# Submission

to the

# Reserve Bank of New Zealand

on the

# Debt Serviceability Restrictions: Consultation Paper

28 February 2022

NEW ZEALAND BANKERS ASSOCIATION
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## About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following seventeen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - China Construction Bank
   - Citibank N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - Industrial and Commercial Bank of China (New Zealand) Limited
   - JPMorgan Chase Bank N.A.
   - Kiwibank Limited
   - MUFG Bank Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

## Introduction

NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand (**RBNZ**) on the Debt Serviceability Restrictions: Consultation Paper (**Consultation Paper**). NZBA commends the work that has gone into developing the Consultation Paper.

## Contact details

3. If you would like to discuss any aspect of this submission, please contact:

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## Summary

### RBNZ should wait to assess the impact of recent measures before introducing DSR

While NZBA supports the introduction of measures that are aimed at safeguarding financial stability and protecting customers from debt that they cannot afford, we note that a number of measures have been introduced in the last 12 months which address these twin goals. The combination of LVR restrictions, CCCFA changes, increasing interest rates and taxation changes in particular appear to be having the effect of slowing growth in the home lending market. We therefore recommend that the RBNZ waits to assess the impact of these changes and other market changes before introducing a Debt Serviceability Restriction (**DSR**).

We note that the introduction of a DSR may result in unintended consequences, particularly in the context of the regulatory and market changes referred to above. We also consider the impact of a DSR is likely to be disproportionate because of the cumulative effect of these restrictions. For example:

- Reducing home lending due to DSR would affect the denominator of the LVR speed limit calculation, which in turn would mean more declined applications. The inter-relationship between these two measures will prevent more borrowers who are able to demonstrate they can afford their proposed lending, and who would have otherwise been approved, from buying a home or moving to a better home.
- The CCCFA and DSRs are both in place to assess affordability but they will likely create contradictory outcomes in some situations – it is very likely that banks will find that some customers pass the CCCFA affordability assessment, but still have to decline lending based on DSR caps, and vice versa. This outcome would be very difficult for frontline staff to explain to customers and would cause frustration and poor customer experience and outcomes.
- DSR will only be imposed on New Zealand registered banks, which creates an uneven playing field and a risk of regulatory arbitrage, as non-bank mortgage providers are not subject to these restrictions. This arbitrage does not provide good outcomes for customers as non-bank lenders generally charge higher interest rates. Additionally, this could undermine the objective of the DSR framework in that it potentially increases financial stability risk in the non-bank lending sector.

### A DTI tool will be complex to implement and require sufficient time to develop

As noted above, there is a real risk of adverse customer impact if the RBNZ introduces a DTI tool, noting the risks in this area as highlighted by recent coverage of CCCFA changes. Given the recently reported customer frustration following the CCCFA changes, our members are very mindful to ensure any future changes are done in a way that achieves the intended prudential risk management outcomes, while minimising customer impact to the greatest extent possible. We also note that these recent changes may have resolved the problem that DTIs would be designed to address, and if that is the case, the resulting customer impact and compliance burden are unlikely to be outweighed by any positive result.

We suggest that the RBNZ waits to assess the impact of LVRs and the CCCFA changes before further developing the framework for DTIs. Once the RBNZ has developed and finalised a DTI framework, banks must have at least 12 months to implement this tool given the complexity of building flow management into lending decisioning and origination tools, and the volume of other regulatory initiatives banks are delivering at present. The implementation timeframe should also take into consideration that key bank IT resources will also likely need to deliver any priority CCCFA changes that might result from the current MBIE review of the recent CCCFA changes.

Whilst recognising the limitations of the test interest floor, NZBA and the member banks support RBNZ developing a test interest rate floor tool, which it can introduce at relatively short notice if it considers action is needed, giving it time to assess, develop and implement a DTI flow restriction if that is required (this assumes it will be a single test interest rate across all customer groups, as it will be very complicated to administer different test rate floors for different groups). The test interest rate floor tool should be the first mechanism the RBNZ deploys if it considers a DSR is necessary, as banks already use test interest rates, and this will minimise customer impact and reduce the pressure to implement DTIs. If it becomes apparent further action is needed, then the RBNZ could require the implementation of DTIs.

## Consistency of approach is critical to ensuring an effective and workable DTI framework

The complexities associated with a DTI restrictions framework are not only challenging for banks, but also for customers, in terms of understanding both how the DTI ratio is arrived at, and the impact on their home loan applications.

