

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020

Division/Agency: Australian Prudential Regulation Authority

Question No: APRA03QON

Topic: APRA's Prudential Guidance

Reference: Hansard, 26 February 2021, p. 38

Member: Senator Patrick

Question:

Senator PATRICK: Thank you; that's actually very helpful. However, I presume from that that the fact is that you'll set a standard. I'm just a bit concerned about the fact that everyone's circumstances are different. Many people will fall within a set of circumstances that may well be covered off by the requirements of the bank under your standards that are designed to protect the bank and the system, but there may well be others that fall outside of those circumstances, and ultimately they may end up in a harmed position. Is there anything you could tell me that would say that that's absolutely not the case, or is it the case that that could occur?

Mr Holland: I think it's a very good question. From APRA's perspective, we have quite specific expectations and rules around borrowing process. I think the committee has heard that in the APS 220, the credit risk management standard, there are a number of paragraphs that govern what we expect a bank to do when it originates a loan to a borrower. That includes a number of checks over whether the borrower has the capacity to repay that loan. In addition, we have guidance that supports that standard and specific guidance around residential mortgage lending that goes into further detail. Having said that, what is important within our standards and our guidance is some flexibility to ensure that the bank can customise that process to the borrower's specific circumstances.

Senator PATRICK: Is it possible for you to provide the committee with that guidance? I don't know whether it's on a bank-by-bank level or whether it's across the board. Is it tailored or is it stuff that you can provide us— either, 'This is the guidance we give,' or, 'Here's an example of the guidance that we gave to a particular, perhaps de-identified bank'?

Mr Holland: Absolutely. The particular guidance I was referring to is published, but we will provide that to the Committee.

Senator PATRICK: It's just a case where navigating government websites can be quite tricky. If you know where it is, it would be really good if you could direct the committee to that. I thank you for your evidence. Thank you, Chair.

Answer:

APRA's prudential requirements are set out in prudential standards, which are legally binding regulations, supported by prudential practice guides. *Prudential Standard APS 220 Credit Risk Management* (APS 220) sets out APRA's key requirements of ADIs in managing their credit risk. APS 220 encompasses all types of lending, including loans to households, small business and large corporates. It covers risks to ADIs over the life-cycle of a loan, requiring ADIs to have appropriate oversight and governance structures, maintain sound lending standards at the point of origination and actively monitor the risk of borrower default until the loan is repaid.

APS 220 includes requirements for consumer credit lending standards. This includes the prudent assessment and verification of a borrower's income, living expenses and other debt commitments. Under APS 220, ADI's credit assessments must include consideration of the borrower's repayment capacity under various scenarios, such as an increase in interest rates or a decrease in income, particularly for less stable income sources such as bonuses. ADIs must also collect reasonable estimates of a borrower's living expenses, and must not rely solely on benchmarks.

The key prudential practice guides for managing credit risk are *Prudential Practice Guide APG 220 Credit Risk Management* (APG 220, currently subject to public consultation) and *Prudential Practice Guide APG 223 Residential Mortgage Lending* (APG 223). These set out APRA's expectations for meeting the requirements of APS 220 and provide examples of best practice. For example, APG 223 contains detailed guidance for an ADI's assessment of a borrower's ability to repay a residential housing loan.

These documents can be accessed via the links below:

- APS 220 : <https://www.legislation.gov.au/Details/F2020L01147>
- Draft APG 220:
<https://www.apra.gov.au/sites/default/files/Draft%20Prudential%20Practice%20Guide%20APG%20220%20Credit%20Risk%20Management%20-%20December%202019.pdf>
- APG 223:
<https://www.apra.gov.au/sites/default/files/APG%20223%20APG%20223%20Residential%20Mortgage%20Lending%20July%202019.pdf>