Reserve Bank of New Zealand
Te Pūtea Matua

Framework for Debt-to-Income Restrictions – Design Elements and Exposure Draft

Consultation Paper

9 November 2022

Non-Technical Summary

Debt-to-Income (DTI) restrictions – what are they?

DTI restrictions on residential mortgage lending set limits on the amount of debt borrowers can take on relative to their income. They can help to support financial stability and sustainable house prices by reducing the risk of 'boom-bust' credit cycles that amplify downturns in the real economy. DTI restrictions complement other tools we use to support financial stability, including loan-to-value ratio (LVR) restrictions on residential mortgage lending.

What is the purpose of this consultation?

This consultation focuses on the technical design aspects of the regulatory framework for DTI restrictions. Rules on these design matters need to be agreed before banks can begin making the systems changes required to allow implementation of DTI restrictions. We are publishing the draft regulatory framework for comment alongside this consultation paper.

The draft framework includes our provisional views on the following design issues:

- How banks should measure income and debt when they calculate DTI ratios;
- How banks should deal with complex lending situations such as multiple borrowers;
- Whether there should be exemptions to the DTI restrictions; and
- Whether DTI restrictions should be the same or different depending on the type of property (for example, investment or owner-occupied).

When will DTI restrictions be implemented?

We have not made a decision to activate DTI restrictions yet. Once the framework is in place and banks' systems are ready, changes to banks' Conditions of Registration would be needed to activate the restrictions. Banks have told us they need around 12 months to prepare their systems for possible implementation of DTI restrictions. If we do decide to implement DTI restrictions, the earliest date we could do so is likely to be March 2024.

How would DTI restrictions affect first-home buyers?

The impacts of DTI restrictions depend in part on how they are calibrated. We will consult on calibration separately once the framework is agreed. However, our analysis indicates that DTI restrictions will impact more heavily on investors and higher-income homebuyers, who borrow at higher DTI ratios on average. Our Memorandum of Understanding with the Minister of Finance on macroprudential policy requires us have regard to avoiding negative impacts, as much as possible, on first-home buyers, to the extent consistent with our financial stability objectives. We are also required to have regard to financial inclusion more generally under our Financial Policy Remit.

What do you think?

Please let us know your views on the questions set out in the Consultation Paper. You can send these to us by email to macroprudential@rbnz.govt.nz (with the subject line 'DTI Framework Consultation 2022'), or in writing to:

Cavan O'Connor-Close
Prudential Policy Department
Reserve Bank of New Zealand
PO Box 2498, Wellington 6140

The deadline for submissions is 5pm on 14 December 2022.

Publication of submissions

All information in submissions will be made public unless you indicate you would like all or part of your submission to remain confidential. Respondents who would like part of their submission to remain confidential should provide both a confidential and public version of their submission. Apart from redactions of the information to be withheld (i.e. blacking out of text) the two versions should be identical. Respondents should ensure that redacted information is not able to be recovered electronically from the document, the redacted version will be published as received.

Respondents who request that all or part of their submission be treated as confidential should provide reasons why this information should be withheld if a request is made for it under the Official Information Act 1982 (OIA). These reasons should refer to Section 105 of the Banking (Prudential Supervision) Act 1989, section 54 of the Non-Bank Deposit Takers Act, section 135 of the Insurance (Prudential) Supervision Act 2010 (as applicable); or the grounds for withholding information under the OIA. If an OIA request for redacted information is made, we will make our own assessment of what must be released taking into account the respondent's views.

We may also publish an anonymised summary of the responses received in respect of this consultation paper.

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Executive Summary

1. In November 2021, the Reserve Bank of New Zealand - Te Pūtea Matua consulted on debt serviceability restrictions (DSRs) on residential mortgage lending.[1] We sought feedback on the merits and potential design of two types of DSRs: restrictions on debt-to-income (DTI) ratios, and a floor on the test interest rates used by banks in their serviceability assessments.

2. DSRs are macroprudential policy tools. We use 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. The main macroprudential tool that has been used by the Reserve Bank to date is loan-to-value ratio (LVR) restrictions on mortgage lending. However, LVR restrictions mainly relate to one dimension of lending risk – the loss given default or LGD. The other key dimension relates to the borrower's capacity to service a loan, which in turn affects the probability of default (PD). DSRs are the main macroprudential instrument used internationally to address this second dimension of housing-related systemic risk.

3. 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 by comparison with investors and existing owner-occupiers.

4. Following consideration of the responses to the consultation, we announced on 27 April 2022 that we intended to proceed with designing a framework for operationalising DTI restrictions, following further consultation with industry and other stakeholders. Since that time we have held a series of bilateral meetings with banks, as well as an industry-wide workshop in September, to discuss design issues related to the DTI framework.

5. We have now prepared an exposure draft of the regulatory framework for DTI restrictions, which will form part of the Banking Supervision Handbook once finalised. The exposure draft is attached to this consultation paper. The consultation paper provides additional context regarding the key design features of the draft DTI framework, and highlights points where we particularly wish to seek submitters' views.

6. We are allowing a five week consultation period with comments on the exposure draft due on 14 December. Although this is shorter than our standard consultation period of eight weeks, we note that the current consultation focuses largely on technical design features, following the April 2022 decision to proceed with designing a framework for DTI restrictions. In addition, we have engaged extensively with banks in the course of developing the draft framework, which has been very helpful in refining our views. We appreciate the extensive input from all involved.

