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17th August 2017

Attention:
Head of Macro-Financial Department
Reserve Bank of New Zealand
P O Box 24989
Wellington 6140

Dear,

Submission on the Consultation Paper:
Serviceability Restrictions as a Potential Macro-Prudential Tool in New Zealand

Thank you for the opportunity to comment on your consultation paper dated June 2017. We appreciate the opportunity to respond and outline our comments for your consideration below.

Summary

The Co-operative Bank (Co-op Bank) is supportive of the Reserve Bank requirements to have a framework that enables it assist with financial stability within NZ. The Co-op Bank however does not believe the Reserve Bank has explored all possibilities and that its proposed implementation of DTI as a tool is a very blunt instrument that is unproven in its ability to effectively manage financial stability.

Responses to RBNZ questions

Q1: Do you have any comments on the evidence that high DTI borrowers are more susceptible to mortgage default and consumption stress? Are there other relevant studies, or other relevant channels through which a DTI policy would influence financial stability?

NZ Banks have for many years implemented both affordability and LVR measures to manage their customer bases. The use of these restrictions is not a new phenomenon.

The RBNZ utilises examples from Ireland and the United Kingdom to represent the need to implement DTI these examples would to hold lower relevance to the case to the need than the RBNZ expresses.

The United Kingdom uses a loan-to-income (LTI) approach, rather than a total debt to total gross income approach. This means that only the borrowing associated with a specific mortgage is taken into account for the calculation, as opposed to total customer debt (eg credit card debt, vehicle loans, personal loans, store cards, hire purchases, etc).

Additionally, the Bank of England Prudential Regulation Authority excludes buy-to-let (residential investment) mortgages from its LTI restrictions. Based on data provided by the RBNZ in their May 2017 Financial Stability Report a greater level of investor loans in NZ have a higher Debt to Income ratio than owner occupied loans therefore implementation of this tool in others jurisdictions appears to be a different stability need that that implied as creating a higher risk in NZ.

Q2: Do you agree that the current levels of debt (relative to income) that some borrowers are able to borrow risk putting them under pressure, especially if interest rates rise? Why are the DTIs achievable in New Zealand apparently higher than in other markets like the UK?

Customers regardless of current income have changes in circumstances that mean the borrowing they do today could cause them stress in the future at any interest rate.

NZ customers are heavy uses of fixed rate mortgages this enable then to build a resilience and buffer against rapid interest rate rises against their income. One other function of an Owner Occupied salary earning customer's is their disposable income when considering a post-tax position. In NZ tax rates are at lower rates than those in many OECD countries including the UK. This provides customers with an additional buffer against the top tax rate of 7% of income that can be used for mortgage repayment or discretionary spending creating an additional buffer in the NZ environment.

As indicated in the May 2017 RBNZ Financial stability report the highest users of high DTI are investors. Most Banks in NZ allow for income haircuts against investor income creating an additional buffer in the serving assessment of providing lending. This is one reason that customer may be more resilient than the UK where this practice varies.

Q3: Do you agree with our assessment of other possible policies that are under the Reserve Bank's control, or do you think one or more of them could be preferable to DTI limits? Are there other policy options under the Reserve Bank's control that we haven't listed that could be relevant?

We agree the RBNZ already has an extensive number of alternatives to DTI and the LVR approach appears to be currently resulting in the outcome the RBNZ is looking in slowing the Housing Market along with increasing the stability of the Registered Banks in NZ.

Q4: If a DTI policy was used, what would be the challenges and issues that could arise in the detailed rules and (for lenders and the Reserve Bank) monitoring compliance with the policy?

Loan to Valve is a relatively simple measure however DTI is much more complicated especially in relation to small business where income is not a straight measure. As the measure for income is not standard the income provided for Banks' to assess a customer servicing for home lending may vary and therefore is open to interpretation between banks. The RBNZ has already identified this as potential issue but has also indicated that Banks' need to collect all a customer income information not just that required for the Home Lending purpose to ensure a more complete picture of NZ household DTI ratio. Not having this complete picture could result in the RBNZ creating an incorrect setting of any of the limits imposed.

That being said the RBNZ has created on Banks' a requirement that whether this policy is implemented or not Banks will be required to increase their data collection on customer's income. This requirement has been made to Banks separate to this public consultation.

The ability for NZ Banks to access standard income information from the Inland Revenue Department (IRD) is not current allowed and is not on the RBNZ's radar to lobby for enabling consistent information for Government consumption.

In the US crisis referred to by the RBNZ non-bank underwriters made more than 12 million subprime mortgages with a value of nearly $2 trillion. The lenders who made these were exempt from federal regulations. This additional level of unregulated supply is said to have created the beginning of the collapse.

Non RBNZ regulated financial entities again will have greater opportunity and incentive to continuing entering the market unopposed and should be monitored by the RBNZ similar to registered Banks. Some have already openly indicated the increased opportunity they have due to the continued restriction being applied to Registered Banks. By not regulating these entities the RBNZ is not able to manage a complete picture of the level of household indebtness for financial stability purposes.

Q5: Do you agree that a DTI policy (if implemented) should be broadly as described above (a speed limit, with similar exemptions to the LVR policy)? Are there other design options or additional exemptions (besides the suggestion described above for relatively inexpensive owner occupied homes) that would be worth considering?

The Co-operative does not see the justification in the RBNZ argument that exemptions should be similar to LVR policy. An affordability measure would need exemptions that relate to income types due to the nature of what may cause a customer to have a higher than normal DTI.

An example of an exemption that is not supported is construction in considering this a customer's ability to afford additional costs should overruns occur in construction would place further strain on finances and therefore the RBNZ stance would provide a message to the consumer that the risks involved in construction are not as great other borrowing which is not correct.

Q6: Do you agree with our assessment of the impacts of a DTI policy as described on the housing market – in particular, that it would not materially affect construction, and would if anything tend to increase the home ownership rate? Are there other potential consequences of the policy for the housing market that we have not discussed?)

If the RBNZ were to make construction lending exempt it would not be materially impacted however the RBNZ is indicating by creating this exemption that the construction sector could in fact have a lower risk impact on the overall finance sector which was not proven to be the case in the last financial crisis given the level of borrowing non regulated financial institutions provided to this sector

Q7: Please comment on the Reserve Bank's analysis of the potential costs and benefits of a DTI policy. Do you see other material costs or benefits, or have views about the magnitudes of the costs and benefits or the method used to derive them?

Although the RBNZ quotes the use of macro policies across a number of countries in nearly all of these example the policies have been implemented but never removed. The full impact of implementation and the material cost on economies is unknown as a result.

Kind Regards

Grant Allerby
Head of Credit
The Co-operative Bank