RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

Framework for Restrictions on High-LVR Residential Mortgage Lending

Prudential Supervision Department
Document BS19

Issued: XX 2013

Ref #5258231

Part 1—Introduction

1. Restrictions on high-LVR residential mortgage lending and the Reserve Bank's objectives

(1) This document sets out the Reserve Bank of New Zealand's (Reserve Bank's) framework for imposing quantitative restrictions on the share of high loan-to-valuation ratio (LVR) loans by registered banks to the residential property sector.

(2) The Reserve Bank has powers under Part 5 of the Reserve Bank of New Zealand Act 1989 (the Act) to register banks and undertake prudential supervision of registered banks.

(3) Section 68 of the Act requires the powers under Part 5 of the Act to be exercised for the purposes of:

(a) promoting the maintenance of a sound and efficient financial system; or

(b) avoiding significant damage to the financial system that could result from the failure of a registered bank.

(4) As set out in the Memorandum of Understanding (the "Memorandum") on "Macro-prudential policy and operating guidelines" between the Governor of the Reserve Bank and the Minister of Finance, quantitative restrictions on the share of high loan-to-value ratio loans to the residential property sector may be deployed to address systemic risks to financial stability.

(5) The objective of the framework set out in this document is to help maintain financial stability, by providing the Reserve Bank with the practical means of imposing restrictions on the share of high-LVR residential mortgage lending undertaken by registered banks. Any decision to impose such restrictions will be taken within the operating guidelines for macro-prudential policy set out in the Memorandum, for the purposes of section 68 of the Act.

2. Branches

This policy applies to all New Zealand registered banks, including overseas-incorporated banks that have a branch in New Zealand.

3. Conditions of registration

Section 74 of the Act permits the Reserve Bank to impose conditions of registration that relate to, among other things, the matter referred to in section 78(1)(fa) of the Act (risk management systems and policies or proposed risk management systems and policies).

4. Public disclosure

Under section 81 of the Act, the Governor General may, on the advice of the Minister and in accordance with a recommendation by the Reserve Bank, prescribe information or data that registered banks must publish in disclosure statements.

5. Regulatory reporting

Under section 93 of the Act, the Reserve Bank may require a registered bank to provide information, data or forecasts to the Reserve Bank. A notice under section 93 may specify:

(a) the periods for which, and form in which, the information, data or forecasts must be supplied; and

(b) the time by which the information, data or forecasts must be supplied.

Part 2—Conditions of registration

6. Standard conditions

(1) One of the Reserve Bank's policy tools within its macro-prudential framework is the use of quantitative restrictions on the share of high loan-to-valuation ratio (LVR) loans by registered banks to the residential property sector. When the Reserve Bank has decided to implement this tool under the decision-making processes of the macro-prudential framework, it will normally do so by imposing three common conditions of registration on all New Zealand registered banks. Appendix 1 sets out the standard forms of the three conditions we will impose.

(2) Condition (1) restricts the share of a bank's new residential mortgage lending over each specified period that falls within the specified higher-LVR ranges.

(3) The version of condition (1) in Appendix 1 is indicative only. The actual condition will normally fall within the following parameters –

(a) The condition will include one or more LVR restrictions, each specifying a permissible proportion of high LVR loans as a percentage of all commitments made in the specified time period: for example, of the total value of commitments in a three month period, no more than 5 percent may relate to loans with LVRs of 95 percent.

(b) The lower boundaries of the LVR ranges will be set as any multiples of 5 percent from 60 percent upwards; however, the maximum percentage levels for each range can in principle be any amount.

(4) Condition (2) in Appendix 1 requires a bank to include in its standard terms and conditions for residential mortgage lending a requirement of the loan contract that the borrower may not grant any additional security over the property without the bank's agreement. The condition will also require that the bank must not give such agreement unless the total of all amounts secured against the property, as a percentage of the property value, would remain at or below the lowest point of the restricted LVR ranges specified in condition (1).

(5) Condition (3) in Appendix 1 prevents a bank from making a new loan secured by a second or lower ranking mortgage over residential property if there is an existing mortgage over the property held by another lender, unless the total LVR of all mortgage loans secured on the property, including the new loan, would remain at or below the lowest point of the restricted LVR ranges specified in condition (1).

(6) For any New Zealand-incorporated registered bank, the three conditions will normally apply to the banking group (as defined in the bank's conditions of registration). For branches of overseas-incorporated banks, the conditions will apply to the registered

bank: this means that the conditions will capture lending booked in any part of the overseas bank, but the scope of the policy is restricted to loans secured on residential property in New Zealand.