[1] https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/debt-serviceability-restrictions/debt-serviceability-consultation.pdf

7. Our discussions with banks to date have indicated that they will require adequate lead time to prepare for the potential implementation DTI restrictions, including updating their IT systems and training front line staff. We intend to allow around 12 months for banks to prepare once the final version of the DTI framework has been agreed. The earliest possible implementation date for DTI restrictions is therefore likely to be March 2024.

8. It should be noted that the framework does not activate DTI restrictions or set a calibration for DTI restrictions at this stage. We intend to consult separately on calibration in 2023, prior to any decision to activate the restrictions via changes to banks' Conditions of Registration (CoR). As part of the calibration exercise, we intend to undertake modelling analysis to better understand the potential impacts of different DTI settings, including interactions with other policies such as the LVR restrictions.

9. Some banks have said to us that it would be helpful to have an indicative starting calibration for the DTI restrictions, set at a non-binding level, to assist them with developing their internal systems. We welcome additional feedback on this suggestion in the responses to this consultation.

Background

10. As set out in our macroprudential policy framework document[2], the purpose of macroprudential policy is 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.

11. In February 2021, the Government issued a direction under Section 68B of the Reserve Bank Act (the S68B) requiring us to have regard to housing policy objectives when exercising our financial stability powers – in particular, to *"support more sustainable house prices, including by dampening investor demand for existing housing stock which would improve affordability for first home buyers"*. The S68B has now been repealed, but the Financial Policy Remit (FPR) requires us to have regard to a similar housing policy objective.[3]

12. 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[4]. The tools comprise:

    - Capital/liquidity instruments: core funding ratios (CFR), the counter-cyclical capital buffer (CCyB), and sectoral capital requirements (SCR); and

    - Borrower-based instruments: loan-to-value ratio (LVR) restrictions and debt serviceability restrictions (DSRs) on residential mortgage lending.

2. DSRs were added to the macroprudential MoU in August 2021, following advice we provided to the Minister of Finance in May 2021 on policy options to support sustainable house prices. The MoU states that in the design and implementation of a DSR, we will have regard to avoiding negative impacts, as much as possible, on first-home buyers, to the extent consistent with our financial stability objectives.

Consultation on DSRs

13. In November 2021 we issued a consultation paper[5] 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.

14. Our assessment of the impacts of the two tools indicated that DTI restrictions were likely to be more effective than test rate floors in supporting financial stability and sustainable

[2] https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Background%20papers/Macroprudential-policy-framework.pdf
[3] https://www.rbnz.govt.nz/about-us/responsibility-and-accountability/our-financial-policy-remit
[4] https://www.rbnz.govt.nz/regulation-and-supervision/banks/macro-prudential-policy/mou-between-minister-of-finance-and-governor-of-rbnz
[5] https://www.rbnz.govt.nz/hub/news/2021/11/views-sought-on-debt-servicing-restrictions-framework

house prices. DTI limits link credit availability to income growth and hence can be more effective in constraining debt levels over a longer period than other macroprudential tools. DTI restrictions can also be calibrated so that there are minimal impacts on first-home buyers, since first-home buyers borrower at lower DTI multiples on average while investors borrow at the highest DTI multiples.

15. Our analysis also suggested that DTI limits can create efficiency costs by impeding access to credit for otherwise creditworthy borrowers, and may create a modest drag on economic activity in the short term. However, we found that these costs would be outweighed by benefits to financial stability over the longer term, with respect to moderating housing cycles and strengthening borrower resilience.

16. In April 2022, following consideration of submissions on the consultation, we announced our intention to proceed with designing a framework for operationalising DTI restrictions, in consultation with the industry and other stakeholders. We also stated that we did not see an urgent need to impose an interim test rate floor, given signs that the housing market was cooling and that other regulatory changes (including the new CCCFA regulations, tighter LVR restrictions on owner-occupiers, and changes to the tax treatment of rental property) were having an impact on the availability of mortgage credit.

17. Since the April announcement, we have held bilateral meetings with a number of banks as well as an industry-wide workshop to discuss issues related to design of the DTI framework. Feedback from these meetings has been very helpful in informing this consultation document and the accompanying exposure draft. We appreciate the extensive input from all involved.

Key design features

18. DTI limits are conceptually straightforward, as they are calculated based on a simple ratio of borrower debt divided by borrower income. However, as we noted in our initial consultation, there are a number of design questions that need to be decided before a DTI limit can be implemented. These include:

    - The treatment of different types of personal income (e.g. wage/salary, rental income), and whether income should be measured as gross or net;
    - The treatment of different types of personal debt (e.g. mortgages, student loan debt);
    - The treatment of business debt and business income;
    - The treatment of complex lending situations, where it may be difficult to calculate a DTI ratio;
    - Whether exemptions to the DTI restrictions should apply, as they do for the LVR restrictions;
    - Whether the DTI restrictions should include 'speed limits', which enable lenders to undertake some lending at DTI ratios above the cap; and

- Whether the DTI restriction should be uniform, or differentiated by borrower or property type (e.g. owner-occupiers vs investors).

