



5 July 2019

**TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS**

**RESPONSE TO SUBMISSIONS – REVISIONS TO PRUDENTIAL PRACTICE GUIDE  
APG 223 RESIDENTIAL MORTGAGE LENDING**

In May 2019, APRA wrote to all authorised deposit-taking institutions (ADIs) to commence consultation on proposed revisions to its guidance on the buffer and floor rates used in borrower serviceability assessments set out in *Prudential Practice Guide APG 223 Residential Mortgage Lending* (APG 223).

The principal purpose of the buffer and floor rates is to take account of the inherent uncertainty in serviceability assessments, particularly in relation to potential movements in interest rates over the life of a long-term loan. While APRA's guidance on the buffer and floor rates has played an important role in limiting excessive borrowing in an environment of low interest rates and high household debt, the changes in the market and economic environment – in particular, the prevailing low interest rate environment and introduction of differential pricing for mortgage products – led APRA to review the appropriateness of the current guidance.

APRA received 26 submissions from ADIs, industry associations and other interested parties; non-confidential submissions have been published on APRA's website. This letter outlines APRA's response to the main issues raised in submissions. APRA has concurrently released the final revised APG 223.

**Removal of the quantitative floor rate**

While the majority of respondents supported APRA's proposal to remove the guidance to use a floor rate of at least seven per cent, some respondents recommended that APRA maintain an explicit floor rate lower than seven per cent, or alternatively set a range. A number of other respondents recommended removing the expectation that a prudent ADI use an interest rate floor and instead suggested that serviceability assessments only use the interest rate buffer. These recommendations were made on the basis that the application of serviceability assessments should be consistent across ADIs and should not be used to improve an ADI's relative competitive position by selecting lower floor rates than their peers. Respondents also requested that APRA provide guidance on the considerations that ADIs should use in determining their own level of floor rate. Some respondents suggested that APRA specify the frequency at which it expects ADIs to review their floor rate(s).

Particularly given the introduction of differential pricing for mortgage products, APRA remains of the view that it is appropriate to remove the quantitative guidance on the floor rate from APG 223. APRA will still expect ADIs to determine, and keep under regular review, their own floor rate(s) based on the current position within the interest rate cycle, and their portfolio mix and risk appetite. At this time, APRA does not believe that additional guidance is necessary.

## **Raising the interest rate buffer**

A number of respondents supported the increase in the expected level of the serviceability buffer from at least two per cent to at least two and a half per cent above the interest rate of the loan, acknowledging that this level supports the maintenance of prudence in overall serviceability assessments. Some other respondents preferred that, based on their analysis of rate increases in previous interest rate cycles, APRA maintain an interest rate buffer of at least two per cent. A couple of respondents requested that APRA should review the serviceability buffer on a regular basis to ensure it remains reflective of the prevailing interest rate environment.

APRA remains of the view that, with the removal of the seven per cent serviceability floor from APG 223, the increase in the expected level of interest rate buffer will ensure that sufficient prudence is retained in ADIs' serviceability assessments, accounting for the inherent uncertainty in lending decisions. APRA also considers that a buffer of two and a half per cent is appropriate in the current environment but, is open to reviewing the buffer rate if needed in the future.

### *Application of the interest rate buffer*

Given the removal of APRA's previous expectation that a prudent ADI would use a buffer 'comfortably above' the rate specified in APG 223, one respondent queried whether the interest rate buffer could be set at the amount specified in APG 223. APRA confirms that the minimum interest rate buffer that APRA considers a prudent ADI would use in its serviceability assessment is two and a half per cent.

For the purpose of clarity, APRA also considers it good practice for a prudent ADI to apply its interest rate buffers and floors to the actual rate to be paid by the customer (but excluding honeymoon rates and discounted introductory rates), rather than the standard variable rate. A minor change has been made in the final revised APG 223 to reflect this.

## **Multiple floor and buffer rates**

A number of respondents queried whether APRA expects ADIs to set multiple floor and buffer rates, submitting that they should be allowed, but not mandated, to do so. One respondent also sought clarity regarding APRA's expectation that an ADI use a set of consistent serviceability criteria across all mortgage products. As per paragraph 27 of APG 223, while APRA considers it good practice to use a single set of serviceability criteria across all mortgage products, an ADI can choose to use different serviceability criteria, including multiple buffer and floor rates, for different products. Where an ADI chooses to do so, APRA expects the ADI to articulate the rationale for using differential criteria, and any implications for the ADI's risk profile and risk appetite.

## **Other matters**

A number of respondents expressed concern that there is a risk that all lenders do not apply a sufficiently prudent approach in their serviceability assessments and therefore to overall systemic risk as the buffer and floor rates in APG 223 do not apply to non-ADI lenders. While APRA only supervises ADIs, responsible lending obligations apply to all lenders. ASIC is currently consulting on its updated guidance in this area.

Some respondents provided comments on aspects of APG 223, including the assessment and verification of income, living expenses and other debt commitments, which are not currently under review. These aspects will be considered when APRA undertakes a broader review of APG 223.

The final revised version of APG 223 can be found at: <http://apra.gov.au/residential-mortgage-lending-adis>.

Yours sincerely,

Pat Brennan  
Executive General Manager  
Policy and Advice Division