Reserve Bank of New Zealand
Te Pūtea Matua

Deposit Takers Core Standards

Policy proposals

16 May 2024

CONSULTATION PAPER

Submission details

The Reserve Bank of New Zealand – Te Pūtea Matua invites submissions on this consultation paper by 5.00pm on 26 July 2024. Please note the disclosure on the publications of submissions below.

Submissions and enquiries

You should make your submission online at https://consultations.rbnz.govt.nz

Email enquiries: dta@rbnz.govt.nz

Publication of submissions

We will publish your submission on the Reserve Bank's website.

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

If you want all or part of your submission to be treated as confidential, you 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 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 your views into account.

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

Navigating this document

This Consultation Paper contains the policy proposals for the four core Deposit Takers Standards (the standards) to be made under the Deposit Takers Act 2023 (DTA).

The document begins with an Executive Summary, followed by an Introduction to provide the background to the development of the standards as a whole. It is then split into chapters, one for each core standard.

- Chapter 1: the Capital Standard sets out the proposed approach to capital requirements
- Chapter 2: the Liquidity Standard sets out the proposed approach to liquidity requirements
- Chapter 3: the Depositor Compensation Scheme (DCS) Standard sets out the proposed approach for DCS disclosure and Single Depositor View (SDV) requirements
- Chapter 4: the Disclosure Standard sets out the proposed approach to disclosure requirements.

Each chapter includes an introduction. The chapters then present the key policy proposals for the standard, which are organised using the Proportionality Framework. This means the chapter first covers the proposed approach for Group 1 deposit takers, then Group 2 deposit takers, then Group 3 deposit takers. The chapters also include the proposed approach for branches of overseas deposit takers, if appropriate.

Following Chapter 4, the document contains a conclusion to this Consultation Paper that summarises the next steps in the development of the standards. The document ends with a glossary (Annex A) and a consolidated list of consultation questions (Annex B).

The document uses consecutive paragraph numbering throughout. Other numbered features, such as consultation questions, are also numbered consecutively. This will aid us in the coordination of submissions on the Consultation Paper. You can read and respond to each chapter separately.

Contents

Executive Summary

1. The Reserve Bank of New Zealand – Te Pūtea Matua (the **Reserve Bank**) is consulting on our policy proposals for new prudential standards to be made under the Deposit Takers Act 2023 (**DTA**).

2. The DTA creates a single, modern regulatory regime for all financial institutions in the business of "borrowing and lending money" in New Zealand - this includes banks and non-bank deposit takers (**NBDTs**).

3. As the kaitiaki (guardian) of the financial system, we design rules to protect and promote the stability of the financial system. Financial stability can be considered a public good that enables communities and businesses to engage in a well-functioning financial system that allocates resources and manages risk throughout the real economy.

4. Our rules seek to avoid the major costs and disruption that could result from the failure of one or more deposit takers. As we saw in the Global Financial Crisis, failure of deposit takers can have wide ranging and long-term impacts for individuals, communities and businesses.

5. The DTA represents a paradigm shift in the way we approach financial stability. The introduction of the Depositor Compensation Scheme (**DCS**) and our new regulatory powers have come with statutory purposes that focus not just on systemic stability, but also on individual entity soundness. These features are a complementary package. The DCS provides benefits to all deposit takers and depositors through socialising the cost of failure, and this is accompanied by a new set of prudential standards to ensure entities benefiting from the DCS are individually safe and sound.

6. The Deposit Taker Standards (the **standards**) will replace our existing prudential requirements that are currently contained in several different sets of documents.[1] Importantly, the standards will be secondary legislation unlike most of our existing non-legislative prudential requirements. The standards will set the rules that deposit takers must meet to be safe and sound enough to take deposits from the public and benefit from the DCS.

7. **We**, the Reserve Bank, may issue standards if we are satisfied they are necessary or desirable to achieve one or more of the purposes of the DTA. The main purpose of the DTA is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system. There are also four additional purposes of the DTA, which are:

    - to promote the safety and soundness of each deposit taker;
    - to promote public confidence in the financial system;
    - to the extent not inconsistent with the main purpose or the other three additional purposes, to support New Zealanders having reasonable access to financial products and services provided by the deposit-taking sector; and
    - to avoid or mitigate adverse effects of the risks to the stability of the financial system and risks from the financial system that may damage the broader economy.

[1] These documents include the Banking Supervision Handbook, Banking Prudential Requirements, disclosure Orders in Council and notices made under section 80 of the Banking (Prudential Supervision) Act 1989.

8. The main purpose is relevant to all the core standards. All core standards also promote the safety and soundness of each deposit taker and/or promote public confidence in the financial system or mitigate risks to the stability of the financial system and the risk posed by the system to the broader economy.

9. This Consultation Paper sets out our key policy proposals for the 4 "core" standards. These are the standards that we will use as the criteria to determine the eligibility of existing banks and NBDTs for licences under the DTA. These standards will form a key part of the overall standards framework when all standards come into effect. The DTA sets out the 4 core standards as the following:

    - Capital – to ensure deposit takers can absorb financial losses while remaining solvent;
    - Liquidity – to ensure deposit takers can meet their financial obligations when they fall due;
    - The Depositor Compensation Scheme (**DCS**) – to ensure effective disclosure by deposit takers about the DCS and to create the single depositor view (**SDV**) information in order to identify depositor entitlements under the DCS in advance of any deposit taker failure; and
    - Disclosure – to ensure disclosure of prudential information by deposit takers to the public.

10. The policy proposals for each of these standards are set out consistently with the Proportionality Framework,[2] which categorises locally incorporated deposit takers into three Groups, depending on their size.

11. This Consultation Paper seeks feedback on the proposed requirements under each standard for all three Groups as well as for branches of overseas deposit takers, where appropriate.

The Capital Standard

12. Chapter 1 contains the policy proposals for the future Capital Standard, to be made under Part 3 of the DTA. The Capital Standard will cover the minimum capital requirements for deposit takers in New Zealand. The capital proposals are designed to support the main purpose of the DTA – to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system. The proposals also establish minimum standards of safety and soundness for each deposit taker from the time they receive a licence from us, while also mitigating adverse effects of risks to the stability of the financial system.

13. Deposit takers largely get their funding from two places – their owners (shareholders – if the deposit taker's corporate form is that of a company) and people they borrow from, including depositors. The money that deposit takers get from their owners (and, in limited circumstances, from their investors) is referred to as capital. This consists of financial resources that can absorb losses.

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[2] The Proportionality Framework is a document made under section 77 of the DTA that sets out how we will take into account the proportionality principle under section 4(a)(i) of the DTA when making prudential standards. To make it easier for different groups of deposit takers to navigate the policy proposals in this document, we have arranged each chapter using the 3 Groups in the framework.

14. We require deposit takers to have minimum levels of capital, meaning a minimum percentage of their funding must come from their owners (and in limited circumstances from their investors). This minimum requirement helps to make sure that the owners of a deposit taker are the first to bear losses, not depositors or other creditors. It also helps make sure that the owners have a meaningful stake in the business, because the more owners have to lose the greater their incentive to manage risks prudently.

15. When the amount of a deposit taker's capital falls too low the deposit takers is likely to fail unless the owners or other investors are able to commit new capital. This means the more capital a deposit taker has, the more money it can stand to lose.

16. However, capital also comes with costs. Higher capital requirements generally result in a deposit taker's owners contributing more towards deposit taker funding. Owners generally demand a higher return than depositors. If a deposit taker suffers unexpected losses, it is the owners that lose their money first, not the people who have lent money to the deposit taker (such as depositors). This means risk is higher for shareholders than for depositors, so shareholders expect to be compensated at a higher rate of return.

17. At a simple level, if the owners' funding (equity) has a higher required return, it costs more than debt funding. So higher requirements can result in higher lending rates, and possibly lower deposit rates, adversely impacting economic output. These costs of capital need to be weighted against the benefits of higher solvency in the system and lower risk of deposit taker failure.

18. These trade-offs are complex. There are factors pushing against deposit takers passing on cost increases. Deposit takers are less able to pass on costs when there is active competition and/or new entrants are emerging. Also, risk is lower when a deposit taker is better capitalised and this will generally mean that owners and creditors will require a lower rate of return than would otherwise be the case. This affects the deposit takers funding costs and limits the extent to which interest rates would increase in these circumstances.

19. In 2019, we completed a comprehensive, multi-year process known as the Capital Review.[3] This was an extensive process to reform our capital adequacy framework. The changes resulting from the Capital Review will not be fully phased in until July 2028. Therefore, we propose to carry over a significant portion of the existing capital requirements to apply to Group 1 and 2 deposit takers. Chapter 1 includes detailed analysis that sets out how we came to this assessment.

20. The proposal to retain most of the existing capital framework for Group 1 and Group 2 deposit takers means that these groups would face the following headline requirements:

    - a minimum total capital ratio requirement of 9% of risk weighted assets (**RWA**)
    - in addition to the 9% of RWA minimum, Group 1 deposit takers would be expected to have a Prudential Capital Buffer (**PCB**) of 9% of RWA
    - in addition to the 9% of RWA minimum, Group 2 deposit takers would be expected to have a PCB of 7% for RWA.

[3] Reserve Bank of New Zealand. (2022, February 28). *Capital Review.* https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/how-we-regulate-and-supervise-banks/our-policy-work-for-bank-oversight/capital-review

21. While the proposals above replicate the requirements currently being implemented following the Capital Review, there are a few particular areas of the capital framework for Group 1 and Group 2 deposit takers that we propose to amend as part of the new standard. These are:

    - the approach to credit risk requirements (to address minor or technical issues raised by stakeholders in previous policy consultations)
    - the approach to market risk requirements (to modernise an outdated aspect of the existing framework)
    - the approach to operational risk requirements (to alter the Standardised Approach, as signalled in the Capital Review decisions).

22. The most significant change to the existing capital requirements relates to the proposed capital settings for Group 3 deposit takers, which are mostly NBDTs. NBDTs are subject to the Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010. These regulations have been in place since 2010 and are substantially different from our capital framework for Group 1 and Group 2 deposit takers.

23. The proposed approach to capital requirements for Group 3 deposit takers aims for a closer alignment with the approach for Group 1 and 2 deposit takers but applied in a proportionate way. Our estimates suggest that, as a whole, the sector has enough capital to meet the proposed approach based on current holdings. However, a small number of individual entities may not currently meet these requirements. A gradual transition path over many years will assist in the adjustment.

24. The proposals for Group 3 deposit takers include:

    - a minimum total capital ratio requirement of 9% of RWA. Currently NBDTs have a minimum total capital requirement of 8% of RWA, which increases to 10% or 12% for those that are exempt from a credit rating
    - in addition to the 9% of RWA minimum, Group 3 deposit takers would be required to have a PCB of 4% of RWA
    - risk weights would be aligned with the Standardised Approach[4] that applies to Group 1 for some categories of exposures and to all exposures for Group 2
    - consideration of whether to require an absolute minimum dollar level of capital.

25. Under these proposals, meeting the minimum total requirement of 9% of RWA under the Capital Standard would be a binding requirement. However, staying above the PCB would not be a binding requirement itself. Instead, a deposit taker falling within the PCB would trigger the Capital Buffer Response Framework,[5] with an increasing intensity of supervisory responses where the deposit taker used more of the PCB.

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[4] The Standardised Approach is the approach to calculating risk weighted assets using a standardised and prescribed methodology, unless the bank is an accredited to use the internal ratings-based approach. *See* BPR 131 for more details: Reserve Bank of New Zealand. (2024, 1 April) https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr131-standardised-credit-risk-rwas-apr-24.pdf

[5] Reserve Bank of New Zealand. (2017, 17 June). *Capital Response Buffer Framework*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/capital-buffer-response-framework-explainer.pdf

26. The proposals would result in an increase in the level of high-quality, loss-absorbing capital for Group 3 deposit takers compared with existing requirements for most of those deposit takers. The proposed changes to the approach to risk weighting for Group 3 would however result in a reduction in risk weights (estimated to be around 10–30%) reducing the impact of higher capital requirements. That is, the combined effect of the capital proposals mean most Group 3 deposit takers should be able to meet the capital policy settings based on current capital holdings.

27. We are also consulting on a transition pathway to help Group 3 deposit takers manage the uplift in their capital requirements. Consistent with the Proportionality Framework, we are proposing that requirements for Group 3 deposit takers will be uniform across all deposit takers in the group. We note that there is a high degree of diversity across Group 3, including in corporate form, ownership models and size. We are interested in feedback about whether there is a basis to consider varying the application of some requirements across different types of deposit takers within Group 3.

The Liquidity Standard

28. Chapter 2 contains the proposed policy for the Liquidity Standard, to be made under Part 3 of the DTA.

29. The proposed Liquidity Standard would set out our liquidity requirements, which would help ensure that deposit takers can provide depositors, and others they need to pay, with their money when they want or need it or when it comes due.

30. It would require deposit takers to carefully monitor and manage their ability to make payments to others. It would also require them to have minimum amounts of cash and other assets that could be sold quickly at a reliable price, to meet financial obligations such as paying bills and deposit withdrawals. The proposed Liquidity Standard aims to support the main purpose of the DTA – to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system.

31. We note that the proposals in Chapter 2 build on work that has already been undertaken as part of the Liquidity Policy Review (LPR). In particular, the first consultation paper (C1) for the LPR was released in February 2022 and the second consultation paper (C2) was released in February 2023. This chapter is the third round of consultation being undertaken for the LPR (C3).

32. Key decisions already made as part of the LPR are:

    - for larger deposit takers, to retain and modify our existing quantitative liquidity metrics (the Mismatch Ratios (MMR) and the Core Funding Ratio (CFR)) rather than adopt metrics that are used internationally (the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR)), as these metrics have served us well, and we believe will continue to do so in the future

    - for larger deposit takers, to tighten the eligibility criteria for liquid assets so that only assets we believe would have a private market during a period of stress would be classified as liquid assets and require deposit takers to hold more of these truly liquid assets. For high-quality assets that we do not think our deposit takers could easily sell in a

stress period, we will accept these assets as collateral through a newly established Reserve Bank 'Committed Liquidity Facility' (**CLF**)

- to apply liquidity requirements across all deposit takers (banks, credit unions, building societies, and finance companies) in a proportionate manner, based on deposit taker size.

33. We anticipate that these decisions will be reflected in the proposed Liquidity Standard, so Chapter 2 only includes our proposals for other matters. Specifically, we are proposing that:

    - all deposit takers be subject to qualitative liquidity requirements that would more clearly define responsibilities for liquidity risk management (although a slightly scaled back set of qualitative liquidity requirements would apply to Group 3 deposit takers)
    - a number of potential modifications be made to the MMR and CFR that will apply to Group 1 and Group 2 deposit takers in order to strengthen these metrics
    - a number of design features and components be included in the CLF
    - a simplified quantitative liquidity requirement (a cash-flow coverage ratio (**CFCR**)) that would apply to Group 3 deposit takers
    - that certain qualitative liquidity requirements apply to branches of overseas banks.

The Depositor Compensation Scheme Standard

34. Chapter 3 contains the proposed policy for the DCS Standard, to be made under Part 3 of the DTA. The DCS is expected to provide eligible depositors with compensation for their protected deposits of up to $100,000 in aggregate, per deposit taker, in the event of a deposit taker failure.

35. This chapter is split into proposed DCS disclosure and SDV requirements. The proposed approach for the standard has been influenced by the practices of overseas deposit insurers and the *Core Principles for Effective Deposit Insurance Systems* published by the International Association of Deposit Insurers.[6]

36. We have previously referred to SDV as Single Customer View (**SCV**). The change in title is to align with the terminology used in the DTA and we intend to use SDV moving forward.

37. Our intentions are that the DCS disclosure requirements:

    - build and maintain public awareness of the DCS
    - provide the public with clear information about their coverage under the DCS
    - prevent the promotion of vague or misleading information about the DCS that may adversely affect depositors' decisions.

38. These requirements seek to improve financial stability by ensuring that depositors are able to structure their affairs in order to protect themselves from the risk of deposit taker failure and thereby reduce the risk of a run on deposits in the event of a failure. Consistent DCS

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[6] Bank for International Settlements, International Association of Deposit Insurers. (2009, 15 May). *Core Principles for Effective Deposit Insurance Systems*. https://www.bis.org/publ/bcbs151.pdf

disclosure requirements will ensure that deposit takers operate on a level playing field and make it easy for depositors to identify DCS-protected deposits.

39. Chapter 3 includes our proposals for both the broad approach to DCS disclosure as well as the detailed requirements. The broad approach refers to the underlying policy for raising awareness of the DCS without over emphasising the risk of a deposit taker failing. The detailed requirements look at when, where and how the DCS disclosure should be made. Our proposals for DCS disclosure are the same across Group 1, 2 and 3 deposit takers.

40. The objective of the SDV requirements is to ensure that deposit takers can generate SDV data files that will enable us to determine the compensation entitlements for eligible depositors and to make compensation payments in an efficient and effective way.

41. Our proposals for SDV relate to the variables we consider should be included in SDV files and as our proposed approach to SDV testing and aggregate reporting. We are proposing that the requirements for each of these areas apply consistently across Group 1, 2 and 3 deposit takers.

The Disclosure Standard

42. Chapter 4 contains the policy proposals for the Disclosure Standard, to be made under Part 3 of the DTA. Requiring disclosure helps depositors, market analysts, investors and other deposit takers (collectively known as 'market participants') make informed decisions about a deposit taker's risk profile. The collective scrutiny of market participants, in turn, helps incentivise the deposit taker to carry on business in a prudent manner.

43. Without our disclosure requirements, deposit takers could be incentivised to not disclose relevant information to market participants or to do so in a way that is harder to compare across institutions. This absence of information could cause damage to the financial system, consumers and public confidence. The aim of our Disclosure Standard is to ensure that market participants have clear, standardised and consistent access to relevant information, in order to protect and promote financial stability. The Disclosure Standard also aims to support depositors having access to timely, accurate and understandable information to help them to make decisions.

44. The disclosure chapter covers the information that must be made publicly available, how it must be made available, when it must be made available, and who these disclosure requirements apply to. Our proposed Disclosure Standard provides a single disclosure regime for all deposit takers using the new powers in the DTA.

45. A key proposal is that we mostly retain the current bank disclosure regime for both Group 1 and Group 2 deposit takers. There are no significant known issues to address with this regime and it works well.

46. For Group 3 deposit takers, we propose proportionally adjusting the Group 1 and Group 2 disclosure requirements in recognition that larger deposit takers pose higher risk to financial stability.

The proposed consultation process

47. We are seeking feedback on all aspects of the proposals in this Consultation Paper. Once we have had time to consider your feedback on the policy proposals, we intend to prepare the Exposure Drafts of the Capital, Liquidity, DCS and Disclosure standards.

48. We intend to publish Exposure Drafts of the standards in 2026 for further feedback to ensure the requirements are precise, easy to interpret, and feasible to comply with. From there, we intend to consider the feedback and finalise and issue the standards in late-2026 or early-2027.

49. The non-core standards are expected to follow a similar process. We intend to consult on these in a separate consultation paper later in 2024.

50. Figure 1 below shows our intended approach to the development of standards. Consulting separately on proposed core and non-core standards allows us to prioritise the development of the core standards, which as noted earlier, are needed for licensing existing banks and NBDTs under the DTA. We hope this phasing also helps stakeholders to manage their input into our consultation process.

Figure 1: Process for developing standards

51. The shift to secondary legislation, and the need for standards to be precise and easy to interpret, means that the language of the existing largely administrative prudential requirements will change in places.

Introduction

Why do we prudentially regulate deposit takers?

52. Deposit takers play a crucial role in the operation of the financial system and economy. In particular, they:

    - provide individuals and businesses with access to essential day-to-day services (such as the ability to make payments using transactional accounts) and investment products
    - provide consumers and business with access to credit.

53. More broadly, by taking deposits and providing credit, they help to ensure the effective allocation of resources across the economy. The nature of deposit takers' business (i.e. carrying on the business of borrowing and lending) also means that they have a high degree of interconnectedness with the rest of the financial system.

54. However, the essential functions carried on by deposit takers, deposit takers' interconnectedness with the rest of the financial system, and the scale of some deposit takers, means that when a deposit taker fails this can have serious impacts on individuals, businesses, and the economy as a whole.

55. The potential scale of these impacts is illustrated by events such as the finance company collapses of 2006-2011. The Commerce Select Committee noted in its 2011 Inquiry into Finance Company failures:

    > *"45 finance companies in New Zealand have failed, either being placed into receivership or entering into moratorium arrangements with debt holders. These failures have put at risk about $6 billion of investors' deposits, much of which will not be recovered. It is estimated that between 150,000 and 200,000 deposit holders have been affected, and the losses to date have been estimated at over $3 billion".*

56. The effects of large deposit taker failures can also be even more severe, as illustrated internationally by the GFC.

57. Ultimately, a sound and well-functioning deposit taking sector and financial system provides an essential public benefit shared by society in much the same way that physical infrastructures – such as roads, water and power systems – provide benefits felt much more widely than by just individual users of these networks.

58. The DTA will replace the existing regulatory regimes for banks and NBDTs with a single modernised regulatory framework for all deposit takers. The DTA strengthens New Zealand's financial system through the introduction of the DCS, new prudential powers and a new suite of standards. These features are a complementary package, ensuring that the benefits of the DCS fund are matched by standards that ensure a minimum level deposit taker soundness.

59. Under the DTA prudential requirements for deposit takers are to be set via standards issued by us. These standards will replace our existing prudential requirements for banks and NBDTs but, unlike most of our existing prudential requirements that are made under the Banking (Prudential Supervision) Act 1989 (BPSA), these standards will be secondary legislation. They

will be legislative rather than administrative instruments and be subject to certain processes common to secondary legislation.[7] As part of our broader role as Kaitiaki (guardian) of the financial system, the development of standards under the DTA gives us the opportunity to create a more coherent prudential framework for deposit takers that better promotes financial stability. We are seeking your feedback as we work to create this more coherent framework that supports the management of prudential risks.

60. This Consultation Paper seeks your input on a subset of the prudential standards, the core standards, which we will use to license existing banks and NBDTs under the DTA.

61. How the core standards fit into the winder suite of standards we expect to make under the DTA is set out in Figure 2 below. We will release a consultation paper on the non-core standards in the coming months.

Figure 2: Deposit Taker Standards prudential framework

Development of the Deposit Takers Act 2023

62. In 2016, New Zealand's financial sector regulatory framework was reviewed as part of the International Monetary Fund's (IMF) Financial Sector Assessment Programme (FSAP). The IMF conducted this assessment using the principles and standards issued by international standard setting bodies in, amongst other things, the banking, insurance, and financial market infrastructure sectors. These principles and standards included the Core Principles for Effective Banking Supervision (the Basel Core Principles) issued by the Basel Committee for Banking Supervision (BCBS).

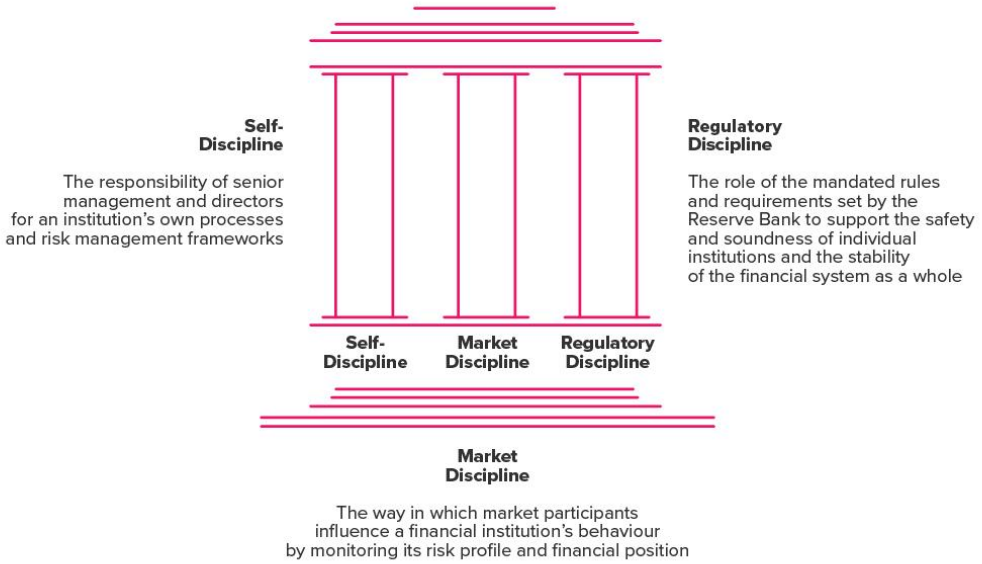
63. The IMF found that our rulebook (and approach to supervision) for banking was light-handed relative to international standards. It encouraged us to issue enforceable supervisory standards on key risks. It also recommended the establishment of deposit insurance.

64. The IMF's FSAP assessment contributed to the development of the terms of reference for the later review of the Reserve Bank of New Zealand Act 1989 (which resulted in both the Reserve Bank of New Zealand Act 2021 and the DTA).

[7] This includes being reviewed by Parliament's Regulations Review Committee, which acts on the Parliament's behalf to ensure that the delegated law-making powers are being used appropriately. It examines all regulations, investigates complaints about regulations, and examines proposed regulation-making powers in bills for consistency with good legislative practice. The committee reports to the House and other committees on any issues it identifies, and the House can "disallow" a regulation.

65. The DTA directly addresses most of the relevant recommendations from the IMF and represents a paradigm shift in New Zealand's regulation of deposit takers. This paradigm shift brings New Zealand's prudential framework for deposit takers closer to international norms. In particular, it aims to better balance the reliance on the 3 pillars of banking regulation by placing more weight on the regulatory discipline pillar than the market and self-discipline pillars we have historically relied upon (see Figure 3).This shift in regulatory approach reflects the wider costs to society following a deposit taker failure.

Figure 3: The 3 pillars approach to banking regulation



Purpose of setting standards

66. The main purpose of the DTA is to protect and promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system (section 3(1)). To that end, the DTA also has the following additional purposes:

- Soundness – to promote the safety and soundness of each deposit taker (section 3(2)(a));
- Public confidence - to promote public confidence in the financial system (section 3(2)(b));
- Accessibility - to the extent not inconsistent with the main purpose or the other additional purposes, to support New Zealanders having reasonable access to financial products and services (section 3(2)(c));
- Avoidance or mitigation of risks – to avoid or mitigate the adverse effect of risks:
    - to the stability of the financial system;
    - from the financial system that may damage the broader economy (section 3(2)(d)).

67. We may issue a standard when we are satisfied that it is necessary or desirable for one or more purposes of the DTA.

68. The guiding purposes for the development of core standards is to promote the safety and soundness of each deposit taker and to promote public confidence in the financial system, while promoting financial stability. The focus on soundness and safety of individual deposit takers is a marked change from the BPSA which sets out a system focus for prudential regulation.

69. The core standards establish baseline soundness for each deposit taker that we license. Eligibility for a licence is based on meeting the minimum requirements set out in the core standards. This in turn enhances public confidence in the licensing decisions we make. Some requirements also avoid or mitigate risks to the stability of the financial system, and the risks that the financial system poses to the broader economy.

70. The requirements of the core standards are not intended in themselves to support New Zealanders having reasonable access to financial products and services.

Principles to consider in setting standards

71. In issuing standards under the DTA, as well as identifying the purpose or purposes for which we are acting, we must take into account certain principles (where they are relevant to the performance or exercise of our powers under the DTA). These principles are:

    - the desirability of taking a proportionate approach to regulation and supervision (section 4 (a)(i));
    - the desirability of consistency in the treatment of similar institutions (section 4 (a)(ii));
    - the desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders (section 4 (a)(iii));
    - the need to maintain competition within the deposit-taking sector (section 4(b));
    - the need to avoid unnecessary compliance costs (section 4(c));
    - the desirability of maintaining awareness of, and responding to, the practices of overseas supervisors that perform functions in relation to any licensed deposit taker or any holding company of any licensed deposit taker; and guidance or standards of international organisations (section 4(d)(i) and (ii));
    - the desirability of ensuring that the risks referred to in section 3(2)(d)[8] are managed (including long-term risks to the stability of the financial system) (section 4(e));
    - the desirability of sound governance of deposit takers (section 4(f));
    - the desirability of deposit takers effectively managing their capital, liquidity, and risk (section 4(g)); and

[8] Deposit Takers Act 2023 section 3 Purposes. (As at 17 February 2024). https://www.legislation.govt.nz/act/public/2023/0035/latest/LMS469453.html

- the desirability of depositors having access to timely, accurate, and understandable information to assist them to make decisions relating to debt securities[9] issued by deposit takers (section 4(h)).

72. The chapters in this Consultation Paper assess the costs and benefits of the proposed standards, taking into account each of the principles above (where those principles are relevant).

Q1	What do you think the cumulative impact of the proposed standards will be on the relevant principles?

Taking a proportionate approach to standards development

73. The DTA provides a single, coherent framework for regulating and supervising all deposit takers – both banks and NBDTs. However, given the diversity of deposit takers and the relative risks they pose there is a clear reason for adopting a proportionate approach to the calibration of requirements. The DTA recognises this in the proportionality principle (section 4 (a)(i)) as well as by requiring us under section 77 to publish a proportionality framework that sets out how we will take account of the proportionality principle. When preparing our proportionality framework, section 77(3) requires us to have regard to the following:

- the size and nature of the businesses of different deposit takers
- the extent to which a range of different requirements are necessary or desirable to promote the safety and soundness of each deposit taker
- the relative importance of different deposit takers to the stability of the financial system.

74. We published our *Proportionality Framework for Developing Standards under the Deposit Takers Act* (the Proportionality Framework) on 14 March 2024.[10] It sets out how we propose to take into account the principle of proportionality when developing standards. The Proportionality Framework will help us balance the costs and benefits of proposed standards consistently and transparently in relation to different types of deposit takers. Taking a proportionate approach to developing standards also helps support a deposit taking sector that is safe, sound and stable, as well as diverse, competitive, innovative and inclusive.

75. In our Proportionality Framework we split out locally incorporated deposit takers into 3 Groups:

- Group 1: deposit takers with total assets of NZ$100 billion or more. This group is the domestic systemically important banks (D-SIBs).
- Group 2: deposit takers with total assets of NZ$2 billion or more, but less than NZ$100 billion.
- Group 3: deposit takers with total assets less than NZ$2 billion.

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[9] Financial Markets Conduct Act 2013 section 8 Definitions relating to kinds of financial products. (As at 16 March 2024). https://legislation.govt.nz/act/public/2013/0069/latest/DLM4090911.html

[10] Reserve Bank of New Zealand. (2024, 14 March) *Proportionality Framework for Developing Standards Under the Deposit Takers Act*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf

76. We have used the Proportionality Framework's groups to consider how best to tailor proportionate requirements when developing standards.

77. In addition to the three groups, we have also tailored requirements for branches of overseas deposit takers (**branches**). Although we partially rely on the regulation of branches by their home regulator, we have also developed tailored requirements because, following our review of our branch policy, we have announced an intention to impose restrictions on branch size and nature of operation in New Zealand. For these reasons, of the core standards, only the proposed Disclosure Standard and a subset of the proposed Liquidity Standard will apply to branches (however we expect that some non-core standards to will also apply to branches).

Q2	What do you think of the way we have taken into account the proportionality principle in developing the proposed standards?

Considering the need for minimum standards arising out of the DTA

78. When developing the proposals in this Consultation Paper, we considered the proposed standards as a whole and their interaction with the DTA, especially the creation of the DCS. The creation of the DCS stands to benefit deposit takers, by increasing trust of depositors in the sector, and may lower funding costs for deposit takers, especially more risky depositors by improving their ability to attract deposits. On the other hand, it socialises risk associated with individual deposit takers across the sector as a whole and across broader New Zealand society, as the DCS will be funded by levies paid by all deposit takers and some or all of the costs of these levies may be passed on to consumers.

79. Therefore, it is important that every deposit taker benefitting from the DCS meets minimum standards that would generally be expected of them. As outlined in the Proportionality Framework, we have reflected the need for minimum standards to support the safety and soundness of individual deposit takers when proposing requirements for each group of deposit taker.[11] This approach supports public confidence in the financial system by minimising the significant harm that could arise should there be failures of a number of deposit takers, similar to what happened during the finance company collapses and the GFC, as discussed above. The approach also supports the soundness of each individual deposit taker, another additional purposes of the DTA.

80. Taking into account the standards as a whole, the introduction of the DTA and the establishment of the DCS, we consider that we are proposing a robust, but proportionate, set of standards for deposit takers that will provide an overall net benefit to New Zealand. The net benefits include costs and benefits to deposit takers and New Zealanders more generally. We will continue to refine our cost-benefit analysis of the core and non-core standards as we receive feedback from public consultation.

[11] When preparing the Proportionality Framework we were required to have regard to, amongst other things, "the extent to which a range of different requirements are necessary or desirable to promote the safety and soundness of each deposit taker" (section 77(3)(b), Deposit Takers Act 2023).

Considering diversity and access to financial products and services

81. Access to financial products and services offered by the deposit-taking sector supports individuals, communities, and businesses to participate in, and contribute to, economic activity. Some deposit takers develop longstanding and deep connections with particular communities and customer groups and can provide services to underserved segments of the population who may otherwise struggle to access finance. This was a strong theme during the development of the DTA and has also been raised by stakeholders since the DTA was passed.

82. In September 2023, we released *Our Approach to Financial Inclusion*, which outlines how we are considering and contributing to an inclusive financial system in line with our role and remit.[12]

83. Financial inclusion is closely linked to the DTA principle on the desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders.

84. This Consultation Paper includes our initial assessment of the likely impact of each of the proposed standards on both the diversity of institutions and access to financial products and services to a diverse range of New Zealanders. However, this assessment is based on limited information. We welcome views from stakeholders who may be able to provide more evidence of the impact of each of the proposed standards. We also analyse other related principles, such as avoiding unnecessary compliance costs, applying a proportionate approach to standards and maintaining competition in the sector as well as depositors having access to timely, accurate and understandable information. These principles can support New Zealanders' access to financial products and services. Therefore, the relevant principles will be addressed as we present our analysis for each core standard.