19. Our position on these design issues is summarised below, and reflected in the text of the attached draft framework. In coming to our views on these design issues, we have endeavoured to adopt approaches that are as simple as possible, in order to minimise implementation and administrative costs. We have also sought to remain consistent with our statutory objective of protecting and promoting the stability of New Zealand's financial system, as well as having regard to impacts on the Government's other policy priorities as set out in our Financial Policy Remit.

Treatment of personal income

Gross vs net income

20. We propose to measure income on a gross (pre-tax) basis, in line with the approach currently followed in the DTI survey. Gross income has the advantage of simplicity, and is also independent of future taxation changes, such as the recent changes to the tax treatment of rental property.

Types of income

21. We propose to allow all forms of personal income to be included within the DTI calculation, including wages and salaries, rental income, boarder income, investment income, foreign income, bonus income, and income from Government benefits.

22. Business income will also be included, to the extent that it is available to service residential mortgage debt and other personal debt. Specific issues related to the treatment of business debt and income are discussed further below.

Income weightings

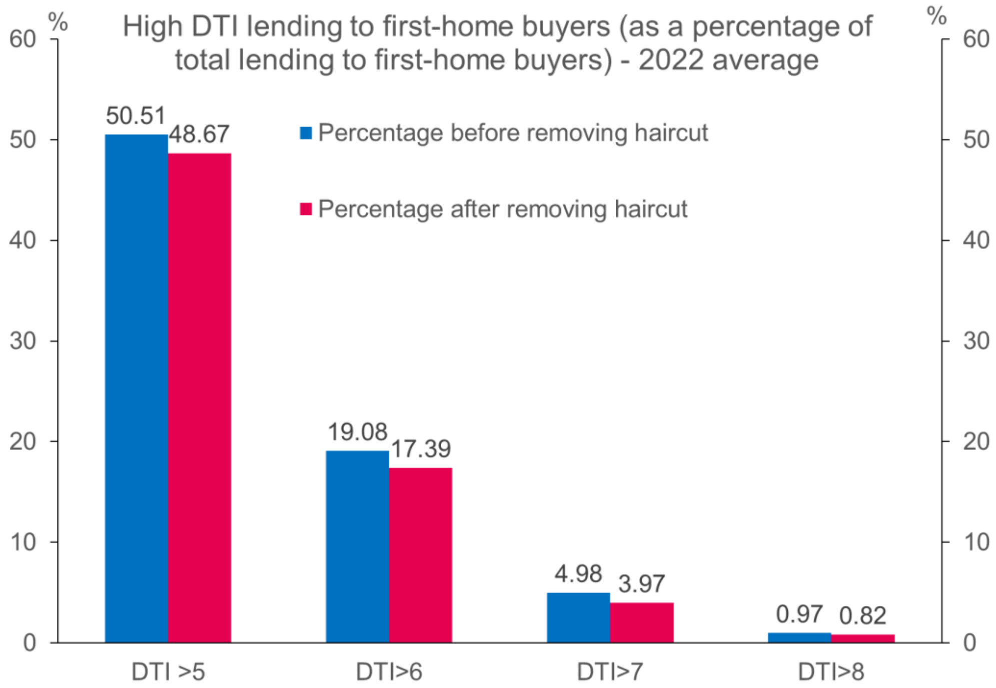
23. We do not propose to apply weightings or 'haircuts' to different types of income when calculating the DTI ratio. Using an unweighted income measure is the simplest approach and ensures consistency across banks and borrowers. Banks may still decide to apply weightings to different types of income as part of their internal serviceability assessments.

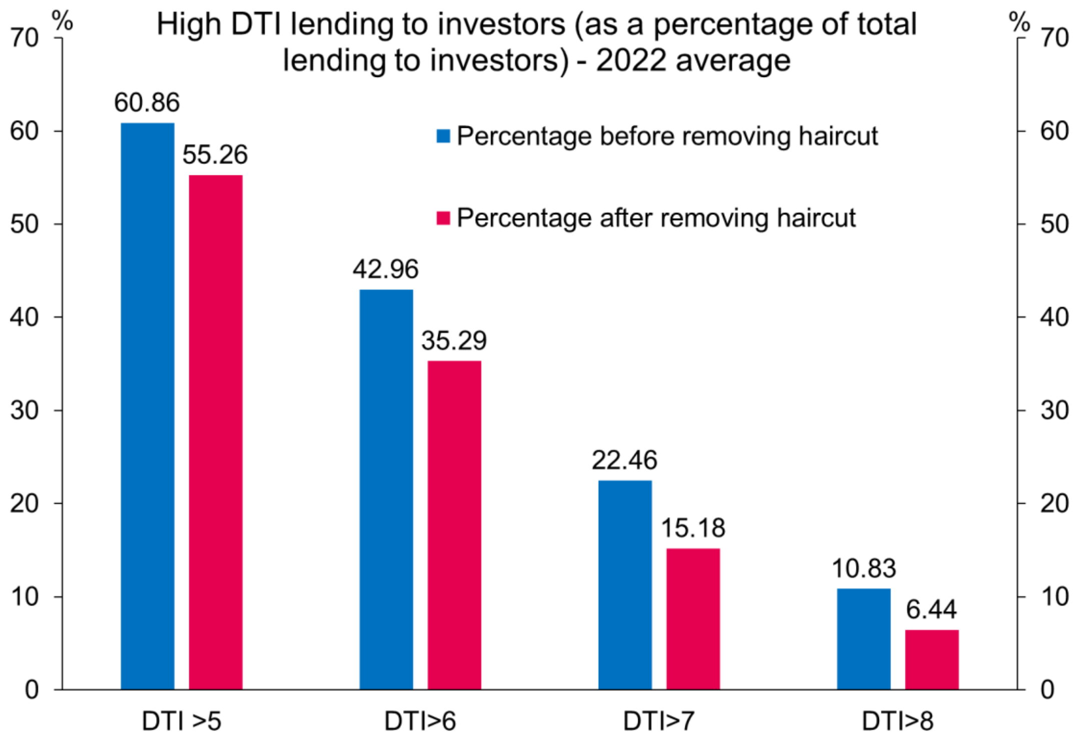
24. We note that removing haircuts on rental income is expected to lead to a reduction in the measured DTI ratio for borrowers with investment property, relative to the data we currently collect via the DTI survey, in which rental income is subject to a haircut of 25 percent. As shown in Figures 1 to 3 below, our analysis indicates that even with haircuts removed, investors still account for the large majority of lending at high DTIs, while first-home buyers account for a small share. This is aligned with the Government's housing policy objective in the FPR and with the macroprudential MoU.

