Summary of Submissions: Exposure Draft of the debt-to-income restrictions framework

3 April 2023

Reserve Bank of New Zealand
Te Pūtea Matua

Contents

Background 2
Consultation process 3
Summary of decisions 3
Part One: Summary of submissions 4
Part Two: Other matters raised in submissions 16

Background

1. The Reserve Bank of New Zealand – Te Pūtea Matua – uses macroprudential policy to reduce systemic risk associated with 'boom-bust' credit cycles in which the financial system amplifies a severe downturn in the real economy. This in turn helps us to meet our statutory objective of "promoting the maintenance of a sound and efficient financial system" as set out in the Banking (Prudential Supervision) Act 1989. The Reserve Bank's macroprudential tools are set out in a Memorandum of Understanding (MoU) between the Minister of Finance and the Governor of the Reserve Bank.

2. In February 2021, the Government issued a direction under Section 68B of the Reserve Bank Act (the 68B direction) requiring us to have regard to housing policy objectives when exercising our financial stability powers. In particular, the 68B direction required the Reserve Bank to "*support more sustainable house prices, including by dampening investor demand for existing house stock which would improve affordability for first home buyers*". Though the 68B direction has now been repealed, the Government's new Financial Policy Remit (FPR) requires us to have regard to a similar housing policy objective.

3. In May 2021 we provided advice to the Minister of Finance on policy options to support sustainable house prices. As a result, Debt Serviceability Restrictions (DSRs) were added to the MoU in August 2021. The MoU states that any design and implementation of a DSR will have regard to avoiding negative impacts on first-home buyers, to the extent consistent with our financial stability objectives.

4. In November 2021 we issued a consultation paper seeking feedback on the merits and potential design of two types of DSRs:

   - Restrictions on debt-to-income (DTI) ratios, which impose a cap on debt as a multiple of income; and

   - A floor on the test interest rates used by banks in their serviceability assessments, which test the ability of borrowers to continue repaying their loans if mortgage rates rise to a certain level.

5. Our assessment of the impacts of the two DSR tools (DTI restrictions and a test rate floor) indicated that DTI restrictions were likely to be more effective than test rate floors in supporting financial stability and sustainable house prices. Our assessment also indicated that DTI restrictions would have less impact on access to credit for first-home buyers, who borrow at lower DTI multiples on average compared to with investors and existing owner-occupiers.

6. Based on this assessment, we announced our decision to operationalise DTIs in April 2022 and progressed to drafting a framework for high-DTI residential mortgage lending.

7. We published an exposure draft of the framework for public consultation on November 9 2022. We also published a consultation paper to accompany the exposure draft which provided additional context around key design features of the draft DTI framework and highlighted areas where we particularly wished to seek submitters' views.

8. Since the close of that public consultation, we reviewed all submissions before making our final decisions and are now publishing the DTI restriction framework which has been approved

by the Board of the Reserve Bank. This document summarises the submissions we received and our response to the main points raised.

Consultation process

9. Consultation on the draft DTI framework lasted from 9 November to 14 December 2022. The Reserve Bank received seven submissions as follows:

   - The New Zealand Bankers' Association (NZBA), who made a submission on behalf of its 18 members (registered banks);
   - Three NZBA members (registered banks), who made individual submissions to supplement the NZBA submission and provide additional views;
   - Two property investor interest groups; and
   - One member of the public.

10. This paper responds to the themes and views raised in those submissions and is not intended to be an exhaustive response to all points raised. Readers are encouraged to refer to the full, non-confidential published submissions for further details. Note that the submission from a member of the public expressed a general opinion on DSRs and did not respond to the content of the consultation document or the proposed framework. This submission is out of scope of the consultation, which is focused on technical design matters. Our rationale for supporting the introduction of DSRs in general, and DTI restrictions in particular, is set out in our previous consultation documents.[1]

11. In addition to receiving written submissions, the Reserve Bank engaged with the banking industry through a series of bilateral meetings as well as a joint industry workshop. In some cases, these meetings saw additional feedback raised beyond what was included in the formal submission. Where possible, we have captured and responded to this additional feedback or points of clarification.

