government agencies, such as the ACCC, to ensure the wider impacts of any proposed measures are well understood.

## Monitoring and review

APRA's macroprudential measures can be either adjusted over time, such as the CCyB, or applied for a limited period of time, such as temporary limits on higher-risk lending. As such, they are closely monitored and could be phased in, adjusted or removed, as risks evolve.

In assessing the effectiveness of macroprudential measures, APRA is guided by several considerations, including:

- **direct impacts:** the direct impacts of macroprudential policy will be reflected in changes to the risk taking or financial resilience of APRA-regulated entities.<sup>18</sup> For example, increases in banks' serviceability buffers will directly influence the risk profile of banks' loan books, since new borrowers should be more resilient to future shocks. In assessing the direct impacts of macroprudential measures, a key area of focus is distributional impacts across cohorts of APRA-regulated entities.
- **broader impacts:** given their connection to the economic and financial cycle, macroprudential measures can also have broader macro impacts. For example,

---

<sup>17</sup> CFR, *Charter*. <https://www.cfr.gov.au/about/charter.html>

<sup>18</sup> Macroprudential rules can also influence the risk taking of non-ADI lenders, where appropriate.

measures which seek to moderate growth in higher-risk bank lending can have indirect impacts for growth in total credit or asset prices, including across regions.<sup>19</sup> These factors are not a direct objective of macroprudential interventions; however, to the extent that higher-risk lending contributes to growth, macroprudential measures may have a moderating impact.

- **spillover impacts:** a key area of focus in implementing macroprudential policy is monitoring potential spillover impacts. For example, the effectiveness of macroprudential measures can be dulled, if a reduction in higher-risk lending at prudentially-regulated entities simply flows to the non-APRA regulated sector. To help mitigate these risks, APRA has powers to apply macroprudential rules to non-ADI lenders, where these lenders are materially contributing to financial stability risks.
- **developments in the external environment:** developments in the broader macro environment are a key consideration in assessing the effectiveness of macroprudential policy; for example, after a shock, a strong rebound in economic activity would reduce the need for ongoing flexibility in capital requirements. Fiscal and monetary policies can also affect financial stability.

In APRA's annual information paper on systemic risks, APRA will outline its assessment of the effectiveness of any macroprudential measures that have been implemented. This assessment would include considerations of direct, broader and any spillover impacts from macroprudential policy.

---

<sup>19</sup> It is often challenging to assess the indirect impacts of macroprudential measures on, for example, housing prices; housing prices are influenced by many factors beyond bank capital requirements or lending standards, including monetary policy and fiscal policy.

# Annex A - Macroprudential instruments

This annex brings together APRA's macroprudential instruments in the existing prudential framework. It also includes the potential instruments that APRA is currently consulting on, alongside this Information Paper. Subject to the outcome of the consultation, and any future changes to macroprudential instruments, this Information Paper will be updated accordingly.

## Existing requirements and guidance

Reference	Requirement
<b>APS 110 (2016)</b>	<p><b>Countercyclical capital buffer</b></p> <p>30. An ADI must hold additional Common Equity Tier 1 Capital as a countercyclical capital buffer, to be calculated in accordance with Attachment C (ADI-specific countercyclical capital buffer).</p> <p>31. APRA will determine the countercyclical capital buffer for the Australian jurisdiction (Australian jurisdictional countercyclical capital buffer) at a level of between 0 and 2.5 per cent of total risk-weighted assets.</p> <p>32. APRA will publish any decision to set, or increase, the level of the Australian jurisdictional countercyclical capital buffer up to 12 months before the date from which it applies. Any decision by APRA to reduce the level of the Australian jurisdictional countercyclical capital buffer will take effect immediately.</p> <p>33. The ADI-specific countercyclical capital buffer is to be applied by extending the range of the capital conservation buffer. Capital distribution constraints, as set out in Attachment B, will apply if an ADI's Common Equity Tier 1 Capital ratio falls within the extended capital buffer range (consisting of the capital conservation buffer plus the ADI-specific countercyclical capital buffer).</p>
<b>APS 220 (2022)</b>	<p><b>Supervisory limits</b></p> <p>111. If APRA considers that there is an excessive level or growth in higher risk lending or credit activity more broadly, APRA may set limits on particular types of lending, including but not limited to, the share of lending or growth rate of lending, to be complied with by all ADIs or a specified class of ADIs. In considering whether there is an excessive level or growth in higher risk lending or credit activity, APRA will have regard to, among other factors, any easing of credit standards and practices and the proportion of an ADI's higher risk lending, including whether this lending is high leverage, high LVR or interest-only.</p>

Reference	Requirement
APG 223 (2019)	<p><b>Serviceability assessments</b></p> <p>32. Good practice would be to apply a buffer over a loan's interest rate to assess the serviceability of the borrower (interest rate buffer). The interest rate buffer would be applied to the interest rate on the loan to be paid by the borrower, ignoring any discounted introductory or honeymoon rates offered for a limited period at origination of the loan. This approach would seek to ensure that potential increases in interest rates do not adversely impact on a borrower's capacity to repay a loan. The buffer would reflect the potential for interest rates to change over several years. APRA expects a prudent ADI's serviceability policies would incorporate an interest rate buffer of at least two and half percentage points.</p> <p>33. In addition, a prudent ADI would use the interest rate buffer in conjunction with an interest rate floor, to ensure that the interest rate buffer used is adequate when the ADI is operating in a low interest rate environment.</p>

