Submission

to the

Reserve Bank of New Zealand

on the

Framework for Debt-to-Income Restrictions – Design Elements and Exposure Draft

14 December 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 eighteen 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.
   - KB Kookmin Bank Auckland Branch
   - 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 Reserve Bank of New Zealand on the Framework for Debt-to-Income Restrictions – Design Elements and Exposure Draft (**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

We appreciate the RBNZ's engagement with the banking industry throughout its work on debt serviceability restrictions. Our key points are set out below, and our answers to the RBNZ's questions are in the table in the Appendix. We are happy to meet with the RBNZ to discuss any aspects of our submission.

In our view, the primary goal in designing this framework should be simplicity - it is crucial that it is easy to understand and apply. Having a complex framework with a number of different rules and considerations will be confusing for both front-line staff and consumers. Better customer outcomes will be achieved if staff are easily able to apply and explain these rules. Further, our view is that the focus of DTI restrictions should be on system risk rather than detailed serviceability assessment (which is covered by internal bank policies and regulated by the Credit Contracts and Consumer Finance Act (**CCCFA**)). This idea underpins many of our responses to the RBNZ's questions, with our preferred option often being the simplest one.

We also support an approach that minimises the compliance burden for banks wherever possible (bearing in mind that compliance requirements for the DTI framework will be on top of other regulatory requirements, such as the CCCFA requirements, which have proved a material compliance burden for customers and staff within the last year).

Even the simplest framework will require significant training and implementation effort, and we encourage the RBNZ to retain the proposed 12-month implementation period that has been signalled.

We strongly support the proposal having an indicative starting calibration, ideally at a level that will be applicable for the prevailing market environment. This will help each of the banks understand the potential scale of complex lending scenarios (i.e. those lending applications where DTIs can't be easily calculated) so they can assess the impact these will have on possible speed-limits. That calibration period will also assist with system design requirements, and with the training and communication required to support effective implementation.

An initial calibration will also allow banks to model the potential interplay between LVR and DTI restrictions and those now imposed by the CCCFA. This will help to identify potential groups of borrowers that are currently assessed as credit worthy, but who may not be able to access bank credit once these restrictions are introduced. However, in providing the indicative starting calibration, it should be made clear that banks are not required to apply the indicative starting calibration in their systems, and report to RBNZ against it, prior to the implementation of any DTI restriction and will have the full 12-month implementation period to make any required system changes.

Appendix: RBNZ Questions

#	Question	NZBA Response
	Personal income	
1	Do you agree with our proposal to measure personal income on a gross rather than net basis?	Yes, NZBA agrees with the proposal to measure personal income on a gross rather than net basis. This is the simplest way to ensure that income is measured in an equivalent way across all banks. We note however that significant systems, staff training and process changes will be required.
2	Do you agree with our proposal to include all forms of personal income in the DTI calculation?	Yes, NZBA agrees with the proposal to include all forms of personal income in the DTI calculation. We also seek confirmation that banks can apply an internal materiality threshold to record, or exclude, some sources of income where the amounts are small and/or difficult to calculate or verify. With respect to calculating gross foreign income when only net amounts are on source documents, we recommend that banks use the net income amount and convert that to NZD to calculate the gross amount (applying NZ tax rates). We also suggest that banks only include gross income available for debt servicing which would allow us to exclude foreign income where there is doubt it can, or will, be remitted to NZ.
3	Do you agree with our proposal to treat all personal income on an unweighted basis (i.e. without ‘haircuts’) while retaining the option to specify haircuts in future if necessary?	We agree with the proposal to treat all personal income on an unweighted basis. However, we do not support the RBNZ retaining the option to specify haircuts in the future. We consider that some unintended consequences could arise from doing so. For example, specifying haircuts to personal income for DTI purposes could inadvertently

