Submission

to the

Reserve Bank of New Zealand – Te Pūtea Matua

on the

Consultation paper: *2025 Review of key capital settings*

October 2025

NEW ZEALAND BANKING ASSOCIATION – TE RANGAPŪ PĒKE
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1. The New Zealand Banking Association – Te Rangapū Pēke (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following seventeen registered banks in New Zealand are members of NZBA:
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   - TSB Bank Limited
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Contact details

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Introduction

4. NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand – Te Pūtea Matua (**Reserve Bank**) on the consultation paper: *2025 Review of key capital settings* (**Consultation Paper**). We acknowledge the work that has gone into developing the proposals in the Consultation Paper and the technical analysis set out in the paper and other supporting documents.

5. We appreciate the opportunity to provide feedback on the proposals to ensure that prudential capital requirements for deposit takers are set at an appropriate level. We consider that now is the right time for the Reserve Bank to reassess its key capital settings to ensure that these are set at an appropriate level that balance the costs and benefits before the capital standard is issued under the Deposit Takers Act 2023 (**DT Act**).

Executive summary

6. In summary, and subject to the additional detail contained in this submission below, we support the adoption of a higher risk appetite than in 2019 but do not consider that the proposals go far enough and submit that the Reserve Bank should seek greater alignment with international approaches. In particular, NZBA makes the following submissions:

    6.1. We broadly support the proposed assessment criteria for the 2025 review of key capital settings (**2025 Capital Review**), subject to some suggested amendments to place greater emphasis on ensuring alignment with international standards and comparable jurisdictions and ensuring that standardised risk weights accurately reflect the risk of the underlying exposures. In addition to the recent developments outlined in the Consultation Paper, we consider that there are other legislative and policy changes since the 2019 review of capital settings (**2019 Capital Review**) that support the adoption of a higher risk appetite than in 2019.

    6.2. We agree with the proposal to remove Additional Tier 1 (**AT1**) capital instruments as a form of regulatory capital for Group 1 and Group 2 deposit takers.

6.3. We support increased granularity of standardised risk weights to more accurately reflect the underlying level of risk. However, members consider that the Reserve Bank's proposed amendments to standardised risk weights remain overly conservative relative to international standards and comparable jurisdictions. We submit that the Reserve Bank should seek to align with international approaches, such as those of the Basel Committee on Banking Supervision (**BCBS**) or the Australian Prudential Regulation Authority (**APRA**). Members recognise that the Reserve Bank's preference is for more simple, less complex capital requirements. However, we do not consider that alignment with international standards and comparable jurisdictions would introduce unnecessary complexity. In addition, we consider that alignment would support international benchmarking of New Zealand's capital requirements.

7. This submission does not address the capital stack options for Group 1 and Group 2 deposit takers, the proposed reduction to the counter-cyclical capital buffer (**CCyB**), transitional arrangements for AT1 capital instruments or the treatment of certain exposure classes under the standardised approach. Our members may choose to submit on these matters separately.

Preliminary matters

Proposed assessment criteria

8. NZBA broadly supports the proposed assessment criteria for the 2025 Capital Review. However, we suggest refinements to the following two criteria:

8.1. **Criterion 6 (Simplicity / achievability)**: Be practical to administer, easy to implement, <u>efficient, accurate</u> and avoid unnecessary compliance costs.

8.2. **Criterion 7 (International alignment)**: Align with international standards ~~where appropriate~~ <u>and comparable jurisdictions, unless analysis provides a strong justification to not align</u>.

<u>Criterion 6 (Simplicity / achievability)</u>

9. NZBA supports the principle that prudential capital requirements should be practical to administer, easy to implement and avoid unnecessary compliance costs. However, the focus on simplicity should be balanced with efficiency and accuracy. For example, standardised risk weights should accurately reflect the risk of the underlying exposures. This is consistent with the legislative principle in section 4(g) of the DT Act: the desirability of deposit takers effectively managing their capital and risk.

