AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY
1 Martin Place (Level 12), Sydney, NSW 2000
GPO Box 9836, Sydney, NSW 2001

T 02 9210 3000 | W www.apra.gov.au

11 November 2021

TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

MACROPRUDENTIAL POLICY: CONSULTATION

APRA has today released an Information Paper setting out its framework for macroprudential policy. To support the implementation of the framework, APRA is also consulting on steps to formalise and embed credit-based macroprudential policy measures within its prudential standards.

Formalising macroprudential measures for ADIs

To embed credit-based macroprudential measures within the prudential standards, APRA is consulting on a proposed new attachment to *Prudential Standard APS 220 Credit Risk Management* (APS 220). The proposed attachment, *Macroprudential policy: credit measures,* would require ADIs to:

- ensure they have the ability to limit growth in particular forms of lending;
- moderate higher risk lending during periods of heightened systemic risk or meet particular lending standards, at levels determined by APRA; and
- ensure there would be adequate reporting in place to monitor against limits.

The proposals in this package do not change the potential macroprudential tools APRA may use, or provide APRA with additional powers. However, they do change the way in which certain measures may be applied. At present, APRA's ability to implement macroprudential measures is somewhat indirect, with credit measures typically enforced through the potential imposition of higher capital requirements where needed. By defining certain credit measures within APS 220, APRA's objective is to strengthen the transparency, implementation and enforceability of macroprudential policy. The proposed attachment to APS 220 includes a set of credit-based macroprudential measures that could be used to address systemic risks if needed. It would also require ADIs to preposition in advance to address potential barriers to implementation, supporting a timely response to any emerging risks.

The limits and lending standards set out in the proposed attachment to APS 220 focus on risks in residential mortgage lending and commercial property lending; together, these portfolios account for more than 70 per cent of total credit extended in Australia. APRA may also broaden the focus of macroprudential measures contained in APS 220 if, over time, other portfolios potentially grow in systemic importance, or other risks emerge.

Proposed credit measures

The proposed attachment to APS 220 includes two main types of credit-based macroprudential measures:

- **lending limits:** the purpose of temporary lending limits would be to moderate any excessive growth in higher-risk lending during periods of heightened systemic risks. These would be applied at the portfolio level. The proposed attachment to APS 220 sets out the most likely types of higher risk lending that may need to be constrained, and for which ADIs must have controls and reporting in place, *ex ante*. The specific calibration and start date for any limit would be advised by APRA at the time, taking into account the risk outlook.

- **lending standards:** APRA may also set minimum requirements for lending standards. These would be applied at the individual loan level and include measures such as the serviceability buffer for residential mortgages. Under the proposed attachment to APS 220, the serviceability buffer for residential mortgages will initially be set to at least 3.0 per cent.[1] This would replace existing guidance in *Prudential Practice Guide APG 223 Residential Mortgage Lending*.

Once the proposed attachment to APS 220 has been implemented, any decisions by APRA to implement temporary limits for particular forms of lending or to set minimum requirements for lending standards would be publicly communicated. APRA would notify ADIs of any limits for the specified loan types ahead of the date from which they would apply.

APRA also intends to review the loan types specified in the attachment to APS 220 on a regular basis, and may revise or add to the set of options, subject to further consultation with industry; this will help to ensure that the range of measures remains up to date and appropriate to the risk environment.

Non-ADI lenders

Under Part IIB of the *Banking Act 1959*, APRA can make rules in relation to non-ADI lenders if those lenders are considered to materially contribute to risks of instability in the Australian financial system. It is APRA's expectation that any rules, if introduced for non-ADI lenders, would likely mirror those set out for ADIs in the draft attachment to APS 220.

While non-ADI lenders would not be subject to any mandatory pre-positioning requirements, it is important that these lenders are aware of the potential rules that could be applied to them. Should APRA determine that non-ADI lenders are materially contributing to risks of instability in the Australian financial system, the draft attachment to APS 220 sets out the main types of credit-based macroprudential measures that APRA would likely apply.

As part of this consultation process, non-ADI lenders should consider the macroprudential measures set out in the draft attachment to APS 220. Any future rules introduced by APRA for non-ADI lenders would be legally binding and made under delegated legislation.

Reporting definitions

As part of the consultation on the proposed attachment to APS 220, APRA requests specific feedback on any implementation issues that could arise from using the definitions of higher-risk loans, as set out in the draft attachment.

To improve the effectiveness of any future macroprudential policy response, APRA is proposing a small change to the reporting definition of borrower income for the purposes of calculating debt-to-income and loan-to-income ratios, under *Reporting Standard ARS 223 Residential Mortgage Lending.* APRA's proposed amendments to ARS 223 can be found at

[1] APRA increases banks' loan serviceability expectations to counter rising risks in home lending, 6 October 2021.

Annex B. These proposed changes would ensure alignment with the new attachment on APS 220.

Once the new attachment to APS 220 is finalised, APRA will consider whether other changes to reporting standards are appropriate.

Next steps

Together with other members of the Council of Financial Regulators, APRA continues to closely monitor risks in residential mortgage lending. As noted in the recent letter on strengthening residential mortgage lending assessments, APRA may consider further macroprudential measures, should risks related to residential mortgage lending continue to build.

A draft of the proposed attachment to APS 220 is provided in Annex A. APRA invites feedback on the draft Attachment. Written submissions on the proposals should be sent to ADIPolicy@apra.gov.au by 28 February 2022.

From 1 January 2022, ADIs will be required to meet the previously finalised requirements of *APS 220 Credit Risk Management*, including *Attachment A – Collateral Valuation* and *Attachment B – Prescribed Provisioning*.[2] APRA expects to finalise its response to the consultation on the new *Attachment C Macroprudential policy: credit measures* in the first half of 2022; these new requirements would come into effect shortly thereafter.

Yours sincerely,

Wayne Byres
Chair

[2] See APRA Letter to ADIs, 19 August 2021, Guidance on credit risk management | APRA

ANNEX A. DRAFT ATTACHMENT TO APS 220

Attachment C – Macroprudential policy: credit measures

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.

Definitions

2. The following definitions are used in this Attachment:

   (a) commercial property lending – consistent with the meaning of commercial property exposure given in *Reporting Standard ARS 230.0 Commercial Property* (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;

   (b) 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:

      (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

      (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;

   (c) interest-only – means a loan on which only interest is paid during a set period and no principal is automatically amortised;

   (d) investment – means a loan for the purpose of housing, where the funds are used for a residential property that is not owner-occupied;

   (e) loan-to-valuation ratio (LVR) – consistent with the meaning given in *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk,* means a ratio calculated by dividing the amount of the loan by the value of the property or properties used to secure repayment;

   (f) 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

   (g) residential mortgage lending – means a loan for housing purposes (funds are used for the purchase, renovation or development of residential property) that is secured by residential property.

Lending limits and standards

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.

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.

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:

   (a) lending with a debt-to-income ratio greater than or equal to four times or six times;

   (b) lending with a loan-to-valuation ratio greater than or equal to 80 per cent or 90 per cent;

   (c) lending for the purposes of investment;

   (d) lending on an interest-only basis; and

   (e) lending with a combination of any two of the types specified in (a) to (d).

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.

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:

   (a) lending for land acquisition, development and construction; and

   (b) lending for the purposes of investment.

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 prudential standard.

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.

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.

ANNEX B. DRAFT REVISIONS TO ARS 223

To ensure there is alignment with the definitions set out in the proposed new Attachment to APS 220, the following consequential amendments are proposed to *Reporting Standard ARS 223 Residential Mortgage Lending* (in tracked changes):

Borrower's gross income	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.