### Proposed requirements (subject to consultation)

Reference	Requirement
APS 110 (2023)	<p><b>Countercyclical capital buffer</b></p> <p>33. An ADI must hold a countercyclical capital buffer, which must be met with Common Equity Tier 1 Capital, to be calculated in accordance with Attachment C to this Prudential Standard (ADI-specific countercyclical capital buffer).</p> <p>34. APRA will determine the Australian jurisdictional countercyclical capital buffer, that applies from time to time, at a level of between 0 and 3.5 per cent of total RWA</p> <p>35. APRA will publish any decision to vary the level of the Australian jurisdictional countercyclical capital buffer up to 12 months before the date from which it applies. Any decision by APRA to reduce the level of the Australian jurisdictional countercyclical capital buffer will take effect immediately.</p> <p>36. The ADI-specific countercyclical capital buffer must be applied by extending the range of the capital conservation buffer. Capital distribution constraints, as set out in Attachment B to this Prudential Standard, will apply if an ADI's Common Equity Tier 1 Capital ratio falls within the extended capital buffer range (consisting of the capital conservation buffer plus the ADI-specific countercyclical capital buffer).</p>

Reference	Requirement
<p>APS 220 (2022)</p>	<p><b>Macroprudential policy: credit measures</b></p> <p>1. This Attachment applies to credit exposures in Australia. Credit exposures in Australia are exposures where the majority of the collateral value securing the loan is located in Australia, or for unsecured loans where the ultimate risk of the exposure is located in Australia.</p> <p><b>Definitions</b></p> <p>2. The following definitions are used in this Attachment:</p> <ul style="list-style-type: none"> <li>• commercial property lending – consistent with the meaning of commercial property exposure given in <i>Reporting Standard ARS 230.0 Commercial Property</i> (ARS 230.0), a facility which has been provided for the development, acquisition or improvement of landed property (real estate), and where the servicing and repayment of the facility is dependent on the cash flows generated by the property itself through sale or rental income, and/or from cash flows generated from other properties owned by the borrower;</li> <li>• debt-to-income (DTI) ratio – means a ratio calculated by dividing the credit limit of all debts held by the borrower by the borrower’s gross income: <ul style="list-style-type: none"> <li>i) debt refers to the credit limit of any debts, such as other mortgage lending, personal loans, credit-cards, consumer finance, margin lending and any other debts held by the borrower, to any party, to the extent this is known to the ADI; and</li> <li>ii) borrower’s gross income refers to the borrower’s annual before tax income verified by an ADI, excluding any compulsory superannuation contributions and before any discounts or haircuts under the ADI’s serviceability assessment policy;</li> </ul> </li> <li>• interest-only – means a loan on which only interest is paid during a set period and no principal is automatically amortised;</li> <li>• investment – means a loan for the purpose of housing, where the funds are used for a residential property that is not owner-occupied;</li> <li>• loan-to-valuation ratio (LVR) – consistent with the meaning given in <i>Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk</i>, means a ratio calculated by dividing the amount of the loan by the value of the property or properties used to secure repayment;</li> <li>• owner-occupied – means a loan for the purpose of housing, where the funds are used for a residential property, that is occupied or to be occupied by the borrower(s) as their principal place of residence; and</li> <li>• residential mortgage lending – means a loan to a households or self-managed superannuation fund that is secured by residential property.</li> </ul> <p><b>Lending limits and standards</b></p> <p>3. Under paragraph 111 of this prudential standard, if APRA considers that there is an excessive level or growth in higher risk lending or credit activity more broadly, APRA may set limits on particular types of lending.</p>

Reference	Requirement
	<p>4. In considering whether there is an excessive risk being generated at a system level, APRA will have regard to, among other factors, trends in credit growth and leverage, growth in asset prices, lending conditions and ADI financial resilience.</p> <p>5. For residential mortgage lending, an ADI must ensure that it has the ability to limit the extent of lending in the following loan types:</p> <ul style="list-style-type: none"> <li>• lending with a debt-to-income ratio greater than or equal to four times or six times;</li> <li>• lending with a loan-to-valuation ratio greater than or equal to 80 per cent or 90 per cent;</li> <li>• lending for the purposes of investment;</li> <li>• lending on an interest-only basis; and</li> <li>• lending with a combination of any two of the types specified above.</li> </ul> <p>6. For residential mortgage lending, an ADI must apply a buffer over a loan's interest rate to assess the serviceability of a borrower. The serviceability buffer must be applied to the interest rate on the loan to be paid by the borrower, ignoring any discounted introductory rates offered for a limited period at origination of the loan. The level of the serviceability buffer must be at least 3.0 per cent, unless determined otherwise by APRA. APRA may vary the minimum level of the buffer between 2.0 and 5.0 per cent.</p> <p>7. For commercial property lending, an ADI must ensure that it has the ability to limit the extent of lending in the following loan types:</p> <ul style="list-style-type: none"> <li>• lending for land acquisition, development and construction; and</li> <li>• lending for the purposes of investment.</li> </ul> <p>8. APRA will notify ADIs of any decision to set a limit, including the limit level and the date from which it would apply, for the loan types specified in this attachment or other loan types as determined by APRA under paragraph 111 of this standard.</p> <p>9. An ADI must report to the Board the level of lending against any limits specified by APRA on at least a monthly basis, for the period in which the limits apply.</p> <p>10. APRA may require ADIs to publicly disclose the level of lending against any limits specified by APRA, for the period in which the limits apply.</p>



APRA