#	Question	NZBA Response
		mandate haircuts across the industry, as it is not feasible for banks to maintain two different haircuts in their systems: one for the calculation of DTI and another for the purposes of credit decisioning.
4	For lenders, how do you currently treat variable income in your serviceability assessments, and approximately what percentage of personal income is variable? This information can be provided in confidence?	We understand that some of our members will provide this information bilaterally to the RBNZ.
5	What is your preferred approach for measuring variable personal income in the DTI calculation – leaving this to banks' discretion, or applying set rules? If you prefer a rules-based approach, what rules would you recommend?	Our preference is that this decision is left to the banks' discretion. A benefit of this approach is that banks can ensure consistency of treatment between their affordability assessments and their DTI calculations.
6	Does the wording of the draft framework clearly convey our design decisions in relation to personal income? If not, how could the text be improved?	Apart from our proposed changes to question 2 above, we are comfortable with the draft wording. The framework should clarify whether self-employed income is included in the definition of variable income.
	Personal debt	
7	Do you agree with our proposal to include all forms of personal debt in the DTI calculation, on an unweighted basis?	Yes, we agree with the proposal to include all forms of personal debt in the DTI calculation, on an unweighted basis. However, we note the definition of debt refers to 'total balance'. We suggest 'total balance' should be replaced with 'the higher of either total limit or total balance'. We recommend there be a discretionary de minimis threshold of $1000 before a debt is to be included in the DTI calculation. This would mean that banks can choose to exclude debts of under $1000 in the DTI calculation. Different bank systems mean that for some banks, including these smaller amounts would lead to unnecessary confusion and complexity, without materially impacting the outcome of the assessment.

#	Question	NZBA Response
8	Do you agree with our proposal to incorporate student loans within the total debt calculation, rather than as a deduction from income?	Yes, we agree that student loans should be included within the total debt calculation, rather than as a deduction from income.
9	What is your view on whether BNPL lending should be included within personal debt?	We recommend excluding BNPL from personal debt. Applying a discretionary de minimis debt threshold (as discussed under question 7), would likely mean BNPL is often excluded, however, we consider there should be an explicit rule excluding BNPL from debt.
10	Does the wording of the draft framework clearly convey our design decisions in relation to personal debt? If not, how could the text be improved?	***Definition of debt*** We would recommend that the definition of "debt" specifically includes reference to credit cards and overdrafts and other types of personal loans. ***Balances v facility Limits*** The definition of "debt" under the draft framework refers to "sum of all loan values". Read on its own this suggests that the calculation uses loan balances rather than facility limits. However, the current DTI return definitions refers to loan values as being: "*total balance of loan values is the sum of all loan values (**typically the limit of each loan**) that the borrower or borrowing parties discloses they are responsible for servicing out of their income.*" Given the inconsistency above, we would welcome clarity as to how debt should be calculated. In particular, this clarity is needed in the context of new commitments vs existing facilities. We note that technically at the time of a new commitment, there is no balance for the loan as that commitment is for a limit to be drawn down at a future date (at which point there will be a balance). Our preference is for the use of facility limits rather than balances as this is a simpler and far more effective control and aligns with

#	Question	NZBA Response
		the current LVR control and affordability assessment under the CCCFA.
	Business debt and income	
11	Do you agree with our proposal not to include business debt in the DTI calculation?	Yes, we agree with the proposal not to include business debt in the DTI calculation. However, we seek additional clarification from the RBNZ around the treatment of business loans secured by residential property. The Framework clearly indicates that <u>all loans secured against residential property</u> are captured within the Framework and this is consistent with their treatment for capital purposes. We note that Paragraph 36 of the consultation document states that "where business income is being used to service residential mortgage lending, this income should be included in the DTI calculation". However, clause 13.4 (3) of the draft Framework states that "Business debt, including business debt secured by residential property, must be excluded from the calculation of total debt." Many business owners borrow directly against their homes in order to inject equity or debt into their businesses. This debt is serviced from business income. The Framework appears to offer conflicting guidance as to whether these loans should be included within the DTI calculation or not. Our understanding is that inclusion within the DTI framework should come down to the type of product offered. That is, if a business loan is secured against a residential property, this product is a business product and not included in the DTI framework. However, where business income is being used to service a residential mortgage, this will be a retail product and fall within the DTI framework.