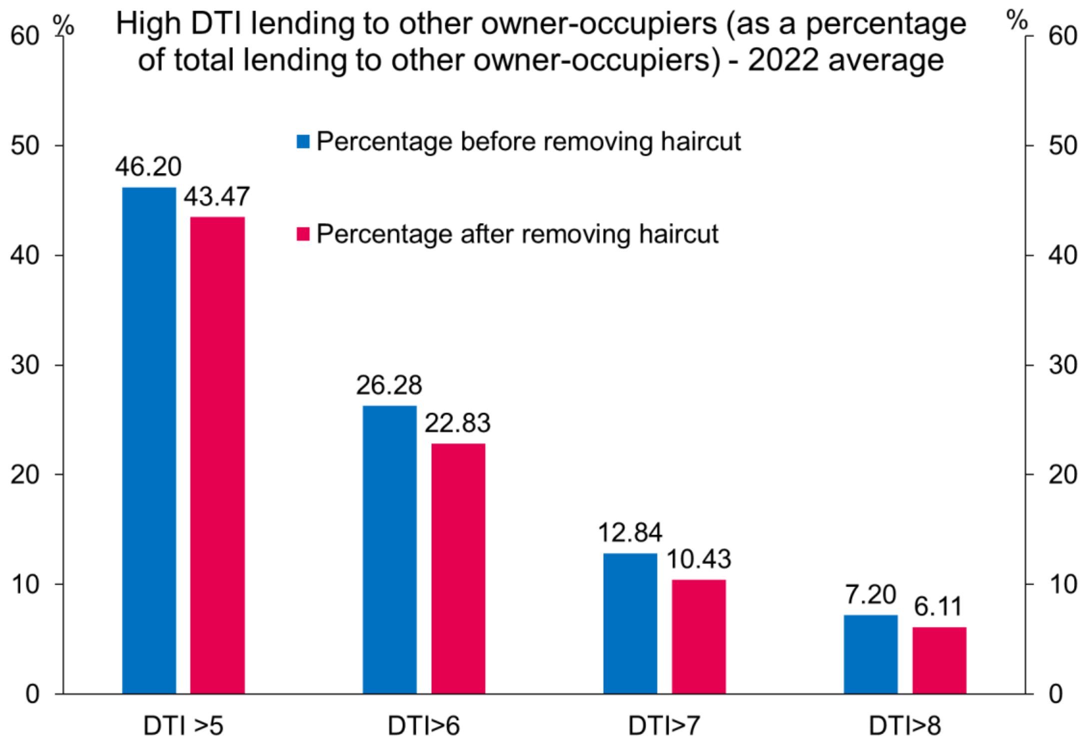
25. Although we do not intend to apply income haircuts at this stage, the wording of the draft framework provides us with the option to introduce haircuts in future, via changes to banks Conditions of Registration (CoR). Haircuts could be used to adjust the relative impact of DTI restrictions on investors and first-home buyers if necessary, for example in response to

changes to borrowing patterns and hence the relative impacts of DTI restrictions on different borrower groups.

Figures 1 to 3 – high-DTI lending by borrower group, with and without income haircuts







Source: RBNZ DTI Survey and RBNZ estimates

Measurement of variable income

26. Some types of income, particularly wages and salaries, are generally stable over time. However, other types of income such as commissions and bonuses can vary from year to year. This raises the question of how banks should measure variable income when calculating DTI ratios.

27. We have considered two options for the measurement of variable income. One is to allow banks to apply their own internal lending policies. This could lead to some variation across banks in the calculation of DTI ratios for similar borrowers. However, we note that variable income accounts for only a small proportion of total income.

28. Alternatively, we could set rules for how variable income is to be measured. For example, we could state that lenders must measure variable income based on the prior 12 months of earnings.

