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18 August 2017

Dear Bernard,

RBNZ CONSULTATION PAPER: SERVICEABILITY RESTRICTIONS AS A POTENTIAL MACROPRUDENTIAL TOOL IN NEW ZEALAND

ASB Bank Limited (ASB) welcomes the opportunity to provide feedback on the Reserve Bank *debt to income (DTI) limit consultation.*

ASB is a subsidiary of Commonwealth Bank of Australia and a related company of Sovereign Assurance Company Limited. ASB does not seek confidentiality for any aspect of this submission.

This submission makes some general comments on the issues raised in the consultation paper, set out below.

The objective of the Reserve Bank's macro-prudential toolkit is to increase the resilience of the domestic financial system. As such, the interventions available in the toolkit should be able to provide mitigants to the risks that financial system participants are exposed to that could impact financial stability, and those tools should only be used when there is evidence that the risk to overall financial stability is unacceptable.

The loan-to-valuation (LVR) restrictions introduced in 2013 were aimed at reducing the risks to the banking sector and providing financial stability by protecting the system from unacceptable disruption via bank balance sheet loss if there were to be a large fall in house prices. Given that potential loss severity experienced by a lender increases with higher LVR, this is a reasonable action if the Reserve Bank judged the proportion of high LVR lending on bank balance sheets to be too high. Bank disclosure statements since the LVR restriction introduction show a reduction in the proportion of mortgage assets that have high LVRs. It is reasonable to conclude that the LVR restrictions have increased the resilience of the domestic financial system as bank balance sheets are now more protected from loss if house prices fall. In this case, there is a clear link between the risk (falling house prices) and the tool used as a mitigant (LVR restriction) to control the consequence (e.g. loss) if this risk occurs.

Compared to the LVR restrictions, it is less clear to us how the contemplated DTI restrictions will provide protection from a known risk and therefore provide for increased resilience of the domestic financial system. Given that DTI is known to be a very crude measure of affordability, presumably the risk that the Reserve Bank is targeting with the contemplated DTI restrictions is the default potential of borrowers if interest rates or unemployment rise. The issue here is that DTI *in isolation* is not good determinant of affordability and therefore implementing restrictions

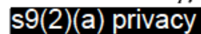
is very unlikely to protect against borrower default risk of rising interest rates or unemployment. Although a crude DTI measure gives some indication of risk (e.g., if all else was equal between two borrowers, then a lower DTI would represent lower risk), we would never consider assessing a customer's ability to service a loan based on DTI alone. In order to ensure loan portfolios are resilient to interest rate shocks we conduct holistic servicing assessments to take individual borrower circumstances into account and apply servicing test rate buffers to ensure borrowers can continue to meet their repayment obligations in periods of rising interest rates.

To this end, we do not consider that the Reserve bank has adequately demonstrated what risk high DTIs in isolation pose to the overall financial system, or quantified the sort of DTI levels that would create that systemic risk in order to justify adding DTI restrictions to their macro-prudential toolkit. Our experience leads us to suggest it is perhaps more appropriate for the Reserve Bank to play a larger role in benchmarking the servicing assessment processes of the banks in order to provide for system strength rather than continuing to pursue DTI restrictions.

Note that we do not believe that DTI restrictions, or any other macro-prudential intervention, should be deployed solely to ration credit in an attempt to moderate house price increases.

If you require any further information in relation to this submission, please do not hesitate to contact me.

Yours sincerely,



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Victoria Johnstone
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