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<tr><th>#</th><th>Question</th><th>NZBA Response</th></tr>
<tr><td></td><td></td><td>We would welcome explicit clarification of the above, perhaps through including examples to demonstrate how this rule works.</td></tr>
<tr><td>12</td><td>Do you agree with our proposal to calculate the business income available to service residential mortgage lending based on taxable profits?</td><td rowspan="2">In our view, the current guidance is slightly confusing and perhaps conflates two different concepts. We suggest a waterfall diagram is used to clearly demonstrate the RBNZ’s intentions. In principle, we support a proposal to calculate income based on taxable profits, but that income should also include wages and other drawings taken from the business. Clarity is needed as to what exactly is able to be included in this business income number.

An alternative is that business income is determined from an after-tax position, starting with Net Profit After Tax (NPAT) figure:

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<tr><td>Step 1</td><td>Start with NPAT</td><td>The starting NPAT figure will already have accounted for shareholder salaries, and/or any salary/wages on a PAYE basis paid to the business owner(s); these items are part of the personal income assessment</td></tr>
<tr><td>Step 2</td><td>Subtract sensitised serviceability costs (P&I) related to business debt</td><td>As per the individual bank’s internal affordability framework</td></tr>
<tr><td>Step 3</td><td>Add back interest</td><td>As per P & L</td></tr>
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<tr><td>13</td><td>If business income is calculated based on taxable profits, do you agree that a deduction should also be made for principal repayments on business debt?</td></tr>
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<tr><td>Step 4</td><td>Add back depreciation</td><td>As per P & L (discretionary)</td></tr>
<tr><td>Step 5</td><td>The result is the business surplus available for distribution in whole or in part to business owners’ or retention in whole or in part by the business – this is what will feed into the income calculation.</td><td>Business Cash Surplus apportionment to be taken to owner’s personal income is at the individual bank’s discretion.</td></tr>
<tr><td>Step 6</td><td>Shareholders Salary or PAYE Wage to Owner already taken to Owners personal income. (IR3 verification)</td><td>As per P&L</td></tr>
</table>
On the matter of whether the business surplus is distributed or retained, it is important that banks retain the ability to assign business surplus to owners (for debt servicing purposes) on a sustainable basis.
We would be happy to meet with the RBNZ to discuss this issue further.
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<tr><td>14</td><td>How should DTI ratios be calculated in cases where it is difficult to disentangle business from residential debt?</td><td>As discussed above, it should come down to the type of product offered. A business product should not be included in the DTI framework.</td></tr>
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#	Question	NZBA Response
15	Does the wording of the draft framework clearly convey our proposed rules for business debt and income? If not, how could the text be improved?	As above, we would welcome clarity on the position where a business loan is secured against a residential property.
	Complex lending situations	
16	Do you agree with our proposal to adopt a set of rules to cover some types of complex lending, with the remainder allocated into the general speed limit?	As noted earlier, our primary concern is that this framework should be clear and simple to apply. In our view, the simplest approach to complex lending is to have a general rule that if you can calculate a DTI, you should do so, and (in those rarer cases) where it is too complex to calculate a DTI, it should be allocated to the general speed limit. We suggest that DTI is calculated at the level of the borrowing party only. There are some complexities around the definition of borrowing party, and we would welcome the opportunity to engage further with the RBNZ to develop some clearer examples as to what is included in this definition.
17	Do you agree with the rules we have set out for complex lending? If not, what changes or improvements would you suggest to the rules?	
18	For lenders, what percentage of your complex lending do you estimate would be covered by the proposed rules, and how much would need to be allocated into the speed limit? You can provide this information confidentially if you wish	We understand some of our banks may provide this information bilaterally.
	Exemptions	
19	Do you agree with our proposal to apply an exemption regime for DTI restrictions that mirrors the current approach for LVR restrictions, with the exception of the combined collateral exemption?	Yes, we would support an exemption that mirrors the LVR regime.
	Structure of the restrictions	
20	Do you agree with our proposal to structure the DTI restrictions in the form of a speed limit and a threshold, based on the value of new lending, as for the LVR restrictions?	Yes, we agree with this proposal. The speed-limit approach is well understood as a result of the LVR Framework, and it provides flexibility so we can support a limited number of credit worthy customers seeking home loans but who are outside any DTI restrictions ultimately applied.