Criterion 7 (International alignment)

10. NZBA considers that the Reserve Bank should seek to align its prudential capital requirements as closely as possible with international standards and comparable jurisdictions (such as the BCBS or APRA). This is consistent with the legislative principle in section 4(d)(i) of the DT Act: the desirability of maintaining awareness of, and responding to, the practices of overseas supervisors.

11. If the Reserve Bank determines that an aspect of its prudential capital requirements should not align with international standards and comparable jurisdictions, the decision should be supported by analysis that clearly demonstrates why the departure is considered to be necessary (e.g. where the Reserve Bank can demonstrate that New Zealand deposit takers are subject to additional or unique risks, which are not fully accounted for in comparable overseas standards).

Risk appetite for capital settings

12. NZBA supports the move away from setting policy requirements using the "1-in-X many years" risk tolerance. This method of communicating risk appetite for financial stability is generally not well understood and is not consistent with international approaches to calibrating minimum capital requirements.

13. We broadly agree with the summary of the key legislative and policy developments since the 2019 Capital Review. In particular, NZBA considers that the new macroprudential tools and annual stress testing programme already in effect, as well as the strengthened non-capital prudential requirements and the enhanced crisis management powers that will take effect under the DT Act, significantly strengthen financial stability and support the adoption by the Reserve Bank of a higher risk appetite for key capital settings than it had in 2019. However, we submit that the enhanced annual stress testing has had more than a minimal impact on capital. The stress testing has demonstrated that banks are sufficiently capitalised to withstand extreme scenarios and supports lower capital requirements.

14. In addition to the legislative policy changes identified in chapter 2 of the Consultation Paper, NZBA also considers that the following developments are relevant to the 2025 Capital Review and support a higher risk appetite:

    14.1. **More comprehensive supervision and enforcement powers**: Under the DT Act, the Reserve Bank will have more comprehensive supervision and enforcement powers, including broader information-gathering powers and on-site inspection powers.

14.2. **Capital overlays**: In the Summary of Submissions and Policy Decisions for the Capital Standard (**Response Document**), the Reserve Bank confirmed that it intends to formalise its ability to impose capital overlays, either through sectoral or entity-specific capital overlays, in the capital standard. The Reserve Bank's enhanced annual stress testing programme should provide the Reserve Bank with a greater ability to identify the build-up of systemic risk in the financial system. Together, these developments should reduce the likelihood that a deposit taker experiences financial stress and avoid or mitigate the risks to the stability of the financial system and the broader economy.

14.3. **Strengthened ICAAP requirements**: In the Response Document, the Reserve Bank also confirmed that it will strengthen the Internal Capital Adequacy Assessment Process requirements to ensure that deposit takers have robust systems in place to assess their own capital needs based on their risk profile, business strategy and market conditions. This, together with the new due diligence duty and risk management standard, should strengthen deposit takers' processes for monitoring and effectively managing their risks and capital requirements.

Capital stack options

15. As mentioned previously, this submission does not address the specific proposals for the regulatory capital stack for Group 1 and Group 2 deposit takers that the Reserve Bank is seeking feedback on, including the proposed reduction to the CCyB.

<u>Transitional path for the prudential capital buffer</u>

16. The prudential capital buffer is currently scheduled to increase on 1 July 2026, 1 July 2027 and 1 July 2028. NZBA would welcome confirmation that these scheduled increases will not proceed when the Reserve Bank announces its decisions later this year. It is important that members have certainty about their future capital requirements so that they can plan for any changed requirements.

Interrelationship between prudential capital requirements and other prudential requirements

17. The composition of the regulatory capital stack for different groups of deposit takers is relevant to other prudential requirements, including the Capital Buffer Response Framework, the connected exposure limit in the connected person policy (BS 8), the denominator of the core funding ratio in the liquidity policy (BS 13), the thresholds for notification and non-objection in the significant acquisition policy (BS 15) and the calculation of the risk score component of the levy for the Depositor Compensation Scheme. These prudential requirements will need to be considered in the context of any decisions made during this review. Members would welcome further clarity on consequential amendments to these (or other) prudential requirements as a result of any changes to the capital stack, including whether the Reserve Bank intends to consult with the industry on any proposed changes to these prudential requirements.

