

M Jackson
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Prudential Supervision Department
Reserve Bank of New Zealand
PO Box 2498
Wellington 6140
Email:
stocktake@rbnz.govt.nz
macroprudential@rbnz.govt.nz

Dear Sir/Madam

Subject: Response to the consultation document on the proposed Dashboard approach to quarterly disclosure¹.

I write to support the proposals to improve the accessibility of information, and agree they will assist in understanding the risk of an individual bank and will facilitate comparisons across banks.

My Interest in this matter

My interest in submitting is because I am a deposit holder in a banking institution in New Zealand, seeking to assess the risk of banks and the banking system to the value of savings. If macroprudential protections fail either at one bank or with the system, then the costs are likely to fall on depositors by, for example:

- the Reserve Bank forcing a reduction of interest rates below natural levels; and/or
- The savings of depositors (e.g. via the OBR mechanism) being reduced to the extent of the bank or system failure.

Question 49: LVR Data

I write in particular in relation to the Question 49 as to whether LVR data should be in the Dashboard. It is my view that the **LVR data must be included in the Dashboard** because it is the lending policy and practice of each individual bank that is critical to understanding the risks of not only an individual bank, but also to macroprudential stability.

Currently, there is only a limited perspective on this major cause of tail risks and associated systemic risks. It is clear however that over the last four years or so New Zealand banks have been aggressively lending at significantly above “prudent norms”² placing in question the stability of New Zealand’s financial system. This lending above “prudent norms” is evident by the following:

- BTL (“buy-to-let” =BTL sector) paying far higher prices on housing relative to the returns they will receive in the form of rent;
- The rate of growth of the BTL residential investment sector, and its large size relative to the total residential sector;

¹<http://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Policy-development/Banks/Dashboard-approach-to-quarterly-disclosure/Dashboard-consultation-Sept2016.pdf?la=en>

² The Bank of Ireland has stated that its DTI limit of 3.5 was set at a “prudent norm” of lending which, “*as long as changes in house prices are motivated by a genuine demand for housing – the rules would have little effect in normal times*”

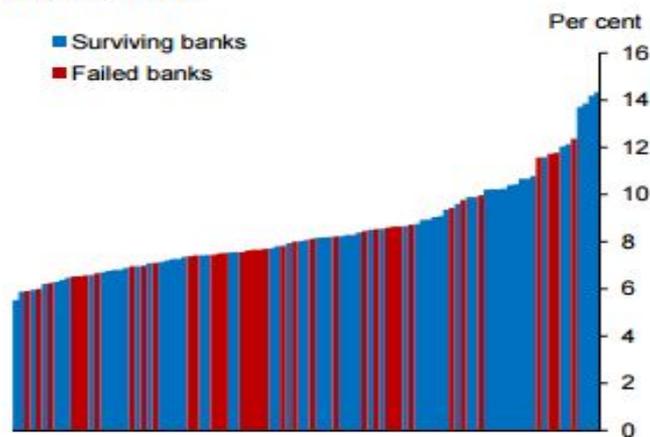
<https://www.centralbank.ie/press-area/speeches/Pages/AddressbyLarsFriselltoIrishEconomyConference.aspx>

- The ANZ CEO stating in October 2016 that lending at high DTI ratios in New Zealand is “already way above what other parts of the world would be”.

Banks do not disclose their lending practices to the residential sector, citing commercial sensitivity when asked to do so;- and stating that they are “*unique and commercially sensitive*”. They state that “*it is not the intention of the Bank’ disclosures statements to provide insights as to the quality of the lending being undertaken by the Bank. The purpose of disclosure statements is provide an account of the Bank’s current financial position and performance*”.