29. The current draft framework reflects the first approach, i.e. allow banks to apply their own internal policies. However, we are aware that this could lead to variation in DTI calculations across banks. We would welcome feedback on this issue, including on the measurement period that should be used if we set a rule regarding assessment of variable income.

Questions regarding personal income

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

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

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?

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.

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?

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?

Treatment of personal debt

30. We propose to include all forms of personal debt within the DTI calculation. For example, this would include mortgage debt, credit card debt, personal loans, and student loans. As with income, we propose to use an unweighted measure of debt where all types of personal debt are counted equally in the DTI calculation.

31. We note that some banks currently report student loans as a deduction from income, rather than as debt. There are arguments in favour of both approaches. However, for simplicity we propose to include student loans as personal debt, but not require expense deductions to gross income for student loan repayments.

32. Borrowers with student loans are subject to relatively high repayment deductions from their gross income[6], regardless of the size of their student loan balance. Therefore, for most borrowers with student loans, calculating DTI ratios based on income deductions would lead to higher DTIs than reporting student loans as debt. This in turn could create a barrier to credit availability for borrowers with student loans, including first-home buyers. This consideration further supports our proposal to include student loans within debt rather than as a deduction from income, in light of our obligations under the Financial Policy Remit to have regard to impacts on first-home buyers and financial inclusion.

33. One form of personal debt that may warrant different treatment is 'Buy Now Pay Later' (BNPL). In our discussions with banks, some have stated that they treat BNPL as an expense rather than debt. This is because it can be difficult to calculate borrowing limits under BNPL, and also BNPL is not currently included in the information held by credit agencies. Banks have also noted that in most cases BNPL accounts for only a very small proportion of total debt.

34. For these reasons, our current view is that BNPL can be excluded from the DTI calculation and the draft framework reflects this. However, we welcome feedback on this point.

[6] Currently 12 percent of gross income above the repayment threshold of $21,268 per annum.

Questions regarding personal debt

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

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

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

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?

Treatment of business debt and income

35. The purpose of DTI restrictions, as set out in the macroprudential MoU, is to reduce systemic risk associated with residential mortgage lending. Therefore, we consider that business debt should generally be excluded from the DTI calculation when it is held separately from mortgage debt.

36. However, where business income is being used to service residential mortgage lending, this income should be included in the DTI calculation. We have considered two main options with respect to the treatment of business income:

    a. Include business income only if and when it is taken as personal income – for example via dividends, a shareholder salary, or self-employed income in the case of sole traders or partnerships.

    b. Include taxable business profits, regardless of whether the profits are taken as personal income or retained within the business. Taxable profits would exclude interest payments on business debt, as these are normally treated as a business expense. For businesses with more than one shareholder, profits would reflect the borrower's equity share in the business.

37. There are arguments for and against both approaches, but on balance we favour approach (b) and this is reflected in the draft framework. Approach (b) allows for flexibility regarding how profits are allocated between business and personal income, which may be particularly important for smaller businesses.

38. If we adopt approach (b), some further questions that could arise include:

    - Whether principal payments on business debt should also be deducted when calculating the business income that is available for mortgage servicing;

    - Whether forecasts of future business income should be permitted, or only actual income.

39. We have not come to a firm view on these points and welcome feedback from respondents. Provisionally, we are minded to deduct principal payments on business debt from the calculation of business income, as these directly reduce the amount of income available to service residential mortgage debt. We are minded not to allow forecasts of

future business income to be permitted, as it would introduce too much uncertainty into the calculation – but we note that the speed limit could be used to accommodate customers with high levels of forecast business income.

40. We note that there may be cases where it is difficult to fully separate business debt from residential mortgage debt, for example in the case of farms. In these cases, we have again considered two options:

    a. Include business debt in total debt, and measure business income based on gross earnings after expenses – but *exclude* interest payments on business debt, to avoid double counting.

    b. Do not specify rules for cases where business and residential debt are difficult to separate, but instead allow such lending to be included within the general speed limit (speed limits will be discussed further below).

41. Again, there are arguments for and against both approaches. Whether the additional complexity of using option (a) is warranted depends in part on the amount of lending involved – if the amount is small, option (b) may be preferable for simplicity.

Questions regarding business debt and income

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

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

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?

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

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?

Complex lending situations

Background

42. Complex lending situations are those where it may be difficult for lenders to calculate a DTI ratio. There are two main potential sources of complexity: firstly, complex structures such as trusts and look-through companies (LTCs); and secondly, situations with multiple borrowers and multiple properties, particularly where the borrowing entities are interlinked but do not fully overlap. Examples of multiple borrower/multiple property situations, ranging from less to more complex, include:

    a. A couple owns an owner-occupied property jointly, and one of them wishes to purchase an investment property separately (or vice versa).

b. Two friends, A, and B, own an investment property jointly with rental income from the property and mortgage expenses split equally. A wishes to purchase another investment property separately, while B wishes to purchase an owner-occupier property jointly with their partner.

c. Similar to (b) but with more borrowers and properties, and the potential addition of complex structures. For example, six individuals hold varying shares in three LTCs, which hold a portfolio of 10 investment properties in total. Three of the individuals also have owner-occupied property, and one of these properties is held in a family trust.

43. Depending on where boundaries are drawn, complex lending situations may account for between five and ten percent of all residential mortgage lending. There is also significant variation across lenders, with the large banks accounting for the bulk of complex lending.