12. This *Summary* document follows the format of the consultation paper published in November 2022. Part One of this document covers questions 1 to 29 of the consultation paper. Part Two covers other matters raised in feedback.

13. The table in the following section summarises the key contentious issues raised in submissions and the associated decisions made by the Reserve Bank. The tables are not exhaustive and other issues are described in more detail throughout the *Summary*.

Summary of decisions

Table A: Key issues and decisions

Issue	Decision
Should we retain the option to specify weightings or 'haircuts' on income, or the option to specify differentiated DTI limits (in future)?	We will retain the option to specify differentiated limits in the future, to help manage the impact of the restrictions on different borrower groups.

[1] https://www.rbnz.govt.nz/have-your-say/debt-serviceability-restrictions

Issue	Decision
Should we allow a discretionary de minimis threshold of $1000 before a debt is included in the DTI calculation?	The framework will allow a discretionary de minimis threshold for debt of $1000, but this will be capped at $5000 in total.
Should we allow joint debt to be apportioned?	Joint debt will be need to be included in full for each borrower (not apportioned).
How should business income be calculated?	Business income will be calculated using net profits after tax, with adjustments.
How should business debt be treated in situations where it is difficult to disentangle business and residential debt?	Banks will have the option to include all debt (including business debt) and income in the DTI calculation, or use the speed limit.
How should complex lending situations be treated?	A set of rules will cover most complex lending situations, with the remainder allocated to the speed limit.
Should we set an indicative starting calibration of the DTI tool?	We will not be providing an indicative starting calibration at this stage. However, once the framework is in place and new data is reported, we may provide an indicative calibration or a range of DTI limits.

Part One: Summary of submissions

14. The consultation paper asked 29 questions relating to the draft framework for high-DTI residential mortgage lending. Below is a summary of the feedback received in response to these questions and the Reserve Bank's response to feedback, where appropriate.

Treatment of personal income

Q1: Do you agree with our proposal to measure personal income on a gross rather than net basis?

15. There was consensus across submissions that measuring income on a gross (pre-tax) basis is the simplest approach. Submitters from the banking industry agreed that this would ensure consistency across banks and noted this approach would allow banks to continue to apply their own credit policy when assessing serviceability. There was also agreement that this proposal would help 'future-proof' the DTI framework from potential taxation changes.

Q2: Do you agree with our proposal to include all forms of personal income in the DTI calculation?

16. The submissions agreed with the Reserve Bank view that all forms of personal income should be included in the DTI calculation. This approach means that income sources such as wages and salaries, rental income, boarder income, investment income, foreign income, bonus income and government benefits would be included. Business income will also be included to an extent, which is discussed later in this *Summary*.

17. Support for this proposal appeared to be based on the understanding that banks would be able to continue to apply their own servicing assessments regarding income sources. One

submission specifically asked whether banks would be able to continue to choose to record or exclude sources of income, in line with their own credit risk policy.

18. The general principle behind this proposal is to promote simplicity within the framework while providing banks with flexibility to apply their own serviceability criteria. Therefore, banks will retain the flexibility to apply their internal income policy or materiality threshold when deciding whether to exclude certain sources of income. This means that banks may calculate a more conservative DTI ratio than if all forms of personal income are included, which the Reserve Bank is comfortable with.

Q3: 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?

19. All submissions were supportive of the proposal to treat all personal income on an unweighted basis. This proposal intends to ensure consistency across banks and borrowers, while providing banks with the flexibility to adjust different types of income as part of their internal serviceability assessments.

20. There was general disagreement with the proposal to retain the option to specify haircuts in the future, if necessary. In particular, submitters from within the banking industry did not support the proposal for reasons including:

    - Specifying haircuts for DTI purposes could impact banks' ability to decide their own credit risk policy;
    - Banks may wish to impose their own haircuts for serviceability assessments, and two different haircuts (regulator-imposed and discretionary) may be difficult to implement and could create confusion for banks and customers; and
    - Other mechanisms, such as the DTI ratio restriction and associated speed limits may be more effective ways to manage lending supply.