85. We also consider that access to financial products and services and financial stability can be interconnected. For example, a well-functioning financial system with low probability of deposit takers falling into financial difficulty increases the likelihood that people can access, and have trust in, the products and services they rely on, thereby increasing access to products and services.

Q3	What do you think the implications of the proposed standards will be on the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services and on financial inclusion more generally? If possible, please provide specific feedback on how these requirements might impact the accessibility and affordability of financial services.

Implications for the Māori economy

86. In line with considering the desirability of the deposit taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders (section 4 (a)(iii)), we are considering the impact of the standards on the Māori economy and the impact of the standards on deposit takers that are part of or interact with the Māori economy. The Māori economy includes Māori customers, iwi, individuals, and Māori

[12] Reserve Bank of New Zealand. (2023, 29 September). *Our Approach to Financial Inclusion*. https://www.rbnz.govt.nz/hub/publications/financial-inclusion-report/2023/our-approach-to-financial-inclusion

businesses, trusts and entities. Support from the financial system ensures that Māori economic activity can contribute to a sustainable and productive economy. This will become increasingly crucial, with a young and growing Māori population that will make up the majority of the labour force growth in the coming years (currently 13% and projected to be 20% by 2040).[13]

87. In 2022 we undertook a consultation on improving Māori access to capital, the feedback from this consultation is informing our ongoing work in this area.[14] Our work to support Māori access to capital also reflects our commitment to identifying opportunities to give effect to Te Tiriti o Waitangi through our mahi and to show how we are delivering on those commitments. In addition, our work contributes to the government's work, led by Treasury, on improving Māori access to capital.

88. The safety and soundness of deposit takers and the stability of the financial system would support a sound basis through which Māori can access financial products and services.

89. This Consultation Paper is an opportunity to seek feedback on the impact the proposals may have on the Māori economy, especially in connection with the interaction of the Māori economy with the financial system and with deposit takers.

Q4 What do you think the impact of the proposed standards will be for the Māori economy, in particular on:

a) the role of the financial system and deposit takers in supporting the Māori economy
b) Māori customers, iwi and individuals and Māori businesses, trusts and entities?

Considering competition

90. Competition is an important consideration in our prudential decision making, as it has a strong connection to efficiency. Moreover, as outlined above, the need to maintain competition within the deposit-taking sector is one of the principles we need to consider when developing standards under the DTA. We consider that the need to maintain competition is always a relevant principle, given all prudential regulation tends to have some impact on competition (even if it is minimal), such as through altering compliance costs the setting of capital or liquidity requirements, or through other mechanisms. Consideration of competition is also closely linked to some other principles, such as avoiding unnecessary compliance costs, proportionality, and the desirability of the deposit-taking sector comprising a diversity of institutions. In some circumstances a prudential requirement may have a marginal negative impact on competition, but this will be justified on a net benefit basis when considering the societal costs of deposit taker failure, the risks to the DCS funds and in light of our financial stability objective.

91. We consider that the DTA and, by extension, the DTA standards will have both positive and negative impacts on competition in the deposit-taking market. Some positive effects include the benefits that smaller players receive by having their relative risk (as compared with larger

[13] Reserve Bank of New Zealand. (2021, 28 January). *Te Ohanga Māori - The Māori Economy 2018*. https://www.rbnz.govt.nz/hub/research/additional-research/te-ohanga-maori---the-maori-economy-2018

[14] Reserve Bank of New Zealand. (2022, 9 August). *Improving Māori Access to Capital*. https://www.rbnz.govt.nz/have-your-say/improving-maori-access-to-capital

deposit takers) reduced through the DCS, the reduction in the risk that larger deposit takers pose to smaller deposit takers through enhanced prudential regulation, and the greater chance of smaller and more vulnerable deposit takers surviving a banking crisis because of enhanced regulation putting them in a better prudential position. Another benefit to competition will come from reducing expansion costs from the single regime for all deposit takers under the DTA. (For example, under the DTA standards we are proposing that risk weights for credit risk will be calculated in the same way for Group 2 and Group 3, reducing the costs for Group 3 entities transitioning into Group 2.) We are also proposing a more unified disclosure regime, which should better drive competition and help consumers make more informed decisions.

92. However, there may be some negative effects (the magnitude of which are uncertain). These include:

    - potentially higher DCS levies for smaller and riskier entities because of higher relative risk (albeit offset by the benefit of the DCS protection)
    - regulatory transition costs for existing NBDTs that may adversely affect their ability to compete in the short term
    - higher costs of participating in the market in the long term, potentially deterring new entrants who could otherwise have more disruptive effects on competition in the deposit taker market.

93. Given these competing factors it is difficult to assess the overall impacts of the change in both the near term and in the long term, and we are interested in your views on the impact of the DTA standards on competition.

Q5	What do you think the cumulative impact of the proposed standards will be on competition? How do you think competition should be factored into our broader analysis of the principles?

Considering our role and those of other agencies through the Council of Financial Regulators (CoFR)

94. New Zealand has a twin peaks model of financial regulation, where one regulator has responsibility for financial stability (us, the Reserve Bank of New Zealand) and another regulator has responsibility for the conduct of financial institutions (the Financial Markets Authority (**FMA**) in New Zealand). The twin peaks model regulators each have their own clear mandate and are separate and equal in power and importance. We have designed the proposed standards with twin peaks in mind, with the core standards designed to support our financial stability mandate, while also allowing for the FMA to regulate conduct-based requirements.

95. For a twin peaks model to work well there must be a degree of coordination between the regulators. To coordinate well with the FMA and other agencies responsible for the regulation of the financial system in New Zealand we have the Council of Financial Regulators – Kaunihera Kaiwhakarite Ahumoni (**CoFR**). It is the body responsible for facilitating cooperation and coordination between CoFR members to support effective and responsive financial regulation.

96. We work collaboratively through CoFR to ensure that we keep other agencies informed of our work and to conduct work together where appropriate (for example, through thematic reviews where the topic covers both prudential and conduct matters). Furthermore, the DTA requires us to consult with CoFR members before issuing a standard.[15] To that end, we have established a reference group comprised of the other CoFR members:

    - the FMA
    - the Commerce Commission
    - the Treasury
    - the Ministry for Business Innovation and Employment (**MBIE**).

97. The input of these agencies is key to avoiding unnecessary regulatory overlap and ensuring the overall framework for the regulation of deposit takers is coherent and works well. Each agency also brings their specific expertise and perspective to support our analysis – for example, the Commerce Commission can support our competition analysis, the FMA and MBIE can facilitate alignment between our prudential regime and the Financial Markets Conduct Act 2013 (**FMCA**) and the broader conduct regime, and Treasury can make wider connections to the overall economy.

Other procedural requirements

98. In addition to consulting with CoFR members, section 75 of the DTA requires us to notify the Minister of Finance about the prudential policy that we intend to implement through the proposed standards and to consult with persons we consider will be substantially affected by the proposed standards. We consider that seeking formal submissions on this Consultation Paper, consulting on the exposure drafts of the standards in late-2025 and conducting industry workshops and any bilateral meetings, constitutes consultation with substantially affected persons.

99. Under the Reserve Bank of New Zealand Act 2021 our Board is also required to have regard to the Financial Policy Remit at the point of issuing standards.[16] We are also required to assess the regulatory impact of policies that we intend to adopt under prudential legislation.[17]

Other design considerations for standards

100. In addition to the points discussed above, there are other considerations that we think should inform the development of the standards. These considerations may help illustrate why we have taken certain approaches in our proposed standards.

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[15] Deposit Takers Act 2023 section 75 Procedure for issuing standards. (As at 17 February 2024). https://www.legislation.govt.nz/act/public/2023/0035/latest/LMS471895.html

[16] Reserve Bank of New Zealand Act 2021 section 49 Board must have regard to financial policy remit when acting in relation to prudential strategic intentions and prudential standards. (As at 20 December 2023). https://www.legislation.govt.nz/act/public/2021/0031/latest/LMS361391.html

[17] Reserve Bank of New Zealand Act 2021 section 255 Assessment of regulatory impacts of policies. (As at 20 December 2023). https://www.legislation.govt.nz/act/public/2021/0031/latest/LMS287212.html

Minimising changes where appropriate

101. As part of the process of developing the standards, we have considered what areas of our existing regulatory regime could be carried over to the new regime. Wherever we have proposed carrying over existing requirements, we have conducted analysis to ensure that:

    - the existing requirements are necessary or desirable for one or more of the DTA's purposes
    - the DTA gives us the authority to make the requirements
    - we have considered each of the relevant principles in section 4 of the DTA.

102. Based on this analysis, we are not intending to make new policy across all standards, if we consider existing policy is fit for purpose. This approach minimises the transition costs to industry and makes the process of developing the proposed standards slightly less complex. However, we cannot simply 'copy and paste' our existing requirements without first carrying out this analysis.

103. While these requirements may stay the same as long as the analysis supports this, we expect that drafting changes are likely as requirements are converted into secondary legislation and consistent definitions are adopted across all the standards.

Aligning with international good practice

104. In developing the standards, we have considered the extent to which we should align with international standards (including the Basel Core Principles) and Australian prudential requirements.

105. Section 4 of the DTA requires that we have regard to:

    "the desirability of maintaining awareness of, and responding to,—

    i. the practices of overseas supervisors that perform functions in relation to any licensed deposit taker or any holding company of any licensed deposit taker; and

    ii. guidance or standards of international organisations."

106. Additionally, our Statement of Prudential Policy[18] states that we must have regard to international good practice when setting prudential requirements. Alignment with the Australian prudential requirements also supports a consistent approach to the regulation and supervision of the different parts of trans-Tasman banking groups, thereby helping to ensure risks are managed in a consistent manner and reducing compliance costs. Trans-Tasman alignment also potentially reduces the risk of regulatory confusion or a lack of compliance because of potentially conflicting requirements, especially given that the 4 largest banks in New Zealand are owned by Australian banks.

107. Therefore, we have generally tried to align with international practice (including considering trans-Tasman alignment) when developing the standards except where:

[18] Reserve Bank of New Zealand. (2022, September 22).*Statement of Prudential Policy*.. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/statements-of-approaches/sopp-2022.pdf

- we have made a recent decision to adopt a different approach
- alignment would be in conflict with other principles under section 4 of the DTA, for example where alignment would impose unnecessary compliance costs and/or not be proportionate to the risk the deposit taker poses to the financial system
- departure is justified by New Zealand specific circumstances
- New Zealand legislation requires an approach that differs from international practice.

108. For these reasons, we are likely to follow international practice more closely when we are creating standards containing new requirements, rather than when we are basing the standards on our existing prudential requirements.

Making use of principles-based regulation where appropriate

109. We propose to make use of more principles-based requirements for qualitative requirements (i.e., we propose obligations that require deposit takers to act in accordance with certain principles or achieve certain outcomes rather than comply with prescriptive rules).

110. We consider that principles-based requirements have value in certain policy areas rather than developing a "tick box" approach, especially where those areas are heavily influenced by a deposit taker's internal culture or where we are trying to lift industry practices over time and ensure that regulated entities take ownership of their approach to managing certain risks.

111. We propose to support more principles-based requirements with guidance on what best practice is. This acknowledges the fact that principles-based requirements can sometimes be less clear, and that best practice guidance can lift industry practices while still leaving space for deposit takers to find the most efficient ways of achieving the required outcomes. We note that best practice guidance may also be especially helpful for smaller entities who may not be as sophisticated or well resourced.

Setting board responsibilities at the appropriate level

112. We are trying to design requirements placed on deposit takers' boards so that boards can be focused on more strategic issues and oversight of management. This reflects directors' due diligence obligations under subpart 3 of the DTA, which imposes a duty on directors to exercise due diligence to ensure that the deposit taker complies with its prudential obligations. We are also trying to avoid imposing specific obligations on boards that could detract from focus on their primary roles of strategy and oversight.

Transition to the new prudential regime

113. Existing requirements carried over into the standards will generally need to come in effect when the BPSA and Non-bank Deposit Takers Act 2013 (NBDT Act), are repealed to avoid the existing requirements lapsing. These Acts are expected to be repealed upon the full commencement of the DTA, which is currently planned for July 2028.

114. For new requirements, there could sometimes be merit in delaying when they come into force (for example, by 12 to 24 months), to allow time for regulated entities to achieve compliance. However, this needs to be balanced against the risk that having a range of dates for

requirements coming into effect could add complexity and make the prudential framework harder to administer.

115. We seek your feedback on what requirements may require bespoke transitional arrangements and our overall approach to transitional arrangements.

Q6	Do you think that this approach to developing standards is appropriate? Is there anything else we should take into account when developing the prudential framework?
Q7	What transitional arrangements would be appropriate? Are there any particular requirements that would take longer to comply with than others?

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 1

Deposit Takers Capital Standard

Deposit Takers Core Standards Consultation

16 May 2024

CONSULTATION PAPER

Non-technical summary

Deposit takers source funding from two places – their owners (often referred to as 'shareholders') and people they borrow from, including depositors (often referred to as 'creditors'). The portion deposit takers source from owners is referred to as 'capital'.

Deposit takers in New Zealand are required to have minimum levels of capital. Capital requirements mean that the deposit taker can absorb losses, reducing the risk of deposit taker failure and supporting financial stability.

Capital helps make deposit takers more resilient to economic shocks and downturns, which helps deliver the main purpose of the DTA – *"to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system."*

But capital does come at a cost. Capital is a more expensive source of funding for deposit takers than debt. Lower levels of capital than those proposed in this chapter may therefore be cheaper for deposit takers. However, the link to costs to borrowers is less clear cut – capital reduces risk and therefore higher levels of capital should reduce the return that shareholders and creditors require.

This chapter of the Consultation Paper covers the key proposed components of the Capital Standard. In some places this takes existing requirements that apply to banks and non-bank deposit takers and brings those into the standard, in other places, new requirements are proposed. At all times this has been done to deliver the main purpose of the DTA and has taken into account principles of the DTA.

Capital requirements for the largest deposit takers – Group 1 and 2 deposit takers – were revised in decisions made during the bank Capital Review in 2019. The proposals in this paper carry over many of these requirements into the standard, with a few small modifications. For the smallest deposit takers – Group 3 – we are proposing an increase in capital requirements, but in a proportionate way, to a lower level than for Groups 1 and 2. The proposals are not expected to have a significant impact on the costs of borrowing or economic activity.

1 Introduction

116. This chapter of the Deposit Taker Standards Consultation Paper focuses on the Capital Standard, to be made under Part 3 of the DTA. The Capital Standard will cover the minimum capital requirements for deposit takers in New Zealand.

117. Deposit takers get their funding from two places – their owners (often referred to as 'shareholders') and people they borrow from, including depositors, (often referred to as 'creditors'). The money that deposit takers get from their owners is referred to as 'capital. This consists of financial resources that can absorb losses.

118. We currently require deposit takers to have minimum levels of capital, meaning a minimum percentage of their funding must come from their owners. These minimum requirements help to make sure that the owners of a deposit taker are the first to bear losses, not depositors or other creditors. It ensures that the owners have a meaningful stake in the business, because the more owners have to lose the greater their incentive to manage risks prudently.

119. When the amount of a deposit taker's capital gets too low, and it cannot get any more capital, the deposit taker is likely to fail. So, the more capital a deposit taker has, the more money it can stand to lose before going out of business. High levels of capital better protect depositors.

120. This chapter sets out our proposed approach to minimum capital requirements for each of the Proportionality Framework's 3 Groups of deposit takers.

121. The Capital Standard will not apply to overseas licensed deposit takers (branches). Capital requirements for branches are set by their home regulators.

1.1 Purpose of the Capital Standard

122. The new regulatory regime under the DTA allows us to create a Capital Standard in order to set minimum capital requirements for deposit takers. Without a Capital Standard, there would be a significant regulatory gap once the DTA comes into force, which would mean that deposit takers would not be required to maintain minimum capital levels.

123. Capital requirements promote the maintenance of a sound financial system and, by reducing the probability or extent of deposit taker failures, also protect the wider economy from the costs that can arise from the failure of financial institutions. Capital requirements also help make sure that the deposit-taking system can continue to supply credit to the economy in times of economic stress, reducing the negative feedback loops that can occur between financial losses to banks and the real economy.

124. By setting minimum capital requirements for deposit takers, the proposed Capital Standard aligns with the main purpose of the DTA: to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system.

125. Some aspects of the proposals also support the following additional purposes of the DTA:

- to promote the safety and soundness of each deposit taker (section 3(2)(a))
- to promote public confidence in the financial system (section 3(2)(b))

- to avoid or mitigate the adverse effects of risks to the stability of the financial system (section 3(2)(d)(i)).

1.2 Current approach

126. The current prudential framework under the BPSA and NBDT Act is made up of banks and NBDTs. Each is covered by a separate set of requirements.

    - capital requirements for banks are set out in the Banking Prudential Requirements (**BPR**) documents and imposed on each bank through their Conditions of Registration (**CoR**).
    - capital requirements for NBDTs are set out in the Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010 and are imposed on each NBDT through a trust deed.

Current requirements for banks

127. Capital requirements for banks have been set as a result of our recent Capital Review.[19] The Capital Review, launched in 2017, was an extensive process to review the capital adequacy framework for locally incorporated, registered banks in New Zealand. It considered the level of capital required to guard against the risks that the failure of a deposit taker poses to New Zealand. Capital settings were strengthened in order to support a sound and efficient financial system.

128. To achieve this, the Capital Review sought to reform all three main aspects of the capital framework:

    - the required ratio of capital to RWA that banks are required to have to support resilience and stability (the ratio)
    - the types of instruments that qualify as capital (the numerator)
    - the approach to calculating RWA to convert actual dollar level exposures into a risk weighted version to reflect the relative risk of each exposure (the denominator).

129. We announced the Capital Review decisions in 2019. This resulted in a material increase in both the quantity and quality of capital that banks are required to have. Table A summarises the key decisions.[20]

[19] Reserve Bank of New Zealand. (2022, 28 February). *Capital Review.* https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/how-we-regulate-and-supervise-banks/our-policy-work-for-bank-oversight/capital-review

[20] Reserve Bank of New Zealand. (2019, 19 December). *Capital Review Decisions 2019.* https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-decisions.pdf

Table A: High-level overview of the 2019 Capital Review decisions

2019 Capital Review Decisions
Ratio
A minimum total capital ratio requirement of 9% for all banks, of which: • 7% must be Tier 1 capital, including a maximum of 2.5% that can be AT1 capital • a maximum of 2% can be Tier 2 capital
Plus, for D-SIBs, a PCB of 9% of RWA (Common Equity Tier 1 (CET1 buffer)), of which • 2% will consist of D-SIB buffer (applied to banks deemed to be systemically important) • 1.5% will be an early-set counter-cyclical capital buffer (CCyB) • 5.5% will consist of a conservation buffer For non-D-SIBs, a Total PCB of 7% (CET1 buffer), of which: • 1.5% will be an early-set CCyB • 5.5% will consist of a conservation buffer
Total capital (including PCB): • 18% of RWA for D-SIBs • 16% of RWA for non-D-SIBs
Numerator – composition of capital
Remove contractual contingency from the definition of capital
Accept redeemable perpetual preference shares as AT1 capital
Accept long-term subordinated debt as Tier 2 capital
Denominator – calculation of risk weighted assets
Increase RWA outcomes for IRB banks to approximately 90% of what would be calculated under the standardised approach: • Apply an 85% output floor for credit risk RWA of IRB banks • Increase the scalar applied to credit risk RWA of IRB banks from 1.06 to 1.2
Only allow Standardised Measurement Approach (SMA) for operational risk modelling
Retain the current market risk capital framework and current standardised approach

130. These decisions are in the process of being implemented over a seven-year period.[21] The phasing-in of the increase in capital buffers began on 1 July 2022 and is due to be completed

[21] Reserve Bank of New Zealand. (2021, 5 May). *Updated Capital Review Implementation Timeline.* https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/updated-capital-review-implementation-timeline.pdf

by 1 July 2028. This timing aligns with the scheduled implementation of the proposed Capital Standard.

131. The current capital requirements for banks are contained in the BPR documents.[22] Each aspect of the capital adequacy framework is set out in a different BPR document. Under the future Capital Standard, all capital requirements for all deposit takers will be in one document.

Current approach to NBDTs

132. Capital requirements for NBDTs were set in 2010, as part of an extensive review in 2008 following the GFC.[23]

133. The NBDT sector comprises two main types of entity: deposit taking finance companies and savings and lending institutions (such as building societies and credit unions). The essential characteristic for an institution to be subject to the NBDT prudential regime is that it offers debt securities to the public and then lends the money out or provides other financial services.

Table B: High-level overview of current NBDT capital requirements

NBDT Capital Requirements
Ratio
Total capital ratio requirement of 8% of RWAs Additional 2% or 4% of RWAs for credit rating exempt NBDTs. Designation of 2% for total liabilities of less than $20 million and of 4% for total liabilities of between $20m and $40m.
Numerator
Non-cumulative perpetual preferences shares can make up 25% of capital (or 50% for qualifying mutual entities)
Denominator
Risk weights specified for a range of exposures, often linked to loan-to-value ratios.

1.3 Proposed policy development approach

134. This chapter sets out the proposed approach to capital requirements for each of the Proportionality Framework's 3 Groups of deposit taker. It discusses specific policy proposals for these Groups and seeks your feedback.

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[22] Reserve Bank of New Zealand. (2022, 28 February). *Banking Prudential Requirements*. https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/banking-prudential-requirements

[23] The development of the current approach is described in this Reserve Bank Bulletin article: Barker, F., & Javier, N. (2010). *Regulating non-bank deposit takers*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2010/2010dec73-4barkerjavier.pdf]

135. We began developing our proposed approach for Group 1 and Group 2 deposit takers by assessing the Capital Review decisions against the main purpose of the DTA. This involved considering how the overall capital package that resulted from the Capital Review aligns with the main purpose of the DTA. Our analysis also involved taking into account the principles set out in the DTA, wherever relevant. This assessment allowed us to identify which parts of the existing capital adequacy framework are suitable under the new regime and which areas we may need amend.

136. We used a variety of approaches to help develop our policy proposals for the areas of the capital framework we identified as needing revisions. These approaches included looking to align with international practice where appropriate, consulting with our prudential regulator peers and our CoFR partners and engaging with industry stakeholders.

137. The aim of the policy proposals in this chapter is to enhance our carefully calibrated capital framework and make sure it is fit for purpose under the new regulatory regime. This process has resulted in proposals for Group 1 and Group 2 that are consistent with the main purpose of the DTA.

138. The capital requirements for NBDTs have not been reviewed since they were established in 2010. For Group 3, we assessed the existing NBDT requirements against the purpose of the DTA and took into account the principles of the DTA. We are proposing a range of changes to the current NBDT requirements to form the new Group 3 capital settings. We propose that this approach to Group 3 capital requirements is the most effective way to achieve the main purpose of the DTA, while also supporting some of the additional purposes.

2 Proposed approach for Group 1 deposit takers

139. Group 1 deposit takers are subject to the most comprehensive prudential requirements because of the importance of the D-SIBs to New Zealand's financial system. The decisions of the Capital Review resulted in a robust capital framework designed to support the stability of the financial system and reduce the risk of problems in the financial system that could damage the broader New Zealand economy. In this way, we can ensure that Group 1 deposit takers are well capitalised and have the resilience to provide financial products and services that meet the needs of New Zealanders.

140. The 2019 Capital Review decisions were informed by a detailed assessment of the costs and benefits of the proposed changes. This assessment demonstrated that the benefits of an increase in stability, primarily in the form of avoiding the costs of a financial crisis, were larger than the costs, the largest of which was a small fall in long-run economic activity resulting from an increase in interest rates of around 0.2 of a percentage point.

Preferred option

141. We propose to carry over most aspects of the existing capital framework for Group 1 deposit takers to the new Capital Standard. This proposal is influenced by the recent refresh of the capital framework through the Capital Review, which led to a significantly reformed and strengthened capital framework. This framework is now more resilient and fit for purpose, taking into account the specific features of the New Zealand financial system in which Group 1 deposit takers play a crucial role.

142. As a result, we have identified that retaining the Capital Review requirements for Group 1 deposit takers is our preferred approach in the proposed Capital Standard. This proposal is based on our assessment that the existing capital framework largely matches the main purpose of the DTA and will help protect and promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system.

143. We have used the Regulatory Impact Assessment (RIA) for the 2019 Capital Review to underpin this analysis.[24] This RIA included estimates of the costs and benefits for the capital requirements. Its key elements are described below in Box A.

144. The proposals in this document would see a continuation of the Capital Review decisions being implemented over the next few years. We are not proposing any further increase to the capital requirements for Group 1 deposit takers, beyond that decided in the Capital Review. Therefore, we consider that the estimates of the costs and benefits of the capital requirements for Group 1 are still valid.

145. As noted in Box A on the following page, we expect the benefits of higher levels of capital to exceed the costs. The benefits primarily arise from a significant increase in the resilience of banks, meaning greater capacity to absorb losses in a crisis and therefore a fall in the probability of a bank failure, that could trigger a financial crisis. Such events are associated with higher economic and social costs. We consider that this strongly aligns with the main purpose of the DTA and also takes into account the principle around the desirability of managing risks to the stability of the financial system and risks from the financial system that may damage the broader economy.

[24] Reserve Bank of New Zealand. (2019). *Capital Review Regulatory Impact Assessment and Cost-Benefit Analysis 2019*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-cost-benefit-analysis.pdf

Box A: Overview of the costs and benefits of capital from the 2019 Capital Review

Capital increases resilience to shocks and reduces the likelihood of bank failure and a financial crisis. The 2019 RIA estimated that this was equivalent to a small increase in economic activity over the long term, as the likelihood of a sharp drop in activity because of financial crisis, triggered by bank failure would be lower.

The RIA also acknowledged that higher capital requirements were likely to increase banks' funding costs and that might contribute to a small increase in interest rates. The RIA concluded that the benefits of greater stability in the financial system, by increasing banks' capacity to absorb losses and remain resilient to economic and financial shocks, more than outweighed the costs of modestly higher interest rates.

One of the key factors addressed in the RIA was the Modigliani-Miller (**MM**) theorem. This is an input to assessing the impact of higher capital requirements on a deposit taker's funding costs and the extent to which higher capital leads to higher interest rates for borrowers.

The MM theorem suggests that when banks are funded with more equity, the risk to investors falls, as the bank is more resilient to shocks and less likely to become insolvent and fail. Consequently, investors' required return on equity falls. Likewise, when banks are funded with more debt and less equity, the risk to investors increases, requiring a higher rate of return on equity to compensate for that additional risk.

Higher capital requirements can therefore have two opposite effects on total funding costs:

- A higher amount of capital can add to funding costs as capital tends to be more expensive than debt.
- A higher amount of capital will reduce funding costs as the required return on capital and debt will fall as risk is lower.

The RIA concluded that the potential effects of the MM theorem would hold only partially. In the context of the Capital Review decisions, this meant that the RIA expected a small increase in a bank's effective funding costs, with the impact of more capital – the first point above – exceeding the reduction in costs from lower risk – the second point above.

In the RIA, the Reserve Bank concluded some of these higher funding costs would be passed on to customers in the form of higher interest rates for borrowing and lower interest rates for deposits. The RIA concluded that any interest rate increases were likely to be modest and estimated that interest rates could increase by around 0.2 percentage points.

This small possible lift in interest rates was expected to lead to a fall of a similar size in long run economic activity. However, we estimated this cost was estimated to be smaller than the gains accruing from higher capital discussed above.[25]

[25] You can find an overview of costs compared with the 2019 estimates in this Bulletin: Reserve Bank of New Zealand. (2024, 18 March). *Biennial Assessment 2023 – Monitoring Capital Review Implementation.* https://www.rbnz.govt.nz/hub/publications/bulletin/2024/rbb-2024-87-03

146. Though we propose to carry over most of the existing capital framework for Group 1 deposit takers, there are certain areas that we are proposing to amend as part of the new Capital Standard. These are discussed separately and include:

- minor amendments to credit risk requirements – largely covering technical issues raised by stakeholders in previous policy consultations
- the approach to market risk requirements – to modernise the outdated framework which was left largely untouched in the capital review
- the approach to operational risk requirements – to alter the standardised approach, as signalled in the 2019 Capital Review decisions.

147. Therefore, our proposed approach for Group 1 deposit takers is for the key results of the Capital Review to continue to apply as follows:[26]

Table C: Proposed Group 1 capital requirements

Proposed requirements
Capital ratio (18% of RWA)
A minimum total capital ratio requirement of 9% for Group 1 deposit takers, of which: • 7% must be Tier 1 capital, including a maximum of 2.5% of which can be AT1 capital • a maximum of 2% can be Tier 2 capital
Plus, a PCB of 9% of RWA for D-SIBs (CET1 buffer), of which: • 2% will consist of D-SIB buffer (applied to Group 1 deposit takers as they are deemed to be systemically important) • 1.5% will be an early-set CCyB[27] • 5.5% will consist of a conservation buffer
Numerator – composition of capital
Capital instruments cannot have any contractual contingency or write-off features. AT1 capital can include redeemable perpetual preference shares, subject to the point above.
Tier 2 capital can include long-term subordinated debt.
Denominator – calculation of risk weighted assets
A scalar of 1.2 is applied to IRB credit RWA calculations. The output floor of 85% of the standardised approach calculation for credit RWA is applied to credit RWA outcomes calculated using the IRB approach.

[26] Table C sets out the eventual requirements as at the end of the transitional period.
[27] We will publish a separate supporting paper covering the implementation of the CCYB.

Proposed requirements
Group 1 deposit takers will need to publicly report both their IRB and standardised approach outcomes (dual reporting).
IRB exposure modelling is restricted to corporate and retail exposures (excluding reverse residential mortgage lending)

148. These requirements are being phased in gradually until July 2028. Group 1 deposit takers are familiar with this implementation timeline and are working towards meeting the new prudential requirements as they come into force. We consider that continuing this process, aside from the proposed amendments described earlier, is the optimal outcome. While deposit takers have already incurred some costs associated with transitioning to the new requirements from the Capital Review decisions, these new requirements have been designed so the financial system should be resilient to shocks up to those that might be expected in a 1-in-200-years event.

149. In addition, there may be risks to the financial system if we deviate from the 2019 decisions. If we disrupt the implementation of the Capital Review (for example, by halting the path to higher levels of capital) the impact of increased resilience will be less than expected in 2019. This would reduce the capacity of Group 1 deposit takers to absorb losses in a shock and would reduce financial stability. Those risks may be enhanced, as would the chances of bank failure, which would be contrary to the main purpose of the DTA.

Internal Capital Adequacy Assessment Process requirements

150. The proposed capital settings for Group 1 deposit takers will continue to include provisions around the Internal Capital Adequacy Assessment Process (ICAAP). We intend to strengthen the current ICAAP settings by formalising them under the proposed Capital Standard. This means there will be ICAAP requirements to replace the ICAAP guidelines currently set out in *BPR100 Capital Adequacy*.[28]

151. The main practical implication of this is that we propose to strengthen the existing ICAAP guidelines so that current statements setting out what a bank 'should' do become what a bank 'must' do.

Sectoral capital requirement

152. The proposed approach for Group 1 capital requirements also includes scope for the possible future use of a sectoral capital requirement (SCR). The SCR is an additional capital buffer that we can put in place to address the build-up of credit in a specific sector (for example, lending to the dairy industry or the residential mortgage sector), which poses risks for the whole system.

[28] Reserve Bank of New Zealand. (2021, 1 October). *BPR100 Capital Adequacy*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr100-capital-adequacy-oct-21.pdf n

153. The role of an SCR is currently covered in our Memorandum of Understanding (MoU) with the Minister of Finance.[29] We are proposing to include scope for an SCR in the Capital Standard so there is a clear and transparent role for the SCR if this is needed in the future. We do not intend to activate the SCR and any future implementation would be covered by a separate policy consultation about the details of the approach.

154. An SCR could be implemented under two different approaches: a sectoral capital overlay (SCO) or overlays to sectoral risk weights (SRW). The SCO approach would see a capital add-on being applied to individual deposit takers, which would be calculated based on the proportion of their total RWAs exposed to the sector that we had concerns about. The SRW approach adjusts risk weights for exposures to the targeted sectors – it is a macro-level overlay on top of the requirements that would otherwise apply through risk weight settings.

155. The SRW approach may be better suited if a policy were required to target a particular segment of a sector, such as investor lending or interest-only lending in the residential mortgage sector. This approach may vary between Group 1 and Group 2 deposit takers, because of the different approach to calculating risk weights for each Group (see discussion in the analysis subsection below). This would effectively reduce capital ratios by increasing the size of the RWA, in line with each deposit takers' exposure to the targeted sector. This means that deposit takers would need to increase capital to offset the impact of the higher RWA.

156. A sectoral capital requirement implemented via a capital overlay (the SCO approach) may be better suited to targeting sectors as a whole, but each deposit taker would have a different minimum requirement, dependent on its exposure to the targeted sector.

157. Currently, we have scope to use the SCR under the macroprudential MoU, however it has not been used historically and, as such, is currently set at 0%. If we consider it necessary to use the SCR in the future, it would likely be set out in licence conditions as per section 92 in the DTA. This gives flexibility to apply the SCR to some deposit takers and not others.

Entity-specific requirements

158. In addition to the proposals above, there may be circumstances where entity-specific buffers or overlays of some sort as required. For example, if a Group 1 deposit taker was taking on high exposures to high-risk sectors, in a way that made its risks highly concentrated in that sector, there might be a basis to add further capital charges.

Analysis

159. We have taken into account the principles under the DTA and are proposing to carry across most of the current capital requirements that apply to Group 1 deposit takers to the new standard, with the exception of the proposed amendments described earlier. Our assessment is that the proposed approach to Group 1 deposit takers is consistent with the main purpose of the DTA. We provide below a more detailed description of how we have considered the principles in reaching the proposed approach.