Options

44. We have considered three broad options for the treatment of complex lending situations, and discussed these extensively with industry stakeholders. The options are:

a. **Create a specific exemption** from the DTI restrictions for complex lending situations.

b. **Allocate complex lending to a general speed limit**, and when calibrating the speed limit, ensure that it is sufficiently large to cover complex lending situations.

c. **Develop a set rules or guidance** for the calculation of DTI ratios in complex lending situations.

Exemption

45. In principle, there are reasonable arguments for creating a specific exemption for complex lending, rather than allocating such lending into the speed limit. This is primarily because complex lending typically involves sophisticated borrowers with high incomes and/or net wealth, and hence in many cases does not present a material financial stability risk. By contrast, the main purpose of the speed limit is to allow banks some flexibility to provide high-DTI lending to their customers in order to reduce efficiency costs and undue barriers to credit from imposing DTI restrictions.

46. However, we have two main concerns with creating a specific exemption for complex lending situations. The first is that it is difficult to draw a precise boundary around which situations would be classed as complex. The second is that having an exemption could incentivise borrowers to deliberately create complex lending arrangements in order to avoid the DTI restrictions. Although this could be addressed in part via anti-avoidance provisions and monitoring, this would create additional complexity and potential uncertainty for lenders.

Speed limit

47. Allocating complex lending to a general speed limit is likely to be the most straightforward approach. However, as noted above, the purpose of the speed limit is primarily to reduce efficiency costs by allowing banks discretion to undertake some lending at high DTI ratios.

48. In addition, variation across banks with respect to complex lending may pose challenges for the speed limit approach. If the speed limit is made large enough to include all complex lending – as well as an allowance for high DTI lending – banks who do more complex lending may be disadvantaged relative to banks who do less.

Rules-based approach

49. Based on our analysis and discussions with banks, we believe it is possible to develop a set of rules that would cover some of types of complex lending. However, creating rules for all possible types of complex lending would be very challenging given the wide range of potential scenarios involved.

Preferred option

50. Based on the above assessment, we are minded to adopt a combination of approach (b) and (c) above for the treatment of complex lending situations. Specifically, we have drafted a set of rules that we consider should cover a significant share (50 percent or more) of complex situations. For the remainder of situations, which we refer to as 'very complex', lending would be allocated to the general speed limit. We welcome feedback on these rules, which are reflected in the draft framework and summarised below.

Rules for complex structures

51. For complex lending structures, our general approach is that the DTI calculation should be based on the relevant debt and income of the individuals who are ultimately responsible for servicing the debt. This means that in most cases, the use of complex structures should not of itself lead to a different DTI ratio, by comparison with a situation where properties are purchased by individual borrowers.

52. For example, if two friends own an investment property via an LTC, the DTI ratio should be the same as if the two friends owned the same property as (joint) individuals. If a family with two parents and two children have an owner-occupied home which is held within a family trust, but the parents have ultimate responsibility for servicing borrowing on the home, the DTI ratio should be calculated based on the parents' total debt and income, including the mortgage debt held within the family trust.

Rules for multiple-borrower / multiple-property lending

53. For multi-borrower / multi-property lending, our proposed approach is as follows. Firstly, if there are multiple properties, but the borrowers are the same for all of the properties, then all debt and all income should be pooled. For example, if a couple jointly owns an owner-occupied property and three investment properties, the debt would include all mortgage debt and other personal debt held by the couple, and all income earned by the couple, in line with the guidelines discussed above regarding treatment of income.

54. Secondly, if there are multiple properties and multiple borrowers, but the borrowers do not share all of the same properties, then the debt should include all debt for which the borrowing party is legally responsible (including all debt under joint and several liability), and the income of the borrowing party should be aggregated. However, income from

linked borrowers outside of the borrowing party should be included only if it will be used to service the debt of the borrowing party.

55. For example, two friends A and B own an investment property together (Property 1), and the debt is serviced through a combination of rental income and both A's and B's salaries. B then decides to purchase an owner-occupied property (Property 2). The DTI on B's new property should be calculated as follows:

    - Total debt should include all mortgage debt on both properties, since B is jointly and severally liable for Property 1, and individually liable for Property 2;
    - Total income should include B's salary as well as the rental income on Property 1. However, A's salary should not be included in the calculation, since it is not being used to service B's debt on Property 2.

Questions regarding treatment of 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?

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?

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.

Exemption regime

56. We propose to apply an exemption regime for the DTI restrictions that largely mirrors the current exemption regime for the LVR restrictions, as set out in BS19 of the Banking Handbook.[7] Specifically, this would include exemptions for:

    - Loans made under Kainga Ora's First Home Loan scheme;
    - Loan refinancing;
    - Loan portability;
    - Bridging finance;
    - New housing construction; and
    - Loans granted in error.

57. We consider that the rationale for these exemptions applies equally to DTI restrictions as it does to LVR restrictions. The exemptions help to mitigate efficiency costs associated with DTI restrictions, and ensure the restrictions do not create barriers to new housing construction or Government assistance to first-home buyers.