21. One submitter advised that if the option to specify haircuts in future was retained, they would expect any income haircuts to be subject to the normal public consultation process.

22. Based on the feedback received, the DTI framework will not retain the option to specify haircuts on income in the future. We acknowledge that introducing haircuts to income once the framework is in place may create complexity and confusion for banks. We will look at alternative approaches to managing lending supply in the future.

Q4: 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.

23. Some submissions from the banking industry provided details on this question in confidence. Current approaches to variable income include the application of internal haircuts and the use of averages over a standard time period. Some lenders also advised their credit policy excludes some forms of variable income from debt servicing, due to their volatility and inconsistency.

Q5: 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?

24. All submissions that commented on this question favoured leaving the measurement of variable income to banks' discretion. Reasons for this view included:

    - As lending experts, banks are best placed to assess affordability on a case-by-case basis;
    - Variability in serviceability assessments will encourage competition between banks;
    - A rules-based approach may add unnecessary complexity for banks and customers; and
    - Allowing discretionary treatment of variable income helps ensure consistency between a bank's own affordability assessment and the DTI calculation.

25. The Reserve Bank acknowledges that a rules-based approach to measuring variable income may add unnecessary complexity. In response, we have amended the DTI framework to allow for banks to measure variable income at their discretion.

Q6: 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?

26. Two submissions made suggestions about the wording around 'personal income' within the draft framework:

    - The NZBA submission sought to clarify whether the definition of 'variable income' includes self-employed income.
    - One bank suggested that 'business income' could be separately defined, particularly if this is calculated from a net (after-tax) position. This suggestion is related to the submission's feedback on business income, which is discussed later in this *Summary*.

27. We can clarify that the definition of 'variable income' does not include self-employed income. The various forms of self-employed income are captured within the definitions of 'personal income' and 'business income'. We have also amended the framework to clarify what is meant by 'business income'.

28. Additionally one submission, from a property investor interest group, noted that it did not support the statement in paragraph 24 of the consultation paper which said "investors still account for the large majority of lending at high DTIs". This feedback relates to the consultation paper and not the wording of the draft framework.

Treatment of personal debt

Q7: Do you agree with our proposal to include all forms of personal debt in the DTI calculation, on an unweighted basis?

29. There was a general consensus across submissions that including all forms of personal debt on an unweighted basis was the simplest approach to the DTI calculation. This means forms of debt such as mortgage debt, credit card debt, and personal loans would all be included and counted equally within the DTI calculation.

30. Two submissions supported this proposal with amendments, which are detailed below.

31. One bank requested that joint debt be allowed to be apportioned (shared out) rather than included in full for each borrower. The submitter contends that joint debt would have been assessed based on joint affordability, and including the full balance of the joint debt would unfairly impact the DTI for an individual borrower with joint debt.

32. Based on the principle of 'joint and several liability', which holds each borrower fully liable for a joint debt, we do not agree with this proposed amendment. Any jointly-held debt will continue to be included in full for each borrower in the DTI calculation.

33. The NZBA submitted that the definition of debt be changed from referring to the 'total balance' of the debt, to instead refer to 'the higher of either total limit or total balance'. Additionally, the NZBA suggested a discretionary de minimis threshold of $1000 for a debt to be included in the DTI calculation. This would mean that banks have the ability to exclude small debts of less than $1000 from the calculation, which may reduce the level of complexity and confusion involved.

34. We have amended the definition of 'debt' in the framework to refer to the sum of all revolving facility limits and any other debt balances, as this will more accurately reflect a borrower's total lending position. We have also implemented a discretionary de minimis threshold of $1000 for debt, as suggested, but imposed a cap of $5000. This means that banks can choose to exclude debts under $1000 from the DTI calculation, up to a total of $5000.

Q8: Do you agree with our proposal to incorporate student loans within the total debt calculation, rather than as a deduction from income?