#	Question	NZBA Response
21	Do you agree with our proposal to apply a uniform DTI limit across all residential mortgage lending, rather than differentiating by borrower or property type?	In principle, we support a uniform DTI limit for simplicity reasons, as long as calibration is appropriate. However, should the RBNZ implement differential speed-limits between owner-occupiers and investors then we believe that there should also be an equivalent of the LVR combined collateral exemption.
	Administrative issues	
22	Do you agree with the proposed general guidance on debt and income verification in the draft framework? If not, what would be your preferred approach?	Yes, we agree with this approach generally, but question whether verification of student loan balances is required.
23	Do you agree with our proposal to measure compliance with the DTI restrictions over a rolling period of three months for larger banks, and six months for smaller banks?	Yes, we agree with this proposal. However, a longer initial measurement period for larger banks would assist to manage the initial implementation, in particular, the complexity of managing the interaction of the LVR and DTI limits.
24	Do you agree with our proposal to monitor compliance via the DTI survey, updated to reflect any changes to the definitions of debt and income?	Yes, we agree with this proposal.
	DTI Calibration	
25	Would it be helpful to have an indicative starting calibration for the DTI restrictions, prior to the restrictions coming into force? If so, please explain how this would assist with your systems development, and indicate whether you have a view on the preferred calibration	Early indication of calibration would be very helpful, but only once the definitions have been finalised. This would assist from a systems perspective and also for setting expectations with customers and the industry (including brokers). It would be helpful for the indicative calibration to be at a level RBNZ sees as being appropriate in the prevailing market environment.
	Impacts of DTI Framework	
26	Do you agree with our assessment of the draft DTI framework proposals against the FPR requirements?	Yes, we agree that the DTA framework is in line with the FPR requirements.

#	Question	NZBA Response
27	For lenders, are you able to provide an estimate of the regulatory costs that you expect to incur in preparing for the potential introduction of DTI restrictions according to the design proposals in the draft framework? This estimate can be provided in confidence	It is difficult to provide an estimate until the guidelines have been finalised. We note that these changes will not just entail changes to systems, but a substantial exercise in customer communication and education, front line staff training etc.
28	Are there any changes that could be made to the draft framework that would further reduce regulatory costs for banks?	We recognise the complexity involved in putting together a DTI framework and think the draft framework strikes the right balance between having a framework that is simple in principle yet caters for the complexity.
29	Are there any changes that could be made to the draft framework that would further reduce the risk of adverse impacts on financial inclusion, or on other aspects of the FPR?	NZBA recognises the risk of adverse impacts of DTI restrictions on specific borrower groups, such as Māori, Pasifika, and migrant communities. These communities tend to have lower incomes and less capacity to save larger deposits. As indicated earlier, we are concerned that DTI restrictions, on top of existing LVR and CCCFA regulations, may disproportionally impact and further disadvantage these communities. Depending on the DTI limit and corresponding speed limit, the impact on the above minority groups and also on First Home Buyers could be material. Lenders are likely to manage speed limits through internal policy settings that could favour certain segments (for example Residential Investors) thus reducing access to lending for other market segments. This could give rise to the potential for inconsistency between the DTI policy intent and the Financial Policy Remit. In addition, complexity in the calculation could also impact financial inclusion if the new framework is difficult to understand, thus may have the impact of dampening demand for credit further, particularly amongst owner occupiers & first home buyers.