[7] https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs19-lvr-restrictions-framework.pdf?sc_lang=en

58. We note that the LVR restrictions also include an exemption for 'combined collateral', where borrowers own both owner-occupied and investment property, and these property types are subject to different LVR caps. As will be discussed in the next section, we are not proposing to differentiate the DTI caps by borrower or property type, hence there is no need for an equivalent to the combined collateral exemption within the DTI framework.

Questions regarding exemptions
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?

Structure of the DTI restrictions

Speed limit and threshold

59. In future, if we activate DTI restrictions, we intend to structure these as a 'speed limit' combined with a threshold or cap, as we do for the LVR restrictions. For example, the DTI restriction could be set at a maximum of 20 percent of new mortgage lending (the speed limit) at a DTI over seven (the threshold or cap). We intend to set the speed limit based on the value of new loans, rather than the number of loans, which again is the same approach as for the LVR restrictions.

60. Speed limits help to mitigate potential efficiency costs from lending restrictions, by allowing lenders flexibility to undertake a portion of lending above the threshold. In addition, as discussed above, speed limits can be used for complex lending situations where calculating a DTI ratio may be difficult.

Uniform vs differentiated restrictions

61. In the LVR framework, the restrictions are currently differentiated according to whether the lending is for property investment or owner-occupied property. Lending on investment property has a lower threshold and a tighter speed limit (currently a maximum of five percent of new lending at LVRs above 60 percent) by comparison with owner-occupied property (currently a maximum of 10 percent of new lending at LVRs above 80 percent). The differentiated restrictions reflect the potentially higher risk of deleveraging and 'fire sale' effects for investment property in a severe housing downturn. They are also aligned with the direction in the FPR to *"support more sustainable house prices, including by dampening investor demand"*.

62. We have considered whether we should also differentiate the DTI restrictions by property or borrower type. However, feedback received from some banks indicates that this could add significant complexity. Moreover, the analysis we presented in our 2021 DTI consultation document showed that investors borrow at much higher DTIs on average, and hence would still be the group most affected under a uniform DTI limit. Figures 1 to 3 above, which are based on 2022 data, show that this remains the case even when haircuts on rental and boarder income are removed. Therefore, for simplicity we propose to apply a uniform DTI limit across all mortgage lending and this is reflected in the draft framework.

63. If the relative share of high-DTI lending by investors vs first-home buyers were to change in future, we consider it would be easier to address this via reinstating haircuts on rental income rather than a differentiated DTI limit. However, we welcome feedback on this point.

Questions regarding structure of the 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?

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?

Administrative issues

Verification of income and debt

64. We propose to provide general guidance on debt and income verification rather than setting specific rules. Accordingly, the draft framework states that banks are expected to undertake their standard lending assessment processes when verifying borrowers' total income and debt, and to adhere to any relevant regulatory requirements, such as the Credit Contracts and Consumer Finance Act (CCCFA).

Compliance period

65. As with the LVR restrictions, we intend to measure compliance over a rolling period – three months for larger banks, and six months for smaller banks. This will enable banks to manage 'lumpiness' or variation in the flows of high-DTI lending.

Reporting and disclosure

66. The Reserve Bank already collects a breakdown by DTI of banks' residential mortgage lending in the new commitments survey. We intend to use these reports to monitor compliance with the restrictions, and to assess any other impacts they may have, for instance on first-home buyers and the availability of credit to small businesses. While this data is provided to the Reserve Bank on a confidential basis, we publish a subset of the data aggregated across banks.

67. We note that our proposed definitions for debt and income differ in some cases from those in the current DTI survey. Once the final framework has been agreed, we will update the definitions and guidance in the DTI survey as appropriate.

68. A registered bank must comply with the Reserve Bank's requirements for public disclosure in relation to DTI restrictions. The requirements for public disclosure are set by Orders in Council. We intend to review whether DTI-related disclosure requirements should be implemented in the future, but have not made a decision at this stage.

Questions regarding 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?

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?

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?

Calibration of DTI restrictions

69. The draft framework does not specify a calibration for the DTI restrictions at this stage. Calibration will be consulted on separately in 2023, prior to any decision to activate the restrictions via changes to banks' CoR.

70. As part of the calibration exercise, we intend to undertake modelling analysis to better understand the potential impacts of different DTI settings on our overall objective of supporting financial stability as well as the additional criteria set out in the Financial Policy Remit. As part of this analysis, we will also consider interactions with other policies, in particular the loan-to-value ratio (LVR) restrictions.

71. Some banks have said to us that it would be helpful to have an indicative starting calibration for the DTI restrictions, set at a non-binding level, to assist them with developing their internal systems. We are uncertain as to whether this is necessary at this stage, given that banks can adopt trial calibrations for system design and training purposes. We also note that final calibration of the DTI restrictions will need to take account of any changes to survey data resulting from changes to the current rules for measuring DTI ratios. However, we welcome feedback on this point.

Questions regarding DTI calibration

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.

Assessment of impacts

72. We included an assessment of the potential impacts of introducing DTI restrictions in our 2021/22 consultation document. We have not repeated this assessment here, given that the framework document largely represents a technical set of rules for implementation of the previous decision. In addition, the impacts of DTI restrictions will depend to a significant degree on the calibration of the restrictions, which will be consulted on separately once the framework is in place. However, as noted above, we have assessed the potential impacts on the DTI ratios of different borrower groups (investors, first-home buyers, and other owner-occupiers) of removing haircuts on rental income.