[29] Reserve Bank of New Zealand. (2021, 2 August). *Macroprudential policy and operating guidelines.* https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/our-relationship-with-other-financial-regulators/our-memoranda-of-understanding/macroprudential-policy-and-operating-guidelines-august-2021

Proportionality and consistency across deposit takers

160. One of the DTA principles taken into account during the development of these proposals is the desirability of taking a proportionate approach to regulation and supervision. We have recently published the Proportionality Framework that sets out this approach.[30]

161. The proposed capital requirements apply this proportionate approach to the amount of capital each Group of deposit taker must have. In the proposal, all deposit takers must have a minimum total capital ratio of 9% of RWA.

162. However, the proposed approach would see Group 1 deposit takers face a higher PCB than Group 2 and Group 3 deposit takers. This carries over the use of the D-SIB buffer from the current framework, which results in a PCB of an extra 2% of RWA for Group 1 deposit takers relative to Group 2 (and an extra 5% of RWA relative to Group 3 as detailed in section 4 of this chapter). This reflects the relative importance of Group 1 deposit takers to the New Zealand financial system and the larger impacts that their failure would have on system-wide financial stability.

163. Currently, all entities designated as Group 1 deposit takers are banks that are also accredited to utilise the internal ratings-based (IRB) model framework to calculate their credit RWAs. These entities must also meet stringent requirements to enable them to utilise the IRB approach. The IRB approach involves the use of inputs from credit models developed internally by the deposit taker to a formula specified by the Reserve Bank. The Reserve Bank must accredit a deposit taker to use the IRB approach and approve the models it uses in its RWA calculation.

164. The use of the IRB modelling approach for credit risk RWAs by accredited deposit takers can lead to a difference in the risk weighted asset outcomes compared with the Standardised Approach, which must be used by deposit takers without accreditation to use the IRB approach. Various changes introduced as part of the Capital Review have reduced the difference between the RWA outcomes for IRB banks and non-IRB banks.[31] This reduction is for a number of reasons:

    - IRB banks (current made up of Group 1 deposit takers) are only able to use their own model to calculate credit risk exposures for two asset classes – all other exposures to credit risk must be calculated using the standardised approach
    - Group 1 deposit takers must apply a scalar of 1.2 to the result they calculated for their credit RWA. If the result of this calculation is less than 85% of the result that would have been achieved by calculating the credit RWA with the standardised approach, then the higher outcome is used.

165. However, the combination of the output floor and the IRB scalar leads to the credit RWAs of the IRB banks being within approximately 90% of the level they would be under the standardised approach used by non-IRB banks. We consider that this is an appropriate outcome - at 90% of the standardised outcome, the result limits any large differences relative to the Standardised Approach, while also reflecting the risk differentiation available in IRB

[30] Reserve Bank of New Zealand. (2023, 30 November). *DTA legislation and regulation.* https://www.rbnz.govt.nz/regulation-and-supervision/depositor-compensation-scheme/regulatory-environment-under-the-dta

[31] There may be circumstance where a Group 2 deposit takers wishes to apply for accreditation to use IRB modelling for credit risk weights. Such an application would face to some stringent requirements as a Group 1 deposit taker seeking to use IRB models.

modelling mechanism to reflect the risk differentiation possible from the use of IRB models, without driving a significantly larger difference relative to the Standardised Approach.

166. While the lower risk weight outcome under the IRB approach will generally result in a lower level of risk weighted assets, the impact on capital requirements is largely removed by the additional PCB of 2% for Group 1 deposit takers. The details of this are shown in more depth in section 3: Proposed approach for Group 2 deposit takers

Consistency across deposit takers

167. We are also comfortable that the application of the requirements based on which Group a deposit taker fits into ensures that similar institutions are treated in a consistent manner.

168. There may be cases in the future in which it is necessary to depart from taking a consistent approach. Consistent with international approaches, there may be instances where capital minimums or buffers are varied for individual deposit takers to reflect the specific circumstances of those deposit takers. For example, a deposit taker with highly concentrated lending to a high risk sector might be subject to an additional capital overlay to manage those specific risks, if we assess those risks as not adequately captured by other settings.

Maintaining competition and sector diversity

169. The DTA includes the following principles, which we have taken into account in the development of the proposals for the Capital Standard:

- desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders
- the need to maintain competition within the deposit-taking sector.

170. The strength and resilience of deposit takers directly impacts the diversity of institutions to provide access to financial service and products. Sound and well capitalised Group 1 deposit takers reduce the risk of failure of one of those deposit takers. This means that deposit takers remain in business and continue to provide financial products and services. This supports the provision of services and competition, by ensuring those deposit takers are more likely to remain viable.

171. However, there are some countervailing factors that we have taken into account regarding the connection between capital and the two DTA principles above.

172. High levels of capital may be a barrier to entering the market. If set too high, such requirements might affect competition and/or limit the diversity of institutions providing services. Our analysis during the 2019 Capital Review commented on the likely impact of the decisions on competition. The impact of higher capital on competition received particular attention in submissions on the Capital Review, with suggestions that the impact on increased competition was not clear.[32]

173. Our assessment at the time of the Capital Review noted that higher capital requirements might potentially exacerbate barriers to entry facing banks who want to compete as deposit

[32] Reserve Bank of New Zealand. (2019). *Capital Review Regulatory Impact Assessment and Cost-Benefit Analysis 2019*. (p. 85). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-cost-benefit-analysis.pdf

takers in the New Zealand retail deposit and retail lending market. Our assessment also noted that the changes to risk weighting, including the imposition of a floor on the calculation in internal models, might help level the playing field with deposit takers required to use the risk weights specified in the Standardised Approach. We consider that these points still apply under the new regulatory regime of the DTA, with prospective new deposit takers potentially facing higher fixed costs as a result of the changes from the capital review and Group 1 deposit takers competing on a more level playing field with other Groups because of the floor on their internal models.

174. Under the Capital Standard, our proposed approach would mean that Group 1 deposit takers would have the highest level of overall capital requirements, in the form of the highest PCB, because of their relative importance to the financial system. This leads to the greatest level of resilience. The impact of a Group 1 deposit taker failing would be felt throughout the financial system and would lead to the risk of contagion from their failure to other deposit takers. Strong prudential requirements for Group 1 entities promotes confidence in the whole financial system, which can support confidence in smaller players and therefore supports the continued diversity of institutions. Failures of other deposit takers in a scenario of a failure of a Group 1 deposit taker would, in addition to the economic costs, reduce the diversity of service providers.

175. Supporting the resilience of Group 1 deposit takers through the proposed capital requirements in the Capital Standard increases the likelihood of those deposit takers remaining solvent and continuing to provide services. This helps ensure that there several Group 1 deposit takers competing for customers.

176. The Capital Review was an extensive, multi-year project supported by rigorous consultation and feedback processes. We prepared a Regulatory Impact Assessment and carefully analysed the costs and benefits of the proposals. The outcomes of the Review are being implemented over the 7-year period up to 2028 to minimise impacts to individual deposit takers and the financial system as a whole. Generally transposing the requirements that flowed from the Capital Review to the new standard is the simplest and most effective way of avoiding unnecessary compliance costs.

177. The inclusion of Tier 2 and AT1 capital instruments as types of eligible capital supports flexibility in capital raising. The loss-absorbing features of these instruments contribute to overall resilience within the system. The requirement for dual reporting by Group 1 deposit takers (that are all currently IRB banks) and the general level of capital required provide additional backstop measures to mitigate any other risks inherent in less loss-absorbent forms of capital. All these factors contribute to an overall approach that balances the desire for prudential strength with a functioning, competitive market serving the needs of all New Zealanders.

178. Therefore, our assessment is that the proposed calibration of capital for Group 1 deposit takers at 18%, made up of a 9% minimum and 9% PCB, supports the main purpose of the DTA, without unduly restricting competition or limiting the diversity of institutions. We are interested in your feedback about whether there are other aspects of these two principles that we may have overlooked.

Compliance costs

179. We have also taken into account the DTA principle that sets out the need to avoid unnecessary compliance costs.

180. For Group 1 deposit takers, most of our proposals are in line with the 2019 Capital Review decisions, including the increase in capital requirements that is being phased in.

181. Continuing with the implementation of the existing requirements minimises the compliance costs Group 1 deposit takers would face under the transition to the DTA.

Consistency with international regulators

182. We continue to monitor and maintain an awareness of the guidance and standards established by international organisations. We follow the fundamental approach set out by the BCBS, but we implement this in a way that takes into account the particular features of the New Zealand financial system. Our proposal to carry across the existing framework into the Capital Standard sees that this alignment with international good practice continues. In this context, additional buffers for the largest, most systemically important banks are a common feature of other regulatory frameworks.

183. A guiding principle of the Capital Review was that the capital requirements of New Zealand banks should be conservative relative to those of our international peers. This intended to reflect the risks inherent in the New Zealand financial system and our regulatory approach.

184. New Zealand has a small open economy that is exposed to changes in global supply and demand. New Zealand is quite reliant on foreign investment and on bank intermediation of investment. In addition, the domestic banking sector is concentrated, with a small number of large banks accounting for most of the market and most of their lending is also concentrated in a limited number of areas, being to homeowners and farmers. New Zealand is exposed to movements in international commodity prices and house price declines. In such an environment systemic bank crises are more likely unless deposit takers are financially strong.

185. Our proposed approach to the standard continues to follow this principle with the capital requirements set for Group 1 and Group 2 deposit takers exceeding the minimum levels recommended by the BCBS.

186. Group 1 deposit takers are subsidiaries of large banks regulated by APRA and are therefore also subject to a level of regulation by overseas supervisors. Although the specific regulatory requirements imposed by APRA are different from those proposed for Group 1 deposit takers in New Zealand, the requirements are all underpinned by the Basel international framework, with adjustments in each country for country-specific factors. This ensures that the regimes do not cause an inconsistency for Group 1 banks, as all are operating within the same general approach, while respecting the philosophical and regulatory differences that result from financial systems that are different in nature and scale.

Effective management of capital

187. As mentioned, the Capital Review outcomes will not be fully implemented until July 2028, which is around the time we expect the Capital Standard to come into effect. We intend to provide deposit takers that have increased capital requirements with a clear transitional pathway to meet the new capital requirements.

188. The level and type of capital required under the new regime means that Group 1 deposit takers may need to conduct some balance sheet strengthening and/or replace certain capital instruments that will gradually be phased out as qualifying regulatory capital. However, although we narrowed the types of instruments that meet regulatory requirements, we also retained a mix of instruments that provide deposit takers with a level of flexibility.

Summary

189. We are proposing to apply the existing requirements for D-SIB banks to the new Group 1 deposit takers when the Capital Standard comes into force. The existing requirements were developed from a comprehensive review of the prudential capital framework and are in the process of being implemented. Except for the specific amendments being consulted on in this document, we do not believe there is any compelling reason why they should be revised again.

190. In reaching this conclusion our central focus has been to ensure that the existing set of policy settings will deliver the main purpose of the DTA. We are confident that this is the case.

Q8	Do you agree with our proposed overall approach to capital requirements for Group 1 deposit takers?
Q9	What impacts would you expect the proposals to have?

2.1 Technical amendments to the credit risk framework

191. During the Capital Review, we amended the framework that banks use to calculate their credit RWA. The changes primarily affected the D-SIBs as they, in aggregate, acted to reduce the difference between the capital outcomes from banks calculating their RWA using the standardised approach and the results from using their own internal modelling.

192. We said we would continue to review credit risk weights requirements as we implemented these changes and would make changes as we consider necessary. This includes areas of the regime where we can see that they are not working optimally or as intended, or where our attention is directed to specific parts that are causing unnecessary difficulty or complication.

193. Following the Capital Review, we responded to requests for small changes to the credit risk framework as part of a set of risk weights changes that were finalised in 2023. During that consultation process some stakeholders asked us to consider some additional technical changes, including to the IRB modelling approach to match recent APRA changes, and we advised we would consider these in the future.[33] The amendments discussed in the following sections cover some of the minor points raised. Other, more complex issues were also brought to our attention and we will continue to monitor the modelling approach as we conduct our policy process.

194. In the following subsections we discuss the proposals to make four minor amendments to the existing risk weight framework that would be implemented in the new Capital Standard. This

[33] Reserve Bank of New Zealand. (2023, 12 September). *Risk Weights Omnibus.* https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/risk-weights/risk-weights-omnibus-response-to-submissions.pdf

means that regardless of whether we make any changes to the status quo following this consultation, the current requirements in these areas will continue to apply until any Capital Standard comes into force.

195. Aside from these four amendments, we are proposing to maintain our existing policy approach in relation to the credit risk weight framework.

2.1.1 Risk weight for longer term exposures to A-rated banks

196. The term 'A-rated banks' refers to banks that have been given an external credit rating of A- to A+[34] or A3 to A1.[35]

197. All deposit takers are required to use the standardised approach to calculate the credit risk weight (the relative 'riskiness' of that part of their loan portfolio) for their exposures to banks. This is irrespective of whether the deposit taker is accredited to use the IRB approach (i.e., Group 1 deposit takers).

198. To do this, a deposit taker must assign a rating grade to each bank that they are exposed to by using a matrix that converts the external credit ratings issued by each of the four main credit rating agencies[36] into a rating grade from 1 to 6. Consistent with this matrix, A-rated banks are given a rating grade of 2.

199. Each rating grade has a specific risk weight that is applied to a given exposure depending on whether the original maturity of the claim was 3 months or less (shorter term), or more than 3 months (longer term).

200. This methodology was based on the BCBS framework at the time it was implemented. Under that framework, the risk weight to be assigned to longer-term exposures to banks with a rating grade of 2 was 50%. This is the same risk weight that is applied to longer-term exposures to banks with a rating grade of 3 (which have significantly lower external credit ratings).[37]

201. The BCBS changed its framework from January 2023 to reduce the risk weight for longer-term exposures to banks with a rating grade of 2 from 50% to 30%. This change was also implemented by APRA.

Preferred option

202. Given this background, our preferred option is to reduce the risk weight for longer-term exposures to A-rated banks to 30%.

Analysis

203. Reducing the risk weight for these exposures aligns our ratings framework with the BCBS framework. It also better reflects the difference in relative riskiness between a bank with a rating grade of 2 and a bank with a rating grade of 3.

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[34] Rating framework used by Standard & Poor's Global Ratings and Fitch Ratings.
[35] Rating framework used by Moody's Ratings.
[36] Standard & Poor's Global Ratings, Moody's Ratings Services, Fitch Ratings, AM Best.
[37] Banks with a rating grade of 3 have credit ratings of BBB- to BBB+ (Standard & Poor's/Fitch), and Baa3 to Baa1 (Moody's).

204. Our analysis suggests it would reduce RWA for all (current) New Zealand registered banks by a little over $1.6 billion New Zealand Dollars (NZD), which would increase the system-wide capital ratio by about 7 basis points.

205. We have taken into account the guidance of international organisations when considering this proposal.

Summary

206. In summary, we are proposing to change the risk weight for longer-term exposures for A-rated banks from 50% to 30%.

Q10	Do you agree with our proposal to reduce the risk weight for longer-term exposures to A-rated banks to 30%?

2.1.2 The effective maturity date of three-month bank bills

207. As described in the previous section, exposures to banks are divided into exposures where the original maturity date is three months or less (shorter term), or where it is more than three months (longer term). The risk weight then applied to bank exposures will vary depending on whether it is a shorter-term or longer-term exposure.

208. New Zealand's financial markets follows a convention called the Bank Paper Maturity Convention. This is documented by the New Zealand Financial Benchmark Facility in the Bank Bill Benchmark Rate (BKBM) and BKBM Trading Window – Operating Rules and Principles.[38] The convention provides for bank paper (or bank bills) to have a valid maturity date that is up to five business days following the actual maturity date. The implication of the convention has been that, where a bank has issued a bank bill with an original maturity date of 90 days, it can have an actual maturity date of 97 days (taking into account a two-day weekend).

209. The BPRs do not define what constitutes 'three months' for the purposes of determining the limit of a shorter-term exposure. Conventionally, it is considered to be 90 days, although the maximum three-calendar-month period is 92 days.

210. This means that bank bills that have been issued for a three-month term but have a 97-day actual maturity date are treated as a longer-term exposure and attract the higher risk weight.

211. We are considering whether bank bills that have been issued for three months (or less) in accordance with the convention should be considered to have an original maturity date of three months or less. If we aligned the three-month period with the maturity convention, this would mean that bank bills with a 97-day actual maturity date would attract the lower risk weight. This may more accurately reflects the actual risk of the exposure.

212. This discussion only relates to exposures to deposit takers as they are differentiated by being treated as either longer- or shorter-term exposures. There is no maturity distinction drawn between exposures to corporates.

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[38] New Zealand Financial Benchmark Facility. (2022, October). *Bank Bill Benchmark Rate (BKBM) & BKBM Trading Window – Operating Rules and Principles* (p. 22). https://www.nzfbf.co.nz/files/benchmark-documents/bkbm-operating-rules-and-principles---october-2022.pdf

Analysis

213. We have limited information about the extent of this issue and are interested in stakeholder information about the scale and likely impacts if we went ahead with aligning definitions.

214. Although we have not carried out a detailed analysis on the impact of this change, our assumption is that it would reduce the number of exposures treated as longer-term exposures and increase the number of shorter-term exposures. As longer-term exposures generally attract higher risk weights, the overall impact would likely be to reduce the aggregate level of credit risk weighted assets which has the corresponding effect of increasing capital ratios.

215. However, our assessment is that the level of change would be negligible. We are interested in your feedback on this assumption, in particular, what proportion of exposures would be affected if we made a change along the lines described above.

216. As with any policy change, there is the potential for unintended consequences, and we are keen to understand what these might be. A potential change may have adverse impacts elsewhere and we would like this information from stakeholders on both the positive and negative implications of aligning the definition.

217. For example, should we make the change, we would like to understand whether the net impact would be largely neutral outside of the specific impacts on the short-term and long-term exposures being targeted. To this end, we are interested in information from stakeholders regarding the interactions with relevant accounting standards and tax requirements. We are also keen to understand whether there are any other market protocols that would be affected.

218. Broadly, we think that such a proposal would contribute to maintaining competition within the sector because it would remove unnecessary distortion caused by the potential for capital costs to be incurred by the inconsistency between our framework and a well-established market practice. One of the principles that we are required to take into account is the desirability of deposit takers being able to better manage their capital, liquidity and risk. We think that a change to effective maturity dates may better enable deposit takers to manage their capital, by ensuring that the approach to credit risk reflects the underlying exposure in line with the characteristics of these bank bills captured in market conventions. The information we are seeking from stakeholders will better allow us to determine whether this is the case.

Summary

219. We are considering accepting that three-month bank bills issued in accordance with the maturity convention described in this section can be considered to have an original maturity date of three months or less for the purposes of determining the correct risk weight for the exposure. However, we are seeking further information on which to fully analyse the proposal before proceeding to consult on a change.

Q11	If we aligned the effective maturity date of three-month bank bills with New Zealand's financial market's maturity convention, what implications would this have from both accounting and tax perspectives?

Q12	What other market protocols might be impacted and what would those impacts be?
Q13	What level of exposures do deposit takers have which would be affected by this change?

2.1.3 Risk weight for exposures to the New Zealand Superannuation Fund

220. The New Zealand Superannuation Fund (NZ Super Fund) is New Zealand's sovereign wealth fund. It invests the Government's capital contributions to help fund New Zealand's superannuation payments in the future. Its mandate is managed by the Guardians of New Zealand Superannuation, an autonomous Crown entity established by the New Zealand Superannuation and Retirement Income Act 2001. As of the 2023 annual report[39], the size of the NZ Super Fund was NZD $65.40 billion. No withdrawals are expected to be made from the NZ Super Fund until 2035.

221. The NZ Super Fund falls within the 'corporate' asset class for the purposes of calculating the risk weight of any exposures. Banks accredited to use the IRB approach can include NZ Super Fund exposures in their internal models within the corporate asset class. For banks using the framework set out in *BPR 131 Standardised Credit Risk RWAs* (BPR131), which we are proposing to carry over to the Capital Standard, the risk weight for a corporate exposure is based on the relevant credit rating. The NZ Super Fund does not have an external credit rating, therefore, under the standardised approach, any exposures to the NZ Super Fund attract a risk weight of 100%.

222. We understand that currently exposures to the NZ Super Fund are primarily via financial instruments used for hedging or other derivative purposes. Currently, when a bank is approved to use the IRB method of calculating their credit risk weights, they must calculate the risk weight for all exposures within the 'corporate' asset class using their own model (including risk weighting) as part of their overall credit RWA calculation. The bank must scale up the result using a regulator scalar, which the Reserve Bank has currently set at 1.2. The bank must also perform the same calculations using the standardised approach (in which case the relevant risk weight for the NZ Super Fund is 100%). If the scaled-up outcome does not reach at least 85% of the standardised approach outcome (the output floor), then the output floor becomes the credit RWA component in the capital ratio calculation.

223. We understand that IRB modelling would generally result in a risk weight that is significantly lower than the 100% number specified in the standardised approach. This has two key implications:

    - banks using the standardised approach will have a significantly higher risk weight than those using the IRB approach, for the same sort of exposures

[39] NZ Super Fund. (2023). *NZ Super Fund Annual Report 2023*. https://nzsuperfund.nz/assets/Uploads/NZ-Super-Fund-Annual-Report-2023.pdf

- for banks using the IRB approach, the output floor calculation could be influenced by the high standardised risk weight in a way which might not truly reflect the underlying risk of the deposit taker's credit portfolio.

Preferred option

224. We propose to create a specific risk weight for the NZ Super Fund set at 20%.

Analysis

225. The data available to us strongly suggests to us that a risk weight of 100% for the NZ Super Fund is disproportionate to the actual risk it represents, and that 20% is more representative of the risk.

226. This assessment is underpinned by two main considerations:

- Is it appropriate to treat the NZ Super Fund as separate from the corporate asset class?
- If the NZ Super Fund is treated as separate from the corporate asset class, what risk weight should be applied?

227. We have concluded that there are specific characteristics of the NZ Super Fund that justify treating it as falling outside of the corporate asset class. These include that the NZ Super Fund:

- was established by Act of Parliament (the New Zealand Superannuation and Retirement Income Act 2001)
- is managed by an autonomous Crown Entity (the Guardians of New Zealand Superannuation) with a remit to invest the fund on a prudent, commercial basis and in a manner consistent with best-practice portfolio management, maximising return without undue risk to the Fund as a whole and avoiding prejudice to New Zealand's reputation as a responsible member of the world community
- reports to the Minister of Finance and Treasury on a quarterly basis.

228. Based on this, we are satisfied that the NZ Super Fund is sufficiently differentiated for other entities that would fit the corporate asset class, including private companies and government-owned entities such as Crown Entities and State-Owned Enterprises (SOEs).

229. In proposing a risk weight at this level, we have considered the risk weights that apply to the following categories:

Table D: Description of public sector entities and corporate exposure classes

Public sector entities	Corporates
For New Zealand entities, this covers local authorities (territorial authorities and regional councils), and the Local Government Funding Agency (LGFA) in BPR131. All banks must use the standardised approach for these exposures, with the risk weight based on	In the standardised approach, risk weights are based on credit ratings. For corporate exposures with the highest credit ratings, a 20% risk weight is applied.

Public sector entities	Corporates
credit ratings. For example, based on the credit rating of the LGFA, it would qualify for a 20% risk weight.	

230. We acknowledge that 20% is the same risk weight that currently applies to claims on a "public sector entity" within New Zealand. We considered whether the NZ Super Fund could fall into this category, but whilst we recognised the state-related aspect of the NZ Super Fund, it did not meet the definition of a "public sector entity". It is also the same risk weight that would apply to a corporate with the highest category of credit rating.

231. In the absence of a specific risk weight, exposures to the NZ Super Fund would lead to a 100% risk weight under the standardised approach, which we think is disproportionately high, and out of line with the risk weight that would apply in internal models. Therefore, our assessment is that setting the risk weight for the NZ Super Fund at the same level as the risk weight applicable to a local authority or a corporate with the strongest credit rating leads to a reasonable and appropriate outcome.

232. We consider this proposed change enables deposit takers to more effectively manage their capital and exposure risk in relation to the NZ Super Fund by more accurately reflecting the underlying risk associated with the exposure. This helps ensure that credit risks are accurately reflected in the prudential framework.

Summary

233. We propose to create a specific risk weight for exposures to the NZ Super Fund, set at 20%.

Q14	Do you agree with our proposal to create a specific risk weight for exposures to the NZ Super Fund?
Q15	Do you agree with our proposal to set the risk weight for exposures to the NZ Super Fund at 20%?

2.1.4 Firm-size adjustments for corporate exposures

234. As part of calculating their credit RWA for exposures to the corporate asset class, IRB banks must currently make a specific firm-size adjustment to one component in the calculation of the exposure if the counterparty is part of a consolidated group and the consolidated group is below a certain size.[40] If the consolidated group meets the size test, it is conventionally known as a small and medium-sized enterprise (SME).

235. We are aware that deposit takers can approach determining whether a counterparty is part of a consolidated group in different ways. This poses a problem as deposit takers may reach

[40] Reserve Bank of New Zealand. (2021). *BPR133 IRB Credit Risk RWAs* (p. 25). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr133-irb-credit-risk-rwas-oct-21.pdf

different outcomes depending on their interpretation of 'consolidated', impacting consistency and clarity.

Preferred option

236. We propose to clarify that 'consolidated' should be interpreted by reference to generally accepted accounting principles in New Zealand (NZ GAAP). This will help make sure that deposit takers are consistent in how they approach determining whether to apply the SME adjustment.

Analysis

237. We consider this is a pragmatic approach which takes into account a framework New Zealand banks and companies are already familiar with and thereby avoids introducing any unnecessary compliance costs. We consider that clarifying 'consolidated' would lead to better and more consistent management of capital.

Summary

238. We propose that we will make it clear in the Capital Standard that any references to 'consolidated' for the purpose of firm-size adjustments for corporate exposures should be interpreted in accordance with NZ GAAP rather than any other basis.

Q16	Do you agree with our proposal to clarify that 'consolidated' should be interpreted by reference to NZ GAAP?

2.2 Quantitative capital requirements for market risk

239. Our market risk requirements set out the methodology that deposit takers must use to calculate their total capital requirements for market risk exposure, which is needed to calculate the overall capital ratio.

240. *BPR140 Market Risk* (BPR140)[41] lays out the existing market risk requirements. These requirements are based on a methodology developed over 25 years ago and have been in place (largely unchanged) since 2008. We are using this opportunity to review them and seek your feedback on modernising our market risk approach in line with the options laid out in this chapter.

241. BPR140 requires banks to have capital against the interest rates, foreign exchange and equity price risks in their trading and banking books. Banks are exposed to two main types of market risk:

- interest rate risk in the banking book (IRRBB)
- the market risk in the trading book.

[41] Reserve Bank of New Zealand. (2021). *BPR140 Market Risk*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr140-market-risk-oct-21.pdf

242. Our current market risk framework differs from the current BCBS standard and does not distinguish between assets held as part of the banking book or the trading book. Instead, it considers both asset categories under BCBS 'Pillar 1' requirements.

243. In this context Pillar 1 involves calculating credit, market and operational risk in line with the prescribed frameworks. Pillar 2 provides for supervisory judgment to ensure that banks have sound internal processes in place and use appropriate risk management techniques to support their businesses. Pillar 2 can be tailored to the risks, needs and circumstances of a particular jurisdiction and bank.

244. The BCBS standard takes a different approach. In this framework, market risk in the trading book is covered under Pillar 1, but market risk in the banking book is covered under Pillar 2. Most jurisdictions around the world follow the BCBS approach. Australia and New Zealand are the only two jurisdictions we are aware of that include both the banking and trading books under Pillar 1.

245. As part of the initial work for the review of the market risk framework we propose to maintain our current approach of regulating both the banking and trading books via Pillar 1. Our capital framework leans strongly towards Pillar 1. This is because of a preference to have transparent rules, rather than relying on each bank's individual approach to risk management ICAAP processes and supervising them on a case-by-case basis. The case-by-case approach is less appropriate in a smaller market like New Zealand, compared to markets where the larger scale of regulated entities who often hold larger trading books justifies more resources for supervision. We therefore consider that a more transparent Pillar 1 approach would lead to better management of capital.

246. The March 2023 collapse of Silicon Valley Bank (SVB), in which failure to effectively manage IRRBB was a significant factor, highlights the importance of managing this interest rate risk effectively, especially in a rising interest rate environment. This risk is caused by fluctuations in the value of banks' assets and liabilities as interest rates change. If not managed well, changing interest rates can adversely affect banks' capital and liquidity positions. In the USA IRRBB is regulated via Pillar 2, and in SVB's case they were below the threshold for parts of this regulation to be applied. Whereas under a Pillar 1 approach we would have seen an increase in SVB's RWAs as interest rates increased and therefore an increase in the capital SVB was required to hold against these assets. As part of the Pillar 1 approach described above, all New Zealand banks are required to hold sufficient capital to cover potential losses arising from interest rate risk, which provides banks with an incentive to manage related prudential risks carefully.

247. Additionally, banks must calculate the capital for market risk using the Standardised Approach – we do not allow the internal models approach. We intend to maintain this requirement for the following reasons:

- using internal models can be difficult to assess whether differences in the capital required for market risk is due to underlying risk or to subjective choices about model design, calibration, and implementation
- we are moving away from internal models in other policy areas, such as operational risk, so moving towards this approach for market risk would be moving against our general policy direction.

Preferred option

248. Our preferred option for market risk in the trading book is to adopt the BCBS Simplified Standardised Approach (SSA).[42] This would update our approach to align more closely with BCBS requirements.

249. Our preferred option for market risk in the banking book is to carry over the underlying policy of BPR140 and maintain the current requirements.

250. Our proposed approach differs from the BCBS standard in one major way – we propose to keep both the banking and trading book under the 'Pillar 1' framework, which is consistent with APRA's approach and therefore helps to reduce compliance costs for APRA-regulated deposit takers. Therefore, we propose to adapt the BCBS requirements in MAR40 to remove references that limit it to the trading book and expand it to cover all market risk faced by the deposit takers.

251. These proposed updates to the market risk framework will help to incorporate some of the lessons from crises like the GFC, where losses in the trading book were important factors in the failure of some banks internationally. Additionally, it will help address feedback from some stakeholders that the current market risk framework is outdated and difficult to implement for newer financial instruments that were not considered when it was first put in place.

252. We also considered 2 other options during our analysis:

- Maintain the status quo and carry over the current requirements in BPR140 into Capital Standard. This option would have the benefit of simplicity and continuity, allowing deposit takers more time to focus on other changes that are being progressed as part of the DTA standards. However, we did not put this forward as the preferred option as it would also not address any of the known challenges that stakeholders have reported with BPR140.
- Follow the BCBS Standardised Approach as set out in MAR20[43] to MAR23 of the Basel framework. This would have the benefit of providing a more risk-sensitive approach to market risk in the trading book. However, we believe that it would be difficult to integrate the banking book into this option and would result in separating the banking and trading book, which we are proposing to avoid. Additionally, deposit takers in New Zealand do not hold large trading portfolios, making the BCBS Standardised Approach disproportionate to the amount of risk in the trading books.

Analysis

253. Our current market risk guidelines were developed in 1997 and were based on the BCBS 1996 amendment to the Basel 1 capital accords. Since then, Basel has updated their market risk framework to deal with new or emerging risks in the trading book. However, our market risk framework has remained largely unchanged.

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[42] Bank for International Settlements. (2020, 26 November). *MAR40 Simplified standardised approach*. https://www.bis.org/basel_framework/chapter/MAR/40.htm

[43] Bank for International Settlements. (2020). *MAR20 Standardised approach: general provisions and structure*. https://www.bis.org/basel_framework/chapter/MAR/20.htm?inforce=20230101&published=20200327

254. Between the Basel I and Basel III Accords, financial markets underwent significant innovation, leading to the creation of complex financial instruments. These innovations outpaced the regulatory framework's ability to assess and manage risks associated with these new instruments. Several events in the 1990s and early 2000s, such as the Asian financial crisis (1997–98) and the dot-com bubble (early 2000s), highlighted the potential for severe market disruptions and increased market volatility.

255. At a high level, updating the status quo to either of the Basel options better aligns with the purpose of the DTA than converting the status quo for Group 1 deposit takers. Either of the Basel-based options would bring our framework for the trading book more up to date. In regard to the banking book, Basel's general risk methodology is largely similar to that outlined in BPR140 with updated definitions, so applying the methodology to IRRBB would be possible. Additionally, deposit takers in New Zealand do not hold large trading portfolios, making the BCBS Standardised Approach (as set out in MAR20) disproportionate to the amount of risk in the trading books.

256. Out of the three options that we considered, adopting the SSA and altering it to allow for IRRBB best aligns with the main purpose of the DTA. We consider that the SSA is an improvement over the current settings and allows us to maintain our unified approach to risks in the banking book and trading book. Additionally, moving to the SSA now does not mean we cannot adopt the full BCBS approach in the future, if the trading books of Group 1 deposit takers grow in size or complexity.

257. The definitions used in the current approach are significantly outdated and the requirements incorporate criteria that at least one stakeholder has informed us are becoming 'unworkable'. Updating the framework to the SSA would remove the additional work that deposit takers are currently having to do to work around the out-dated definitions and provisions in BPR140 and would therefore avoid unnecessary compliance costs.

258. However, the BCBS Standardised Approach would impose a larger regulatory burden on deposit takers. This seems disproportionate to the size of the market risk deposit takers are currently taking on, particularly when considering the other regulatory measures, such as the wider capital requirements, that we already impose.

259. We do not expect this to have a large impact on the capital that deposit takers need to have to cover market risk. However, we are requesting additional data below on the size and composition of deposit takers market risk. This will allow us to better estimate the impact this change would have on the minimum capital we require deposit takers to have, if we decide to proceed with the proposed market risk change.