Unfortunately, it is apparent that monitoring capital ratios from disclosure statements is not sufficient for a depositor to manage risks. Capital ratios only address risks of a Gaussian nature involving random fluctuations around an average, and those risks are very different animals to tail risks caused by imprudent lending practice combined with the characteristics of housing markets. The distinction has been made on this topic by the following comparison: “*no study of the height of hamsters, however good, will ever give us much sense of the height of giraffes*”³. This is further evident from the following graph⁴ from the Bank of England. It is clear from this graph that no study of capital ratios, however diligent, offers much benefit in assessing the risk of bank failure.

Chart 3: Risk-based capital ratios of major global banks, end-2006^(a)



Source: Capital IQ, SNL, published accounts, Laeven and Valencia (2010).

(a) The classification of bank failure is based on Laeven and Valencia (2010), updated to reflect failure or government intervention since August 2009.

Given that housing markets have tended to have significant tail risks, I have concluded that it is the quality of the lending by a bank to the residential sector that is the key risk. It is this risk that has system implications because imprudent practice can lead to the failure of a bank that might have had seemingly respectable capital ratios prior to a crisis.

If the RBNZ were to have in place permanent and meaningful LVR and DTI limits so constraining the lending of commercial banks, then the quality of lending of banks to the residential sector would be

³ Attributed to Rebonato in the paper: “Capital Inadequacies: The Dismal Failure of Bank Capital Regulation” by Dowd, Hutchinson, Hinchliffe 2011.

⁴ <http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2012/speech596.pdf>

assured. However, the insufficiency of the current LVR limit constraint applied to BTL investors⁵, the lack of permanency of that constraint, and the lack of any DTI constraint on bank lending to the residential sector, - all underline the necessity for detailed information disclosure on lending from each bank to properly assess risk.

The disclosure of LVR information on each bank's residential mortgage lending will be a valuable insight to not only the riskiness of a bank but the system itself. In particular, because of the powerful cyclical amplification effect⁶ of the BTL sector (residential investment sector) on the dynamics of the entire housing market, it is the LVR of the lending directed toward BTL investors that is a key metric for assessing risk.

The Required Information

The information that will assist in the assessment of risk of the BTL sector includes:

- 1) The amount of lending in each decile of LVR above an LVR of 30%. That is, the disclosure of lending at LVR in each of the ranges: 30% to 39%, 40% to 49%, 50% to 59%, etc. extended as high as necessary to capture all BTL lending of each bank;
- 2) The proportion of total lending to the BTL sector versus the owner-occupier sector of residential lending for each bank.

I understand that the loan-value-ratio (LVR) data collection project requires banks to provide to the RBNZ a breakdown of their residential mortgage lending by LVR bracket. I therefore do not see any significant additional cost in providing this LVR information to public channels. However to the extent there is additional cost, I believe it is vastly outweighed by the long run cost to depositors, the economy, and society that is caused by imprudent lending by banks to the BTL sector.

As with the other information proposed to be provided, I ask that this information from each bank should be made easily downloadable for use in spreadsheets etc, so that the position of each bank in respect of its LVR lending profile to the BTL sector can be compared to that of the entire banking sector.

Summary

In summary, the disclosure of a bank's financial position and historic performance is not sufficient, the disclosure of lending practice by reference to LVR data of the BTL sector is not only essential for a depositor to assess risk of each commercial bank but to assess risk of the financial system itself.

Thank you for consideration of my submission.

Yours faithfully

M Jackson

⁵ The LVR limit to BTL investors is currently set at 60%, - this is still too high relative to: (i) the current level of rental yields, (ii) the elasticity of supply of the housing market.

⁶ For example: the powerful pro-cyclical effects of lending to the BTL sector is indicated in the Bank of England's working paper SWP619 dated October 2016 where it applied an agent-based model of the housing market to study the impact of macroprudential policies on key housing market indicators. The BOE found in this model that increases in the size of the BTL sector amplify house price cycles and increase house price volatility and that *"The increased demand from BTL investors also drives up the level of house prices by around 59 percentage points. This higher price reduces the number of owner-occupiers that can afford to buy a house, reducing their market share by about 25 percent. They turn into tenants, renting from the BTL investors that bought the houses."*