73. In addition, we have undertaken a qualitative assessment of the proposed DTI framework against the requirements set out in the FPR, which was published in July 2022, subsequent to our decision to proceed with the design of a framework for DTI restrictions.

Financial Policy Remit (FPR)

74. The Financial Policy Remit, which was issued by the Minister of Finance on 30 June 2022 and took effect on 1 July 2022, emphasises the desirability of a strong, efficient and inclusive financial system, with a low incidence of failure of regulated entities. It also signals that we should encourage a competitive financial system and have regard to Government priorities on climate change, financial inclusion, cyber resilience and supporting sustainable house prices. The full text of the Remit is available on the Reserve Bank's website.[8]

75. The table below outlines how we have had regard to the components of the Financial Policy Remit in the policy proposals in this consultation paper.

Table 1 – Assessment against Financial Policy Remit

Component of the Financial Policy Remit	Relevance with proposals in this paper
It is desirable to have a financial system that is strong, efficient and inclusive, with a low incidence of failure of entities regulated by the Reserve Bank.	The design proposals in the DTI framework will provide us with the option of introducing DTI restrictions in future. Our analysis indicates that DTI restrictions can enable help to support a strong financial system with a low incidence of failure of regulated entities.
Within the appetite of a low incidence of failure, a competitive financial system should be encouraged so as to best ensure ongoing financial efficiency and inclusion.	The design proposals in the draft DTI framework specify a consistent approach to measurement of DTI ratios across different lenders, which will help to ensure competitive neutrality.
Imposing regulatory and supervisory costs that are proportionate to the expected risks and benefits to the financial system and society.	Preparing for the potential introduction of DTI restrictions will impose regulatory costs on lenders. Wherever possible, we have adopted simple definitions in the draft DTI framework and used rules that are consistent with existing regulations (for example, the exemption regime for LVR restrictions) in order to minimise these costs.
Encouraging new investment and financial innovation that raise the productive potential of the economy.	The design proposals in the draft DTI framework are not expected to have material impacts on this element of the FPR.

[8] https://www.rbnz.govt.nz/about-us/responsibility-and-accountability/our-financial-policy-remit

Component of the Financial Policy Remit	Relevance with proposals in this paper
Encouraging the allocation of financial resources in a way that maximises the sustainable long-term growth of the New Zealand economy.	If DTI restrictions are implemented in future, we acknowledge that they will create some efficiency costs via barriers to credit access for otherwise creditworthy borrowers. As discussed in our 2021 consultation, our analysis indicates that these costs would be outweighed by the longer-term benefits to financial stability. In designing the DTI framework, we have endeavoured to minimise potential efficiency costs wherever possible – including through the use of exemptions and speed limits, which allow banks discretion to continue with some high-DTI lending. The calibration of DTI restrictions (i.e. the level of the speed limit and threshold) is also an important determinant of efficiency costs. As noted above, calibration will be consulted on separately once the framework is in place. If DTI restrictions are implemented, they are expected to moderate housing credit cycles. This may help to support the efficient allocation of financial resources between housing and other sectors of the economy.
Support more sustainable house prices, including by dampening investor demand, which would improve affordability for first-home buyers.	DTI restrictions can help to support sustainable house prices by moderating housing credit cycles. Under the design proposals in the draft framework, DTI restrictions are expected to impact more heavily on investors and thereby dampen investor demand, as investors borrow at higher DTI ratios than other borrowers on average.
Building resilience and facilitating adaption of New Zealand's economy, society and environment to climate change.	The design proposals in the draft DTI framework are not expected to have material impacts on this element of the FPR.
Improving financial inclusion and maintaining financial sector diversity.	The impacts of DTI restrictions on different borrower groups will depend in part on calibration of the limits, which will be consulted on separately prior to any decision to activate the tool. Our analysis indicates that first-home buyers and lower income borrowers more generally would be the groups least affected by a DTI limit under our design proposals. In addition, as noted above, DTI restrictions are expected to dampen investor demand for housing, which may improve opportunities for other borrowers to enter the housing market. The proposed exemption framework and speed limits – including the exemption for borrowers eligible for Kainga Ora First Home Loans – should further help to minimise any potential impacts on lower-income first-home buyers, and hence support financial inclusion.

Component of the Financial Policy Remit	Relevance with proposals in this paper
Improving New Zealand's cyber resilience.	The design proposals in the draft DTI framework are not expected to be material to this element of the FPR.

Questions regarding impacts of DTI framework

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

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.

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

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?

Next steps and timeline

76. Submissions on this consultation close on 14 December 2022. Once we have considered the submissions, we will draft a final version of the DTI framework, which will need to be approved by the Reserve Bank Board. We expect to publish the final framework, along with a summary of submissions, in March or April 2023.

77. As previously indicated to the industry, we intend to allow a minimum of 12 months for banks to be operationally ready to implement DTI restrictions. Accordingly, the earliest 'go live' date for implementation of DTI restrictions is expected to be March 2024.

78. We will consult separately on the potential calibration of DTI restrictions over the course of 2023, in advance of any final decision to implement DTI restrictions via changes to banks' CoR. We also note that under the new Deposit Takers Act, both DTI restrictions and the existing LVR restrictions will need to be converted into Lending Standards.