It is important that if the same customer is assessed by more than one bank for a home loan, the DTI calculation outcome is the same. This means establishing standard industry definitions and treatment of the various types of customer income and debt, as well which elements are excluded from DTI (as opposed to exempt).

NZBA is ready to work with the RBNZ on what is required to produce a consistent DTI calculation, and welcomes further detailed consultation on framework design.

Please see our responses to the RBNZ's questions from the Consultation Paper set out in the table below.

| # | Question | Response |
|---|---|---|
| 1 | Do you have any comments on the potential interaction between debt serviceability restrictions and other policy measures related to the housing market? | Please refer to our comments above about the unintended consequences that may arise from overlaying DSR tools with other recent changes.<br><br>Implementing DSR together with LVR is likely to lead to a compounded impact on the housing market; a DSR framework reduces lending, and therefore reduces the denominator that is used to calculate the amount of lending allowed within LVR speed limits, further constricting banks' ability to lend above 80% LVR. This outcome is likely to disproportionately impact first home buyers and other customers attempting to enter the property market. In addition, this interplay between LVR measures and DTI restrictions could prove challenging to manage for banks, leading to increased conservatism and, in turn, further restricting the availability of credit generally. |
| 2 | Do you have any comments on the problem definition for debt serviceability restrictions? | Please refer to our comments in the body of this submission. The recent combination of LVR adjustments and CCCFA changes may resolve the problem that DSRs are designed to resolve; the RBNZ should wait and assess the impact of these changes and decide whether a problem still exists to necessitate DSRs. |
| 3 | Are there any other policy options we should consider to address the issues set out in the problem definition? | NZBA does not have any comments at this stage. |
| ***DTI Limits*** | | |
| 4 | How should different types of income be treated in DTI calculations? | **Gross income vs net income**<br>NZBA supports using gross income before shading.<br><br>Using gross income data will be more likely to mirror banks' existing lending processes and will be simpler for customers to understand. This approach will support transparency and facilitate compliance with any new rules.<br><br>A bank will often start with the customer's gross income and then apply adjustments and haircuts depending on its internal credit policy rules. Gross income will provide a better comparison of DTIs across banks as it won't be affected by each bank's individual credit policies. |

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<table>
<tr><th>#</th><th>Question</th><th>Response</th></tr>
<tr><td></td><td></td><td>Additionally, a gross income measure will allow banks to set and apply their own risk appetite settings more easily. Use of a net income figure would require the RBNZ to set standardised allowances for differing income types (and prescribe any haircuts) to have consistency across the industry or it would have to accept that banks apply their own rules to determine net income available for servicing.<br><br>The chances of miscalculation (data accuracy) are also lower as the gross figure avoids the issues of identifying and validating recurring deductions from a customer’s income (for example, KiwiSaver deductions, student loan repayments or child support).<br><br>We recommend that DTI rules are kept simple and aligned to existing LVR rules with respect to their treatment of income.<br><br>It will be important to ensure that the standards are drafted in a way that does not incentivise a particular borrowing vehicle or structure over another one that might receive more favourable treatment. The rules should support a level playing field so the overarching purpose of supporting more sustainable house prices is more likely to be achieved<br><br>Treatment of different types of income<br>NZBA agrees with the RBNZ that developing a set of rules for types of income other than wage/salary and rental income would be resource-intensive and likely unnecessary, and we look forward to further consultation on these more detailed design elements.<br><br>We would welcome further clarity on the following:<ul><li>How should future income be treated (e.g. what allowance should be applied)?</li><li>Income provided by a third party (such as the guarantor/parents). Is this income permitted to be used in the calculation? Does the guarantor need to pass the DTI calculation? We anticipate that the introduction of DTIs will encourage more joint borrowing especially for first home buyers. We would welcome clarity on how income is treated where there is joint borrowing taking place.</li><li>What verification of income will be required? It is important that any verification requirements do not conflict with the CCCFA verification requirements.</li></ul></td></tr>
<tr><td>5</td><td>How should different types of household debt be treated in DTI calculations?</td><td>NZBA recommends using total unweighted household debt</td></tr>
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| # | Question | Response |
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| | | We agree that the simplest approach is to use a total unweighted measure of household debt. As the RBNZ notes, banks are still free to differentiate between mortgage and other debts when undertaking their internal serviceability calculations.<br><br>**Small business loans should be excluded**<br>We also support the proposed exclusion of small business loans from DTI calculations. Business loans are, by their nature and definition, not loans for personal purposes so these should be excluded from DTIs even if the relevant business loan is secured by a residential property.<br><br>**Student loans**<br>It is difficult to comment on the treatment of student loans from both income and debt perspectives, as they contain complexities, and we look forward to further consultation on these more detailed design elements.<br><br>Contingent liability should be expressly excluded from a DTI calculation.<br><br>**Treatment should align with CCCFA**<br>We request that the treatment of other types of debt under any new rules is aligned to CCCFA.<br><br>Ideally, as similar systems are often already in place (treatment of debt under CCCFA) banks would favour debt being treated in a similar way for ease of implementation within their existing systems. It will also make compliance with any new rules easier.<br><br>**DTI caps**<br>NZBA agrees with the RBNZ that a broad DTI cap makes sense in the New Zealand context, and recommends a broad cap rather than application to only owner-occupied property. This approach will also be simpler for banks to implement and have a lesser impact on customers and loan administration. |
| 6 | Should a DTI restriction incorporate exemptions, and if so should the exemption framework mirror the current LVR regulations? | Ideally, the DSR would incorporate the same exemptions as the current LVR framework (apart from the combined collateral exemption). However, we would like to consider this topic further once a more detailed context is provided as part of the RBNZ's next consultation round. |
| 7 | Should speed limits apply under a DTI restriction? If yes, should there be separate speed limits for different borrower groups? | We support a speed limit approach that allows for a level of flexibility, but note that speed limits are complex measures which can be difficult to apply. We do not support different speed limits for different borrower groups, as this would add to the complexity. While speed limits and/or |