Data Collection

260. We are looking to collect more data on the size, composition and nature of market risk that deposit takers are taking on in both the banking and trading book. As part of this consultation, we would appreciate any information that deposit takers can provide us, on a confidential basis, about banking book and trading book exposures on a normal day and on an Official Cash Rate (OCR) decision day.

261. We will use the data collected as part of this consultation to inform ongoing data collection requirements. This will allow us greater insight into the size of deposit takers' market risk exposures going forward.

Summary

262. We propose to update the current market risk requirements currently laid out under BPR140 to be based on the SSA, laid out in MAR40 of the BCBS framework. We will be adapting the SSA to remove references to the trading book from MAR40 and apply the same framework to both the banking and trading book.

263. Additionally, we are proposing to maintain a single 'Pillar 1' framework for all the market risk requirements and to only allow a standardised approach to calculating capital requirements for market risk.

264. We are also looking to collect better data on the size, composition, and nature of risks that deposit takers are taking on in both the banking and trading book. As part of this we are asking deposit takers to confidentially provide the Reserve Bank with information on a normal day and on an OCR decision day.

Q17	Do you agree with our proposed approach to capital requirements for market risk for Group 1 deposit takers?
Q18	Is there additional information that would help monitor market risk developments?
Q19	Can potential Group 1 deposit takers provide us, on a confidential basis, information about banking book and trading book exposures on a normal day and on an OCR day?

2.3 Standardised operational risk capital requirements

265. This section covers the calculation of quantitative capital requirements for operational risks. We will cover the processes and systems for managing operational risks (qualitative) in a separate consultation paper for non-core standards later in 2024. This paper focuses only on the quantified measures of operational risk, which are added to a deposit taker's total RWA.

266. Operational risks are those that may result from inadequate or failed internal processes or systems, the actions or inactions of people or external drivers and events. Operational risk is inherent in all products, activities, processes and systems. It includes legal risk, regulatory risk, compliance risk, conduct risk, technology risk, data risk, reputational risk and change management risk.

267. Operational risk events can result in direct financial losses to an entity and may also compromise the entity's ability to continue to provide critical operations and services for customers. In extreme cases it could lead to entity failure. Operational risk failures can impose losses on a bank and these losses need to be adequately captured in the prudential framework.

268. Our current approach to standardised operational risk capital requirements refers to two Basel II approaches. The first is the Alternative Standardised Approach (ASA). *See* BPR150

Standardised Operational Risk (**BPR150**).[44] The second is the Advanced Measurement Approach (**AMA**), which includes internal models for banks to calculate operational risks). *See* BPR151 AMA Operational Risk (**BPR151**).[45]

269. In the 2019 Capital Review decisions, we noted that we intended to adopt the new Basel III framework that replaces the existing standardised and internal models approaches with a new standardised approach. This would mean that BPR150 would remain, in a revised form, and BPR151 would eventually be discontinued.

270. At the time of the Capital Review, we stated our intention to consult about the details of this at a future point. We are including proposed changes to our operational risk framework in this Consultation Paper, rather than running a separate process. We will retain the existing approach to operational risk until the proposed Capital Standard comes into force.

271. We note that BPR151 is currently in place as the IRB-accredited banks that previously used BPR151 are still required to comply with qualitative requirements from BPR151 (through the Conditions of Registration), even though they are now following the standardised approach in BPR150. The qualitative requirements in BPR151 do not apply to the other banks, as they only use BPR150. The proposed approach for the DTA standards is that the quantitative requirements for operational risk will be set out in the Capital Standard. Proposed qualitative requirements for operational risk, where relevant, will be set out in the non-core standards. The policy consultation for these will be carried out later in 2024.

Preferred option

272. Our preferred approach for Group 1 deposit takers is as follows:

- implement the Basel III Standardised Measurement Approach (**SMA**), using the Business Indicator Component to calculate operational risk capital[46]
- set the internal loss multiplier **(ILM)** to 1 (meaning no ILM adjustment).

Analysis

Status quo

273. Our current standardised framework on capital requirements for operational risk is set out in BPR150. The approach largely adopts the ASA from Basel II. The status quo calculation is as follows:

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[44] ASA is based on the Basel II Standardised Approach (TSA) which uses annual revenue within the broad business lines and beta factors equation. Broadly speaking, ASA is a slight variation of TSA, in that it includes a mixed scaling factor. The requirements set out in BPR150 align with the ASA. *See* BPR150 for more information: Reserve Bank of New Zealand. (2021, October). *BPR150 Standardised Operational Risk.* https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr150-standardised-operational-risk.pdf

[45] AMA is based on internally developed risk-measurement frameworks by banks adhering to prescribed standards (methods include scenario analysis, scorecard analysis, etc.). The Reserve Bank has since decommissioned banks from complying with the quantitative requirements in BPR151. See BPR151 for more information Reserve Bank of New Zealand. (2021, October). *BPR151 AMA Operational Risk.* https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/exposure-drafts/bpr151-ama-operational-risk.pdf

[46] Bank for International Settlements. (2023). *OPE25 Standardised approach.* https://www.bis.org/basel_framework/chapter/OPE/25.htm?inforce=20230101&published=20230330

$$Capital\ Requirement\ for\ Operational\ Risk = \frac{\sum_{t=1}^{12}(0.00525 \times LA_t)}{12} + \frac{\sum_{t=1}^{12} Max[(0.18 \times AGI_t), 0]}{3}$$

where:

- LA_t refers to the gross dollar value of the retail and commercial loans
- AGI_t refers to the gross dollar value of revenue from all other activities.

274. Banks must take LA_t values from each of the previous twelve quarters and multiply the sum of the quarterly values by 0.525%.[47] The product is then divided by twelve to derive a quarterly average across the three years.

275. Banks must then take the greater of zero and the product of the sum of all relevant activities that make up AGI_t over each of the previous 12 quarters multiplied by 18%.[48] The product (or zero if greater) is then divided by three for the average across three years.

276. Both components (quotients) are then added together to calculate the operational risk capital required.

International Developments

277. In 2017, as part of Basel III revisions of the Basel Framework, the BCBS removed all previous Basel II approaches to calculating operational risk capital. The BCBS deemed the Basel II approaches to be insufficient for losses incurred by some banks. They also concluded that the nature of these losses, particularly in events of misconduct and inadequate systems, highlighted the difficulty with using internal models, such as AMA, for calculating operational risk capital.

278. In general, we find the BCBS rationale for replacing the Basel II approaches with the SMA convincing. This is in line with the capital management principle in the DTA as well as the principle of the desirability of maintaining awareness of, and responding to, guidance or standards of international organisations.

279. The key aspect is that we find that the LA_t and AGI_t components of our current operational risk formula behave in a similar way to the Gross Income (GI) proxy metric (GI underpins many of the Basel II approaches). The BCBS outlined flaws in the GI proxy metric, many of which we agree are flaws and outline further in the next subsection.

280. The Basel III reforms introduced the SMA under the operational risk framework, a single standardised approach that replaced all Basel II approaches (including internal models). The SMA formula for calculating operational risk capital is as follows:

$$Business\ Indicator\ Component\ (\boldsymbol{BIC}) \times Internal\ Loss\ Multiplier\ (\boldsymbol{ILM}) = Operational\ Risk\ Capital\ (\boldsymbol{ORC})$$

[47] This figure is the prescribed beta for commercial banking (15%) multiplied by the scaling factor (0.035) set out in Basel II. For more information *see* Bank for International Settlements. (2014). *Consultative Document Operational risk – Revisions to the simpler approaches*. https://www.bis.org/publ/bcbs291.pdf] for more information.

[48] 18% is the highest prescribed beta in Basel II as 'all other activities' covers a breadth of different business activities.

Business Indicator Component

281. The Business Indicator Component (BIC) is the first component of the SMA equation and is calculated as:

$$\text{BIC} = \text{BI} \times \alpha$$

where:

- BI is a financial statement-based proxy for operational risk exposures
- α is a set of regulatory determined marginal coefficients (set out by BCBS) that increases in line with BI size – larger BI figures will be multiplied by a larger prescribed factor.

282. Readers can refer to the Basel III operational risk framework for more detail on this calculation.[49]

Business Indicator proxy metric

283. The BCBS preferred the SMA over all the Basel II approaches because it is underpinned by the Business Indicator (BI) proxy metric. Under the current approach in BPR150, operational risk capital is calculated using the Adjusted Gross Income (AGI) proxy metric, which is derived from the GI proxy.[50] The BCBS considered the BI proxy to be more accurate than GI (and therefore AGI) for calculating operational risk exposures. This was because:

- BI is an absolute measure, while GI is not[51]
- BI captures the volume of business, which GI cannot[52]
- BI includes more variables directly related to operational risk which GI nets/omits[53]
- BI weighs banking activities proportionate to the exposure to operational risk (activities not as influenced by operational risk are weighted less, and vice versa).[54]

284. For the reasons outlined above, we consider the use of the BI proxy metric (which underpins the BIC portion of the SMA equation) to be more accurate than the status quo proxy of $\boldsymbol{LA_t}$ and $\boldsymbol{AGI_t}$, which have similar flaws as GI. We therefore consider that the BI proxy metric is a better tool for managing the operational element of capital management and has the benefit of being consistent with international practice. For more information on the variables that a

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[49] Bank for International Settlements. (2023). *OPE25 Standardised approach*. https://www.bis.org/basel_framework/chapter/OPE/25.htm?inforce=20230101&published=20230330

[50] *See* Reserve Bank of New Zealand. (2021). *BPR150: Standardised Operational Risk*, paragraph B1.42 of https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr150-standardised-operational-risk.pdf?sc_lang=en&hash=E0A2AFB28A2D705A412686ACDAB80498]

[51] This means a decline in GI because of systemic or bank-specific events, including those involving operational risk losses, results in a calculation where operational risk capital decreases when it should be increasing.

[52] BI considers elements that GI does not, such as other operating expenses and the volume of fee and commission business, and thus it is a more accurate measure of the volume of activities. For more information *see* Bank for International Settlements. (2014). *Consultative Document, Operational risk – Revisions to the simpler approaches*. https://www.bis.org/publ/bcbs291.pdf

[53] These variables include profit and loss from the banking book, other operating expenses, fees, and commission expenses. These activities are more closely associated with operational risk as they rely on internal processes and people more than other activities.

[54] In particular, BI recognises activities such as interest income generated by pure lending activity as traditionally less exposed to operational risk – weighing them lower; while increasing the weight of activities more exposed to operational risk; such as gains and losses on traded or sold portfolios, commissions from services payments, fees received from securitisation of loans and origination and negotiation of asset-backed securities and penalties from inadequate market practice – much of these activities were catalytic to the GFC.

deposit taker must use when calculating BI, *see* the Basel III document on calculating standardised operational RWA.[55]

Q20	Do you agree with our proposal to use the Business Indicator proxy metric to calculate operational risk exposures?

BI Marginal Coefficient (α)

285. Table E explains the BI marginal coefficients(α) by describing the Basel III regulatory ranges for marginal coefficients as set out in the Basel III operational risk framework.

Table E: BI Ranges for marginal coefficients

BI Range (in €bn)	BI Marginal Coefficient
≤1	12%
1<BI≤30	15%
>30	18%

286. We propose converting the Basel III BI ranges for the BI marginal coefficients from Euro (€) to NZD. We consider the BI ranges sufficiently capture the risk with increasing BI figures and believe converting to NZD without adjusting the ranges is the simplest and most efficient course of action. This also takes into account the DTA principle covering the desirability of maintaining awareness of, and responding to, guidance or standards of international organisations. It also considers the DTA principle covering the need to avoid unnecessary compliance costs.

287. Table F shows our proposed NZD converted BI ranges. Using Table E, this means that for a deposit taker with a BI figure of NZD 3billion, the BIC would be calculated as:

$$BIC = 12\% \; x \; \$1.75billion + 15\% \; x \; (\$3billion - \$1.75billion) = \$0.3975billion$$

Table F: Proposed NZD converted BI ranges for Marginal Coefficients

BI range (in $NZD bn)	BI marginal coefficient
≤1.75	12%
1<BI≤50	15%
>50	18%

[55] Bank for International Settlements. (2023). *OPE25 Standardised approach*. https://www.bis.org/basel_framework/chapter/OPE/25.htm?inforce=20230101&published=20230330

Q21	Do you agree with our proposal to convert the Basel III Business Indicator ranges to NZD when calculating the Business Indicator marginal coefficient?

Internal Loss Multiplier

288. The ILM is the second component of the SMA equation. The ILM is a risk-sensitive component capturing a bank's internal operational loss history over a rolling 10-year period.

289. The key purpose of the ILM is to function as a scaling factor that adjusts the baseline operational risk capital requirement (the BIC) depending on the operational loss experience of the bank. This aims to represent more operational exposures, and the capital required, more accurately.[56]

290. Deposits takers required to calculate ILM have to ensure that their internal Loss Data Collection (LDC) processes are sufficiently robust and cover the required 10-year history. The LDC requirements as set out in Basel III are more detailed than the Basel II standardised approaches, including expectations of formal internal review by a deposit taker's validation units and internal audit functions.

291. The Basel III framework also states that prudential regulators can elect to set the ILM equal to one at their discretion.[57] This means that capital requirements in such cases would be determined solely by the BIC.

292. Internationally, both APRA and the United Kingdom's Prudential Regulation Authority (PRA) have used their national discretion to set the ILM equal to 1. Both APRA's Discussion Paper[58] and the PRA's assessment of the ILM[59] noted a number of challenges, including:

- it causes capital to rise after a loss event rather than being in place before a loss event to increase resilience
- the potential for extraneous volatility in capital and a significant misalignment between current exposure and capital[60]
- the linkage of capital to events related to historical businesses and controls which may have since changed.

293. We have provided a short summary of the costs and benefits of the ILM in Table G below:

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[56] For example, a deposit taker with a history of robust operational processes (no losses) will not be required to hold as much capital as the BIC calculation (an ILM less than one) while a deposit taker with a history of operational blemishes (losses), will be required to hold more than the BIC calculation (an ILM more than one).

[57] Bank for International Settlements. (2017). *High-level summary of Basel III reforms*. https://www.bis.org/bcbs/publ/d424_hlsummary.pdf

[58] Australian Prudential Regulation Authority. (2018, 14 February). *Discussion Paper, Revisions to the capital framework for authorised deposit-taking institutions*. https://www.apra.gov.au/sites/default/files/2020-06/Revisions%2520to%2520the%2520capital%2520framework%2520for%2520ADIs_0.pdf

[59] Bank of England. (2022, 30 November). *CP16/22 – Implementation of the Basel 3.1 standards*. Ch.8 Operational risk. https://www.bankofengland.co.uk/prudential-regulation/publication/2022/november/implementation-of-the-basel-3-1-standards/operational-risk

[60] In particular, the volatility can arise from underpinning capital requirements on historical performance to predict future losses. The PRA considered low-probability high-impact events, given their heterogeneity, to be generally insufficient predictors of other unlikely events and, therefore, future losses.

Table G: Costs and benefits of the Internal Loss Multiplier (ILM)

Benefits	Costs
• Scaling factor can more accurately represent capital requirements for operational risk based on loss history (i.e., higher capital requirements for banks with historical losses, lower capital for banks without)	• The effect that capital rises after a loss event rather than being in place before a loss event to increase resilience, can be unnecessarily onerous for a bank during stress periods • Historical losses, given their heterogeneity, may not be sufficient predictors of future losses • LDC requirements for the ILM and data required for the 10-year rolling period is onerous and can be unfeasible for newer deposit takers

294. Our assessment is that in the New Zealand context, the costs of implementing ILM outweigh the benefits and would not lead to better capital management and therefore not align with the main purpose of the DTA. As such, we propose setting the ILM equal to 1.

Q22 Do you agree with our proposal to set the Internal Loss Multiplier to 1?

Impacts

295. Our initial assessment is that our proposal to use the SMA to calculate operational risk capital results in a more risk-sensitive calculation of operational risk exposures. We consider this will mainly come through our proposal to replace the LA_t and AGI_t components of the status quo formula with the BI proxy metric, which we consider to be a more accurate representation of a deposit taker's operational risk.

296. We do not expect the SMA to be more onerous than the status quo for Group 1 deposit takers to calculate; the BI proxy metric largely consists of financial-statement-based proxies, which we consider to be readily available to deposit takers. We also consider the ILM too complex to administer and that its costs outweigh its benefits. Our proposal to set the ILM to 1 further minimises the efficiency costs of adopting the SMA.

297. For the reasons stated above, it is our view that adopting the proposed SMA has minimal impact on the operational burden of deposit takers while improving the risk-sensitivity of the capital calculation, in line with their operational risk exposures.

298. We do not expect this to have a large impact on the capital that deposit takers need to have to cover operational risk. However, there is a component of the operational risk calculation that includes the absolute value of the profit or loss on a deposit taker's banking book and trading book. As outlined in section 2.2 (on market risk) we do not have enough data on the banking book and trading book in general.

299. We are requesting additional data on deposit takers' banking books and trading books for the market risk. We can also use this data to better estimate the component of the operational risk calculation related to the banking book and trading book and how that contributes to the

impact on the minimum capital we require deposit takers to have if we decide to proceed with the proposed operational risk change.

Summary

300. We propose adopting the SMA as set out in the Basel III operational risk framework to calculate operational risk capital requirements for Group 1 deposit takers. Internal modelling approaches will no longer be available if this proposal is adopted.

301. We further propose to set the ILM equal to 1. This would mean that Group 1 deposit takers rely only on the BIC portion of the SMA when calculating operational risk capital. We consider the BIC to be a simpler, more risk-sensitive approach to calculating operational risk capital compared to the status quo.

302. Regarding the BI ranges, we consider the Basel III ranges to be sufficient in capturing the increasing risk of increasing BI figures in New Zealand's context and proposes converting the Basel set BI ranges into NZD.

303. Overall, our proposals help align our approach with the reformed Basel III operational risk framework and remove the previous approach of ASA in BPR150. We believe this best reflects the main purpose of the DTA.

Q23	Do you agree with our proposed approach to operational risk capital calculation for Group 1 deposit takers?

3 Proposed approach for Group 2 deposit takers

304. The scope of the Capital Review included both D-SIBs and non-D-SIBs. The non-D-SIBs largely form Group 2 and generally are comprised of existing small and medium New Zealand-incorporated registered banks. These deposit takers are less systemically important compared to Group 1 deposit takers and do not have the same interconnectedness with other financial service providers, though many Group 2 deposit takers rely on Group 1 deposit takers to operate.

305. However, these deposit takers do have the potential for sectoral or regional importance and/or service specific markets. For the smaller deposit takers in Group 2, systemic importance is likely to be relevant primarily in terms of potential concentration in the relevant sector, region or market served. However, even these smaller deposit takers can pose contagion risks for the wider financial sector during a crisis.

306. As mentioned in section 1.2 above, the Capital Review led to increases in the quality and quantity of capital that banks must have. These were calibrated proportionally so that the new capital ratio requirements for non-D-SIBs are lower than for D-SIBs to reflect their relative levels of risk.

Preferred option

307. As with Group 1, we propose to carry over the settings for non-D-SIBs from the existing prudential capital framework into the new Capital Standard. Overall, our requirements for Group 2 are calibrated to be slightly simpler than those for Group 1. We consider this is a

reasonable and proportionate approach with the size and nature of the Group 2 population in mind.

308. This proposal means the requirements that currently apply to non-D-SIB banks would continue to apply to Group 2 deposit takers as follows (bearing in mind that these requirements are in the process of being phased-in via a transitional pathway).

Table H: Proposed capital requirements for Group 2

Proposed requirements
Capital ratio (16% of RWA)
A minimum total capital ratio requirement of 9% for Group 1 deposit takers, of which: • 7% must be Tier 1 capital, including a maximum of 2.5% of which can be AT1 capital • a maximum of 2% can be Tier 2 capital
Plus, a PCB of 7% of RWA for non-D-SIBs (CET1 buffer), of which: • 1.5% will be an early-set CCyB[61] • 5.5% will consist of a conservation buffer
Consistent with the above, a Tier 1 capital requirement (including PCB) of 14%, of which: • 2.5% can be made up of Additional Tier 1 capital (AT1)
Numerator – composition of capital
Capital instruments cannot have any contractual contingency or write-off features AT1 capital can include redeemable perpetual preference shares, subject to the point above
Tier 2 capital can include long-term subordinated debt
Denominator – calculation of risk weighted assets
Must use standardised approach for all exposures, unless accredited to use IRB

309. In addition to the proposals above, where we have proposed minor technical amendments to credit risk weight elements within the standardised approach, these would equally apply to Group 2 deposit takers as well as Group 1.

Entity-specific requirements

310. In addition to the proposals above, there may be circumstances where entity-specific buffers or overlays of some sort are required. For example, if a Group 2 deposit taker were taking on high exposures to high-risk sectors, in a way that made its risks highly concentrated in that sector, there might be a basis to add further capital charges.

[61] We will publish a separate supporting paper covering the implementation of the CCYB.

Analysis

311. For the same broad reasons as discussed in relation to Group 1 deposit takers above, we have concluded that the proposed approach is the optimal way to design the Group 2 requirements as it takes into account the outcomes of the comprehensive Capital Review and continues their application on a proportional basis. The Capital Review was subject to a thorough cost-benefit analysis that considered how different-sized entities would be able to comply with the new, more stringent requirements.

312. Whilst Group 2 has a lower level of capital requirements, these requirements are in the process of being strengthened because of the Capital Review. This is lifting financial stability and, if continued as proposed, will help to deliver the main purpose of the DTA.

313. In addition, strongly and appropriately capitalised institutions reduce the risk of those institutions failing, which means they remain in business and continue to provide a range of products and services. This supports competition by ensuring a base level of prudential quality exists in new competitors.

A focus on risk weighting

314. We have also looked at some of the commentary regarding IRB modelling that banks have provided in their submissions to the Commerce Commission's study into personal banking.[62] Some of the smaller (Group 2 and Group 3) banks have stated that they are at a disadvantage as they are not able to use the IRB modelling approach.[63]

315. In particular, capital ratios are applied to assets that are risk-weighted, rather than recorded at their balance sheet value. Hence, the level of capital delivered by a given capital ratio depends on the risk weights that are applied to those assets. The 2019 Capital Review changes included reforms that had the effect of altering the risk weights used by the four D-SIBs, accredited to use IRB models, where outcomes were considered too low relative to the risks they represented in some areas, and too low relative to the risk weights applying to other banks.

316. The four D-SIBs must now apply a 'floor' in their risk modelling, set at 85% of the risk weighted outcome of the approach used by non-D-SIBs. The proposals for Group 1 deposit takers in this document propose that the output floor be retained.

317. The IRB modelling approach had previously provided a significantly lower risk weight outcome for the D-SIBs relative to non-D-SIBS, lifting the D-SIB capital ratio for similar exposures.

318. Following Capital Review changes there is now much less difference between the capital a large bank and a small bank must have for a particular loan.

319. When combined with the increase in a scalar applied to credit risk RWA for IRB banks (from 1.06 to 1.2), our analysis indicated this would lead to RWA outcomes for IRB banks being approximately 90 percent of what would be calculated under the Standardised approach, an increase from a level of around 70-75 percent in prior years.

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[62] Commerce Commission. (2024). *Market study into personal banking services*. https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-personal-banking-services

[63] For example, TSB, Kiwibank, Co-op and SBS made a joint submission to the Commerce Commission study into personal banking, the key points of which related to the cost of funding, fixed costs of regulation with no ability to scale, concern about beneficial capital treatment available because of IRB modelling of residential mortgage loans.

320. Table I below shows the impact of the inclusion of the output floor and the 1.2 scalar that is applied to IRB credit risk weight outcomes, on bank funding costs, based on a stylised example for residential mortgage loans, with the following assumptions:[64]

- A cost of debt of 4%
- An equity risk premium of 6% (meaning a cost of equity of 10%)
- The corporate tax rate of 28% (which is applied to the cost of equity to give the required pre-tax return the bank needs to generate)
- The following average risk weights for a residential mortgage loan:
  - 37% under the Standardised approach, the approximate average over recent years
  - 31.7% under IRB with the higher IRB scalar (which has applied from 1 October 2022)
- Banks operate with a 10% CET1 capital ratio prior to the capital review changes (approximately the level banks operated with in practice, and following the capital review changes, banks' CET1 ratios increase by around 2 percentage points (to 12%) for non-DSIB banks, and 4 percentage points for DSIB banks
- The cost of equity does not decline as the equity share of funding increases (in practice we would expect the cost of equity to fall given it would have a less volatile return).

Table I: Impact of proposed Group 1 and Group 2 approaches to risks weights on funding costs

	Formula	Post-capital review with output floor and increased IRB scalar		Including DSIB buffer	
		Standardised	IRB	Standardised	IRB
Cost of equity		10%	10%	10%	10%
Corporate tax rate		28%	28%	28%	28%
Required return on equity	A	13.9%	13.9%	13.9%	13.9%
Cost of debt	B	4%	4%	4%	4%
Total loan value	C	$100.00	$100.00	$100.00	$100.00
Risk weight	**D**	**37%**	**31.7%**	**37%**	**31.7%**
Risk-weighted asset	E = C x D	$37.00	$31.70	$37.00	$31.70

[64] This is the same example as contained in the Reserve Bank's Submission on Personal Banking Services Market Study to the Commerce Commission *See* Reserve Bank of New Zealand. (2024, 18 April). *Submission on Personal banking services market study: draft report*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/information-releases/2024/rbnz-submission-commerce-commission-personal-banking-services-market-study.pdf

	Formula	Post-capital review with output floor and increased IRB scalar		Including DSIB buffer	
value					
CET1 capital ratio	F	12%	12%	12%	14%
Quantity of equity funding	G = F x E	$4.44	$3.80	$4.44	$4.44
Quantity of debt funding	H = C – G	$95.56	$96.20	$95.56	$95.56
Weighted average cost of funding	I = (A x G + B x H)/C	4.44%	4.38%	4.44%	4.44%
Funding cost advantage (bps)			**6.3**		**0.0**

321. A key conclusion from this stylised example is that, due to the relatively small contribution of equity funding to the overall funding of the banks' lending, capital requirements have fairly modest effects on total funding costs and therefore loan interest rates, particularly when compared to other factors such as banks' operating expenses, or access to lower cost debt funding (e.g. due to their risk profile or having a strong deposit franchise). In the example in Table I, after the capital review the IRB banks have a 6.3 basis point funding advantage, purely through risk weighting. However, once the additional DSIB buffer is added on, there is no funding cost advantage. We consider the continuation of the requirement for Group 2 deposit takers to use the standardised approach to calculate their credit risk exposures provides for the most proportional approach to supervision. Although it is more risk sensitive, the IRB approach is resource intensive for both the deposit taker and supervisors to create and to monitor the appropriateness of the models which rely on significant levels of historical data. Given the fundamental differences in scale and types of business between Group 1 and Group 2 deposit takers, we believe the standardised approach continues to provide the most appropriate form of credit risk calculation.

322. We continue to hold the view that the IRB approach does not lead to IRB banks having a significant 'competitive edge' over other banks. The increase in scalar and the introduction of the output floor as part of the Capital Review have reduced the gap in outcomes to a maximum of 15%, given the 85% output floor. In addition, the Group 1 deposit takers would also be subject to the additional D-SIB buffer of 2% of RWA that would not apply to Group 2 or Group 3 deposit takers. We also consider that the IRB approach incentivises accredited deposit takers to effectively manage their capital and risk, by having a more sophisticated understanding of the risk they bear.

323. Competition is not effective if new entrants do not have the resilience to remain in business; early failure of new entrants can lead to distrust in novelty and innovation, which are otherwise desirable characteristics in a financially inclusive society. By maintaining competition

within the deposit-taking sector in this manner, we are continuing to support the diversity of institutions.

Summary

324. We are proposing to apply the existing requirements for non-D-SIB banks to the new Group 2 deposit takers when the Capital Standard comes into force. We think this is a sound outcome that takes into account the principles of the DTA and, in particular, results in no unnecessary compliance costs.

Q24	Do you agree with our proposed overall approach to capital requirements for Group 2 deposit takers?

3.1 Technical amendments to the credit risk framework

Preferred option

325. We propose that the proposals set out in subsections 2.1.1, 2.1.2 and 2.1.3 (covering minor technical amendments to the credit risk framework) also apply to Group 2 deposit takers. Proposal 2.1.4 is not relevant to Group 2 deposit takers as it relates to the IRB approach.

Analysis

326. The proposals in those subsections are relevant to Group 2 deposit takers as they amend the credit risk weight framework for the standardised approach. Applying these changes to Group 2 deposit takers promotes consistency across the standardised credit risk framework, which leads to consistency in the treatment of similar institutions and minimises compliance costs for entities that move between the Groups. The proposals, as discussed in section 2.1 for Group 1 deposit takers, also promote better management of capital and risk.

Summary

327. We propose that proposals 2.1.1, 2.1.2 and 2.1.3 will also apply to Group 2 deposit takers.

Q25	Do you agree that proposals 2.1.1, 2.1.2 and 2.1.3 should also apply to Group 2 deposit takers?

3.2 Quantitative capital requirements for market risk

Preferred option

328. We propose that Group 2 deposit takers adopt the same capital requirements for market risk as Group 1 deposit takers, as discussed in section 2.2 above.

Analysis

329. We consider the proposal and analysis for Group 1 deposit takers in section 2.2 also applies to Group 2 deposit takers for two main reasons:

- Group 2 deposit takers already operate under the same framework as Group 1 under BPR140. It would not make sense to update the requirements for Group 1 but leave the outdated requirements in place for Group 2
- the rules are largely auto proportional; for example, if a deposit taker does not have a trading book, they can simply zero out this portion of the calculations. Group 2 deposit takers that do not have a trading book will not need to deal with this part of the calculation.

Summary

330. We propose the same capital requirements for market risk for Group 2 deposit takers as Group 1 deposit takers.

Q26	Do you agree with our proposed approach to capital requirements for market risk for Group 2 deposit takers?
Q27	Can potential Group 2 deposit takers provide us, on a confidential basis, information about banking book and trading book exposures on a normal day and on an OCR decision day?

3.3 Standardised operational risk capital requirements

Preferred option

331. We propose that Group 2 deposit takers adopt the same capital requirements for operational risk as Group 1 deposit takers, as laid out in section 2.3 above.

Analysis

332. We consider the proposal and analysis for Group 1 deposit takers in section 2.3 above also applies to Group 2 deposit takers. In particular, we consider the implementation of the BIC to be manageable and the ILM to be unnecessarily complex to administer for Group 2 deposit takers. The ILM approach would therefore impose unnecessary compliance costs.

333. Additionally, the use of the marginal coefficient that is scaled by BI figures will incorporate a level of proportionality into the operational risk capital calculation. For example, we assume bigger deposit takers will have bigger BI figures, which would trigger a higher marginal coefficient. A higher marginal coefficient would equate to a higher operational risk capital charge. We expect that Group 2 deposit takers would calculate lower BI figures than Group 1 deposit takers, which would trigger a lower marginal coefficient and, consequently, a lower operational risk capital charge as compared to Group 1.

Summary

334. We propose the same capital requirements for operational risk for Group 2 deposit takers as Group 1 deposit takers.

Q28	Do you agree with our proposed approach for Group 2 deposit takers to have the same operational risk capital requirements as Group 1 deposit takers?

4 Proposed approach for Group 3 deposit takers

335. In the Proportionality Framework, Group 3 consists of smaller deposit takers, with total assets up to $2 billion.

336. Because of their size, any spill-over impacts from the failure of a Group 3 deposit taker to the wider economy are likely to be relatively small. However, the failure of a small deposit taker would be significant for its creditors and potentially significant at a regional or community level. In addition, regular failures would undermine confidence in the financial system and could indirectly lead to stress elsewhere in the system. Capital requirements are an important safeguard against these risks and help promote the safety and soundness of each deposit taker.

337. This section covers the proposed approach to capital requirements for Group 3 deposit takers, which intends to promote the stability of the financial system and promote the safety and soundness of each deposit taker. The section starts by setting out the proposed overall requirements below and then goes on to set out more detailed proposals in the following order:

- capital ratio requirements (including minimum capital requirements)
- composition of capital
- the approach to credit risk
- the approach to market and operational risk
- a transition path
- international perspectives.

338. This section concludes with a cost-benefit analysis of all the proposals, comparing these to the current NDBT regime.

339. In summary, our estimates suggest the proposals for Group 3 deposit takers should not have a significant net impact on most existing NBDTs, with the majority already sitting above the proposed minimum and buffers discussed in this section. For the entities that do require additional capital, our estimates suggest this should small and can be raised over a number of years.

Preferred option

340. We propose the following overall capital requirements for Group 3 deposit takers in order to support financial stability and deliver the main purpose of the DTA. The proposals also support the following additional purposes of the DTA:

- to promote the safety and soundness of each deposit taker (section 3(2)(a))
- to promote public confidence in the financial system (section 3(2)(b))

- to avoid or mitigate the adverse effects of risks to the stability of the financial system (section 3(2)(d)(i)).