35. Views on this proposal were mixed, with the NZBA and one individual bank agreeing with the proposed approach to incorporate student loans as debt, rather than as a deduction from income. This treatment of student loans aims to minimise impacts on borrowers with student loans, who are more likely to be first-home buyers.

36. Another bank and a property investor interest group did not support the proposal and instead advocated for student loan repayments to be deducted from income. One submission specifically disagreed with the Reserve Bank view that this treatment of student loans would lead to higher DTIs for borrowers with student loans or create barriers to credit availability.

37. We acknowledge that banks currently have the ability to choose whether to record student loans as debt, or as a deduction from income. The framework will incorporate student loans within the total debt calculation, to better align with the treatment of income on an unweighted basis. This means that some banks will need to change their approach. A uniform approach across all banks will help ensure the DTI framework is consistently applied and improve the accuracy of data reported to the Reserve Bank.

Q9: What is your view on whether BNPL lending should be included within personal debt?

38. There was consensus across all submissions that 'Buy Now, Pay Later' (BNPL) lending should not be included within total debt, but instead should be left for banks to assess as part of their internal serviceability assessments. The submissions suggested that as BNPL debts are generally small and short-term, including them in the DTI calculation may create unnecessary

complexity and confusion while having a limited impact on the DTI ratio. Banks will continue to assess BNPL debt repayments as part of their internal serviceability assessments.

39. Two submissions also noted that the Government is developing rules for the treatment of BNPL debt, under the Credit Contracts and Consumer Finance Act 2003 (CCCFA). While these rules are still being developed, an initial proposal to include BNPL as a consumer credit contract where the expense exceeds a specified amount may work similarly to the NZBA's suggested de minimis threshold for debt.

40. We appreciate the unique characteristics of BNPL debt and agree that they can be sufficiently captured as an expense within banks' serviceability assessments, and therefore will be excluded from the definition of 'debt'. We note that the treatment of BNPL debt is being considered under CCCFA and will monitor the developments and review this aspect of the DTI framework if necessary.

Q10: 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?

41. Three submissions provided suggested changes to the wording around 'personal debt' within the draft framework:

- One submission highlights a possible inconsistency in the wording, where the phrase "the sum of all loan values that a borrowing party discloses they are responsible for servicing out of their income" may be at odds with the decision to include all joint debt for an individual borrower.
- The NZBA suggests that the definition of 'debt' specifically references credit cards, overdrafts and other types of personal loans.
- Both the NZBA and another submission suggest that clarity is required around the definition of debt, particularly relating to the difference between facility limits and balances. These submissions suggest 'debt' is calculated as the sum of facility limits rather than balances, to align with the Loan-to-Value (LVR) restriction and CCCFA regulations, plus the balance of any other loans.
- One submission points out that the draft framework would determine total debt at the time that the registered bank provides the loan. However, as the loan may be provided after a period of weeks or months after the application date, the submission suggests that total debt is determined at the time of the application instead.

42. We have amended the DTI framework to reflect the suggested changes above and strengthen the clarity of the definitions around 'debt'. This includes changing the time period for determining total debt from the time the loan is provided, to the time of application.

Treatment of business debt and income

Q11: Do you agree with our proposal not to include business debt in the DTI calculation?

43. The majority of submissions agreed with the proposal to not include business debt in the DTI calculation, with some submissions raising points of clarification which are detailed below.

- The NZBA requested clarification around the treatment of business lending secured by residential property and whether this is to be included in the DTI calculation. The submission suggests that this should be determined by the product category and that a business loan (even if secured by residential property) is still a form of business lending and should be excluded from the DTI calculation.

- One submitter noted that in certain scenarios, such as for customers in the agricultural sector, business and personal debt may be closely inter-mingled. This may create difficulty when trying to separate and exclude business debt and may require all debt and income to be included.

- Another submission highlighted a potential complication in regards to sole traders who operate under their own name instead of a corporation. The same submission also questioned whether the debt of residential landlords would be excluded as business lending, particularly as other Government agencies such as Inland Revenue have categorised residential renting as a 'business'.