(7) After imposing such conditions, the Reserve Bank will keep under review the impact of doing so on high-LVR residential mortgage lending, and on the credit and housing price cycle more generally. In light of changing conditions the Reserve Bank may remove the three conditions, or may vary condition (1) in order to tighten or loosen its settings as appropriate.

(8) The Reserve Bank will also monitor individual banks' compliance with the conditions as part of its regular supervisory oversight. The Reserve Bank expects banks to comply with the spirit of the policy as well as with the letter of its requirements. If the Reserve Bank identifies new business models being set up which have no obvious purpose other than to circumvent any LVR restrictions currently in place, it will take action as appropriate, which could for example take the form of a supervisory response to an individual bank, or an adjustment to the policy wording as necessary.

(9) The Reserve Bank undertakes to give registered banks at least two weeks' notice of its intention to impose, vary or remove such conditions. (Section 74(3) of the Act requires the Reserve Bank to give at least seven days' notice.)

7. Definitions

For the purposes of this document, including for conditions of registration imposed under the Act,—

"BS2A" means the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" [dated March 2013];

"BS2B" means the Reserve Bank of New Zealand document "Capital Adequacy Framework (Internal Models Based Approach)" [dated May 2013];

"exempt", in relation to a residential mortgage loan, means that the loan falls within one of the exemption categories set out in section 9 of this document and the registered bank offering the loan has elected to treat it as exempt;

"IRB bank" means a New Zealand-incorporated bank that is accredited by the Reserve Bank to use the internal ratings-based approach to credit risk for capital adequacy purposes;

"loan value", in relation to a new commitment for a residential mortgage loan—
(a) for an IRB bank has the same meaning as "current loan balance" as defined for the purpose of defining "loan to value ratio" in BS2B, in respect of the property to which the mortgage commitment relates; or
(b) for any other registered bank has the same meaning as "loan value" as defined for the purpose of defining "loan-to-valuation ratio" in BS2A, in respect of the property to which the mortgage commitment relates.

"loan-to-valuation ratio", in relation to a residential mortgage loan—
(a) for an IRB bank, has the same meaning as "loan to value ratio" as defined in BS2B; or
(b) for any other registered bank has the same meaning as in BS2A.

"new commitment", in relation to a residential mortgage loan and in relation to a specified time period, has the meaning set out in section 8 of this document.

"non-exempt", in relation to a residential mortgage loan, means a loan that is not exempt;

"residential mortgage loan"—

(c) for an IRB bank, means a loan fully or partially secured by a mortgage over a residential property and falling within the bank's "residential mortgage" category under its internal ratings based approach to credit risk;

(d) for any other registered bank, means a loan fully or partially secured by a first ranking mortgage over a residential property that is used primarily for residential purposes either by the mortgagor or a tenant of the mortgagor.

"residential mortgage loan in New Zealand" means a residential mortgage loan, defined as in this section, for which the relevant residential property is in New Zealand;

8. New commitments

(1) For the purposes of this policy, a bank enters into a new commitment for a residential mortgage loan on the day that the bank sends the loan documentation to the applicant's solicitor. This is typically the day on which the bank has made an irrevocable offer to an applicant for a residential mortgage loan and the borrower has accepted the offer. By this point in the process the credit risk should be regarded as being the same as if the asset was already on the balance sheet.

(2) New commitments do not include pre-approvals that may or may not lead to a firm offer of finance. Necessary (but not sufficient) conditions for a new commitment are that a specific property has been identified and that an amount has been agreed for the loan that the customer will draw down, or in the case of a mortgage lending facility, for the facility limit.

(3) If the bank has entered into a new commitment before the date on which the LVR conditions of registration come into force (the "switch-on date"), the conditions do not apply to that commitment. Conversely, if a bank has given a customer a mortgage pre-approval before the switch-on date of the conditions, but the pre-approval does not result in a new commitment until after the switch-on date, the conditions do apply to that new commitment.

(4) The LVR limits, for each period defined in the condition of registration, apply to every non-exempt residential mortgage loan arising from a new commitment that the bank has entered into on a date falling within that period. The date on which amounts are drawn down under a new commitment is not relevant for this purpose.

(5) Committed but undrawn amounts on an existing mortgage lending facility that was established before any period defined in the condition of registration are not included in new commitments for that period.