Table J: Proposed requirements for Group 3 deposit takers

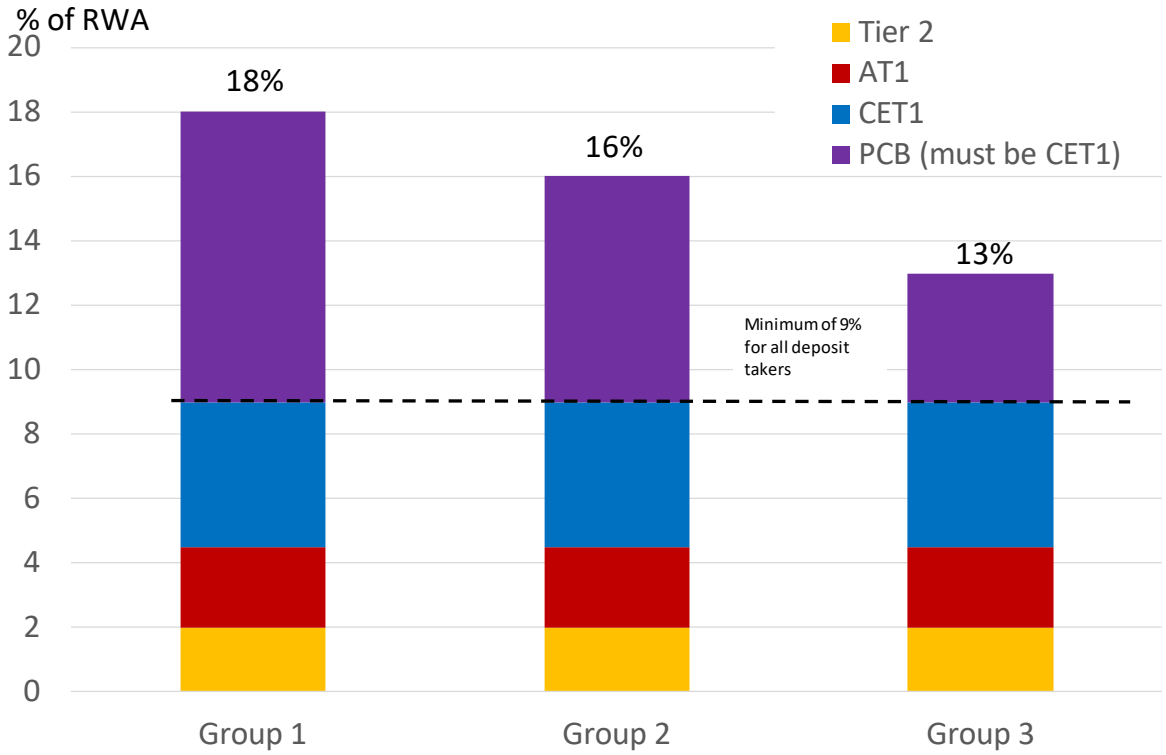
Feature		Summary of feature
Minimum total capital plus prudential buffer requirements	13% of RWA	Smaller than the Group 1 (18%) and Group 2 (16%) equivalent numbers. An additional 1% would be added for credit-rating-exempt deposit takers, regardless of liability size. This is a smaller addition than the 2% and 4% additions that currently apply.
Minimum total capital ratio	9.0% of RWA	The same as Group 1 and Group 2 deposit takers
Minimum Tier 1 ratio	7.0% of RWA	The same as Group 1 and Group 2 deposit takers
Minimum CET1 ratio (including Mutual Capital Instrument)	4.5% of RWA	The same as Group 1 and Group 2 deposit takers
Maximum AT1 for Tier 1 purposes	2.5% of RWA	The same as Group 1 and Group 2 deposit takers
Maximum Tier 2 for total capital purposes	2.0% of RWA	The same as Group 1 and Group 2 deposit takers
Prudential Capital Buffer (PCB)	4.0% of RWA	Smaller than the 9% PCB for Group 1 and 7% PCB for Group 2 An additional 1% will be added for credit rating exempt deposit takers
Treatment of credit risk weighted assets	Standardised credit risk weights from BPR 131	Same standardised credit risk weights that apply to Groups 1 and Group 2

Analysis

341. These proposals would result in an increase in the minimum amount of high-quality, loss-absorbing capital for Group 3 deposit takers compared with existing requirements for most of those deposit takers. The rationale for this proposed approach is set out in detail in the rest of this chapter. Figure 4 below summarises the proposed settings for Group 3, compared with Groups 1 and Group 2.

342. The lower requirements for Group 3 compared with Group 1 and Group 2 is one way we are proposing to take a proportionate approach to regulation and supervision. The proposed increase in regulatory capital requirements is consistent with the wider direction of recent regulatory policy changes, including the increases in regulatory capital for banks in the 2019 Capital Review.

Figure 4: Proposed capital requirements as a percent of risk weighted assets



343. Currently, banks and NBDTs are covered by separate prudential frameworks. This will change under the DTA, which will set standards for the prudential requirements for all deposit takers. This section formalises our proposal for proportionate treatment of Group 3 deposit takers for their capital requirements.

344. The proposed approach to capital requirements for Group 3 deposit takers aims for a closer alignment with the rest of our capital framework and therefore closer alignment with the proposals for Group 1 and Group 2 deposit takers. The proposals for Group 3 would also result in the alignment of risk weighting requirements between Group 3 and the standardised approach that will apply to Group 2 (and Group 1 for a limited set of exposures).

345. The proposals would see Group 3 deposit takers with a minimum capital requirement of 9% and a PCB of 4%, bringing the total capital ratio to 13%. This is an increase in policy settings compared with the existing requirements that apply to NBDTs. Offsetting the increase in the ratio is the decrease in risk weights as a result of changes to this part of the framework.

346. When assessing the overall impact of the proposal on existing non-bank deposit takers, we have considered the impact of the full suite of proposals, including changes to risk weights.

347. As a starting point, current total capital ratios from across the NBDT sector are shown in Table K.

Table K: NBDT capital ratios[65]

	Building Societies and other[66]	Credit Unions	Finance Companies
Capital ratio (%, end of December 2023)	14.4	12.9	19.0

348. While Table K above shows that, in aggregate, NBDTs are close to or above the proposed 9% minimum plus 4% PCB, the proposed increase may be above the current capital ratio of some NBDTs. However, as noted above, we expect that the proposal to apply the existing standardised bank risk weights to exposures of Group 3 entities will lead to a significant fall in calculations of risk weighted assets compared with the status quo. This would lift capital ratios relative to those in the table above.

349. The impacts of risk weight changes are discussed in more detail in later sections of this document. and the precise impact would depend on a deposit taker's actual exposures at the time of any changes. Nevertheless, our assessment is that risk weighted assets could decline by between 10% and 30%, automatically lifting capital ratios by 2-3%.

350. We have undertaken detailed analysis based on confidential data we hold. Our assessment, discussed in more depth in subsequent sections of this document is that any shortfalls in capital among existing entities as a result of the Group 3 proposals will be limited. For example, with risk weight declines of around 10%-30%, we estimate that the majority of deposit takers should not face a shortfall of capital, and any such shortfall is likely to be small. There is also a transition period of several years to allow time to raise capital if needed. This type of analysis is sensitive to the assumptions used and we are interested in your feedback about the accuracy of these estimates.

Q29	Do you agree with our proposal to set the minimum total capital for Group 3 deposit takers at 9% with a 4% prudential capital buffer, to align with the requirements for Group 1 and Group 2?
Q30	Do you agree with our proposal that Group 3 deposit takers that are exempt from a credit rating should face an additional buffer of 1%?

4.1 Capital ratio requirement

Preferred option

351. Our preferred option is to set a minimum total capital ratio of 9% for Group 3 deposit takers. This is the same as the minimum requirement that we are proposing for Group 1 and Group 2. We propose a PCB of 4% of RWA for Group 3 deposit takers, which differs from the proposed PCB for Group 1 and Group 2 deposit takers. The PCB must be made up completely of CET1.

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[65] Reserve Bank of New Zealand. (2024, 1 May). *Financial Stability Report May 2024*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2024/may-2024/fsr-may-24.pdf

[66] Other NBDT refers to Christian Savings Limited.

Deposit takers that are credit-rating exempt would be required to hold an additional 1% that must also be made up completely of CET1.

352. For all groups, it is important to note that the minimum and the buffer operate in different ways. Failure to meet the minimum would mean a deposit taker was not meeting the minimum requirement. This would be a breach of the Capital Standard, likely requiring intervention to ensure that appropriate responses are in place to restore the minimum requirement. However, a failure to meet the full buffer requirements is less severe, with the main responses being restrictions on dividend payments. Nevertheless, the responses would get increasingly strong if the ratio continued to fall towards the proposed minimum requirement of 9%.

353. The proposed calibration would help support the main purpose of the DTA, to protect and promote financial system stability. This outcome also serves some of the additional purposes of the DTA. In particular:

- To promote the safety and soundness of each deposit taker (section 3(2)(a))
- To promote public confidence in the financial system (section 3(2)(b)).

354. The DTA principles were taken into account as part of the calibration, as discussed in the section below.

Analysis

Calibration of minimum capital requirements

355. The proposed minimum capital ratio of 9% of RWA matches the proposed minimum requirement for Group 1 and Group 2, while the PCB is smaller for Group 3 than for Group 1 and Group 2.

356. Our assessment is that using the same minimum of 9% for Group 3 entities will help drive consistency across groups and enhance simplicity. The difference between Group 3 and the other groups is in the lower proposed PCB for Group 3.

357. For the calibration of the PCB at 4%, our assessment is that this is an appropriate way to ensure that the requirements are proportionate, because of the small size of the Group 3 entities and the more limited impact that their failure would have on financial system stability.

358. We do not consider it appropriate to calibrate capital for small deposit takers to the same levels of capital that are required for Group 1 (18%) and Group 2 (16%). Those calibration have been set to limit the probability of a banking crisis to a 1-in-200-years event.

359. The assets of Group 3 deposit takers make up less than 1% of total financial system assets. The level of capital for these deposit takers is therefore unlikely to be a major driver of financial system stability in the way that it is for Group 1 and Group 2. This is because the failure of a Group 3 entity is unlikely to lead to a failure of large deposit takers and is therefore also unlikely to trigger wider system impacts.

360. Nevertheless, capital for Group 3 deposit takers does make a contribution to financial stability in the following ways:

- capital promotes the safety and soundness of individual deposit takers – this supports the additional purpose in section 3(2)(a) of the DTA
- the failure of a Group 3 entity would undermine confidence in the financial system – capital therefore supports the additional purpose in 3(2)(b) of the DTA
- the failure of Group 3 entities would remove a source of competition from the system and could reduce the diversity of institutions and access to financial products and services for some people.

361. In addition, at PCB levels of less than 4% of RWA it is possible that there would be insufficient capital buffers for the purposes of implementing the range of actions that are available for the resolution and/or recovery actions for a stressed Group 3 deposit taker. A reasonably sized buffer allows for an escalating set of responses to be triggered as an entity's capital ratio declines. The 4% PCB is calibrated towards the lower end of this range.

362. The proposed 13% capital ratio, including the buffer, means that the risk of a Group 3 deposit taker failing will be higher than a Group 1 or 2 deposit taker. We consider this higher risk to be proportionate to the risks associated with failure.

363. Because they are small, the lower capital ratio requirements for Group 3 have a limited effect on the system-wide calibration of capital sufficient to withstand a shock equivalent to a 1-in-200-years event – this calibration was a key element of the bank Capital Review in 2019. This level of resilience will continue to be provided by the requirements for Group 1 and Group 2. Relative to the existing requirements for NBDTs, the proposals for Group 3 result in a lift in resilience for Group 3 deposit takers.

364. It is not practical to directly convert the Group 3 requirements into a 1-in-x year summary statistic, as we have previously used this for the purposes of calibrating the resilience of the whole system. Nevertheless, the lower capital requirement is equivalent to saying that failures will happen more often.

365. Instead of targeting a '1-in-x-years' number we have based the assessment on the level of capital that we consider will deliver the key aspects of stability that are relevant for Group 3, as set out above.

366. Our overall assessment is that a sufficient buffer is required above any minimum capital requirement to enable implementation of a capital buffer response framework for smaller deposit takers. A reasonably sized buffer (for example around 4–6%) would allow for an escalating set of responses to be triggered as an entity's capital ratio declines. The 4% PCB is calibrated towards the lower end of this range. This will support financial stability and confidence in the system while also increasing the safety and soundness of individual deposit takers.

367. A lower requirement would limit the scope to respond adequately. For this reason, we are not comfortable with a lower capital ratio requirement, as this would increase the risk of entity failure, would undermine confidence in the system and could start to impinge on system-wide stability, albeit in a limited way.

368. We are proposing that requirements for Group 3 deposit takers will be uniform across all Group 3 deposit takers, in line with the Proportionality Framework.

Additional capital buffer for those who are exempt from a credit rating

369. At present, NBDTs that have a credit-rating exemption have a minimum total capital ratio of 10% or 12%, depending on the size of their liabilities. NBDTs that do have a credit rating face a minimum total capital ratio of 8%.

370. For deposit takers that have a credit rating, this can help signal their financial capacity and resilience. This is an important source of market discipline for the deposit taker and an indicator of financial circumstances for creditors. We consider this to be an important feature of the existing framework for NBDTs.

371. We propose to carry forward the requirement for an additional buffer for those that are unrated. Reflecting the increase in the prudential capital buffer already proposed for Group 3 deposit takers, we propose the additional buffer for unrated deposit takers to be 1%, regardless of the size of the Group 3 deposit taker. As part of the implementation of this approach (and of section 70 of the DTA), we propose to provide scope for exemptions from credit ratings, albeit with the additional capital requirements described here.

Entity- specific requirements

372. In addition to the proposals above, there may be circumstances in which entity-specific buffers or overlays of some sort are required. For example, if a Group 3 deposit taker were taking on high exposure to high-risk sectors, in a way that made its risks highly concentrated in that sector, there might be a basis to add further capital charges.

Proportionality and consistency across deposit takers

373. One of the DTA principles taken into account during the development of these proposals is the desirability of taking a proportionate approach to regulation and supervision.

374. The proposed capital requirements take a proportionate approach to the amount of capital each Group of deposit taker must have. All deposit takers must have a minimum total capital ratio of 9% of RWA. However, it is proposed that Group 3 deposit takers would face a significantly lower PCB than Group 1 and Group 2. This reflects the lower risk to financial system stability in the event of the failure of a Group 3 deposit taker.

Maintaining competition and sector diversity

375. The DTA includes the following relevant principles that we must take into account:

- the desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders (the diversity principle)
- the need to maintain competition within the deposit-taking sector (the competition principle).

376. The strength and resilience of deposit takers directly impacts the diversity of institutions to provide access to financial services and products. Sound and well-capitalised Group 3 deposit takers reduce the risk of failure of a Group 3 deposit taker. This means that deposit takers remain in business and continue to provide financial products and services. This supports provision of services and competition as those deposit takers are more likely to remain viable.

377. High levels of capital requirements may be a barrier to entering the market. If set too high, such requirements may inhibit competition and or limit the diversity of institutions providing financial products and services.

378. To deepen this analysis, we have considered the concept of market failure. Capital addresses this by ensuring that requirements take into account all the costs of deposit-taker failure. If the proposals in this chapter are implemented, Group 3 deposit takers should be less likely to fail, as they have more capital to absorb losses. This helps retain competitors in the market and supports the diversity of service providers.

379. However, the increased requirements may make it more difficult for new entrants to have sufficient capital to enter the market or could result in existing deposit takers leaving the market. These factors illustrate the competing effects on welfare from more capital – lower risk of failure lifts welfare, but barriers to entry may limit competition.

380. We have designed two counterfactuals under different policy settings to illustrate these factors in comparison with the proposals in this chapter.

Table L: Indicative counterfactuals for competition

Counterfactual	Summary of analysis
Counterfactual 1: Existing NBDT requirements applied to Group 3 deposit takers	In this setting, there is no PCB. However, while risk weights are higher, the net impact is lower minimum capital requirements. In this counterfactual the risk of Group 3 deposit taker failure is higher. This reduces competition as these failed deposit takers will not remain in operation. This will reduce the diversity of services. At the same time, it would be easier for new deposit takers to enter the market, increasing competition. The net impact of these competing factors is uncertain.
Counterfactual 2: Group 2 requirements applied to Group 3 deposit takers	This results in a higher PCB than with the proposed settings and that in Counterfactual 1 above. This increases the soundness of Group 3 deposit takers, without any significant increase in system-wide stability. Entry barriers are high and likely to substantially limit new entrants as well as making it harder for existing entities to stay in operation. In this counterfactual the benefits of capital to stability and retaining competitors in the market are likely to be exceeded by a loss of service diversity.

381. Our assessment is that the calibration of capital for Group 3 deposit takers at 13% (including the proposed PCB) supports the main purpose of the DTA, without unduly inhibiting competition or the diversity of institutions in the deposit-taking sector. We are interested in your feedback about whether there are other aspects relating to these principles that we should take into account.

Summary

382. Our proposals for Group 3 deposit takers promote the safety and soundness of each deposit taker while protecting and promoting financial system stability.

383. Our proposals focus on financial system stability considerations. However, we recognise that the diversity of institutions to provide access to financial products and services (diversity) and competition may be influenced by capital requirements. Diversity and competition are also influenced by a myriad of other factors such as business strategy, financial literacy of customers, and economic conditions.

384. In addition, accessibility is reflected to some degree through the proportional approach taken in our proposed approach. This would see lower capital requirements set for Group 3 relative to higher requirements for Group 1 and Group 2 deposit takers.

385. Our assessment is that the proposals in this paper allow for a more diverse set of deposit takers than if all deposit takers had to meet higher requirements, such as those for Groups 1 and Group 2.

386. In weighing up these different factors, our assessment is that the proposed capital requirements support the main and additional purposes of the DTA.

4.2 Additional requirement: minimum capital levels

387. We have proposed a set of capital requirements in section 4.1 to support the purpose of the DTA "to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system". For most deposit takers those capital requirements also help support the additional purpose in section 3(2)(a) "to promote the safety and soundness of each deposit taker". For the smallest deposit takers the suite of capital requirements are likely not to be sufficient to support the soundness of individual deposit takers and ensure they hold sufficient capital to meet their fixed costs.

388. This section covers options to further support the additional purpose to promote the soundness of Group 3 deposit takers. One option is to set a minimum dollar level of capital in addition to the capital ratio requirements. There are likely to be other ways of supporting the soundness of these deposit takers and we are open to hearing alternative ways to support the soundness of the smallest deposit takers.

Introducing a minimum capital requirement

389. This first consideration in this subsection is whether to introduce a minimum dollar value capital requirement. This would be set up similarly to the current minimum requirement for registered banks, but at a lower dollar value. Group 3 deposit takers would need to comply with both this requirement and the capital ratios when calculating their minimum regulatory

capital. For the smallest deposit takers this would set a minimum floor on the amount of capital they must hold over and above the capital ratio.

390. The main alternative to this option would be to maintain the status quo. If we did this, then the capital ratio would be the sole requirement for setting the minimum capital requirements for Group 3 deposit takers.

391. Additionally, some alternative options to address the safety and soundness of the smallest deposit takers are included in the 'other potential options' subsection below.

Analysis: introducing a minimum capital requirement

392. The main purpose of the DTA is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system. Introducing a minimum capital requirement would likely have a small impact on this by helping ensure the soundness of smaller Group 3 deposit takers and underpin public confidence, which might be eroded through repeated failure of small, undercapitalised deposit takers. However, given the small size of the deposit takers affected by this requirement we consider it would not have a large impact on the overall financial system.

393. The DTA also includes a secondary purpose to ensure the soundness of individual deposit takers. The capital ratio proposals would support the additional purposes regarding soundness of individual entities and public confidence for most deposit takers. Introducing a minimum dollar value capital requirement would go a step further to bolster the soundness of the smallest deposit takers. We are considering the extent to which the addition of the dollar value minimum capital requirement is warranted over and above the existing proposals for minimum capital ratios are sufficient.

394. Evidence from overseas shows that smaller UK banks are more prone to fail than larger financial institutions[67] and a similar result was found in the USA.[68] This is also consistent with the experience in New Zealand where multiple small NBDTs have closed since the NBDT sector became regulated by the Reserve Bank in 2013. Therefore, imposing an additional capital requirement on these deposit takers will help provide additional capital for them to draw on during times of stress, which should help them survive periods of financial stress, supporting depositors to access their funds.

395. The introduction of a minimum capital requirement will also positively impact another additional purpose of the DTA to promote public confidence in the financial system. Public confidence in the financial system might be eroded through repeated failure of small, undercapitalised deposit takers.

396. However, the introduction of a minimum capital requirement may impact two of the principles to be taken into account under the DTA. First, it could negatively impact the diversity of deposit takers by adding a hurdle for new deposit takers to enter the market, and it could

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[67] Logan, A. (2001). *The United Kingdom's small banks' crisis of the early 1990s: what were the leading indicators of failure?* Bank of England Quarterly Bulletin, working paper 139. https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2001/the-uk-small-banks-crisis-of-the-early-1990s-what-were-the-leading-indicators-of-failure.pdf

[68] Foley, M., Cebula, R., Downs, J. and Liu X. (2023). *Examining small bank failures in the United States: an application of the random effects parametric survival model.* Journal of Financial Economic Policy, vol. 15, issue 2, 104–122. https://econpapers.repec.org/article/emejfeppp/jfep-12-2022-0297.htm

make it harder for some existing small NBDTs to remain in the market. This could lead to a decrease in the diversity of deposit takers, which could be especially pronounced in some under-served communities that some existing NBDTs serve.

397. Second, introducing a minimum capital requirement may have negative competition impacts by introducing a marginal new requirement new deposit takers. We consider that initially the competition impacts would be quite small, as the smallest deposit takers will not immediately be a major source of competition because of their small customer base and often limited number of products. However, these small new entrants could grow over time into competitors for the Group 1 and Group 2 deposit takers.

Calibration

398. If we were to introduce a dollar value minimum capital requirement, we would need to determine what value to set this at. Our preferred option would be to calibrate this to ensure that all firms are of sufficient scale to be able to operate effectively as deposit taker. This includes the ability to meet operating expenses and fixed costs, including the cost of complying with regulatory requirements, which are likely to be a larger proportion of total cost for a Group 3 deposit taker than for a Group 1 or Group 2 deposit taker. Our initial assessment is that the dollar value minimum capital requirement would be in the range of $5 million to $10 million.

Analysis: calibration

399. We have established this $5 million to $10 million range based on the purposes and principles in the DTA. The purpose of ensuring the soundness of individual deposit takers encourages a higher minimum, to minimise the chance of failure. However, the principles discussed above when analysing the introduction of a minimum capital lean towards a lower calibration. Considering these factors as a whole has led us to propose the current range, noting that we are open to feedback on alternative calibrations.

400. The capital needed to effectively operate as a deposit taker will depend on the individual deposit takers' business models. We are interested in your feedback from firms around their planned future scale under the DTA, and what they would see as the minimum size that would allow effective operation under the DTA. A minimum capital level based on minimum scale will enhance the stability of individual deposit takers. If we decide to implement the minimum capital requirement for Group 3, we will do further analysis on this to finalise the minimum dollar value, noting we expect this to be in the $5 million to $10 million range.

Other potential options

401. We are open to considering other options that would address our concerns about the individual soundness of the smallest deposit takers. We have included a potential option for consideration and welcome feedback on other alternatives that submitters feel would improve the soundness of the smallest deposit takers. One option would be introducing a minimum capital requirement for new entrants only. This would help shore up the capital strength during the new entrance period, with the requirement would in place for a limited period (for example, a 3-year minimum capital requirement for new entrants).

Summary

402. We are considering a range of ways to support the additional purposes in the DTA, including to promote the soundness of these deposit takers. One option is to set a minimum dollar level of capital in addition to the capital ratio requirements, potentially in the range of $5 million to $10 million. Under this proposal new entrants and existing Group 3 deposit takers will need to meet both the capital ratio and the minimum capital requirement for their regulatory capital requirement.

403. The proposed minimum capital requirement for Group 3 deposit takers would enhance the soundness of the smallest individual deposit takers. It may have a negative impact on the diversity of deposit takers and might have a negative impact on competition by creating an additional hurdle that could limit new entrants from entering the market.

404. We are open to other measures that would help improve the soundness of the smallest deposit takers. We have included an alternative measure as a starting point, but we are open to ideas that would help improve the soundness of the smallest deposit takers.

Q31	Do you support the introduction of a minimum capital requirement for Group 3 deposit takers?
Q32	Do you have any other proposals that would address the concerns laid out for the smallest deposit takers?
Q33	Do you support our proposed approach to calibrating the minimum capital requirements to ensure individual entity soundness?
Q34	Do you have any feedback on the initial assessment of our estimated calibration range of $5 million to $10 million?
Q35	Can current NBDTs and potential Group 3 deposit takers confidentially inform us of their planned future size and scale, and any impact an absolute minimum requirement would have?

4.3 Composition of capital

Preferred option

405. Our proposed approach for the capital composition of Group 3 deposit takers has the following features:

- regulatory capital to consist of CET1, AT1 and Tier 2 capital – these are the same categories available to Group 1 and Group 2 entities
- Mutual Capital Instruments (MCI) to be incorporated into the definition for CET1
- Additional Tier 1 capital instruments (up to 2.5% of Tier 1 requirements) and Tier 2 capital instruments (up to 2% of Total Capital requirements) can make up the same share of capital as available for Group 1 and Group 2 deposit takers
- simplification of requirements relative to Group 1 and Group 2

- a transition period to manage any non-compliant capital instruments.

Analysis

Status Quo

406. NBDTs currently have different definitions setting the boundaries of what forms of capital can be recognised as regulatory capital. The current NBDT regulations consist of:
    - a concept of 'gross capital', which consists of a range of different forms of capital, including retained earnings, ordinary shares, perpetual preference shares and a range of reserves
    - fewer forms of capital compared with the equivalent requirements for banks – in particular there are no MCIs and no Tier 2 capital
    - simplified requirements for capital instruments and no notification processes covering the processes for issuing capital instruments.

407. Some of the main differences are summarised in Table M.

Table M: Differences in current capital definitions

Definition	Banks (BPR110 and BPR120)	NBDT regulations
Ordinary shares	Must meet range of CET1 requirements (see 'Role of CET1' section below)	No CET1 concept, but ordinary shares must meet similar requirements
Retained earnings	Considered as CET1	Considered as capital
Deductions	Range of CET1 deductions for expected losses, crossholdings, fair value gains and losses, goodwill and deferred taxes	Range of deductions including fair value gains and losses, goodwill and deferred taxes
Mutual Capital Instruments from 1 September 2023	Incorporated into CET1 definition on 1 October 2023	None
Perpetual non-cumulative preference shares	Qualify as Additional Tier 1 capital if certain requirements are met, including: • most subordinate capital apart from CET1 • redeemable only after 5 years with Reserve Bank approval • discretionary coupon payments • must meet notification processes • no resetting of coupons	No AT1 concept, but preference shares must meet several requirements, including: • non-redeemable • discretionary dividends • no resetting dividends There are no notification requirements

Definition	Banks (BPR110 and BPR120)	NBDT regulations
Subordinated debt	Subordinated debt is recognised as Tier 2 capital, provided certain requirements are met Must meet BPR120 notification processes, including legal templates and check lists	Not included

Role of CET1

408. CET1 capital is a long-standing concept, drawn from Basel international frameworks, and is a central component of current capital requirements for banks. As set out elsewhere in this document, Group 1 and 2 deposit takers need primarily this form of capital to meet their capital requirements both now and under the proposed Capital Standard.

409. The key features of CET1 are described in Table N.

Table N: Key features of CET1 capital

Feature	Explanation
Permanence	A CET1 instrument should have no maturity date and should not be redeemable. If instruments are redeemable, there is a risk that investors will be repaid when a bank is in distress, or if not repaid, signal to the market the bank's worsening financial condition.
Subordination	Investors should be the first to absorb losses and their claim should represent the most subordinate claim on a banks' assets. Investors should only receive (a portion) of their funds (if any) once all senior liabilities have been settled.
Proportionality	Surplus assets should be distributed proportionally to the capital contributed. This reinforces market discipline; if investors participate proportionally in the gains or losses of the bank, they have greater incentives to monitor the bank
Distributions	Distributions must not be 'coupon-like' (i.e., be linked to the principal paid at issuance or subject to a contractual cap). Distributions must also be non-obligatory and any waived distributions must be non-cumulative.
Voting rights	Investors should have full voting rights arising from ownership of the shares.
Variable value	Variable value CET1 capital should be loss absorbing on a going concern basis. This occurs when losses are transferred to investors while the bank remains viable.

410. CET1 is not part of the current NBDT framework, but the regulations covering NBDTs do have a concept of 'gross capital', which includes many of the same features as CET1, including ordinary shares and retained earnings.

411. We intend to apply the concept of CET1 capital to Group 3 deposit takers. Our assessment is that the ordinary share and retained earning concepts from the current NBDT regulations

would meet the CET1 definitions in the BPR documents. We propose that CET1 definitions from Group 1 and Group 2 be applied to Group 3. This takes into account the DTA principle of the desirability of consistency in the treatment of similar institutions.

412. It is important that the key concepts of CET1 be replicated for Group 3, but we are open to your feedback about how this can be done without creating undue compliance costs for Group 3 deposit takers. The specification of CET1 deductions for Group 1 and Group 2 is particularly complex and may benefit from simplification for Group 3.

Role of Mutual Capital Instruments within CET1

413. In 2023, we introduced an MCI that qualifies as capital for mutually-owned banks. We propose that this MCI will be available to all mutually owned deposit takers in all groups, including Group 3.

414. A mutual deposit taker is one that is owned by its members (customers) that use its services, that is the people who deposit with and borrow from the bank.

415. Mutual deposit takers are founded on the principles of 'mutuality'. The rights of a shareholder of a company (such as the right to vote, dividends and surplus assets) are attached to each share held by the shareholder (rights 'per share'). In contrast, the rights of members come from their membership of the mutual (rights 'per member'). This means that members of a mutual bank own an equal share of the bank, hold equal voting rights (one vote per member) and are entitled to an equal share of dividends and surplus assets (upon wind-up or liquidation), no matter their scale of business with the bank.

416. Mutually owned deposit takers face an additional barrier to raising capital compared with other types of deposit takers. This occurs because mutually owned deposit takers cannot issue instruments that qualify as CET1 capital because the eligibility criteria for ordinary shares conflict with some of the core tenets of mutuality. This confines mutual deposit takers' CET1 capital to retained earnings (accumulated profits not distributed to members), which represents members' ownership interest in the deposit taker.

417. As a result, mutually owned deposit takers can be restricted in their capacity to build buffers of high-quality, loss-absorbing capital and then to use this to grow their lending. This might affect their ability to compete on a level playing field, which may have implications for financial stability.

418. In October 2023, after a detailed series of consultations, we added the MCI into the definitions of CET1 capital for banks. As noted earlier, we will be including the MCI in the capital definitions for Group 1 and Group 2 deposit takers. We are also proposing that the MCI be included in the definition of CET1 for Group 3 deposit takers.

419. Based on the analysis we completed during 2022 and 2023, we are confident that the MCI will perform as needed as CET1 capital for Group 3 deposit takers structured as building societies and cooperative companies. We consider that allowing MCI in the definition of CET1 capital promotes the financial system having a diversity of institutions to provide access to financial products and services for a diverse range of New Zealanders. However, there may be practical barriers for credit unions in using MCI that are discussed in a subsequent section of this chapter.

420. We are interested in stakeholder feedback about whether the MCI is a useful instrument for mutually owned Group 3 deposit takers to build buffers of high-quality, loss-absorbing capital.

Role of AT1 capital instruments

421. Redeemable Perpetual Preference Shares (RPPS) can qualify as AT1 capital for banks as part of the current bank capital adequacy framework. As detailed elsewhere in this paper, these instruments will be carried over into the Capital Standard for Group 1 and Group 2 deposit takers. These must meet a range of requirements and are only redeemable (or repayable) with our prior agreement.

422. Though the Capital Review did generally consider improving the quality of capital we saw a role for AT1 capital in the capital framework, in limited quantities.

423. RPPS are not of the same capital quality as ordinary shares. This is because the redeemable feature means there is a risk that investors may be repaid, even when the bank should retain the funding for capital purposes. As a safeguard against these risks, we must approve any redemption of the RPPS. Nevertheless, this process can generate its own risks. For example, if we decline a redemption because of concerns about a deposit taker's capital position, financial markets may interpret this as a sign of stress in the deposit taker. This can make it hard for the deposit taker to obtain funding and can make a bad situation worse. We therefore have put strict limits on the amount of AT1 that a bank can use to meet minimum requirements, which we propose to retain for all Groups of deposit takers in the DTA.

424. However, on balance, given the risk-mitigating measures available and the fact that non-payment of dividends is non-cumulative, we view RPPS as satisfactory AT1 capital if held in modest amounts (relative to sufficient better-quality capital).

425. We propose to extend the role of AT1 capital into the standard for Group 3 deposit takers. At present, the NBDT sector relies heavily on retained earnings. Our assessment is that some diversification from this into another form of capital, through a wider range of capital instruments, could be beneficial to provide capital flexibility for Group 3 deposit takers.

426. During the Capital Review in 2019, improvements to capital quality were balanced against the cost of higher capital quality through higher interest rates passed on to customers. To lower the cost of higher capital quality, banks were allowed to contribute a portion of AT1 and Tier 2 towards total capital. At that time, it was found that the contribution of AT1 to Tier 1 capital *'could be done to reduce the interest rate impacts whilst not materially forfeiting any increased resilience'*.

427. Our assessment is that this conclusion remains valid for Group 3 deposit takers – a contribution of AT1 to Tier 1 capital requirements would not forfeit any increase in stability associated with the increase in minimum requirements. AT1 may also provide some additional flexibility for Group 3 deposit takers that are constrained in the capacity to grow retained earnings or issue other capital instruments.

428. We do not expect the inclusion of AT1 to represent a significant change for Group 3 deposit takers, as the RPPS have many features that are the same, or similar to, the features of perpetual non-cumulative preference shares under current NBDT regulations. These are compared in Table O below.

Table O: Comparison of current preference share key requirements (not exhaustive list)

AT1 (Redeemable Perpetual Preference Shares)	Non-cumulative perpetual preference shares (current instrument available for NBDTs)
Most subordinate capital apart from CET1.	Nature of preference through subordination not stated.
Redeemable only after 5 years with Reserve Bank approval.	Not redeemable
Discretionary coupon/dividends payments. Coupon/dividends do not accumulate if not paid.	Discretionary dividend payments. Dividends do not accumulate if not paid.
No resetting of coupons	No resetting of coupons
Notification processes consist of legal templates and checklists that must be provided to the Reserve Bank	No notification processes

429. We intend that the requirements for the perpetual preference shares (PPS) for Group 3 would be significantly less complex than for the RPPS for Groups 1 and 2. We propose to apply simplified requirements for Group 3 to make it easier for these to be issued by small deposit takers. This is discussed in the simplification subsection in section 4.5 of this chapter.