44. The Reserve Bank can confirm that business lending secured against residential property will be excluded from the DTI calculation.

45. We also acknowledge there are some situations where separating business and residential debt is difficult, such as in the agricultural sector. Our response to this issue is detailed in Question 14. We can also confirm that the debt of residential landlords will not be excluded as business lending and the DTI framework will capture all residential mortgage lending.

Q12: Do you agree with our proposal to calculate the business income available to service residential mortgage lending based on taxable profits?

46. Most submissions did not agree with the proposal to calculate business income for the DTI calculation based on taxable profits. Some submissions advise that the guidance around business income in the draft framework is unclear, and have provided suggestions for alternative guidance:

    - The NZBA and one bank's submission both advised a clearer and more consistent way to calculate business income is to use Net Profit After Tax (NPAT) with adjustments made to determine the amount of business income available to service the debt. The two submissions included a step-by-step explanation of how business income can be calculated using NPAT. Both submissions also advocated for banks to retain the flexibility to assess the allocation of business surpluses on a sustainable basis, as per their own serviceability assessment policies.

    - Another bank's submission questioned whether, given the complexity of business income, loans substantially serviced by business income should be captured by the DTI restriction framework. If business income was to be included, this submission expressed the view that it should only be included if the borrower has direct influence over the distribution of this income (such as small-to-medium enterprise business owners).

    - This same submission suggested the use of profits after tax (instead of taxable profits) to determine business income, with the application of an individual tax rate, to create the equivalent of a salary. The submission also advocated for the use of forecasted income in the serviceability assessment.

- Another submission advised that business income should be calculated based on the amount that is taken as personal income by the borrower.

47. Residential mortgages serviced by business income will continue to be captured by the DTI restriction framework. Based on the feedback received, we have amended the rules for calculating business income to align with the NZBA's suggested approach, which was reiterated by an individual bank in their submission. We have also provided for banks to retain flexibility around allocating business surpluses on a sustainable basis.

Q13: 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?

48. All submissions with a view on this question agreed with this proposal in principle. The two submissions that suggested using NPAT included deducting principal repayments on business debt in their step-by-step guidance and advised it was a necessary step to accurately determine business surplus.

Q14: How should DTI ratios be calculated in cases where it is difficult to disentangle business from residential debt?

49. Submissions on this question offered varied approaches to scenarios where it is difficult to disentangle business debt from residential debt. Suggestions included:

    - Always excluding business debt – assessing whether debt is a business product and if it is, excluding it;
    - Creating an exception to the rule, that when it is difficult to disentangle business and residential debt, all debt and all income can be included in the DTI calculation; and
    - Not creating any specific rules for this type of scenario and instead relying on the speed limit to capture any lending that falls into this category.

50. The Reserve Bank appreciates there will be some situations where business debt and residential debt will be difficult to separate. In these situations, we are comfortable with banks choosing to pool all debt (including business debt) and all income to calculate a DTI ratio and have updated the framework to reflect this. This option will be discretionary and banks may choose to instead utilise the speed limit to capture these loans.

Q15: 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?

51. Some submissions provided suggested improvements to the wording of the proposed rules for business debt and income in their answers to questions 12 to 14. In addition to those suggestions, two bank submissions proposed that the framework also include a clear definition of 'business debt', and drafted some wording in support of this.

52. We have amended the framework to clarify what is meant by 'business debt', taking into account the submitters' suggested wording.

53. One bank also raised concerns over the framework's use of the word 'must' in relation to the business debt and income and complex lending situations guidance. This submission

acknowledged the intent of the framework to minimise doubt, but felt that the use of the word 'must' did not allow for sufficient flexibility. The submitter asked that this be reviewed once the guidance in the framework has been finalised.

Complex lending situations

Q16: 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?

54. Submissions with a view on this question offered mixed views on whether adopting a set of rules for some complex lending situations would be useful. The two property investor interest groups did not support this approach and preferred that these situations be left to lenders to apply their own policy or utilise the speed limit.