9. Exempt categories

(1) For the purposes of this policy, a bank may treat a new residential mortgage loan as *exempt* if:

(a) the loan is made or will be made under Housing New Zealand's Mortgage Insurance Scheme (MIS), including the Welcome Home Loan scheme and Kainga Whenua programme; or

(b) the loan is taken out or will be taken out to refinance an existing residential mortgage loan, and the new loan is to the same borrower as under the existing loan, is secured on the same property, and is for an amount that is less than or equal to that of the existing loan; or

(c) the borrower is taking out the loan to purchase a residential property that he or she intends to occupy, and the borrower is either currently occupying, or has occupied within three months of the date of the new commitment, another residential property on which the borrower has or had a residential mortgage loan, and –

(i) if the previous residential mortgage loan has been repaid, the loan-to-valuation ratio and the loan value of the new loan are less than or equal to the corresponding values for the previous residential mortgage loan at the time that it was repaid and before the application of the final payment; or

(ii) the loan-to-valuation ratio and the loan value of the new loan are less than or equal to the corresponding values for the existing residential mortgage loan on the property that the borrower is moving out of, on the date that the new commitment is made; or

(d) the loan (“bridging finance”) is to enable a borrower to complete the purchase of a residential property (the “new property”) on a date before the date on which he or she completes the sale of another residential property (the “old property”) provided that –

(i) the new property will be the borrower’s principal residence after the completion date of the sale of the old property, and the old property has been the borrower’s principal residence until the completion date of the purchase of the new property; and

(ii) the registered bank requires the bridging finance to be repaid as soon as the sale of the old property has been completed; and

(iii) to the extent that a residential mortgage loan amount is expected to remain outstanding on the new property once the bridging finance has been repaid, for the purpose of the LVR restrictions that amount is to be treated as the loan value associated with a new commitment for a non-exempt residential mortgage loan, dated when the bank is first committed to providing that loan.

(2) These exemptions are framed so as to be permissive rather than prescriptive. A bank may be unable to decide conclusively whether a particular loan commitment falls within one of the exemption categories, in which case the bank must treat the loan as non-exempt.

(3) The exemptions set out in sub-paragraphs 9(1)(b) and (c) are intended to allow transferability of existing high-LVR lending. If an owner-occupier currently has a mortgage loan falling within one of the LVR ranges that is restricted, these exemptions mean that that person will be able to switch to a different lender or to new mortgage terms on the same property, or to move house, and still borrow up to the same amount and LVR limit, without being affected by the restrictions. However, there is a time limit of three months on this transferability.

(4) The exemption in sub-paragraph 9(1)(d) is intended to allow someone who is moving house to take out a temporary bridging loan if they have not been able to sell their existing home before completing the purchase of their new home, without the total bridging loan amount being caught within the restrictions of the policy. The LVR limits are intended to apply to the mortgage loan on the new property as it will be once the bridging finance has been repaid.

10. Illustrative example of LVR restrictions

The following is a worked example of how LVR restrictions would apply in a particular case:

Time period: the three calendar months from 1 February 2013 to 30 April 2013 inclusive.

A bank takes on 150 new commitments to provide residential mortgage lending during this period (that is, the date on which each of these becomes a commitment in terms of Section 8 falls on a date within the three months).

Twelve of these commitments are for mortgage loans falling within the exemptions in Section 9 (eg Welcome Home loans).

Of the 138 non-exempt loans, 17 have LVRs in the 80 percent-and-over range, of which ten have an LVR in the 90 percent-and-over range.

The total loan value associated with the 138 loans is $70 million. The total loan value associated with the 17 loans is $6 million, with 10 of these loans having LVRs in the 90 percent-and-over range and a total value of $4 million.

Assume that LVR restrictions are in force with the settings exactly as shown in Appendix 1.

In this case the bank –

- breaches sub-clause (a) (the loan value associated with LVRs over 90 percent ($4 million) is 5.7 percent of the total non-exempt loan value ($70 million): the maximum allowed is 5 percent), and
- complies with sub-clause (b) (the loan value associated with LVRs over 80 percent ($6 million) is 8.6 percent per cent of the total non-exempt loan value ($70 million): the maximum allowed is 12 percent).

11. Variations to standard conditions of registration

(1) As noted above, the Reserve Bank will normally apply the standard conditions of registration equally across all registered banks in New Zealand. In particular, if a new bank is registered during a period when LVR restrictions are in force, the standard LVR condition would be included in the new bank's conditions of registration from the date that it is first registered.

(2) If it appears to the Reserve Bank at any point that an individual bank is deliberately exploiting areas of uncertainty in the definitions to act against the spirit of the policy, we would consider taking action against that bank. Such action could address the concern directly by varying the standard LVR conditions or by imposing an additional condition relating to LVRs, or could take some other form as appropriate.

Part 3—Requirements for public disclosure and regulatory reporting

12. Disclosure requirements

(1) A registered bank must comply with the Reserve Bank's requirements for public disclosure in relation to LVRs. These requirements apply to branches of banks incorporated overseas as well as to New Zealand incorporated banks. Further, directors of a registered bank, and the New Zealand chief executive officer for a registered bank incorporated overseas, must attest in disclosure statements that the

registered bank has, at the reporting date and over the accounting period, complied with the requirements set out in the bank's conditions of registration.

