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WAYNE BYRES
Chairman

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TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

RESIDENTIAL MORTGAGE LENDING: INTEREST-ONLY BENCHMARK

APRA's actions to reinforce sound residential mortgage lending practices in recent years have prompted authorised deposit-taking institutions (ADIs) to improve significantly their lending standards and reduce higher risk lending. This has strengthened, in APRA's view, both the resilience of individual ADIs and overall financial system stability; it has also helped to reduce the risks associated with the high level of household indebtedness, subdued household income growth, low interest rates and strong competitive pressure.

In April 2018, APRA announced the removal of the supervisory benchmark on investor loan growth, reflecting the improvements that ADIs have made to lending standards. APRA is now also removing the supervisory benchmark on interest-only lending, for ADIs that have provided assurances on the strength of their standards.

Removing the interest-only benchmark

The benchmark on interest-only lending was put in place as a temporary measure in 2017, with the aim of reducing the level of interest-only lending and improving the quality of mortgage portfolios.[1] Since the introduction of the benchmark, the proportion of new interest-only lending has halved, and interest-only lending at high loan-to-valuation ratios (LVR) has also declined markedly. In summary, as with the benchmark on investor loan growth, this measure has served its purpose.

In removing the benchmark on investor loan growth, APRA sought assurances from ADI Boards on mortgage lending policies and practices.[2] This included confirmation that lending policies meet APRA's expectations as set out in *Prudential Practice Guide APG 223 – Residential Mortgage Lending* (APG 223). The majority of ADIs have now provided these assurances.

For ADIs that have provided the necessary assurances on their lending standards and are no longer subject to the investor loan growth benchmark, the interest-only benchmark will also no longer apply, with effect from 1 January 2019. For other ADIs, it will be removed concurrently with the removal of the investor loan growth benchmark.

[1] APRA letter to all ADIs, 'Further Measures to Reinforce Sound Residential Mortgage Lending practices', 21 March 2017.

[2] APRA letter to all ADIs, 'Embedding Sound Residential Mortgage Lending Practices', 26 April 2018.

Next steps

In APRA's view, interest-only mortgages, and in particular owner-occupied interest-only lending, remain a higher risk form of lending. As a result, APRA expects that ADIs will maintain prudent internal risk limits on interest-only lending. These internal limits should cover both the level of new interest-only lending and the type, including lending on an interest-only basis to owner-occupiers and lending on an interest-only basis at high LVRs. As noted in APG 223, interest-only periods should be of limited duration, particularly for owner-occupiers, and serviceability assessments should test borrowers' ability to repay principal and interest over the actual repayment period (excluding the interest-only term).

APRA plans to conduct a review of ADI risk controls on interest-only lending next year, as part of a broader assessment of improvements that have been made in lending standards. Together with the other members of the Council of Financial Regulators, we will also continue to monitor closely conditions in the housing market more generally. As with investor loan growth, a re-acceleration in interest-only lending at an industry-wide level would raise systemic concerns. In such a scenario, APRA would consider the need to apply industry-wide measures in response.

Yours sincerely,

Wayne Byres
APRA Chairman