55. Submissions from banks and the NZBA were more supportive of the concept of a set of rules. The NZBA advocated for a general rule that if it is possible to calculate a DTI within a complex lending situation, then it should be calculated. All other situations should be captured within the speed limit. The NZBA suggested this approach to promote clarity and simplicity.

56. The Reserve Bank acknowledges that it is unlikely that all complex lending situations can be captured within a set of rules. However, we believe that a set of rules to cover some situations will better ensure they are dealt with as consistently as possible. This will also help to reduce the number of complex cases assigned to the speed limit, which enables banks to utilise more of the speed limit at their discretion.

Q17 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?

57. Submissions from the banking industry suggested improvements to the proposed rules for complex lending:

    - One bank reiterated their view that joint debt should be allowed to be apportioned in situations where there are overlapping borrowing structures. They suggest that banks be able to apportion joint debt as the higher of either the declared liability ratio or 50 per cent of the debt. Our response to this feedback is provided under Question 7.

    - The NZBA and one bank both submitted that DTI be calculated at the level of the 'borrowing party' only, which would take into account the debt and income for those applying for a specific loan. The submissions argue that this would result in fewer DTIs being overstated and be the simplest approach.

58. We appreciate the challenges around complex lending situations and have amended the guidance in the DTI framework to help increase clarity. While the main concept behind the rules for complex lending situations remains the same, we have strengthened the text for these rules and incorporated numerical and illustrative examples for additional clarity.

Q18: 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.

59. Some banks provided this information to us on a confidential basis and there was a degree of variation in their responses, however these were all below ten per cent. These submissions

expressed the view that a more accurate percentage estimate could be given once the framework has been finalised.

Exemption regime

Q19: 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?

60. Most submissions supported the application of an exemption regime for DTI restrictions that mirrors the current exemption regime for LVR restrictions (not including the combined collateral exemption). This proposal intends to help mitigate the efficiency costs associated with DTI restrictions and ensure they do not create barriers to new housing construction or for first-home buyers.

61. One submission that supported the proposal additionally requested that the 'construction loan' exemption be amended. The exemption in the LVR framework currently allows for the purchase of newly constructed homes at a later stage of construction or within six months of completion, from the developer. The submitter proposes this exemption be modified so that it applies to purchases within six months of completion from the original purchaser. The submitter's rationale for this request is that newly constructed properties can be sold prior to the original purchaser occupying them and preventing the exemption from including both developers and the original purchaser may limit the construction of new homes. This submitter also noted that the list of exempt categories in the consultation paper did not mention 'remediation', however this was in error and 'remediation' is included in the framework.

62. When considering the future use of differentiated limits for investors and owner-occupiers, some submissions also queried whether the 'combined collateral' exemption would be included in the DTI exemption regime. Further discussions with the submitters showed that there were differing views about whether a 'combined collateral' exemption is necessary for the DTI restrictions. Some submitters did not believe this particular exemption is as relevant to DTI restrictions as it is to LVR restrictions.

63. We intend to undertake a review of the exemption regime for both LVR and DTI restrictions to ensure they are fit-for-purpose. We acknowledge the 'construction loan' exemption category could be updated and are open to making amendments. We will also undertake analysis to determine whether the 'combined collateral' exemption category is appropriate for the DTI framework.

Structure of the DTI restrictions

Q20: 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?

64. All submissions agreed that structuring the DTI restrictions in the form of a speed limit and threshold is a sensible approach, particularly because this is an established and understood concept under the LVR restrictions. Some submitters acknowledged that a speed limit provides flexibility to lenders who want to support credit-worthy borrowers who are outside the DTI restrictions.

65. One submitter added that the use of the speed limit for complex cases was not ideal and would prefer rules for complex cases, to allow the speed limit for discretionary credit decisions and errors. The same submitter also raised concerns about the interaction between the LVR and DTI restrictions and speed limits and requested the Reserve Bank consider whether the introduction of a DTI restriction could allow LVR restrictions to be re-calibrated. One suggested recalibration was to apply a uniform LVR limit across borrower types.