(2) The requirements for public disclosure are set by Orders in Council, from which the following paragraph summarises the LVR-related disclosure requirements applying to registered banks.

(3) In its disclosure statement for every quarter, a registered bank must disclose a breakdown of its stock of housing lending broken down by LVR category. Loans for which no LVR figure is available must be included in the over-90 percent LVR category.

(a) IRB banks disclose the total exposure amounts, including the credit-equivalent amount of any off-balance sheet exposures as used in their capital calculation. The valuation used in the LVR ratio is the value of the property at the origination date of the loan. The LVR categories are LVR≤60%, 60%<LVR≤70%, 70%<LVR≤80%, 80%<LVR≤90%, and LVR> 90%.

(b) Other New Zealand-incorporated banks and branches of overseas-incorporated banks disclose the amount of residential mortgage loans in accordance with the definitions in BS2A. The LVR categories are LVR≤80%, 80%<LVR≤90%, and LVR> 90%.

(4) The Reserve Bank intends to review these current disclosure requirements in light of experience with the new regulatory reporting on LVRs, and after considering what additional public information the financial markets and commentators may be interested in during periods when high-LVR limits are in force.

13. Reporting to the Reserve Bank

(1) The Reserve Bank is putting in place reporting requirements on the LVR breakdown of banks' residential mortgage lending. This will provide a more detailed breakdown than is currently in the disclosure requirements, and will cover monthly data on new commitments as well as the outstanding stock of housing lending.

(2) We intend to use these reports generally to monitor credit conditions and the build-up of credit risk in the housing market. During periods when LVR restrictions are in place, we will also use these reports to help monitor compliance with the restrictions, and to assess other impacts they may have, for instance on the availability of credit to small businesses.

(3) While this data will be provided to the Reserve Bank on a confidential basis, we expect to publish a subset of the data aggregated across banks once consistent, standardised data are available.

Appendix 1 – Standard conditions of registration

The following is the standard form for conditions of registration to impose quantitative LVR restrictions on all registered banks. The figures in condition (1) are purely illustrative, and should not be taken as any indication of the actual levels of restrictions that the Reserve Bank would impose in any particular circumstances:

1. That, in respect of new commitments for non-exempt residential mortgage loans in New Zealand that the [banking group] / [registered bank] enters into during each three month period ending on the last day of a calendar month –
   (a) no more than [5 percent] of the aggregate amount of the loan values associated with such commitments may relate to commitments associated with loan-to-valuation ratios (LVRs) greater than or equal to [90 percent];
   (b) no more than [12 percent] of the aggregate amount of the loan values associated with such commitments may relate to commitments associated with LVRs greater than or equal to [80 percent];

   [additional such restrictions as need be]

   For the purposes of this condition of registration, “non-exempt”, “residential mortgage loan in New Zealand”, “new commitment”, “loan value” and “loan-to-valuation ratio” have the same meaning as in the Reserve Bank of New Zealand document entitled “Framework for Restrictions on High-LVR Residential Mortgage Lending” (BS19) dated [month year].

2. That the [banking group] / [registered bank], in respect of each new commitment for a residential mortgage loan in New Zealand that it enters into while this condition is in force –
   (a) must ensure that the loan contract prevents the borrower from granting any additional charge over the property without the bank’s permission; and
   (b) must not, while this condition is in force, give permission to the borrower to grant an additional charge over the property in favour of another creditor unless the total of the amounts secured on the property after the additional charge has been granted would remain below [X%]. [– *where X% will be set at the lowest point of the range restrictions specified in condition (1)*]

   For the purposes of this condition of registration, “residential mortgage loan” and “new commitment” have the same meaning as in the Reserve Bank of New Zealand document entitled “Framework for Restrictions on High-LVR Residential Mortgage Lending” (BS19) dated [month year].

3. That [neither the registered bank nor any other member of the banking group must enter] / [the registered bank must not enter] into a new commitment to lend against a second- or lower-ranking mortgage over a residential property in New Zealand if another lender has in place an existing residential mortgage loan secured on the same property, unless the sum of the loan amount arising from the new commitment and all loans secured by higher-ranking mortgages from other lenders is no more than [X%] of the property value determined at the time that the new commitment is or would be made. [– *where X% will be set at the lowest point of the range restrictions specified in condition (1)*]

   For the purposes of this condition of registration, “residential mortgage loan” and “new commitment” have the same meaning as in the Reserve Bank of New Zealand document entitled “Framework for Restrictions on High-LVR Residential Mortgage Lending” (BS19) dated [month year].