Additional Tier 1

18. NZBA agrees with the proposal to remove AT1 capital instruments as a form of regulatory capital for Group 1 and Group 2 deposit takers. We agree with the Reserve Bank's assessment of the proposal to remove AT1 capital instruments against the proposed assessment criteria. We also agree with the description of the challenges involved in issuing a sufficient volume of AT1 capital instruments given their legal form as equity instruments.

19. NZBA would welcome clarity on the transitional arrangements for AT1 capital instruments when the Reserve Bank announces its decisions later this year.

Standardised risk weights

20. NZBA supports increased granularity of standardised risk weights to more accurately reflect the underlying level of risk. However, members consider that the Reserve Bank's proposed changes to standardised risk weights remain overly conservative relative to international standards and comparable jurisdictions.

Residential mortgage lending

Proposed standard risk weights

21. We support increased granularity of risk weights for residential mortgage lending (**RML**). However, we submit that the following changes should be made to the proposal to further increase granularity and align with APRA's approach to standardised risk weights:

    21.1. Provide for additional granularity by introducing separate bands for RML with a loan-to-value (**LVR**) ratio between 60.01% to 70% and 70.01% to 80%; and

21.2. Lower the proposed standardised risk weights for RML with a LVR ratio less than 50% to 20% (rather than the current proposal of 25%) and RML with a LVR ratio between 50.01% to 60% to 25% (rather than the current proposal of 30%).

22. We understand that the Reserve Bank's reservation with setting risks weights this low for RML with a LVR ratio less than 50% is because 20% is the risk weight that currently applies to RML where the loan has lenders mortgage insurance (**LMI**) underwritten by Kāinga Ora. However, we submit that lower standardised risk weights for RMLs with a LVR ratio less than 50% would more accurately reflect the risk of these loans. This is supported by the results of annual industry stress tests, which demonstrate that the loss given default and loss rates on RMLs with a low LVR are not significant due to the substantial equity buffers that the borrowers have built up.

23. In addition, RML that has LMI underwritten by Kāinga Ora represents a small proportion of total RML and therefore the 20% risk weight makes very little difference to the total risk weighted assets or capital levels of deposit takers.

24. Finally, for clarification, we understand that:

24.1. the third bullet point on page 75 of the Consultation Paper is intended to read: "Past due owner-occupied RML with<u>out</u> LMI remains at 100%, but past due investor RML with<u>out</u> LMI increases from 100% to 120%"; and

24.2. no changes are proposed to the risk weights for RML that has LMI underwritten by Kāinga Ora, which would remain at 20%.

25. If this is not the intention, we would be grateful if the Reserve Bank could clarify.

Corporate lending

26. We support the proposal to introduce two new corporate exposure categories for SME retail and SME corporate lending, which aligns with the BCBS and APRA approaches. However, in order to fully assess the proposal, members would welcome additional clarity on the proposed scope of the relevant definitions (e.g. SME corporate).

27. NZBA also submits that additional corporate exposure categories should be added for unrated borrowers that take into account the credit characteristics of the relevant exposure and align with BCBS and APRA approaches. The current standardised risk weight for unrated corporate exposures of 100% is an overly blunt approximation of the risk of the underlying exposure.

Commercial property lending

28. Members do not agree with the Reserve Bank's proposal to apply standardised risk weights starting at 100% for all commercial property lending as this would be an overly blunt approximation of the risk of the underlying exposure.

Personal lending

29. We support a new standardised category for personal lending. However, we consider that the Reserve Bank's proposed risk weight for unsecured personal lending would be overly punitive. We submit that risk weights for personal lending should align with those that apply to "retail exposures" under APRA's standardised approach to credit risk in APS 112 and the BCBS Framework.