66. We agree that use of the speed limit only for complex cases is not desirable and have set out some rules in the framework in order to minimise how many complex lending situations are captured in the speed limit. We also acknowledge that the introduction of a DTI restriction will need to be carefully calibrated and are currently undertaking work to analyse the possible interaction between LVR and DTI restrictions.

Q21: 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?

67. Most submissions support the use of a uniform DTI limit across all residential mortgage lending, instead of differentiated restrictions for investors and owner-occupiers. These submitters agree that a single limit would be the simplest approach.

68. When considering this proposal, one submitter highlighted that if there were to be differentiated limits in the future, the DTI exemption regime should include an equivalent of the 'combined collateral' exemption under the LVR exemption regime.

69. Another submitter noted that if the Reserve Bank chooses to implement differentiated limits at a later date, the change would require system and strategy adjustments. The same submitter also raised the point that a uniform limit across borrower and property types may have adverse effects on first-home buyers as the allocation of speed limits may favour investors.

70. The Reserve Bank continues to hold the view that a uniform DTI limit across borrower and property types is the simplest approach, particularly in the initial stages of implementation. However, we would like to retain the option of setting differentiated limits in the future if necessary. As the DTI survey is updated and new data is reported, we may see changes in the relative share of high-DTI lending to investors and owner-occupiers. If that occurs, a differentiated limit could be used to manage the impact of the restrictions on different borrowers. We appreciate that changes to the structure of the restrictions post-implementation may be complex. With that in mind, we have signalled the potential use of differentiated limits to banks so that they can prepare their systems for this possibility.

Administrative issues

Q22: 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?

71. All submissions with a view on this question support this approach. In their submission, the NZBA seeks to clarify whether the guidance around debt verification requires the balances of student loans to be verified as this is not specified in the framework.

72. We have amended the guidance around debt verification within the framework to clarify that the balances of student loans should be verified, as part of verifying all actual or intended loans held by the borrowing party.

Q23: 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?

73. There were mixed views on this proposal. One bank expressed its support for this approach, whereas another bank advocated for a six-month compliance measurement period for all banks, regardless of size.

74. The NZBA suggested a longer initial measurement period for larger banks while they adjusted to the new restrictions. This suggestion was supported by the bank who advocated for a six-month period for all banks, if the Reserve Bank continues to differentiate between bank sizes.

75. We appreciate that a longer measurement period for larger banks could be beneficial, particularly when a DTI restriction introduced. We are open to this possibility and will continue to engage with banks during their implementation of the framework to determine if a longer measurement period is appropriate.

Q24: 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?

76. The majority of submissions supported the proposal to monitor compliance with the DTI restrictions via the established DTI survey. Two banks emphasised the need for clarity around the definitions of debt and income within the DTI survey and advocated for this clarity to be provided as early as possible to assist with technology changes.

77. One property investor interest group did not agree with this proposal and felt it would create uncertainty. This submission requested that regulations be "clear, simple and fixed".

78. We will monitor compliance with the DTI restrictions using the existing DTI survey, as this is well established and understood. The DTI survey will be updated to reflect the new definitions in the framework.

Calibration of DTI restrictions

Q25: 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.

79. The NZBA submission and one bank's individual submission advise that an indicative calibration for the DTI restrictions would be helpful, particularly from a system delivery perspective. The two submissions explain that an indicative calibration would help banks to build strategies and also aid in communicating the new restrictions to customers and staff.

80. In regards to their view on a preferred calibration, these two submissions suggest that the calibration should be at a level that is appropriate in the prevailing market.

81. Another bank submits that an indicative starting calibration would not be helpful in regards to systems development. This submitter believes that an indicative calibration could cause confusion and create additional technological work. This bank would prefer the DTI restriction to be calibrated at the time of commencement.

82. The Reserve Bank will not be providing an indicative starting calibration at this stage, as we do not yet have data using the new definitions in the DTI framework. However, we will monitor and assess the data as it is collected and may provide an early indication of calibration closer to commencement of the restrictions. Banks are able to set their own starting calibration if that is useful for implementation, and we can provide banks with more reported data about their position, relative to others, for high-DTI lending.