430. We also propose that any existing PPS that have been issued by NBDTs before the issuance of a DTA licence will be recognised as capital for Group 3 deposit takers under the AT1 heading, so long as they are within the maximum contributions of AT1 to Tier 1 requirements. Any excess may be able to be recognised as Tier 2 capital, provided that Tier 2 limits have not been exceeded. This is discussed in more detail in section 4.6 about the transitional path.

431. As in the case of MCI, the legislation governing credit unions may provide some practical barriers to credit unions issuing AT1. We have addressed this issue in a separate section of this chapter.

Role of Tier 2

432. The capital framework created by the 2019 bank capital reforms also includes another type of capital, 'Tier 2'. As described elsewhere in this paper, these instruments will be carried over into the standard for Group 1 and Group 2.

433. Under the 2019 reforms Tier 2 capital consists of long-term subordinated debt with no contractual conversion features.

434. Because it is subordinated to depositors' and senior creditors' claims, Tier 2 capital acts as a protective buffer for depositors and senior creditors in the event a deposit taker is liquidated. Tier 2 capital serves several other purposes as well. There are many ways a failed bank may be resolved – liquidation is just one option – and thus Tier 2 can play a role in other forms of resolution, although, as set out in the Capital Review, this role is limited in New Zealand.

435. Tier 2 capital also has a role outside of resolution, as part of market discipline. Holders of Tier 2 capital are exposed to loss if a deposit taker fails and therefore can be expected to monitor

the bank for signs of weakness. Thus Tier 2 capital can also be a source of discipline on management, incentivising managers to take fewer risks than they otherwise might.

436. Tier 2 capital is incorporated in the capital framework through a total capital requirement and total capital minimum. We propose that Tier 2 has the same role for Group 3 deposit takers. Ultimately, we consider that the resolution value of Tier 1 is much higher relative to Tier 2 and can be better utilised to resolve a small deposit taker during or after a stress event.

437. Tier 2 provides Group 3 deposit takers with some flexibility, potentially at a lower cost than other forms of capital, because investors typically require a lower return on Tier 2 capital, as it is lower risk. These issues are considered in more depth in the preliminary assessment of costs and benefits.

438. As the same time, we recognise that there may be practical limits on issuing Tier 2 for some deposit takers. In addition, as with MCI and AT1, there may be additional barriers for credit unions. We discuss these issues in the subsection on the issuance of MCI, AT1 and Tier 2 instruments by credit unions.

Capital flexibility and simplification

439. Under the current regulations, NBDTs can issue preference shares, which are similar to, but less complex than, the AT1 that banks can issue. NBDTs face a limit of 25% of capital, or 50% for qualifying mutuals (cooperative companies or credit unions) for their use of preference shares.

440. While extra flexibility may help Group 3 entities manage their capital requirements, as small entities they may face constraints. For example, there are a range of compliance, legal and issuance costs associated with issuing capital instruments. For small amounts of capital instruments these compliance costs may be too large.

441. We are interested in stakeholder feedback about this topic. We are also open to your feedback about whether the publication of templates for the purposes of Group 3 capital instruments would be useful to help mitigate these issues, or whether other actions would make MCI, AT1 and Tier 2 more attractive for Group 3 deposit takers.

442. In the case of templates, we proposed this for banks as part of the implementation of the bank Capital Review proposals in 2020. Stakeholders did not support this approach as they preferred to retain flexibility to issue instruments in line with their own preferred approaches. However, we are interested in stakeholder views regarding Group 3.

Issuance of MCI, AT1 and Tier 2 instruments by credit unions

443. Diversification of capital may be challenging for credit unions given their obligations under the Friendly Societies and Credit Unions Act 1982 (FSCU Act). We have considered this in the context of CET1 (for the purposes of credit unions issuing MCI) as well as for AT1 and Tier 2 instruments.

CET1 (MCI)

444. The CET1 principles are permanence, subordination, proportionality, distributions, voting rights and variable value. Accordingly, CET1 instruments should have no maturity date and not

be redeemable. Under these criteria, our assessment is that credit union shares are ineligible as CET1 because they must be withdrawable (*see* section 107 of the FSCU Act).[69]

445. Credit union securities may be compatible with many of the CET1 principles if not for the lack of voting rights (*see* section 107A of the FSCU Act).

446. However, two possible areas of contention relating to CET1 principles relate to 'full voting rights' and 'variable value'. Regarding voting rights, the FSCU appears to rule this out for securities issued by a credit union. Additionally, the section states that each share should be of a fixed amount of $1 denomination, which may not meet the 'variable value' principle that ensures CET1 capital is loss absorbing on a going-concern basis.

447. We are interested in stakeholder views about how credit unions may issue MCIs in accordance with the FSCU Act. We are interested in whether credit unions broadly have the capacity and powers to issue MCI in accordance with their rules (*see* section 107B of the FSCU Act) or whether the voting rights requirement should be modified in some way for credit union securities to be eligible MCI.

AT1 and Tier 2 capital instruments

448. Our preliminary assessment is that there are no obvious barriers in the FSCU Act to a credit union issuing credit union securities as AT1 or Tier 2 capital instruments. However, credit union securities may be issued only to members, which might limit their attractiveness. We are interested in stakeholder feedback on this point as well as any other AT1 or Tier 2 requirements that may pose challenges under credit union rules.

Q36	Do credit union securities provide a useful capital-raising tool for CET1 (MCI), AT1 capital, or Tier 2 capital?
Q37	Does the requirement to be a member of the credit union, or the lack of voting rights, make credit union securities an unattractive CET1 (MCI) proposition?
Q38	Do credit unions have the capacity and powers to enter transactions creating MCI, AT1 capital or Tier 2 capital other than through credit union securities?

Effective management of capital

449. We intend to provide deposit takers a clear transitional pathway to meet the new capital requirements. For Group 3 deposit takers the proposed transitional path is described in subsection 4.6. The level and type of capital required under the new regime means that they may need to carry out some balance sheet strengthening and/or replace certain capital instruments, which will gradually be phased out as qualifying regulatory capital.

[69] Friendly Societies and Credit Unions Act 1982. (As at 15 June 2023). https://www.legislation.govt.nz/act/public/1982/0118/latest/whole.html

Summary

450. After considering the trade-offs between higher capital quality and simplicity in requirements, we propose that most of the capital requirements are made up of CET1.

451. We are proposing that Group 3 deposit takers may use the same amounts of AT1 and Tier 2 as provided for Group 1 and Group 2 deposit takers. This is subject to the same constraints as Group 1 and 2. As part of this, all PCB requirements must be met with CET1 capital.

452. There are important differences in the form of entities comprising Group 3. While there are some mutually owned deposit takers in Group 2, most Group 1 and Group 2 deposit takers are structured as companies. In Group 3 there are a number of mutually owned deposit takers, in the form of building societies and credit unions.

453. We are proposing including the MCI in the set of regulatory capital instruments available for Group 3 deposit takers to provide an additional option for these deposit takers to meet the increase in requirements set out in section 4.1 of this Consultation Paper. However, we acknowledge that there may be practical constraints to issuing capital instruments for Group 3 deposit takers. Over the short-term, we expect Group 3 deposit takers to retain a greater proportion of profitability as retained earnings to meet higher capital requirements. Based on feedback, further policy development may ease this difficulty.

Q39	Do you agree with our proposed capital composition for Group 3 deposit takers?
Q40	Do you agree that simplifying the capital issuance process would be useful for Group 3 deposit takers?
Q41	Is the MCI a relevant instrument for credit unions and, if included, what would be the impacts of removing the voting rights requirement that currently applies for MCI for banks in the BPR documents?

4.4 Approach to risk weighted assets: credit risk

Preferred option

454. Our proposed approach is for Group 3 deposit takers to use risk weights that match the current standardised credit risk weighted assets approach that applies to banks, as detailed in BPR131.[70] This treatment would place Group 3 deposit takers on par with Group 1 (for those exposures where Group 1 deposit takers must use the standardised approach) and Group 2 deposit takers, all of whom will be required to use the standardised approach.

455. We are also proposing that the three changes we are intending to make to the credit risk weight framework for the standardised approach (as discussed in subsections 2.1.1, 2.1.2 and 2.1.3) would equally apply to Group 3 deposit takers. The outcome of our proposed approach

[70] Reserve Bank of New Zealand. (2024, 1 April) *BP131 Standardised Credit Risk RWAs*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr131-standardised-credit-risk-rwas-apr-24.pdf

is that standardised risk weights for equivalent exposures would be the same for all deposit takers.

Analysis

Status quo

456. The risk weighted assets approach for NBDTs has not been reviewed since the regulations began.[71] Moreover, the existing risk weights in the NBDT regulations tend to be higher than existing risk weights for similar exposures in the standardised approach that currently applies to banks.

457. In addition, the status quo for NBDTs also includes some separate exposure categories, for example property development, that are not separately covered in the bank standardised approach. This was developed to match the high-risk lending undertaken by some NBDTs before the GFC. In particular, the failure of some finance companies with heavy exposures to sectors such as property development led to the creation of a specific category of risk weights for this lending with a higher risk weight. This does not exist in the standardised approach for banks, where such exposures would generally be considered part of the corporate category.

458. Under the DTA the Reserve Bank will directly supervise all Group 3 deposit takers and introduce a suite of prudential standards to promote financial system stability. Our assessment is that this reduces the need for a more conservative set of risk weights for Group 3.

Table P: Credit risk weighted assets comparison for Group 3 deposit takers

Exposure	Standardised bank approach (currently applied to non-D-SIBs)	Current NBDT regulations
Cash	0%	0%
Crown and the Reserve Bank	0%	0%
Other sovereigns	0%–100% based on credit rating	Not covered
Public sector entities	20%	20%
Banks	Based on maturity of claim, credit ratings	20%
Residential mortgage	20%–150% based on Loan-to-Value Ratio (LVR) and lenders mortgage insurance Investment loans have higher risk weight than non-investment	20%–150% based on LVR and lenders mortgage insurance Investment and non-investment loans treated the same
'Past due' residential mortgage	100%	20%–150% based on LVR and lenders mortgage insurance

[71] *See* Deposit Takers (Credit Ratings, Capital Ratios and Related Parties) Regulations 2010. Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010 (SR 2010/167) (as at 01 May 2014) Contents – New Zealand Legislation]

Exposure	Standardised bank approach (currently applied to non-D-SIBs)	Current NBDT regulations
Agriculture	Not separately specified. Likely to be classified as corporate or other asset (100% risk weight)	100%–150% based on LVR
Property development		150%–300% based on LVR
Other property and commercial		100%–150% based on LVR
Personal (consumer) loans		100% if registered under personal property. Otherwise, 150%
All other loans	100%	100%–200% based on LVR.
Equity	250% for Business Growth Fund, 300% for NZX-listed, 400% for all others	600%
Other assets	100% for any other on balance sheet asset	350%
Credit risk mitigation	Options to recognise guarantees or other risk mitigants to reduce risk weight	100% with financing statement, 150% with no financing statement
Corporate rated short-term	20%–150% depending on rating grade	20%–150% depending on rating grade
Corporate rated long-term	20%–150% depending on rating grade	20% to 150% depending on rating grade

Options considered

459. We considered a range of options for the approach to risk weights:

Table Q: Options for Group 3 risk weights

Option	Commentary
Status quo	We rejected the status quo on the basis that there was no strong case for setting separate risk weights for Group 3 compared with the standardised approach. Having separate approaches would add complexity and make movement into Group 2 more challenging. Our focus has been on ensuring that risk weights reflect the underlying credit risk. As Group 3 deposit takers will be supervised by the Reserve Bank and we do not see a strong reason to have higher risk weights for the same sorts of exposure. If a Group 3 deposit taker is taking on additional risk, not managed through risk weights, then we will consider appropriate supervisory responses.
Proposed approach: use risk weights from	Our proposed approach is for Group 3 deposit takers to use risk weights that match the current standardised credit risk weighted assets approach that applies to banks, as detailed in BPR131. This treatment would place Group 3 deposit takers on a par

Option	Commentary
standardised banking approach	with Group 1 (for those exposures where Group 1 deposit takers must use the standardised approach) and Group 2 deposit takers, all of whom will be required to use the standardised approach.
Reduce the categories of exposure	Exposure for Group 3 deposit takers could be collapsed into a smaller group, for example, Residential, Corporate and Other. This would create a significantly simpler approach, with fewer compliance costs. However, this would come at the expense of a loss of risk variability, with less scope for risk weights to reflect the actual underlying risk of a Group 3 deposit taker's exposure. This approach would also mean deviating from the standardised approach that is proposed to apply to Group 2 (and for some categories of exposures for Group 1).
Keep some additional categories for Group 3	Group 3 deposit takers would be required to use higher risk weights for property development, consumer lending and other categories not currently included in the standardised banking framework. This would match the existing approach for NBDTs, in which there are separate risk weights for these categories. This would have the advantage of continuing to assign higher risk weights to lending that may be riskier. However, to the extent that such lending is more risky, this would also be relevant for lending by Group 1 and Group 2 deposit takers. As such, we do not see a strong case for modifying this just for Group 3, given that all deposit takers will be covered by the same standards and the same supervisory approach.

460. The last of the options in Table Q above has been the main alternative approach that we investigated as a comparator to the proposed approach. In designing this alternative, we designed an option that would apply to all deposit takers, resulting in an addition of a range of new exposure categories to the existing standardised approach.

461. This alternative approach would provide more risk differentiation and would ensure that potentially riskier lending is risk weighted at a higher risk weight. We have rejected this alternative on the basis that it would add complexity to the approach, increasing compliance costs without necessarily delivering more financial stability.

462. We prefer an approach that applies the existing standardised risk weights to all deposit takers, promoting the consistent treatment of similar institutions and creating a more coherent prudential framework across all Groups of deposit takers. Where necessary, we propose retaining scope to implement supervisory responses if we assess that the risk weights are not adequately managing the risks of their exposures. For example, 'Pillar 2' adjustments requiring extra capital could be applied if we considered a deposit taker had large concentrations of exposures to particular sectors of the economy that were not managed by the risk weighting approach.

Simplification

463. While our proposed approach is for Group 3 deposit takers to use risk weights that match the current standardised credit risk weighted assets approach that apply to banks, we are open to simplifying this to make it easier for Group 3 deposit takers to implement and therefore

reduce unnecessary compliance costs. To do this we intend to design a simplified set of requirements, using the same risk weights, that would apply to Group 3 deposit takers.

464. We are interested in feedback from stakeholders about ways that the requirements could be simplified, while retaining the standardised risk weights. Some of the ideas that we may progress, subject to feedback, include:

- removing credit risk mitigation from the Group 3 requirements – this part of the current standardised approach introduces significant complexity and may not be needed for Group 3. This may affect the use of netting by Group 3 deposit takers in some circumstances
- exclude requirements for off-balance sheet items – the standardised framework covers credit equivalent amounts for off-balance sheet items, which are not currently provided for in NBDT requirements
- exclude requirements regarding Credit Valuation Adjustments – this primarily covers derivatives, which are unlikely to be relevant for Group 3 deposit takers, given their existing business models.

465. We will consider feedback on these points in advance of designing the exposure drafts of the actual requirements.

Impacts of proposed risk weights – some examples

466. As noted above, the proposals for credit risk weights for Group 3 would see the same risk weights as currently apply for banks using the Standardised Approach. This would mean that Groups 2 and Group 3 would have the same risk weights for the same types of exposures. The impact of this proposal is that the result of the higher capital ratio requirements compared with the status quo is smaller than it otherwise would be.

467. Tables R and S below show some examples of risk weight outcomes for a Group 3 deposit taker with assets of $1 billion.

468. Tables R and S show two stylised examples. In Table R, the deposit taker has property development and 'other' exposures subject to high risk weights in the current framework. In Table S the deposit taker does not have property development and 'other' exposures subject to high risk weights in the current framework. The reduction in risk weights is higher in Table R, and therefore the increase in minimum capital plus PCB is lower, than for the example in Table S.

Table R: Examples of risk weighting impacts for an NBDT with high risk weight exposures

	Risk weight (current)	Risk weighted assets (current)	Risk weight (proposed)	Implied RWA under proposed approach
Residential Mortgages - $250m (75% LVR)	50%	$125m	35%[72]	$87.5m

[72] For non-property-investment residential mortgage loans.

	Risk weight (current)	Risk weighted assets (current)	Risk weight (proposed)	Implied RWA under proposed approach
Residential Mortgages - $500m (50% LVR)	35%	$175m	35%[73]	$175m
Property Development - $150m (75% LVR)	200%[74]	$300m	100%	$150m
Other (no financing statement) - $100m	200%	$200m	100%	$100
Total Risk Weighted Assets		$800m (current)		$51.3m (proposed approach)
Capital for RWA		$64m (8% current)		$66.6m (13% proposal)

Table S: Examples of risk weighting impacts for an NBDT with no high risk weight exposures

	Risk weight (current)	Risk weighted assets (current)	Risk weight (proposed)	Implied RWA under proposed approach
Residential Mortgages - $500m (75% LVR)	50%	$250m	35%[75]	$175m
Residential Mortgages - $500m (50% LVR)	35%	$175m	35%[76]	$175m
Total Risk Weighted Assets		$425m (current)		$350m (proposed approach)
Capital for RWA		$34m (8% current)		$45.5m (13% proposal)

Summary

469. Our proposed approach is for Group 3 deposit takers to use risk weights that match the current standardised credit risk weighted assets approach that applies to banks, as detailed in BPR131.

470. We have taken into account the DTA principles in developing our proposed approach. In particular:

[73] For non-property-investment residential mortgage loans.
[74] For first ranking security.
[75] For non-property-investment residential mortgage loans.
[76] For non-property-investment residential mortgage loans.

- the proposals contribute towards the effective management of capital and the risks of entity failure. The options ensure risk weighting is aligned with actual risk
- the consistency in the treatment of similar institutions
- the proposals avoid unnecessary compliance costs.

Q42	Do you agree with our proposed approach to risk weighted assets for credit risk for Group 3 deposit takers?

4.5 Approach to risk weights: market risk and operational risk

471. For Group 3 deposit takers we are proposing to carry over the existing requirements faced by NBDTs. The only change is that we are proposing to separate out the capital calculations for operational and market risk. This will make no difference to the outcome of the calculation, unless a Group 3 entity has a large trading book exposure.

Preferred option

472. For Group 3 deposit takers, our preferred option is to continue with the simplified market and operational risk calculation currently included in the regulations of the NBDT Act. The regulation sets out a simple calculation (below) based on total and credit risk weighted assets and provides the quantitative capital requirement for market and operational risk.

473. The current calculation:

$$[(total\ assets\ +\ deposit\ takers'\ risk\ weighted\ amount\ for\ credit\ risk)\ \div\ 2]\ \times\ 0.175 = capital\ required\ for\ market\ risk\ and\ operational\ risk$$

474. The current calculation involves pooling operational and market risk to provide for a combined scalar of 0.175 (or 17.5%).

475. We are proposing to separate out the operational and market risk components of the calculation. This would involve a flat operational risk capital calculation of 12.5% of the average of total assets and credit risk weighted assets, and a flat market risk capital calculation of 5% of the average of total assets and credit risk-weighted assets (RWA) (shown below). These calculations will add up to give the same capital requirement as the current single calculation but will make incorporating secondary thresholds more straightforward.

476. The proposed calculations:

$$Quantitative\ capital\ requirement\ for\ operational\ risk = [(total\ assets\ +\ deposit\ takers'\ risk\ weighted\ amount\ for\ credit\ risk) \div 2]\ \times\ 0.125$$

$$Quantitative\ capital\ requirement\ for\ market\ risk = [(total\ assets\ +\ deposit\ takers'\ risk\ weighted\ amount\ for\ credit\ risk) \div 2]\ \times\ 0.05$$

477. We are also proposing a secondary threshold requirement for the market risk capital calculation in which additional capital will be required for Group 3 deposit takers with relatively large trading books compared to their total book. This will better reflect the risks that Group 3 deposit takers that have larger trading books may encounter, enabling us to move a Group 3 deposit taker to the Group 2 requirements for market risk capital calculations. We

discuss this in more detail in the 'Secondary threshold to move to Group 2' subsection below.

478. Our preferred option incorporates a simpler, less burdensome approach that maintains the current NBDT capital requirements for Group 3 deposit takers but splits the current single calculation into two separate calculations. We consider that this supports the safety and soundness of individual deposit takers, by linking operational risk requirements to the size of their assets.

Secondary threshold to move to Group 2 requirements for market risk

479. The Reserve Bank will utilise the main asset threshold for when a Group 3 deposit taker will become a Group 2 deposit taker, with one difference. For the purposes of market risk, we also propose having a secondary trigger for Group 3 deposit takers with large trading books. Once a Group 3 deposit takers trading book exceeds a percentage of assets (to be determined) then the Group 3 deposit taker will be considered a Group 2 deposit taker for the purposes of calculating their quantitative capital requirements for market risk. For clarity, they would maintain the Group 3 requirements for other areas of the capital standard.

480. We have not yet determined the level of the trigger as we do not have sufficient data on the size of the market risk (either IRRBB or in the trading book) for Group 3 deposit takers. However, we do not expect that small deposit takers will have significant trading books. To underpin our assessment of the appropriate level of the trigger, we are asking Group 3 deposit takers to provide us with information about the size of their trading book, both in absolute terms and as a percentage of assets. This information would not be divulged as part of any publication of submissions.

Q43	Do you agree with our proposal to separate the operational risk calculation from the market risk capital calculation for Group 3 deposit takers?
Q44	Do you agree with our proposal to include a secondary threshold to move a Group 3 deposit taker to Group 2 for market risk requirements?
Q45	At what level (either dollar value or percentage of assets) do you think the secondary threshold should be set?

Analysis

481. A relevant DTA principle for Group 3 deposit takers is proportionality. The requirements proposed for Group 1 and Group 2 deposit takers are not necessary for the size of the market risk in each Group 3 deposit taker. However, given the collective size of Group 3 deposit takers we intend to maintain a capital requirement for market risk. Our main concern when designing the requirement for Group 3 is simplicity to provide continuity to existing small deposit takers and to allow for the emergence of new deposit takers that will improve the diversity of options for consumers. Therefore, we believe that the best option is to carry over the existing requirements for Group 3 as much as possible.

482. The status quo calculation currently uses a scalar of 0.175 (or 17.5% of the average of total assets and credit RWA). The 0.175 scalar was derived from New Zealand registered banks'

operational and market risk figures and adjusted upwards to reflect the fact that operational risk is generally higher for smaller deposit takers in relative terms.

483. We consider this rationale remains appropriate for Group 3 deposit takers. However, as we are proposing to separate the operational and market risk capital charges, we considered the consequential changes this would have to the calibration of the scalar. We propose to use only aggregate operational risk figures of the deposit-taking industry as we separate the calculation from market risk – this equates to approximately 10% of credit RWA and 5% for market risk.

484. We also propose incorporating an additional 2.5% requirement to reflect the increased vulnerability to operational risk that smaller institutions are prone to. We do not see the need to incorporate a similar adjustment for market risk as small deposit takers are not likely to be exposed to more market risk than larger deposit takers, and if they do take on more market risk the secondary threshold will move them to the Group 2 requirements. Therefore, we propose a flat operational risk capital charge of 12.5% of the average of credit RWA and total assets for Group 3 deposit takers, and a flat market risk capital charge of 5% of the average of credit-RWA and total assets.

485. We are comfortable that the proposed approach sufficiently takes into account the proportionality principle. In developing our approach to market and operational risk capital for Group 3, we considered the strength (i.e., higher or lower capital requirements) and comprehensiveness (i.e., precise and detailed versus approximate methodologies to calculate capital) of our approach while meeting the main purpose of protecting and promoting financial system stability set out in the DTA. Given that Group 3 deposit takers are smaller, less complex and make up a small percentage of the deposit-taking market, it is our assessment that simple, flat capital charges for market and operational risk is the most suitable approach for reducing the compliance burden without compromising system stability.

486. Internationally, other jurisdictions have also sought to implement simpler capital charges for smaller institutions for operational and market risk where appropriate. For example, APRA has proposed a flat capital charge approach for smaller Authorised Deposit-taking Institutions (ADI) regarding operational risk capital, where the specific proposed operational risk charge is 10% of credit RWA. This is similar to the approach that the Reserve Bank has proposed for Group 3 deposit takers.

487. For the secondary threshold, for Group 3 deposit takers with large trading books, we do not expect any of the existing NBDTs to be immediately affected by this requirement. However, with the upcoming introduction of the DCS, there may be an increased appetite for new or existing deposit takers to take on more trading risk using depositors' money – as it is insured up to a limit. The secondary trigger will ensure that in this situation these deposit takers are required to use the more risk sensitive approach to calculating capital requirements used by Group 1 and Group 2 and, therefore, are likely to have to hold more capital against potential losses from their trading operations than in the standard Group 3 calculation.

488. For most Group 3 deposit takers these requirements replicate the current NBDT requirements. Therefore, they should not materially impact the amount of capital that Group 3 deposit takers must have. For Group 3 deposit takers that trigger the secondary market risk threshold, these requirements will require them to hold additional capital. We will do further analysis

once we have received the data requested from Group 1 deposit takers to estimate the impacts of this.

Summary

489. We propose that Group 3 deposit takers continue with the existing quantitative capital calculation for market risk that applies to NBDTs for operational and market risk.

490. However, we are proposing one change to the status quo by suggesting the calculation will be split into separate components for market risk and operational risk. This will then provide capacity to alter the market risk requirements in cases where the Group 3 deposit takers have large trading book exposures.

Q46	Do you agree with our proposed approach to capital requirements for market risk for Group 3 deposit takers?
Q47	Do you agree with our proposed approach to capital requirements for operational risk for Group 3 deposit takers?
Q48	Can potential Group 3 deposit takers provide us, on a confidential basis, information about banking book and trading book exposures on a normal day and on an OCR decision day?

4.6 Transition path

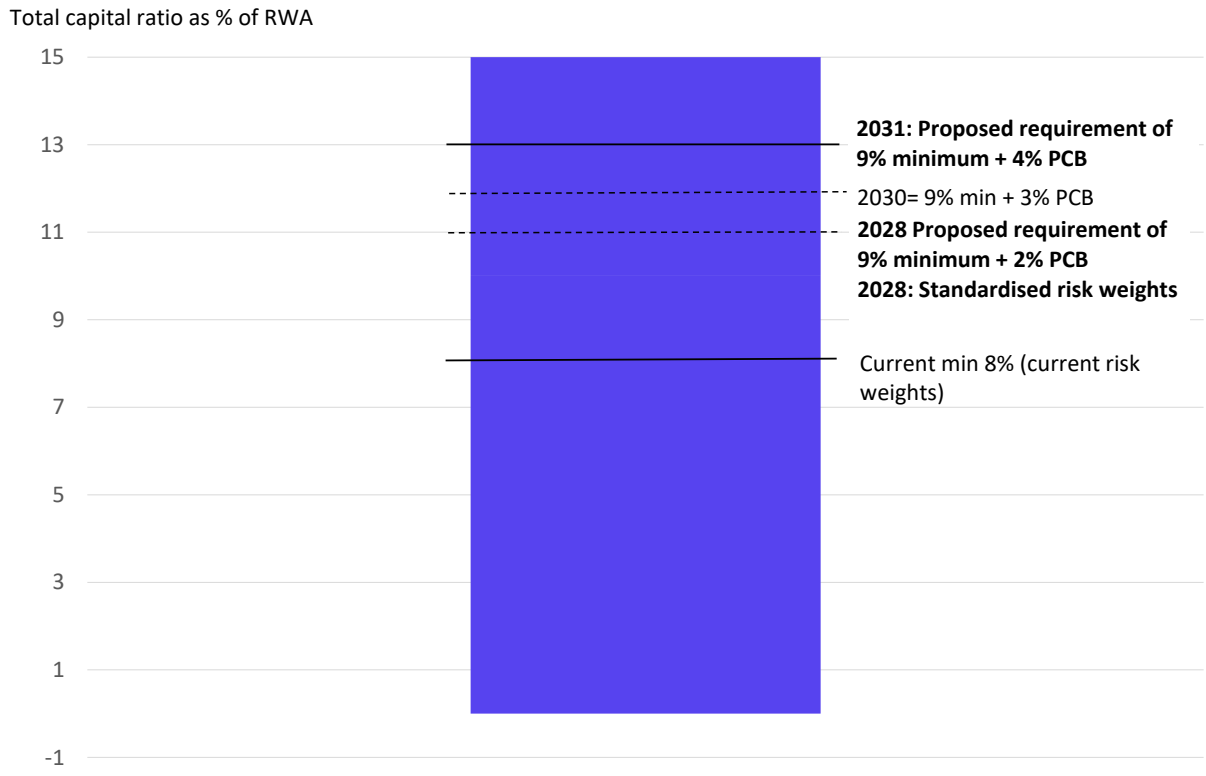
491. We are proposing no changes to any requirements until the Capital Standard begins to take effect under the DTA in 2028. Therefore, in the period up to 2028, all existing NBDT requirements would remain as they are now.

492. Once the DTA Standard takes effect in 2028, we are proposing that the increases in capital requirements would be gradually phased in, as part of the increase in capital requirements for Group 3 deposit takers compared with the status quo. The shortfall analysis indicates that most Group 3 deposit takers would be broadly able to meet the preferred option. However, some deposit takers will face more challenges. In addition, as Group 3 entities largely raise capital through retained earnings, fast increases in capital are not possible.

493. In addition, we are proposing that the standardised risk weights would apply to Group 3 immediately upon the implementation of the Capital Standard in 2028. On average this will mean a reduction in risk weights for most classes of exposure upon implementation.

494. We want to ensure that the transition does not result in any weakening in capital requirements during the transition period which could result from the reduction in average risk weights. To achieve this, in the transition path below, we intend that the upon implementation in 2028, Group 3 deposit takers would face a minimum total capital requirement of 9% of RWA, with a PCB of 2% of RWA. We estimate that this total level of 11% including buffers, would be approximately equivalent to the existing 8% requirement for NBDTs. This would mean that there would be no fall in the minimum amount of capital that an entity would require.

Figure 5: Proposed transition path



495. We propose no increases in 2029, with the rest of the PCB proposed to be phased in in 2030 (an additional 1% PCB) and 2031 (the final 1% of the PCB). This would mean that the full proposed total minimum capital ratio of 9% of RWA and PCB of 4% of RWA would be in place by 2031.

496. We note that other transition paths may also be possible. We have considered whether the Capital Standard could identify two separate sub-groups and apply the higher requirements upon implementation in 2028 for deposit takers with sufficient capital. Our assessment is that this would add unnecessary complexity.

497. Similar considerations will be necessary for assessing new entrants. At this point our assessment is that any new entrants should be able to comply with the full capital requirements, rather than being subject to a transition period.

Q49	Do you agree with our proposed transition path for Group 3 capital requirements or are there alternatives that would better balance the factors discussed above?

4.7 International perspectives

Basel

498. We have considered the approaches taken in a range of other countries, as well as the Basel framework.

499. The BCBS approach to proportionality incorporates the simplification of prudential requirements. The BCBS has noted that "supervisory practices should be commensurate with the risk profile and systemic importance of the banks being supervised".[77] It also considered how proportionality can be implemented. According to a global study conducted by the BCBS, prudential requirements could be implemented through:

- a limited or simplified set of BCBS standards ('simplified')
- a more comprehensive or conservative set of BCBS standards ('conservative')
- a mix of limited and conservative set of standards ('combination'), such as applying simplified for some standards and comprehensive for others.

United Kingdom

500. In the UK, the PRA published a discussion paper[78] setting out their intention to consider the *"appropriate prudential framework for smaller PRA-regulated banks and building societies ('firms') that are neither systemically important nor internationally active, with the intent to maintain their resilience while simplifying prudential regulation of those firms and supporting those among them wishing to grow"*.

501. The PRA discussion paper considered several issues that are relevant for our own consideration of the design of appropriate settings for Group 3 deposit takers in New Zealand. A key concept in the PRA documents is that a simplified system can be either more streamlined or more focused:

- the PRA describes a more streamlined system as one where the existing prudential framework is used as a starting point, with modifications for the elements that appear overly complex for smaller firms
- the PRA describes a more focused approach as one based on a narrower set of factors with a more conservative calibration.

502. The PRA points to a trade-off:

- the streamlined approach causes less difficulty for firms transitioning between frameworks as the broad structure is similar to the framework for larger firms

[77] Bank for International Settlements. (2021, July). *Proportionality in bank regulation and supervision – a joint global survey.* https://www.bis.org/bcbs/publ/d523.pdf

[78] Bank of England Prudential Regulation Authority. (2021). *Discussion Paper DP1/21 – A strong and simple prudential framework for non-systemic banks and building societies*. https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/discussion-paper/2021/dp121.pdf

- the focused system maximises simplification but may have to be very conservative compared with the streamlined approach to manage risks, as there is limited capacity to tailor risks to exposures.

503. The proposals for Group 3 deposit takers in this chapter have aspects that are similar to some of the concepts covered in the UK description of a streamlined approach. However, it should be noted that the UK's approach to credit unions seeks substantially smaller capital ratio requirements than those that apply to other types of deposit takers. A discussion of the UK settings is available in the link in the footnote. [79]

504. The UK has taken a significantly different approach from the one we are proposing in this document. In the UK, there are a large number of credit unions of varying sizes. To address this there is a range of requirements, which vary depending on the size of the credit union and the extent of the risks posed. In the UK, the PRA determined that their requirements were appropriate for the profiles of those entities and the features of the UK financial system.

505. As part of the Proportionality Framework, we have settled on having just three Groups, rather than a more complex set of groups to cover credit unions, or other sub-groupings of Group 3 deposit takers.

506. We concluded that lower capital requirements for credit unions, or other sub-groups, would not be sufficient to deliver the purpose of the DTA. We are interested in alternative perspectives you have about this matter.

507. We are proposing that the broad structure of the framework is the same across all 3 Groups, with variation to reflect the role of proportionality and simplification where possible.

