NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Reserve Bank of New Zealand

on the

Consultation paper: Adjustments to restrictions on high-LVR residential mortgage lending

10 August 2016

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About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following fifteen 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
- Bank of Tokyo-Mitsubishi, UFJ
- Citibank, N.A.
- The Co-operative Bank Limited
- Heartland Bank Limited
- The Hongkong and Shanghai Banking Corporation Limited
- JPMorgan Chase Bank, N.A.
- Kiwibank Limited
- Rabobank New Zealand Limited
- SBS Bank
- TSB Bank Limited
- Westpac New Zealand Limited.

Background

3. NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand (**RBNZ**) on its Consultation Paper: Adjustments to restrictions on high-LVR residential mortgage lending (**Consultation Paper**), and commends the work that has gone into developing it.

4. Rather than answering each individual question posed in the Consultation Paper, we set out below the industry's key submissions.

5. If you have any questions about this submission, or would like to discuss any aspect of the submission further, please contact:

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NZBA supports the proposed LVR restrictions

6. NZBA considers LVR restrictions are an appropriate macro-prudential measure to help mitigate the risks around the current New Zealand housing market environment,

and fully supports the proposed further adjustments to high-LVR residential mortgage lending.

7. The proposed LVR restrictions apply a consistent approach across New Zealand, removing the distinction between Auckland and the rest of the country. NZBA welcomes this simplified approach as it will reduce system and process complexity of administering differing geographical limits (noting that some complexity will be retained for reporting the Auckland buckets).

NZBA has some concerns around pre-approvals and timeframes

8. There is a residential mortgage pre-approval pipeline that contains LVR lending in excess of the new rules. These pre-approved agreements need to run their course before full compliance with the new restrictions can be achieved. The implementation date of 1 September 2016 will not allow sufficient time for existing pre-approvals to work through the pipeline. NZBA understands that this pre-approval pipeline that extends through to mid-January 2017.

9. To NZBA's knowledge its member banks have acted within the spirit of the proposed LVR framework and imposed the amended restrictions for new lending (as requested by RBNZ). Therefore, provided all banks continue to act within the spirit of the proposed revisions, the actual implementation date could be delayed without resulting in increased lending to the affected buckets. NZBA submits that an implementation date of 1 October 2016 should be considered.

10. NZBA proposes an initial reporting period of six months is the most practical approach. Such a period would further allow banks to smooth the pre-approvals over the initial compliance period while adjusting to the new calculations. In line with NZBA's suggested implementation date above, the initial reporting period of six months should end on 31 March 2017.

Further work is required before the introduction further macro-prudential tools

Debt-to-income ratios

11. NZBA considers that RBNZ should work closely with industry to carefully consider the relevance and operational implications of debt-to-income (**DTI**) ratios as a macro-prudential tool, in order to determine whether they are an appropriate tool to achieve a reduction in risks currently seen in the housing market.

12. NZBA submits that the full effect of the LVR restrictions should be assessed before additional measures, such as DTI ratios, are implemented. As acknowledged by RBNZ, borrower DTI ratios will naturally ease as a result of tighter LVR restrictions.

13. If after a thorough assessment RBNZ considers such measures are necessary, NZBA encourages RBNZ to engage and consult extensively with the industry. A DTI framework presents significant design and implementation challenges. For example:

a. Significant work will be required to define what constitutes debt and what constitutes income.

b. Loan-to-income (**LTI**) and DTI are completely different concepts. A significant amount of time will be required to devise a methodology that can take into account customer lifestyles, spending habits etc.

c. If/when a proposed methodology is devised and proposed, it is expected that reaching industry agreement will be a protracted process. Consistency of application across the industry will be challenging, as currently there exists significant variation across the industry (for example, in the treatment of income values and income types). While this may not be a priority for RBNZ from a housing market risk mitigation perspective, bank customers deserve to be confident that the rules are consistent.

d. DTI measures would add a substantial level of complexity for both customer and staff understanding, and design and delivery of effective education and communication would take considerable effort.

e. For DTI measures to be effective, changes to the Credit Reporting Privacy Code will be required to allow the sharing of customer loan balance in addition to the five fields which are currently shared (Loan Opening Balance/Limit, Product, Open Date, Account Status & Account Performance). If banks do not have customer loan balance information then they must rely on customers to disclose their debt with other banks/organisations. As any DTI rules will be public, there is a risk that customers will not fully disclose, or choose not to disclose, such information on application forms and banks would have limited ability to identify this (for customers who do not otherwise bank with them). This would further encourage split banking.

14. NZBA submits the industry should be afforded the ability to fully assess the impact of DTI ratios in terms of system and process changes, and to identify any unintended consequences, before the RBNZ commences any DTI framework development.

Capital overlays

15. NZBA submits that any capital response should be proportionate, noting that banks are well capitalised and, as acknowledged in the Consultation Paper, LVR restrictions have resulted in healthier risk profiles in bank books.

16. As with DTI ratios, NZBA submits that the full effect of the LVR restrictions should be assessed before any capital overlays are implemented. The introduction of capital overlays before such time would be premature.

Construction exemption

17. NZBA considers that the construction exemption is currently too restrictive. The challenges associated with the existing settings are evidenced by the low use of the

exemption versus the original RBNZ forecasts. Given the intent of this exemption is to support the supply of new residential property to the market, NZBA submits the current restrictions limiting the exemption to "off the plans" or early stage of construction should be extended to include buildings that are further advanced in the building phase. In short, if the property being acquired is adding to the housing stock, it should be exempt from the LVR regime. RBNZ may wish to consider some restriction to limit this so that the exemption can only be utilised once per property, possibly evidenced through title documentation, to manage risks of market speculation. The present settings that impose restrictions to the early stage of a build, such as foundations or framing, may be considered arbitrary and are difficult for developers, customers, and banks to navigate.

18. NZBA further submits that any concerns that RBNZ has around exempting all new developments (for example, concerns about over stimulation of the development sector and/or excessive housing supply) are well managed through bank credit risk management and lending practices.

19. Any potential RBNZ concerns that an amended exemption could be leveraged by investors can also be managed by banks through their credit processes. RBNZ might consider it appropriate, for instance, for banks to maintain credit standards for lending to developers and not to loosen these as a result of any changes to the exemption.

20. RBNZ might also want to continue to source reporting from banks to monitor the use of the exemption for any signs of unintended responses.

21. Given the recent release of the Auckland Unitary Plan, and impact on new build activity (particularly developers who will need to progress with building, even in the absence of a signed sale and purchase agreement i.e. a spec development), NZBA submits this amendment is key to supporting the flow of new stock into the market.