Assessment of impacts

Q26: Do you agree with our assessment of the draft DTI framework proposals against the FPR requirements?

83. Two submissions provided a response to this question and both agreed the Reserve Bank assessment of the draft DTI framework against the priorities within the Financial Policy Remit (FPR) is accurate.

Q27: 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.

84. Some submissions from the banking industry provided an indication of their expected regulatory costs, on a confidential basis. Those that provided a view advised that it is difficult to estimate costs until the framework has been finalised. Some submissions noted that costs would extend beyond system changes, and include educating staff and customers about the new DTI restrictions.

Q28: Are there any changes that could be made to the draft framework that would further reduce regulatory costs for banks?

85. One submission advised that changes to the framework in the future, such as introducing differentiated speed limits, would likely require a significant amount of work, and incur additional regulatory costs for banks. This submission noted that banks have experienced changes to the LVR restrictions and predict that changes to the DTI restrictions post-implementation would be difficult to manage. The submission advocated for avoiding changes to the DTI framework once it has been implemented.

86. The same submission also emphasised that receiving guidance on any changes to the DTI survey requirements would assist in accommodating DTI reporting as part of the implementation.

87. One submission reiterated their view from the DSRs consultation that a test interest rate floor would be a more cost-efficient way to meet the Reserve Bank's policy objectives. This view is out of scope of the current consultation, which is focused on technical design matters. Our rationale for preferring a DTI restriction rather than an interest rate floor is discussed in our previous consultations.

Q29: 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?

88. The NZBA submission acknowledged the increased risk of adverse impacts on groups such as Māori, Pacific Peoples and migrant communities who may have lower incomes and a reduced capacity to save larger deposits. This submission raised concerns that the

interaction between LVR, CCCFA and a new DTI regulation may compound the impact on these communities.

89. The NZBA and one bank submission also emphasised that the impact of the framework would depend on the specific calibration of the DTI restrictions and associated speed limit. The submissions point out that lending institutions may choose to favour allocating the speed limit to investors, which could disadvantage first-home buyers. This could create a conflict with the Financial Policy Remit's requirement to improve affordability for first-home buyers.

90. Finally, the NZBA submission highlights that there is an additional risk to financial inclusion, particularly if the complexity of the framework makes it difficult to communicate and understand.

91. The Reserve Bank appreciates the submissions' concerns around the impact of DTI restrictions on financial inclusion. DTI limits are not intended to bind heavily on low-income borrowers or first-home buyers, and this is supported by our analysis which shows investors tend to borrow at higher DTI ratios. In case the data shows a change from this trend in the future, we have retained the option to impose differentiated limits for investors and owner-occupiers which may mitigate impacts on vulnerable borrowers and first-home buyers. We acknowledge that the exact calibration of the DTI restrictions will influence their level of impact and will consider this carefully during the calibration stage.

Part Two: Other matters raised in submissions

Format and structure of the framework

92. One submitter advised that the simplicity, understanding and application of the framework could be enhanced by reordering the sections of the document. The submitter highlighted sections of the framework that were particularly confusing, such as 'Complex lending situations' and provided an alternative order for the document to help increase clarity.

93. We appreciate the need for simplicity and clarity within the framework document and have amended the format and structure of the framework to reflect the suggested changes.

The use of examples and visuals

94. Some submissions suggested that the use of illustrative examples and visuals (such as diagrams) could assist in communicating the rules in the framework. For example, the NZBA suggested using a "waterfall" diagram to demonstrate how business income should be calculated. Another submission mentioned that practical examples throughout the framework would be a useful resource to banks when training their staff on the DTI framework. The submission also pointed out that illustrative examples could minimise inconsistency and confusion across banks.

95. We appreciate the suggested improvements to the framework and understand how explanatory guidance can improve understanding of the rules. In response to this, we have incorporated further numerical and illustrative examples, where appropriate.