508. Key proposals in this chapter that would be the same across all Groups include:

- same minimum capital ratio requirement of 9%, with variation in the size of the PCB
- same capital instruments available in the same quantities across all Groups
- standardised risk weights are the same for all Groups.

Australia

509. In Australia, APRA supervises 36 credit unions and building societies and 11 friendly societies.[80] Additionally, 102 finance companies, including general financiers and pastoral finance companies, provide prudential information to APRA and are regulated by the Australian Securities and Investments Commission (ASIC).

510. APRA recently completed a comprehensive review of its capital framework. The subsequent reforms to Australia's capital framework are aimed at meeting the updated BCBS framework while reflecting the characteristics of the Australian economy.

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[79] Bank of England. (2023, 26 July). *Policy Statement 11/23 – Credit Unions: Changes to the regulatory regime*. https://www.bankofengland.co.uk/prudential-regulation/publication/2023/july/credit-unions-changes-to-the-regulatory-regime ; and Bank of England Prudential Regulation Authority. (2022, September). *Consultation Paper CP7/22 – Credit Unions: Changes to the Regulatory Regime*. https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2022/september/cp722.pdf]

[80] Reserve Bank of Australia. (2021, December). *Main Types of Financial Institutions*. https://www.rba.gov.au/fin-stability/fin-inst/main-types-of-financial-institutions.html

511. Previously, proportionality rested on differences between the BCBS standardised and advanced approaches. Now, smaller, less complex standardised banks face simplified capital requirements.[81] Under the new framework, banks with total assets below AUD $20 billion are eligible to use simplified requirements and would be categorised as non-significant financial institutions (non-SFIs).

512. APRA is considering how to build on the simplified framework for capital and expanding it to other prudential requirements in order to further enhance proportionality in the prudential framework. For now, APRA proposes streamlined requirements as follows:

Table T: APRA streamlined capital requirements[82]

Risk area	APRA Streamlined requirements
Credit risk	Consistent with standardised approach
Operational risk	Simple, flat-rate add-on of 10% of total credit and securitisation RWA.
Counterparty credit risk	No counterparty credit risk capital requirements or reporting
Interest rate risk in the banking book	No specific risk management requirements, with some reporting to allow APRA supervisors to monitor the risk
Leverage ratio	No leverage ratio requirements or reporting
Public disclosures	Replacing disclosure requirements with an APRA data publication, to be confirmed during consultation.[83]

4.8 Analysis of costs and benefits

513. As a starting point to assess costs and benefits we considered modelling the costs and benefits of capital for Group 3 deposit takers by adapting the modelling approach of higher capital requirements for banks in the 2019 Capital Review.

514. The modelling approach worked for banks, as modelling parameters can be inferred from past capital issuances, securities listed on exchanges and from comparable studies conducted by other central banks.

515. In addition, for banks, we were modelling the impact of capital on the stability of the whole system. Capital levels are one of the most important determinants of financial system stability. As discussed above, increases in capital for small deposit takers will have only marginal benefits on reducing the probability of a financial crisis at a system level. On the costs side,

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[81] These banks must be domestic with no trading book activities, offshore businesses or international funding sources. APRA estimate around 70 banks benefit from simplified requirements.

[82] Australian Prudential Regulation Authority. (2021, November). *Information Pape, An Unquestionably Strong Framework for Bank Capital*. https://www.apra.gov.au/sites/default/files/2021-11/Information%20paper%20%20An%20Unquestionably%20Strong%20Framework%20for%20Bank%20Capital.pdf

[83] At present, under Prudential Standard APS 330 Public Disclosure, all authorised deposit-taking institutions (ADI) must disclose regulatory capital, reconciliation between the composition of its regulatory capital and its audited financial statements, and full terms and conditions of regulatory capital instruments including quantitative and qualitative information about its capital adequacy in standard format.

increases in capital for Group 3 will have little impact on interest rates in the economy as a whole.

516. Therefore, while these factors of the Capital Review – the benefits of reducing the risk of a financial crisis and the costs of higher interest rates – are relevant for small deposit takers, we have concluded that the same modelling approach cannot be easily adapted for small deposit takers. We have not therefore estimated a quantified set of costs and benefits in the same way that we did for banks in the Capital Review.

517. Our assessment is that the primary drivers of the costs and benefits for small deposit takers are different from the factors we considered in the Capital Review. Furthermore, based on their size, our assessment is that the expected economy-wide impacts will be limited, and the economy-wide benefits of extra capital will be small. Thus, we have not quantified the expected rise to funding cost and flow on impact to economy-wide interest rates for small deposit takers.

518. Our key consideration has been to identify the longer-term benefits of raising the capital requirements and quality to promote the safety and soundness of deposit takers and public confidence in the financial system. We want capital that is sufficiently high to provide depositors and creditors confidence while supporting a diverse sector.

Benefits

519. The benefits of the capital proposals for Group 3 deposit takers are described below.

Table U: Benefits of the proposed capital settings for Group 3 deposit takers

Benefit	Affected party	Transmission
Lower risk of failure and impacts on creditors	Creditors	Higher capital levels reduce the probability of deposit taker failure. If a small deposit taker fails, there is a risk that its creditors will lose money. These impacts are unlikely to be widespread, given the small role of the deposit-taking sector within the wider financial sector. Nevertheless, there could be real impacts on those creditors and in the communities they serve. More capital reduces this risk. Fewer failures also help promote confidence in the financial system.
Less risk of contagion	Other deposit takers	Failure of one entity could spill over to others, either because there are financial connections, or because sentiment drives people away from small deposit takers once one fails. Contagion effects on larger institutions are less likely.
Less risk of loss of economic activity in regions and sectors	Some sectors and regions	Some sectors and regions might be exposed to risks of spillover impacts from the failure of a small deposit taker. This might be particularly relevant if a small deposit taker has a lot of customers or creditors in a particular region or industrial sector.

Benefit	Affected party	Transmission
Failure can reduce competition		While more capital can limit the number of depositors, at the same time, more capital means less risk of failure. Entity failure would reduce competition by reducing the number of providers, so more capital can help maintain competition.
Diversity of institutions		While more capital could limit the diversity of institution types, at the same time, more capital means less risk of failure. Entity failure would reduce the diversity of institutions by reducing the number of deposit takers.

Costs

520. This section discusses costs in more depth, including an analysis of possible capital shortfalls and the impact on the system.

Table V: Costs of the proposed capital settings for Group 3 deposit takers

Cost	Affected party	Transmission
Higher interest rates for borrowers	Borrowers	A higher capital ratio means more deposit-taker funding must come from equity and less from debt. As discussed elsewhere in this chapter, this can result in higher funding costs in some circumstances. If deposit takers react to higher funding costs by passing these on to borrowers, then borrowers will pay more in interest.
Reduced economic activity	Sectors or regions	Higher interest rates tend to be associated with lower economic growth, as the higher costs discourage consumption and investment. For small deposit takers these impacts are likely to be focused on regions or sectors where activity is located. Because of their small size, relative to the financial system, economy-wide impacts are unlikely.
Can affect competition	New Zealanders	Some small deposit takers may not remain viable if they are required to have higher capital levels. Further, capital requirements may restrict new entrants from entering the market. Some small deposit takers are likely to have difficulty raising additional capital, particularly the small, mutually owned credit unions. This suggests more capital may inhibit competition. But at the same time, more capital means less risk of failure. Entity failure would reduce competition. The competition implications of capital are not straight-forward to assess.

Shortfall analysis

521. As a further illustration of the impacts of the proposals we have considered the extent to which the proposals would generate capital shortfalls for existing NBDTs if they meet the higher capital setting described earlier in section 4 of this chapter.

522. To complete this assessment, we considered all the proposals with a focus on the higher ratio requirements, once buffers are included, and the changes to risk weights. Overall, if all existing NBDTs are licenced as Group 3 deposit takers, the preferred option is expected to lift minimum total capital requirements across the Group. This is made up of two, somewhat offsetting, effects:

- the introduction of a 13% minimum total capital ratio requirement, including the PCB, is above the existing 8% requirement capital requirement for NBDTs.
- on average, the use of standardised risk weights will reduce the level of risk weighted assets for Group 3 deposit takers as the risk weights will tend to be lower than currently faced by NBDTs. This reduces the increase in capital associated with the proposed increase in capital ratios.

523. The estimates below are indicative only, to illustrate possible outcomes. The actual outcomes would depend on the precise types of exposure for each deposit taker.

524. In Table W we show our estimates of the change in minimum capital requirements across NBDTs currently operating in New Zealand. As NBDTs all currently have capital that is above the minimum level, the increase in minimum requirements in Table W is not the same as the actual increase in capital levels that deposit takers would need. As many of these deposit takers have capital above the current minimums, this current capital could be used to meet rising policy settings in these proposals.

525. To make the calculation in Table W, we estimated the minimum capital required at present, then estimated the minimum capital required at the proposed higher minimum levels, after adjusting for the overall reduction in risk weights associated with the proposals. This analysis is only indicative and is based on our own analysis of how existing exposure would map to the risk weight proposals in this Consultation Paper. In practical terms, a lot could change in capital and risk weighted assets positions by the time any proposals are implemented, and these numbers should be read with that in mind.

Table W: Overall increase in minimum capital requirements by deposit taker type (Reserve Bank estimates as at December 2023)

Current RWA	Minimum capital level for existing requirements [84]	Current actual capital	Estimated revised RWA	Estimated minimum plus buffer capital level in proposals
$2,400m	$192m	$330m	$1,950m	$254m

[84] This is an approximation as in practice there are add-ons for NBDTs with credit rating exemptions.

526. In aggregate, there is sufficient actual capital in the NBDT sector to meet the increases proposed in this Chapter. However, this may not be true for each deposit taker within the sector.

527. For NBDTs currently well above the minimum levels, the proposed higher requirements would not create a shortfall in their existing capital positions and they would instead have a smaller surplus of their actual capital above the regulatory minimum and buffer requirements.

528. To further assess this, we have defined the shortfall as the difference between the required capital in the proposed approach relative to current capital levels. That is, shortfall indicates that current capital levels would be inadequate. It is possible that some Group 3 deposit takers may want to have buffers higher than those that we have proposed. We have not factored this into the analysis. However, this would mean that Group 3 deposit takers would need to raise capital by more than our estimates.

529. To estimate shortfalls in capital, we have taken the following approach, using confidential entity-specific data:

- existing capital levels have been compared with required capital levels under our proposed approach in this paper
- the assessment includes the impact of the proposed increase in minimum and buffer requirements
- the assessment includes the offsetting impact of lower average risk weights for some exposures
- once all these features are factored in, we estimate that a small number of deposit takers may not, based on their current capital levels, have sufficient capital to meet the proposed increases
- we estimate that any shortfall is likely to be small.

530. Based on shortfall analysis, we expect that there may be a small number of deposit takers that will need to increase their capital levels if the proposed approach proceeds. This may be challenging for some of these deposit takers – particularly for the mutually owned deposit takers that can have limited options to raise capital. Nevertheless, our estimates suggest that these shortfalls are relatively limited and the addition of the MCI as an option for raising capital may help offset some of these pressures. The transition path in subsection 4.6 proposes a gradual introduction of the proposed increases, to provide deposit takers time to adjust.

531. As noted previously, the use of one set of requirements for all Group 3 deposit takers is consistent with the Proportionality Framework, though we do recognise that there is significant diversity across the sector. We are interested in your feedback about whether there are grounds to vary any of the proposed requirements for subsets of Group 3.

Q50 Do you agree with the conclusions in the shortfall analysis?

Summary

532. While the proposed capital ratios would represent an increase from the status quo for Group 3 deposit takers, there are offsetting impacts to the total capital required as a result of the proposed changes to the calculations of RWA.

533. Accordingly, our initial assessment is that Group 3 capital may increase slightly overall, as it has for Group 1 and Group 2 deposit takers during the implementation of the Capital Review decisions. However, our preliminary assessment is that most Group 3 entities will not have a shortfall in capital because of our proposed approach.

534. The shortfall analysis above shows that any shortfall is most likely to be in the credit union sector. To assist with this, we propose a transition period for these Group 3 deposit takers to raise more capital and the addition of the MCI to allow these entities to raise capital more easily from their members.

535. We consider that we have struck the right balance between a slight increase in capital for Group 3 deposit takers, to bring the existing NBDT regime more in line with the direction of the recent Capital Review while not increasing Group 3 capital requirements to the same level as Group and Group 2 deposit takers. This is intended to maintain a proportionate approach while promoting financial system stability and the safety and soundness of individual Group 3 deposit takers.

5 Conclusion

536. We consider that the proposed Capital Standard is necessary to ensure that deposit takers maintain minimum capital levels, which help reduce the likelihood of deposit taker failures and protect the wider economy. This aligns with the main purpose of the DTA: to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system.

537. This chapter set out our proposed approach to capital requirements for each Group of deposit taker. In some areas, we have proposed carrying over existing capital requirements into the standard. In other areas, we have proposed new requirements. We have taken into account all relevant DTA principles throughout our analysis for each proposal.

538. Based on this analysis, we propose that Group 1 and Group 2 deposit takers continue to face the capital requirements currently being implemented following the 2019 Capital Review decisions, with a few small modifications for credit, market and operational risk. For Group 3 deposit takers, we are proposing an increase in capital requirements, but in a proportionate way, to a lower level than for Group 1 and Group 2 deposit takers. We are seeking your feedback on all aspects of these proposals.

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 2

Deposit Takers Liquidity Standard

Deposit Takers Core Standards Consultation

16 May 2024

CONSULTATION PAPER

Non-technical summary

Liquidity requirements help ensure that deposit takers can provide depositors, and others they need to pay, with their money when they want or need it, or when it comes due. Our liquidity requirements do this by requiring deposit takers to carefully monitor and manage their ability to make payments to others. This includes requiring deposit takers to have a minimum amount of cash, and other assets that can be sold quickly at a reliable price, to meet financial obligations such as paying bills and deposit withdrawals.

Liquidity Policy Review

This chapter builds on work undertaken as part of the Liquidity Policy Review (LPR). The LPR is a comprehensive, multi-year, review of our liquidity policy that started in February 2022 with the release of a first consultation paper (C1). A second consultation paper (C2) was released in February 2023, followed by the announcement of some key decisions on C2 issues in December 2023.

The C2 decisions were to:

- retain and modify our existing quantitative liquidity metrics (the Mismatch Ratios and the Core Funding Ratio), as these metrics have served us well, and we believe will continue to do so in the future
- tighten the eligibility criteria for liquid assets so that only assets we believe could be sold in a private market during a period of stress would be classified as liquid assets and require deposit takers to hold more of these liquid assets. We will accept high-quality assets that we do not think our deposit takers could easily sell in a stress period as collateral through a newly established Reserve Bank 'Committed Liquidity Facility' (CLF)
- apply liquidity requirements across all groups of deposit takers in a proportionate manner.

What are we consulting on now?

This chapter proposes:

- revised qualitative liquidity requirements that would more clearly define responsibilities for liquidity risk management by deposit takers, which we intend to apply across Groups of deposit takers in accordance with the Proportionality Framework
- potential modifications to strengthen and update our existing quantitative liquidity requirements, such as reflecting the impacts of the forthcoming DCS. These modified requirements would apply to almost all existing banks (Group 1 and Group 2 deposit takers under our Proportionality Framework)
- the potential features and components of the CLF
- a simplified quantitative liquidity requirement that would apply to our smaller deposit takers (Group 3 deposit takers under our Proportionality Framework)
- certain qualitative liquidity requirements that we believe should apply to branches of overseas banks.

1 Introduction

539. The Liquidity Policy Review (**LPR**)[85] is a comprehensive, multi-year, review of our liquidity policy that started in February 2022 with the release of an initial consultation paper (**C1**).[86] In February 2023, we released a second consultation paper (**C2**) that consulted on some significant policy issues, including the potential adoption of the BCBS[87] Liquidity Coverage Ratio (**LCR**) and Net Stable Funding Ratio (**NSFR**) to replace our existing metrics, the Mismatch Ratios (**MMR**) and the Core Funding Ratio (**CFR**). We announced key decisions on these C2 issues in December 2023, which included our decision to retain and modify our existing metrics rather than adopt the BCBS metrics and to tighten our eligibility criteria for liquid assets.

540. We propose to reflect these two decisions in the requirements for Group 1 and Group 2 deposit takers under the proposed liquidity standard (while they were made after the passage of the DTA, we consider they are necessary or desirable for one or more purposes of the DTA, and we had regard to the principles in the DTA when coming to these decisions).

541. As a result, this chapter focuses on other significant policy issues for the LPR. Some are issues about which initial views were sought in C2, while other issues are being consulted on for the first time.

1.1 Purpose of the Liquidity Standard

542. Our liquidity requirements help ensure that deposit takers can pay their liabilities when they fall due. The policy does this by requiring deposit takers to carefully monitor and manage their ability to make payments to others, and by requiring them to have a minimum amount of cash, and other assets that can be sold quickly at a reliable price, to meet financial obligations such as paying bills and deposit withdrawals.

543. The purposes of the DTA include protecting and promoting the stability of the financial system, promoting the safety and soundness of each deposit taker, and promoting public confidence in the financial system. Our liquidity requirements are necessary or desirable for all of these purposes as they improve banks' capability to manage liquidity risk and lower the likelihood of liquidity problems resulting in their failure.

1.2 Current approach

544. Our liquidity requirements, which have been in place since 2010, have generally functioned well and served their purpose in helping to ensure that banks adequately manage their liquidity risk. However, these requirements have not been comprehensively reviewed since that time. There have been significant developments that support the case for reviewing the

[85] Reserve Bank of New Zealand. (2023, 9 February). *Review of liquidity policy (BS13).* https://www.rbnz.govt.nz/have-your-say/2022/review-of-liquidity-policy

[86] Reserve Bank of New Zealand. (2022). *Liquidity Policy*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs13-liquidity-policy.pdf

[87] The BCBS or 'Basel' is a committee of international banking regulators that establish best practice and standards for banks.

policy now, including our recent Liquidity Thematic Review[88] and Liquidity Stress Tests, as well as the COVID-19 pandemic.

545. The objective of the LPR is to ensure our liquidity policy remains fit for purpose. Over time, it has become apparent that certain parts of our liquidity requirements could be strengthened, clarified, or updated. However, we are not aware of any significant deficiencies in our liquidity requirements that fundamentally undermine their ability to achieve their objective.

1.3 Proposed policy development approach

546. As noted above, as part of the LPR, we published several decisions on C2 in December 2023.[89] These included:

- retaining and modifying our existing quantitative liquidity metrics (the Mismatch Ratios (MMRs) and the Core Funding Ratio (CFR)), as these metrics have served us well, and we believe will continue to do so in the future; and
- tightening the eligibility criteria for liquid assets so that only assets we believe would have a private market during a period of stress would be classified as liquid assets and require deposit takers to hold more of these liquid assets. For high-quality assets that we do not think our deposit takers could easily sell in a stress period, we will accept these assets as collateral through a newly established Reserve Bank 'CLF'.

547. We propose to incorporate these decisions into the requirements for Group 1 and 2 deposit takers under the proposed liquidity standard, as:

- we consider that they are necessary or desirable for the purpose of protecting and promoting the stability of the financial system, promoting the safety and soundness of each deposit taker, and promoting public confidence in the financial system. Specifically, by ensuring that robust quantitative requirements are in place to ensure that these deposit takers effectively manage their liquidity risk, and that only appropriate assets may qualify as liquid assets under these quantitative requirements; and
- in coming to these decisions in December 2023 we had regard to both the considerations in the Financial Policy Remit, and the relevant principles in the DTA.[90]

548. As a result, this chapter focuses on other significant policy issues for the LPR, some of which are an extension of the issues consulted on in C2, and some of which are being consulted on for the first time.

549. This chapter does not include specific proposals on information that must be disclosed to the Reserve Bank under the proposed liquidity standard (information that must be disclosed to the public at large is addressed in the Chapter 4 Deposit Takers Disclosure Standard of this

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[88] Reserve Bank of New Zealand. (2021, 30 September). *Thematic review of compliance with liquidity policy.* https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/thematic-reviews/thematic-review-of-compliance-with-liquidity-policy

[89] Reserve Bank of New Zealand. (2023). *Liquidity Policy Review*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/liquidity-policy-review/liquidity-policy-review-consultation-paper-2-key-decisions.pdf]. This document also contains an analysis of how we have taken into account the principles in section 4 of the DTA, and the considerations in the Financial Policy Remit (FPR) in relation to the decision to retain the MMR and CFR metrics.

[90] Reserve Bank of New Zealand. (2023). *Liquidity Policy Review* (pp. 46–49, 64–68). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/liquidity-policy-review/liquidity-policy-review-consultation-paper-2-key-decisions.pdf

Consultation Paper). This is partially contingent on final policy decisions on the content of the proposed liquidity standard but will also need to be considered in the context of other reporting obligations deposit takers may have under the Reserve Bank of New Zealand Act 1989 and the DTA. We anticipate consulting on this as a part of later consultation on exposure drafts of the proposed standards.

LPR principles

550. The LPR is guided by six principles, which arise out of C1. These principles complement the relevant principles in the DTA which we must take into account.

Table X: LPR principles

LPR principles
1. Liquidity requirements should be calibrated using assumptions that reflect stress scenarios to help ensure financial stability.
2. The liquidity policy should encourage deposit takers to make reasonable efforts to maximise reliance on private sector liquidity.
3. Liquidity requirements should have regard to international practice, while reflecting the New Zealand context, and be proportional by taking into account the differing size, nature, and complexity of all deposit takers.
4. The liquidity policy should contain both qualitative and quantitative requirements and encourage deposit takers to take a holistic approach to their management of liquidity risk.
5. Liquidity requirements should be sufficiently prescriptive to promote and facilitate consistent interpretation and implementation by deposit takers to enhance comparability and market discipline.
6. Liquidity requirements should be practical to administer and seek to avoid any unnecessary complexity and compliance costs.

551. As set out in our first LPR consultation (C1), our starting point is that we do not want to see an overall material weakening in liquidity requirements relative to the qualitative and quantitative liquidity requirements currently in place, as we consider this may have a negative effect on financial stability and therefore be inconsistent with the main purpose of the DTA.

2 Proposed approach for Group 1 deposit takers

2.1 Qualitative requirements

552. Qualitative liquidity requirements and guidance are an essential part of liquidity policy and help ensure that deposit takers are taking a holistic approach to managing their liquidity risk.

553. Our liquidity policy for banks (BS13), which was implemented in 2010, used the BCBS qualitative liquidity principles as a basis for developing the qualitative requirements and guidelines contained in our policy. As a result, the qualitative liquidity requirements and guidelines in our liquidity policy, which can be found in Section D of BS13 are generally

aligned with the BCBS's qualitative liquidity principles. A comparison of the BCBS's liquidity principles and our qualitative liquidity requirements and guidelines is contained in C@ Appendix 1.[91]

554. The BCBS's qualitative liquidity principles are contained in its *Principles for Sound Liquidity Risk Management and Supervision (2008)*, which include seventeen principles for governing, measuring, managing, and supervising liquidity risk. In January 2019, the BCBS completed a review of these principles and confirmed that they remain fit for purpose and advised that banks and supervisors should remain vigilant about liquidity risks in financial markets.[92]

Preferred option

555. Despite the high degree of alignment between the BCBS's qualitative liquidity principles and our existing qualitative requirements and guidelines, we are proposing some revisions to our qualitative liquidity requirements that are intended to streamline and further clarify these requirements, while also applying such requirements in a proportionate manner.

556. The proposed revised qualitative liquidity requirements for Group 1 deposit takers are contained in tables Y and Z below. We have also indicated the comparable paragraphs in BS13 in parentheses. Please note that:

- some of the wording of the requirements will likely change as the requirements are incorporated into the proposed standard, and we will consult on the wording at the exposure draft stage of consultation
- standards apply to deposit takers, so where the tables below refer to obligations being imposed on the Board or senior management, they may be reflected in the standard as an obligation for the deposit taker to ensure that the Board or senior management complies with those obligations (or a requirement of similar effect)
- it is possible that some of the requirements may be incorporated into guidance rather than the standard itself (this guidance may either relate to compliance with the standard or with the duty of directors under section 93 of the DTA). If so, we will consult further on this at the exposure draft stage of consultation next year.

Table Y: Proposed qualitative liquidity requirements for Group 1 deposit takers

Proposed qualitative liquidity requirements
Board responsibility for liquidity risk management (BS13 paragraphs 76 and 85)
a. A deposit taker's Board of Directors (Board) is ultimately responsible for the sound and prudent management of liquidity risk at the institution. Each deposit taker must maintain a liquidity risk management framework, approved by the Board, that is commensurate with, and adequate to manage, the level and nature of liquidity risk exposures (including foreign currency exposures) at the

[91] Reserve Bank of New Zealand. (2023, 9 February). *Liquidity Policy Review Consultation Paper #2 (Significant Policy Issues)*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/liquidity-policy-review/liquidity-policy-review-consultation-paper-2-significant-policy-issues.pdf

[92] The BCBS press release announcing the finding of this review, and the principles themselves, *see* Bank for International Settlements. (2019). *Basel Committee completes review of Principles for sound liquidity risk management and supervision*. https://www.bis.org/press/p190117.htm]

institution. This framework must be reviewed to determine whether it remains appropriate at least every three years, and the outcome of each review must be reported to the Board. The framework must be amended where necessary whenever there is a material change to the deposit taker's liquidity risk, and these amendments must be approved by the Board.

b. A deposit taker must have a framework for how its Board will ensure that senior management and other relevant personnel have the necessary knowledge, expertise, and experience to manage liquidity risk at the institution.

c. The Board is ultimately responsible for ensuring that the deposit taker is always complying with all liquidity requirements (during the normal course of business).

Liquidity risk management framework (BS13 paragraphs 88 and 89)

Each deposit taker's liquidity risk management framework must contain, at a minimum:

a. a statement and description of the institution's liquidity risk tolerance;

b. the institution's strategy and policies for managing liquidity risk within its tolerance and for complying with minimum regulatory liquidity requirements;

c. an effective process for identifying, measuring, monitoring, and controlling liquidity risk.

Senior management responsibilities for liquidity risk management (BS13 paragraph 86)

a. Senior management is responsible for developing, maintaining, and updating the institution's liquidity risk management framework in accordance with the Board-approved liquidity risk tolerance for the institution.

b. Senior management must report at least annually to the Board on the institution's liquidity risk, the performance of its liquidity risk management framework, and notify the Board of any developments that could have, or will have, a material impact on the institution's liquidity risk.

c. Senior management must recommend to the Board any changes to the institution's liquidity risk management framework that would help the institution better manage the impacts of any significant developments (potential or actual).

d. Senior management is responsible for the implementation of the deposit taker's liquidity risk management framework throughout the institution, including any associated policies, procedures, and internal controls.

e. Senior management is responsible for ensuring that liquidity stress testing exercises are conducted, at least every two years, and that these exercises are used for the development and maintenance of the institution's contingent funding plan (that should, at a minimum, address the outcomes of these liquidity stress testing exercises). This requirement is closely related to the requirements under the heading "Liquidity stress testing (paragraphs 103 and 104 of BS13)" in this table.

f. Senior management is responsible for understanding how the institution's liquidity risk interacts with other risks facing the institution, such as credit, market, operational, and reputational risk.

Managing intra-day liquidity positions (BS13 paragraph 91)

A deposit taker must actively manage its intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions.

Liquidity stress testing (BS13 paragraphs 103 and 104)

a. A deposit taker must conduct stress tests, at least every two years, for a variety of short-term and

protracted institution-specific and market-wide stress scenarios to identify potential sources of liquidity stress and to ensure that current exposures remain in accordance with its liquidity risk tolerance. A deposit taker must use stress test outcomes to adjust its liquidity risk management framework and its contingent funding plan as needed. b. Stress test exercises and outcomes must be reported to the Board, and senior management must recommend to the Board any changes to the institution's liquidity risk management framework that would address any shortcomings identified by these stress tests.
Contingent funding plan (BS13 paragraphs 119 to 128) A deposit taker must have a contingent funding plan (CFP), approved by the Board (and re-approved by the Board at least every two years, or earlier as circumstances warrant). The CFP should set out the strategies and actions for addressing a range of liquidity stress events, including short-term and protracted institution-specific and market-wide stress scenarios. The CFP must establish clear lines of responsibility and include clear invocation and escalation procedures.
Cash flow projections (BS13 paragraphs 95 and 96) A deposit taker must have a framework for comprehensively projecting cash flows arising from assets, liabilities, and off-balance sheet items over a time horizon(s) determined appropriate by the institution. These cash flow projections must be considered under both normal conditions and stress scenarios.
Funding strategy, and sources and diversification of funding (BS13 paragraphs 109 to 113) A deposit taker must establish and maintain a funding strategy, approved by the Board (and re-approved by the Board at least every three years, or earlier as circumstances warrant), that provides effective diversification in the sources and maturity of funding.
Active management of collateral positions (BS13 paragraphs 96 and 116) A deposit taker must actively manage its collateral positions, if any, and its stock of unencumbered and encumbered assets.

Table Z: Proposed qualitative liquidity requirements that may be included in guidance

Proposed qualitative liquidity guidance
1. Pricing of liquidity risk A deposit taker should account for the liquidity risk associated with its main business activities and products and consider factoring such risk into its pricing of products.
2. Funding strategy, and sources and diversification of funding A deposit taker should maintain an ongoing presence in its chosen funding markets and strong relationships with funds providers to promote effective diversification of funding sources. A deposit taker should regularly gauge its capacity to retain funds from each source. It should identify the main factors that affect its ability to retain funds and monitor those factors closely to ensure that estimates of fund retention remain valid.
3. Active management of collateral positions A deposit taker should monitor the legal entity and physical location where collateral (if any) is held

and how it may be mobilised in a timely manner.
4. Contingent funding plan The contingent funding plan should be regularly tested and updated to ensure that it is operationally robust.
5. Sufficiency of liquid assets In the normal course of business, a deposit taker should ensure that it always maintains sufficient liquid assets to meet all net cash outflow obligations that are scheduled to, or could reasonably, arise under a range of stress events.
6. Sufficiency of stable funding sources A deposit taker should ensure that their main business activities are funded with sufficiently stable sources of funding.

Analysis

557. The qualitative requirements are designed to promote effective management of liquidity risk, and therefore support financial stability, in line with the main purpose of the DTA.

558. The qualitative liquidity requirements and guidelines in our current liquidity policy are generally aligned with BCBS's qualitative liquidity principles, and therefore are generally aligned with international standards. However, we believe that our proposed streamlining and clarification would help promote and facilitate consistent interpretation and implementation of our requirements by deposit takers (thus supporting the principle of consistency in the treatment of similar institutions). We also consider that it would make our requirements more practical to administer (thus avoiding unnecessary compliance costs).

559. The qualitative requirements allow for different ways of planning how to manage liquidity. This should avoid unnecessary compliance costs.

560. Relative to our existing qualitative liquidity requirements and guidelines, we do not consider that the implementation of these revised qualitative liquidity requirements would require Group 1 deposit takers to incur any significant additional compliance costs. However, we welcome your feedback on this.

Summary

561. We propose that the qualitative liquidity requirements and guidance for Group 1 deposit takers be the requirements and guidance set out above in Tables Y and Z. We consider that these requirements will help ensure that Group 1 deposit takers effectively manage their liquidity risks, while at the same time supporting more consistent interpretation and implementation of our rules and making them more practical to administer. While compliance with these requirements will involve some compliance costs, we consider that those costs are proportionate and justified given the benefits of the proposals (i.e., helping to ensure the prudent management of liquidity risks by Group 1 deposit takers).

Q51	Do you have any comments or suggestions on the proposed qualitative liquidity requirements for Group 1 deposit takers?
Q52	Do you have any views on our intention to supplement our qualitative liquidity requirements for Group 1 deposit takers with qualitative liquidity guidance?
Q53	Do you have any comments or suggestions on the proposed qualitative liquidity guidance for Group 1 deposit takers included in the standards, as opposed to through non-binding guidance?
Q54	Do you agree with our assessment of the costs/benefits of our proposed qualitative liquidity requirements for Group 1 deposit takers?

2.2 Quantitative requirements – modifications to MMR and CFR

562. In C2, we consulted on the potential adoption of the BCBS's LCR and NSFR, to replace our existing MMR and CFR. After conducting our own analysis and considering the feedback we received on this issue, we announced our decision to retain and modify our MMR and CFR in our C2 decisions published in December 2023.[93]

563. In C2, we indicated that we were inclined to make modifications to the MMR and CFR if these metrics were retained. Some potential modifications to these metrics were outlined in C2 chapter 6 which received mostly positive feedback. There were strong calls for our revised metrics to account for the implementation of the DCS and insured deposits.

564. In this section we describe and explain our proposed modifications to the MMR and CFR that would apply to Group 1 deposit takers.

565. Our proposed modifications to the MMR and CFR reflect our experience with these metrics, as well as feedback received from banks. We do not believe that there are significant deficiencies in the current form of the MMR and CFR. However, we consider that these proposed modifications, if implemented in part or in their entirety, would serve to strengthen the MMR and CFR as they would better reflect the modern-day nature of liquidity risk and quantitative liquidity risk management.

566. Following this consultation process and announcement of key decisions, we will consider whether to bring forward any DCS-related changes to align more closely with the actual implementation of the DCS (currently expected in mid-2025).

567. Given that we recently made decisions on the 'liquid assets' component of the MMR as part of C2, we are not proposing any additional changes in this area as part of this consultation process.

[93] Reserve Bank of New Zealand. (2023, 5 December) *Liquidity Policy Review: Summary of Submissions, Key Decisions and Regulatory Impact Statements: Consultation Paper #2 (Significant Policy Issues)*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/liquidity-policy-review/liquidity-policy-review-consultation-paper-2-key-decisions.pdf

Q55	Do you agree with our assessment of the potential benefits of our overall proposed modifications to the MMR and CFR?
Q56	What are the expected costs of implementing these proposed modifications to the MMR and CFR? Are there any proposed modifications that would be particularly costly to implement, relative to the potential benefits?

