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TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

MACROPRUDENTIAL POLICY CREDIT MEASURES

APRA has today finalised revisions to *Prudential Standard APS 220 Credit Risk Management* (APS 220), to include a new attachment on macroprudential policy credit measures. The draft attachment was released for consultation in November 2021.[1]

The aim of the new requirements for macroprudential policy is to strengthen the transparency, implementation and enforceability of future policy responses to systemic risks. *APS 220 Attachment C – Macroprudential policy: credit measures* includes a set of credit-based macroprudential measures that APRA could use, if needed, to address risks to financial stability. In identifying specific measures, APRA's intent is for ADIs to be prepositioned in advance so as to avoid potential barriers to timely and effective implementation.

Submissions to the consultation were generally supportive of APRA's objectives.[2] APRA is therefore finalising the new attachment to APS 220 without material revision to the draft proposals. ADIs will be required to meet these new requirements from 1 September 2022.

Issues raised in consultation

This letter details the feedback received during consultation and APRA's response, as set out below. The feedback mainly related to requests for further consultation ahead of implementing any measures, and for further detailed specificity on definitions.

Further consultation

A number of submissions requested that APRA commit to further public consultation ahead of implementing future macroprudential policy measures. As has historically been the case, ADIs would be given advance notice on APRA's concerns in the lead up to macroprudential policy interventions. APRA has also updated the new attachment to APS 220 to clarify that ADIs would be given at least one month notice, prior to any lending limits being implemented. This is broadly consistent with APRA's recent approach to increasing banks' serviceability buffers.

As set out in APRA's macroprudential policy framework, prior engagement with the Council of Financial Regulators (CFR) would also be an essential prerequisite for initiating any macroprudential policy response.[3] This ensures that there is alignment, among financial regulators, on the assessment of the risk outlook and the need for a macroprudential policy response. It also provides an opportunity to assess the wider impacts of policy options, including potential economic and distributional impacts.

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[1] See Letter to ADIs, November 2021, Macroprudential policy consultation.

[2] APRA received nine submissions to the consultation. Non-confidential submissions have been published on APRA's website.

[3] See Information paper, November 2021, Macroprudential policy framework.

Carve outs

A number of respondents suggested that APRA should *a priori* exclude certain loan types from the proposed lending limits specified in APS 220. For example, some ADIs suggested that construction loans be carved out from any future limits on high debt-to-income (DTI) lending, given their role in contributing to housing supply and economic activity. Other respondents suggested that first-home buyers be excluded from any limits focused on loan-to-valuation ratios.

Consistent with APRA's macroprudential policy framework, APRA and the CFR will consider the broader impacts of potential policy options at the time, taking into account the risks that are being targeted, possible unintended consequences and alternative options. However, narrowing options today with specific carve outs, when future risks are not known, could reduce the effectiveness of APRA's macroprudential policy toolkit.

Detailed definition of limits

A number of respondents requested greater clarity regarding the detailed definitions of potential future lending limits. For example, some respondents requested clarity over whether future lending limits would be measured on a monthly or quarterly basis. Other respondents sought further detail on whether these limits would apply to growth in total loans outstanding or to new originations. Some smaller ADIs suggested that they should be afforded additional flexibility, given their smaller balance sheets .

The design of future lending limits would need to be appropriate to the risks at the time. For those loan types specified in Attachment C of APS 220, prudent ADIs would have systems in place to monitor growth in loans outstanding and new originations on at least a monthly basis. While APRA will consider the need for proportionality as part of future policy responses, an outcome where higher-risk lending simply migrates from larger to smaller entities would not be consistent with APRA's macroprudential objectives.

Debt-to-income (DTI) ratio

Some ADIs sought clarification as to whether buy now pay later (BNPL) or HECS-HELP debt should be treated as debt for the purposes of DTI reporting.[4] Under *Reporting Standard ARS 223 Residential Mortgage Lending*, DTI is defined as the ratio of the credit limit of all debts held by the borrower, to the borrower's gross income. To ensure a consistent approach is taken across industry, APRA has clarified below that HECS-HELP loans and debt incurred through BNPL schemes would be included in DTI ratios.

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.
Debt-to-income ratio	The ratio of the ***credit limit*** of all debts held by the borrower, to the ***borrowers' gross income***. Include the ***credit limit*** of any debts, such as other mortgage lending, personal loans, credit-cards, consumer finance, margin lending, buy now pay later debt, Higher Education Loan Program (HELP) or Higher

[4] The Higher Education Loan Program (HELP) replaced the Higher Education Contribution Scheme (HECS) in 2005.

	Education Contribution Scheme (HECS) debt, and any other debts held by the borrower, to any party, to the extent this is known to the ADI.

Disclosure requirements

Under the new attachment to APS 220, 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. This provides an important mechanism for transparency and public accountability, where appropriate.

One respondent raised concerns that public disclosure could have impacts on competition. APRA will consider ACCC advice as part of any future decisions to require public disclosure of macroprudential policy on a case by case basis.

Corresponding amendments

To ensure appropriate alignment with the final Attachment C to APS 220, APRA is also making corresponding amendments to relevant guidance and reporting standards:

- ***Guidance.*** APRA has updated *Prudential Practice Guide APG 223 Residential Mortgage Lending* to align with new requirements for a prudent setting of the serviceability buffer.

- ***Reporting Standards.*** APRA has updated cross references across relevant reporting standards, including *Reporting Standard ARS 223 Residential Mortgage Lending*.[5]

Corresponding edits to these documents have been published with marked up changes.

Next steps

In the current environment, with high household indebtedness and rising interest rates, it is important that ADIs are prudently managing risks in residential mortgage lending. APRA expects ADIs to closely monitor housing lending risks, to ensure that aggregate portfolio risks remain within appetite and that standards for new lending remain prudent.

From 1 September 2022, ADIs will be required to meet the new requirements of APS 220, as set out in *Attachment C – Macroprudential policy: credit measures*. While some ADIs have indicated they may need further time to implement changes to technology systems and internal policies, APRA expects that these actions will be progressed as quickly as possible this year.

Wayne Byres
Chair

[5] Several respondents also raised feedback regarding the importance of aligning commercial property definitions more broadly across the prudential framework. APRA plans to address this as part of finalising reporting standards relevant to the capital reforms.