| # | Question | Response |
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| | | exemptions may somewhat mitigate impacts on particular borrower groups such as first home buyers, adding DSRs to RBNZ's macroprudential toolkit will inevitably have some impact on these groups. As discussed above, it is therefore important to carefully assess and forecast the combined effects of existing regulatory settings and the proposed introduction of a DSR in light of the current state of the policy problem they are intended to solve. |
| 8 | Do you have any views on the potential calibration of a DTI limit? | In our view it would not be appropriate to comment on calibration at this point in time. As noted above, given the number of new measures that have been introduced in the last 12 months, we support first assessing the impact of such measures through the rigorous assessment of data before the consideration of calibration of DTI restrictions. |
| 9 | Are there any other issues that should be considered if DTI limits were to be implemented? | NZBA does not have any comments at this stage. |
| ***Floors on test interest rates*** | | |
| 10 | Which methodology for setting test rate floors do you prefer? Please explain your reasoning | The majority of our members prefer Option A – a uniform fixed test interest rate floor. In our view this will be the simplest to administer and implement. We note that it would be very complicated to administer different test rate floors for different customer groups.<br><br>This option would allow RBNZ to set the rate on a 'through the cycle' basis which would minimise test rate volatility and give more stability to serviceability assessments for banks and customers alike. |
| 11 | For banks, please provide information on how your test rates are currently set (on a confidential basis if necessary) | If the RBNZ requires further detail on this question we suggest they contact our members bilaterally. |
| 12 | Are there any other issues that should be considered if test interest rate floors were to be implemented? | We would welcome further clarity as to the types of debt test rate floors would apply to. It is not clear whether the intention is that they would apply to new lending, funded bank lending or to all bank lending. |
| 13 | Do you have any comments on our assessment of the impacts of implementing DSRs? | As noted above, we suggest first assessing the impact of other recently introduced measures (LVRs, CCCFA etc.) before consideration of DSR implementation.<br><br>Test rates provide a servicing buffer which in practice is added to many other buffers that banks already apply within their affordability assessments (e.g. income haircuts and expense benchmarks). Expanding test rate buffers further is unlikely in our view to materially improve financial system resilience as it merely changes customers' discretionary spending or savings capacity. |

| # | Question | Response |
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| | | However, it may prevent some customers who would otherwise be approved for home lending from getting a home loan – generally first home buyers or those with lower incomes. Conservative test rate settings are unlikely to protect customers who experience financial stress due to job loss or a material change in their health or relationship status. |
| 14 | Would it be feasible to set test rate floors at different levels for different borrower groups, in order to mitigate potential impacts on first-home buyers? | It would be very complicated to set test rate floors at different levels for different customer groups. |
| 15 | Do you have any comments on our indicative timeframes for decision-making and implementation of DSRs? | Please refer to our comments in the body of our submission. |