2.2.1 Natural minimum of 100%

568. The 'natural minimum' for the MMR is currently 0%. This is because the numerator of the ratio (roughly 'liquid assets' less 'net cash outflows') is a very small number relative to the denominator ('total funding', which is the sum of 'market funding' and 'non-market funding'). As at 31 December 2023, the aggregate one-week MMR was 9.8% and the aggregate one-month MMR was 9.5%; these figures are relatively high from a historical perspective, largely caused by the monetary stimulus deployed in response to the COVID-19 pandemic.

Preferred option

569. That the MMR and CFR be structured so that they both have a natural minimum of 100%. In the MMR this would be achieved by having liquid asset as the numerator and net cash outflows as the denominator. In the CFR this could be achieved by applying a factor of 75% to the denominator.

Analysis

570. Given that the objective of the MMR is to help ensure banks' liquid assets exceed net cash outflows (just like the LCR, which has a natural minimum of 100%), it does not appear necessary to divide the difference of these two components by 'total funding'. We consider it would be sufficient (and perhaps more appropriate) for the ratio to have 'liquid assets' in the numerator and 'net cash outflows' in the denominator, like the LCR.

571. In the C2 feedback, one submitter noted that were the MMR to have a natural minimum of 100%, it could create confusion with the LCR, which also has a 100% natural minimum. However, we do not believe this to be a strong enough reason to maintain the 0% natural minimum, as most users would be aware that we do not use the LCR.

572. Were we to adopt a 100% natural minimum for the MMR, we believe it may also be desirable to have a 100% natural minimum for the CFR to maintain consistency across the two metrics. The current minimum requirement for the CFR is 75%; because of the calibration of this metric, it does not have a 'natural minimum' of either 0% or 100%. This is partly because a 'factor' (discount rate) is not applied to the denominator of this metric (i.e., 'total loans and advances') which therefore implies that all loans and advances should be funded entirely with core funding. Given that it is unnecessary for all loans and advances to be funded entirely with core funding (as not all loans and advances are 'long-term'), the existing calibration of this metric requires that 'core funding' be at least 75% of 'total loans and advances'.

573. A simple way to adopt a 100% natural minimum for the CFR would be to apply a factor of 75% (0.75) to the denominator of this metric. While this change would be contrived to achieve a 100% natural minimum for the CFR, we believe such a change may be desirable so that both

the MMR and CFR can have natural minimums of 100%. A 100% natural minimum for the CFR would also be consistent with the 100% natural minimum for the NSFR.

574. We consider that changing the structure of the MMR and CFR so they both have a natural minimum of 100%, will make the metrics more easily understood by depositors, thereby supporting the principle of depositors having access to timely, accurate, and understandable information to assist them in making decisions relating to deposits. It may also make deposit takers' individual results under the metric slightly more easily comparable.

Summary

575. We propose that the MMR and CFR be structured so that they both have a natural minimum of 100%. In the MMR this would be achieved by having liquid assets as the numerator and net cash outflows as the denominator. In the CFR this could be achieved by applying a factor of 75% to the denominator. In both cases, having a natural minimum of 100% will help make the metrics slightly more understood by depositors, and possibly assist them in comparing different deposit takers.

Q57	Do you agree that both the MMR and CFR metrics should be restructured so that they each have a natural minimum of 100%?

2.2.2 Redefining 'market funding' to include insurance companies and superannuation funds, along with banks, credit unions, building societies and finance companies

576. Our current liquidity policy uses the term 'market funding' to capture deposits and debt securities held by financial institutions, as well as other tradeable debt securities not held by financial institutions, and other funding provided by parties related to the bank. Our policy defines 'financial institution' according to subdivision K62 Financial and Insurance Services of the Australian and New Zealand Standard Industrial Classification (ANZSIC) 2006, and therefore captures banks, credit unions, building societies, finance companies and central banks.

Preferred option

577. We propose to add insurance companies and superannuation funds to the definition of market funding.

Analysis

578. The intention of the 'market funding' category is to capture funding that is most likely to 'run' (or not rollover), in full, in a stress scenario. As such, we believe it is appropriate for the 'market funding' category to continue to include financial institutions such as banks, credit unions, building societies and finance companies, as these institutions are (or should be) sophisticated enough to carefully manage their credit risk and have contingencies in place if the safety of their bank deposits comes into question. This can be done, for example, by having multiple banking relationships, which many of these entities do.

579. Our liquidity policy does not currently capture insurance companies under 'market funding'. Insurance companies, however, also carefully manage their credit risk and often have multiple

banking relationships in place, so may be prepared to withdraw their deposits in full at the first sign of stress. Additionally, superannuation funds are not captured under 'market funding', but these funds are (or should be) operated by sophisticated money managers that carefully monitor credit risk and have the capability to withdraw their deposits in full at the sign of stress.

580. We are therefore proposing to add insurance companies and superannuation funds, both of which fall under subdivision K63 Insurance and Superannuation Funds of ANZSIC 2006, to our definition of 'market funding' to better reflect the liquidity risk exposure of deposit takers, and therefore better allow for the effective management of liquidity risk.

581. Some submitters have suggested that the ANZSIC codes have not been designed for the way they are used in our liquidity policy. As such, we are interested in exploring potential better alternatives to capture these entities under our definition of 'market funding'.

Summary

582. We propose to add insurance companies and superannuation schemes to the definition of market funding, as these entities are likely to be of a similar level of sophistication to other entities captured within the existing definition of market funding (and as such, are likely to 'run' at a similar rate). We are interested in potential alternatives to using ANZSIC codes to capture these entities in the definition of market funding.

Q58	Do you agree that we should add insurance companies and superannuation funds to our definition of 'market funding' under our liquidity standard?
Q59	Do you have any comments on what the impacts (quantitative or otherwise) might be of the addition of insurance companies and superannuation funds to our definition of 'market funding'?
Q60	Do you have any suggestions for how entities could be captured under 'market funding' without using ANZSIC codes?

2.2.3 Introducing a new category for 'Insured deposits'

583. The DCS is scheduled to come into effect in mid-2025, at which time eligible depositors with protected deposits up to $100,000 (per deposit taker) may be entitled to compensation.

Preferred option

584. We propose that the run-off rate[94] for insured deposits under the MMR be 3% and that the factor for insured deposits under the CFR be 95%.[95]

[94] By run-off rate we mean the percentage of deposits that would be withdrawn in a hypothetical stress scenario. A 3% run-off rate for insured deposits means that we assume that 3% of insured deposits would be withdrawn in such a scenario.

[95] By factor, we mean the percentage of deposits on call or with a residual maturity of up to 1 year that qualify as core funding. A factor of 95% for insured deposits of this type means that 95% of these qualify as core funding.

Analysis

585. All else being equal, we would expect insured deposits to run-off at a lower rate than uninsured deposits in a liquidity stress, which is consistent with the objective of the DCS to protect and promote financial stability. We therefore consider it is necessary and appropriate to introduce a new category for insured deposits in both the MMR and the CFR.

586. The specific and ultimate calibration of the metrics will be finalised after the completion of a quantitative impact statement (QIS), which will occur shortly after we consult on an exposure draft of the proposed liquidity standard. However, were this category for 'insured deposits' to be introduced under the existing calibration of the metrics, it seems reasonable that the run-off rate for insured deposits could be 3% or 4% under the MMR (lower than the current run-off rate of 5% for deposits up to $5 million), and the factor for insured deposits could be 95% under the CFR (higher than the current factor of 90% for deposits up to $5 million). These lower (for the MMR) and higher (for the CFR) rates for insured deposits would reflect the expectation that insured deposits function as a more stable source of funding than uninsured deposits.

587. We consider that by allowing the metrics to better reflect actual risk in times of stress, it would lead to deposit takers more effectively managing their liquidity risk. This in turn would contribute to the DTA purposes of protecting and promoting the stability of the financial system, promoting the safety and soundness of each deposit taker, and promoting public confidence in the financial system, while at the same time minimising the compliance costs associated with the metric.

Summary

588. Under the existing calibration of the MMR, we are proposing that the run-off rate for insured deposits be 3% and that the factor for insured deposits under the CFR be 95%. We consider that this more accurately reflects the actual risk in times of stress once the DCS is in operation.

Box B: Broader review of certain run-off rates

Before finalisation of the revised liquidity standard, and as part of the QIS, we will be reviewing the specific and overall calibration of the MMR and CFR to ensure that they appropriately reflect the nature of liquidity risk at the time of implementation. While at this time we are not proposing to increase the existing 5% run-off rate for uninsured deposits less than $5 million under the MMR, we believe it could be prudent to increase this current 5% run-off rate potentially up to around 10%.

Some factors that suggest a higher than 5% run-off rate may be appropriate include:

- technological change and more widespread adoption of such change (e.g., internet and app-based banking).
- a desire to have more distinct/differentiated run-off rates across categories.
- treatment of similar deposits internationally under the LCR.

Notwithstanding the finalised run-off rates, we intend to monitor developments in this space over the coming years, particularly between the implementation of DCS (expected to be around mid-2025) and the implementation of the liquidity standard (scheduled for 2028).

Q61	Do you agree with our proposed treatment of insured deposits under the MMR (where they would have a run-off rate of 3%) and CFR (where they would have a factor of 95%)? If not, what alternative treatments might be appropriate?
Q62	Do you have any views on what the appropriate run-off rate for uninsured deposits less than $5 million should be under our revised liquidity standard? Is the existing 5% run-off rate still appropriate, or should this rate be recalibrated?

2.2.4 Introducing new and higher run-off rates for non-market funding

589. The highest run-off rate for non-market funding under the MMR is currently 80%, for deposits over $50 million. Correspondingly, the factor for deposits over $50 million under the CFR for determining the amount of a bank's core funding is 20%.

Preferred approach

590. In addition to the proposed new run-off rate of 3% for insured deposits discussed above, we propose to add a new run-off rate of 90% for uninsured deposits over $100 million. This will make the run-off rates in the MMR as follows:

Table AA: Proposed run-off rates for non-market funding in calculating the MMRs

Size band	Insured Deposits	Uninsured deposits <$5m	Uninsured deposits $5m to $10m	Uninsured deposits $10m to $20m	Uninsured deposits $20m to $50m	Uninsured deposits $50m to $100m	Uninsured deposits over $100m
% to be included	3%	5%	20%	40%	60%	80%	90%
	New						New

591. In addition to the proposed new factor of 95% for insured deposits discussed above, we propose to add a new factor of 10% for uninsured deposits over $100 million. This will make the factors for determining the amount of a Group 1 deposit taker's core funding under the CFR as follows:

Table AB: Proposed percentages of non-market funding to be included in core funding

Size band	Insured Deposits	Uninsured deposits <$5m	Uninsured deposits $5m to $10m	Uninsured deposits $10m to $20m	Uninsured deposits $20m to $50m	Uninsured deposits $50m to $100m	Uninsured deposits over $100m
% to be included	95%	90%	80%	60%	40%	20%	10%
	New						New

Analysis

592. The US regional banking crisis in 2023 showed that large corporate deposits can indeed be withdrawn in substantial amounts very quickly. In the case of SVB, corporate deposits were

estimated to have run off at a rate of 80% in only a few days.[96] The existing 80% run-off rate for deposits >$50 million under the MMR therefore appears to have been a reasonable predictor of corporate deposit run-off in the case of SVB.

593. Nevertheless, we consider it may be prudent to prepare for a bank run that may be even more severe than that experienced at SVB, due in part to the ability of information to spread quickly (such as information about the real or perceived precariousness of any given deposit taker) and the ease of moving money. To address this risk, we believe there is merit in introducing an additional size-band category with an even higher run-off rate. As such, we are proposing to add a new size-band category for deposits over $100 million with a 90% run-off rate and a corresponding CFR factor of 10%. We consider that this would support the purposes of protecting and promoting the stability of the financial system, promoting the safety and soundness of each deposit taker, and promoting public confidence in the financial system. We consider that adding extra levels of graduation into the run-off rates would lead to more accurate measurement of liquidity risk, and that the impact on compliance costs is likely to be minimal, but we seek feedback on this assessment.

Summary

594. We are proposing that the run-off rates in the MMR be those set out in table AA in paragraph 576, and that the factors for the CFR for determining the amount of a Group 1 deposit taker's core funding be those set out in table AB in paragraph 577. This reflects the possibility of a run occurring at a faster rate because information about the real or perceived state of a deposit taker can spread more quickly than was previously the case.

Q63	Do you agree with our proposal to introduce a new size band category of funding for deposits over $100 million in both the MMR and CFR?
Q64	Do you have alternative views on the appropriate threshold and calibration for this potential new category of funding?

2.2.5 Integrating the existing 'deposit grouping' provisions with the DCS's 'Single Depositor View' approach

595. In the C2 submissions, many banks requested that further guidance be provided around how deposits should be 'grouped' under our liquidity policy. What method would they use to assign deposit amounts to the appropriate size band in certain cases, which involves trying to determine which individual/entity ultimately 'controls' the deposit, as in some cases a deposit may be controlled by a third party rather than the owner of the deposit?

Preferred option

596. We are considering whether it's feasible for the grouping of deposits under the liquidity policy to be based upon the same rules used to generate Single Depositor View (SDV) files (or upon actual SDV files generated in accordance with the proposed DCS standard).

[96] Board of Governors of the Federal Reserve System. (2023). *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank*. https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf

Analysis

597. In C2 submissions, many stakeholders submitted that our existing policy on how they should undertake grouping likely results in an inconsistent grouping approach being applied across banks.

598. As part of this Consultation Paper, we are also consulting on the proposed SDV standard. It may be possible to require the grouping of deposits under the liquidity policy to be based upon the same rules used to generate SDV files (or upon actual SDV files generated in accordance with the proposed DCS standard). We note that alternative approaches may be complex to design and administer, and that there may be potential efficiency benefits if it is possible to rely upon SDV rules in this way.

599. One issue with requiring the grouping of deposits to be based upon SDV rules could arise where "look through" arrangements apply.[97] For DCS purposes, these accounts are referred to as "relevant arrangements" and will be covered by DCS regulations (as opposed to through standards).

600. In some cases (i.e. regulated client money or property services) it will not be possible to identify the persons with a beneficial interest in the deposit, what proportion of the deposit each of those persons' beneficial interests cover, and what proportion of the deposit is therefore protected by the DCS.[98] In these cases it may be necessary to allow deposit takers to automatically treat a prescribed percentage of these deposits as insured and the remainder as uninsured when grouping deposits.

Summary

601. We are interested in feedback on whether there would be any issues associated with requiring the grouping of deposits under the liquidity policy to be based upon the same rules used to generate SDVs.[99]

Q65	Do you consider that there are any issues with requiring the grouping of deposits under the liquidity policy to be based upon the same rules used to generate SDVs?

2.2.6 Eliminating 'undrawn committed lines granted to the registered bank' as a cash inflow in the MMR

602. Under the MMR, banks can include, as a cash inflow:

> "*75 per cent of undrawn committed lines granted to the registered bank available within [one week/one month], up to a maximum amount from any one provider of 3 per cent of the bank's total funding, and a maximum amount from all providers together of 9 per cent of the bank's total funding*".

603. Under the LCR, banks are not permitted to include amounts from committed facilities as cash inflows. The LCR states:

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[97] By look through arrangements we mean circumstances where the entitlement to compensation under the DCS sits with persons who have a beneficial interest in the protected deposit rather than the holder of the deposit themselves.

[98] In the normal run of events this information would be collected after the DCS payout is triggered

[99] Or upon actual SDV files generated in accordance with the proposed DCS standard.

"No credit facilities, liquidity facilities or other contingent funding facilities that the bank holds at other institutions for its own purposes are assumed to be able to be drawn. Such facilities must receive a 0% inflow rate, meaning that this scenario does not consider inflows from committed credit or liquidity facilities. This is to reduce the contagion risk of liquidity shortages at one bank causing shortages at other banks and to reflect the risk that other banks may not be in a position to honour credit facilities, or may decide to incur the legal and reputational risk involved in not honouring the commitment, in order to conserve their own liquidity or reduce their exposure to that bank"

Preferred option

604. We are proposing to remove the inclusion of amounts from undrawn committed lines as a cash inflow from the MMR.

Analysis

605. We propose to make this change for the same reasons that undrawn committed lines are not permitted under the LCR - that is, to reduce the risk of liquidity shortages in one deposit taker causing liquidity risks in other institutions and to reflect the risk that other deposit takers may not be in a position to honour credit facilities, or may decide to incur the legal and reputational risk involved in not honouring the commitment, in order to conserve their own liquidity or reduce their exposure to that deposit taker. We consider that this approach would better reflect international practice and should lead to deposit takers better managing liquidity risk.

606. While most banks currently do not report amounts from such committed lines anyway, we recognise that this could be a significant change for some Group 1 deposit takers, and we are interested in understanding the impacts of this approach.

Summary

607. We propose to remove undrawn committed lines as a cash inflow from the MMR to reduce the risk of liquidity shortages in one deposit taker causing liquidity risks in other institutions and to reflect the risk that other deposit takers may not be in a position to honour credit facilities or may decide to incur the legal and reputational risk involved in not honouring the commitment, in order to conserve their own liquidity or reduce their exposure to that deposit taker.

Q66	What are your views on whether the MMR should eliminate the inclusion of amounts from undrawn committed lines as a cash inflow?

2.2.7 Changing the 'one-month MMR' to a '30-day MMR'

608. Our liquidity policy defines 'due within one month' as:

"payable by close of business on the day one calendar month after the business day at which the limit applies".

Preferred approach

609. We propose that the actual length of the 'one-month' MMR be standardised to '30 days'.

Analysis

610. The current definition of 'due within one month' results in the actual period for the one-month MMR varying from 28 days to 31 days, given that the number of days in each month varies (for example, February usually has 28 days, whereas July has 31 days). This change would make the length of the MMR consistent with the LCR (which is a 30-day metric).

Summary

611. We propose that the actual length of the 'one-month' MMR be standardised to '30 days', to ensure that the same measurement period is always used for the metric.

Q67	Do you agree with standardising/changing the period of the 'one-month' MMR to 30 days?

2.2.8 Retaining the 'one-week' MMR (and renaming it to a '7-day' MMR), while potentially applying a higher run-off rate to insured deposits than under the '30-day MMR'

612. During the C2 process, in assessing the LCR and NSFR, we compared the one-month MMR (rather than the one-week MMR) with the LCR, as these two metrics are more comparable in length ('one month' and '30 days'). However, C2 noted: "We will analyse whether to retain a one-week liquidity coverage metric in our revised liquidity policy separately."

Preferred option

613. We propose that the 7-day MMR be retained, and we are exploring whether it should have higher run-off rates than the 30-day MMR.

Analysis

614. Some of the feedback in response to C2 suggested that if the MMR and CFR were retained, the one-week MMR should be removed. Some submitters suggested that the one-week MMR was not necessary given the existence of the one-month MMR.

615. However, we consider there is value in having an MMR metric for a shorter period than one month or 30 days, such as the one-week MMR. With the existence of only a one-month or 30-day MMR, it would be possible for deposit takers to comply with a metric of this duration but be non-compliant during some of this period. This could occur if, for example, banks' net cash outflows are significantly higher in the early part of the stress period than in the latter part of the period. We are inclined to retain the one-week (7-day) MMR to serve as a checkpoint to help ensure that deposit takers are also prepared to deal with a liquidity stress that may be more acute in its early stages and are therefore better able to manage their liquidity risk.

616. Additionally, given that liquidity stress at a deposit taker may be more acute in the early stages of the stress event, we are seeking feedback on applying a higher run-off rate for funding under the 7-day MMR than under the 30-day MMR.

Summary

617. We propose to retain the 7-day MMR and are interested in your views on whether the run-off rates in the 7-day MMR should be higher than the run-off rates in the 30-day MMR. We consider that retention of the 7-day MMR (possibly with higher run-off rates than the 30-day MMR) is appropriate given the possibility that liquidity stresses could be more acute during the early stages.

Q68	Do you agree that the one-week/7-day MMR should be retained?
Q69	If retained, should the 7-day MMR apply higher run-off rates than under the 30-day MMR? If so, to which category(ies) of funding should any higher run-off rates apply?

2.2.9 Removing the two-year maturity requirement for tradeable debt securities to qualify as 'core funding'

618. The CFR helps to ensure banks are funding their assets (loans and advances) with sufficient levels of 'core funding', while targeting funding with a maturity of greater than one year. When funding obtained from tradeable debt securities has a residual maturity of more than six months and not more than one year, this funding can still qualify as 'core funding' (at a discount factor of 50%) so long as it has an original maturity of two years or more.

Preferred option

619. We propose to remove the two-year maturity requirement for tradeable debt securities to qualify as core funding.

Analysis

620. The current 'two-year maturity' requirement encourages banks to obtain funding from tradeable debt securities with original maturities of two years or more, so that they can receive the benefit of such funding as 'core funding' when the residual maturity falls between six months and one year. However, the ability of such funding to serve as 'core funding' is not affected by its original maturity once its residual maturity falls within this range.

621. In C2, we noted that we would consider removing the requirement for tradeable debt securities to have an original maturity of two years or more to qualify as 'core funding' once its residual maturity falls between six months and one year. We received support for such a change.

622. We are therefore proposing to remove this two-year maturity requirement, which would allow funding received from tradeable debt securities to qualify as core funding when its residual maturity falls between six months and one year (at the existing discount factor of 50%), regardless of its original maturity.

623. This would represent a slight relaxation of the current rules, but we do not anticipate it having any negative effects on financial stability given that the other requirements to qualify as core funding are likely to be sufficient.

Summary

624. We propose that we remove the two-year maturity requirement for tradeable debt securities to qualify as core funding.

Q70	Do you agree that funding received from tradable debt securities should qualify as core funding when its residual maturity falls between six months and one year (at the existing discount factor of 50%), regardless of its original maturity?

2.2.10 Removing the provision that would allow deposit takers to make 'any reasonable simplifying assumption' in calculating these metrics

625. Our liquidity policy (paragraph 29) states:

> *"...the registered bank may adopt any reasonable simplifying assumption in its method of calculation of any of the three quantitative ratios that has the effect (if any) of decreasing the value of that ratio."*

Preferred option

626. We propose that the 'any reasonable simplifying assumption' provision be removed.

Analysis

627. Our Liquidity Thematic Review[100] uncovered several practical issues associated with this provision, noting:

> *"Simplifying assumptions were being made that were not well substantiated and these were not always conservative."*

628. The Liquidity Thematic Review report contained the section on the following page regarding this provision:

[100] Reserve Bank of New Zealand (2021, 8 September) *Liquidity Thematic Review*. https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/thematic-reviews/thematic-review-of-compliance-with-liquidity-policy

Reasonable simplifying assumptions

Banks may use any reasonable simplifying assumption in the calculation of the liquidity ratios, as long as the effect (if any) is to decrease the value of that ratio. This is then a conservative assumption.

All banks are using simplifying assumptions

All banks applied at least one simplifying assumption. Many of these were:

- not properly documented,
- did not have any accompanying evidence or analysis to demonstrate they were conservative; and
- were not subject to periodic review ensuring they remain fit for purpose.

Assumptions must be substantiated and reviewed

Throughout the review we heard statements that the outcome of an error in the calculations was a decrease in the applicable liquidity ratio and therefore was conservative and in-line with the Policy. The use of reasonable simplifying assumptions is not intended to encompass miscalculations or errors in the liquidity calculation that happen to result in a conservative outcome. An assumption must be a conscious decision, overcoming an obstacle to calculating in line with the Policy and must be supported by evidence and analysis. We also expect steps be taken to overcome any obstacles over time. In the interim, we expect banks to periodically review whether assumptions remain necessary and still provide an appropriate outcome.

629. Given that our liquidity policy has now been in place for over 14 years, we are proposing not to carry over this provision into the proposed liquidity standard. We consider that this change would be in line with the main purpose of the DTA, in that better liquidity management promotes financial stability. We are interested in understanding the compliance costs implications of this proposed change.

Summary

630. We propose to not include the 'any reasonable simplifying assumption' provision in the proposed liquidity requirements for Group 1 deposit takers.

Q71	Do you agree with the removal of the provision that allows deposit takers to make any reasonable simplifying assumption in calculating its quantitative ratios?

2.2.11 Continuous quantitative requirements following the introduction of Settlement Before Interchange 365 (SBI365)

631. Settlement Before Interchange (SBI), first introduced in 2012, is the SWIFT-based payment system used by banks for retail payments and is administered by Payments NZ. SBI365 is an upgrade to SBI that allows retail payments to be settled seven days a week rather than only on business days. It came into effect on 26 May 2023 for these participating banks: ANZ, ASB, Bank of China, BNZ, Citi, HSBC, ICBC, Kiwibank, TSB and Westpac.

632. In LPR C1, we noted that work on the implementation of SBI365 was underway, and that we would seek feedback on whether more frequent calculation (and potentially reporting) of certain liquidity metrics should be required when it is implemented.

Preferred option

633. We propose that the compliance with our minimum quantitative requirements should, in the normal course of business, occur on an ongoing basis or continuously rather than 'at the end of each business day'. (As discussed below, this change is consistent with BCBS's LCR.)

Analysis

634. Our view is that the basic MMR and CFR metrics will not be affected by SBI365 because these requirements define cash inflows and outflows using 'contractual dates', rather than settlement dates. Notwithstanding, there is a possibility that the ability to settle payments over the weekend could result in a shift in consumer/business behaviour to scheduling and making more payments over the weekend. However, given that there do not appear to be any strong incentives for consumers/businesses to alter their behaviour in response to weekend and non-business day settlement, we expect any change in behaviour to be small.

635. The fact that currently banks must comply with our minimum quantitative requirements 'at the end of each business day', implies that the quantitative requirements do not necessarily need to be complied with at other times (such as intra-day and on non-business days).

636. We are therefore proposing that, in the normal course of business, we will require compliance with our minimum quantitative requirements at all times during each business day. For comparison, the BCBS's LCR states "…absent a situation of financial stress, the value of the ratio be no lower than 100%…on an ongoing basis…".

637. Requiring compliance with our quantitative requirements continuously during business days raises the question of whether our liquidity standard should also require deposit takers to comply with our quantitative requirements continuously during all calendar days.

638. We seek your feedback on the feasibility and desirability of deposit takers complying with quantitative requirements on a continuous basis and calculating their MMRs and CFR seven days a week – including what the expected compliance costs and implications of such requirements might be.

Summary

639. We propose that compliance with our minimum quantitative requirements should, in the normal course, occur on an ongoing basis (rather than 'at the end of each business day'). This reflects the fact that under SBI365 payments may occur seven days a week.

Q72	Do you have any views on whether, in the normal course of business, we should require Group 1 deposit takers to comply with their quantitative liquidity requirements 'on an ongoing basis', 'at all times', or 'continuously'? What would be the expected costs and implications of such a requirement?
Q73	Do you have any views on whether we should require Group 1 deposit takers to calculate their MMRs and CFR seven days a week? What would be the expected costs and implications of such a requirement (e.g., potential staffing requirements over weekends)?

2.2.12 Creating a Committed Liquidity Facility

640. In the decisions on C2 announced in December 2023 we stated that we would tighten the eligibility criteria for liquid assets. However, at the same time we were conscious of ensuring adequate market functioning in financial markets and noted that New Zealand is a country with a limited supply of liquid assets relative to the demand from the deposit-taking sector.

641. To address this shortage, we will establish a Committed Liquidity Facility (**CLF**); the Reserve Bank would enter into an agreement with deposit takers to provide them with liquidity via a repurchase (repo) facility,[101] with CLF-eligible assets serving as collateral. The Reserve Bank will charge a standing fee to deposit takers for the ability to access the CLF.

642. The detailed design features of the CLF will not be included in the proposed liquidity standard – instead, we expect that they will be reflected in agreements between deposit takers and the Reserve Bank. However, the CLF forms an important part of the overall package of proposals arising out of the LPR and will influence the proposed liquidity standard in a variety of ways. (For example, the standard will need to indicate the extent to which access to the CLF can be taken into account in calculating a deposit taker's liquid assets.) In addition, we are undertaking further consultation on the LPR as part of the process of developing core standards (rather than on a standalone basis). For these reasons we are consulting on high-level features of the CLF in this Consultation Paper.

Preferred option

643. Our preferred option for the features of the CLF is set out in table AC below:

Table AC: Potential features/components of the Committed Liquidity Facility

CLF feature/component	
Eligible Deposit Takers	Deposit takers that are subject to the MMRs (Group 1 and Group 2 deposit takers) and are domestic markets counterparties of the Reserve Bank would be eligible. We are open to feedback from Group 1, Group 2 and Group 3 deposit takers (that are currently not domestic market counterparties on the benefits they would expect to receive if they had access to the CLF.
Size of CLF	We expect the CLF may contribute up to 40% to 50% of a deposit taker's total assets contributing to its MMR (i.e., the sum of Level 1 and Level 2 liquid assets, plus CLF). This range is informed by the historical demand for different types of liquid assets under the current policy and estimates of the availability of liquid assets in the future. One option could be to set the size of the CLF for each individual deposit taker in the relevant bilateral agreement. This is the approach that was taken by APRA and the Reserve Bank of Australia (**RBA**). However, we consider that it would be more efficient to set a cap that would be the same for all CLF counterparties. We expect to finalise the cap on the CLF's contribution to total MMR assets (i.e., currently expected to be in the range of 40% to 50%) around one year prior to the new standard becoming effective. This would allow us to determine the cap with better visibility of the supply of liquid assets at the time, while still allowing sufficient time for deposit takers to rebalance portfolios if required. Furthermore, we intend to review the cap at least annually, with the possibility that it may be increased/decreased according to the supply of liquid assets and our assessment of the impact on market functioning of deposit takers' liquid asset holdings.

[101] Subject to certain conditions being met. For example, the deposit taker must have positive net worth (i.e., be solvent).

Standing Fee	The dollar value of the standing fee paid would be the standing fee (in basis points) multiplied by the amount of the deposit taker's CLF. The standing fee is intended to capture the liquidity benefit provided by the CLF. In practice, this is difficult to determine precisely. The fee in basis points will be calculated using a methodology to be determined. The methodology may take account of the composition of an individual deposit taker's CLF-eligible assets. However, we intend for the fee methodology to be relatively simple and transparent.
Borrowing Fee	Official Cash Rate (OCR)/Overnight Index Swap (OIS), plus a spread as determined by us.
Conditions	Deposit taker has positive net worth (i.e., is solvent).
Length of Contractual Agreement	Open ended (no end date), subject to meeting the conditions, but could be terminated by either party with sufficient notice (e.g., one month notice provided by the deposit taker and one year's notice provided by us). Note that certain parameters will be adjustable on an annual basis (for example the size and the fee).
Term of Borrowing	As agreed between us and the counterparty at the time of borrowing, for a maximum of 30 days. CLF borrowing may be repaid early by the borrower but not called early by us.
Eligible Securities	All repo-eligible securities with us, including Level 2 liquid assets where the holdings of those assets exceed the Level 2 cap.
Risk margins and haircuts	Consistent with risk margins (haircuts) used in other Reserve Bank liquidity facilities, which are subject to change.
Diversification Requirements	There would be no explicit diversification requirements for holdings of CLF-eligible assets. However, at this time, we intend to retain eligibility limits of all residential mortgage-backed securities (including covered bonds) in accordance with a deposit taker's encumbrance ratio, as currently set out in BS13A.[102]
Renewal	CLF amounts for each deposit taker would be reviewed annually and set for the upcoming year.

Analysis

644. A CLF is one of three options put forward by the BCBS for jurisdictions to address an insufficient supply of liquid assets under the LCR, with the other two options being to allow foreign currency high quality liquid assets (HQLA), and to allow additional use of Level 2

[102] Reserve Bank of New Zealand. (2022). *BS13A Liquid Assets Annex*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs13a-liquid-assets-annex.pdf

assets with a higher haircut. While these options could be used in combination, we have decided to address any shortage of liquid assets solely through the establishment of a CLF, given concerns over the ability of deposit takers to convert foreign currencies into NZD in a stress scenario and the relatively lower levels of liquidity, and availability, of Level 2 liquid assets (Kauri bonds and Local Government Funding Agency (LGFA) securities).

645. For deposit takers, the CLF will provide access to a Reserve Bank repo facility, while also allowing them to use the amount of their CLF to supplement their holdings of liquid assets to meet minimum liquidity requirements (plus any buffer that deposit takers choose to hold). From our perspective, a CLF provides a means of ensuring that solvent deposit takers have sufficient liquidity to address a temporary liquidity stress scenario (given the shortage of liquid assets in New Zealand), promoting the main purpose of the DTA – financial stability.

646. Table AC outlines potential features/components of the proposed CLF. This table is similar to that in Appendix 4 – Overview of the Committed Liquidity Facility of the C2 *Summary of Submissions, Key Decisions, and Regulatory Impact Statements* released on 5 December 2023.

647. We are seeking your feedback on the potential features/components of the CLF outlined in Table AC. Following this consultation, our Financial Markets Department intends to undertake industry liaison on more detailed CLF design features/components, such as the proposed legal agreement with deposit takers using the CLF and the intended operating model.

Summary

648. We agreed to implement a CLF when we published our decisions on C2 in December 2023, Subject to the views of submitters and further analysis, we propose that the CLF have the features set out above in Table AC.

Q74	Do you have any views/comments on the potential features/components of the CLF outlined in Table AC?
Q75	Do you have any views on whether the CLF should be operated as a completely new facility, or via an existing facility with additional documentation as required?

3 Proposed approach for Group 2 deposit takers

3.1 Qualitative requirements

Preferred option

649. We are proposing that Group 2 deposit takers be subject to the same qualitative liquidity requirements that apply to Group 1 deposit takers (as set out in Tables Y and Z above).

Analysis

650. The main purpose of the DTA is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the

stability of the financial system. Our proposed qualitative liquidity requirements are designed to serve this main purpose. Given the similar nature of liquidity risk across Group 1 and Group 2 deposit takers, we consider it appropriate for them to be subject to the same requirements consistent with the principle of treating similar institutions in a similar manner. This approach would also maintain comparability across these two Groups of deposit takers with respect to qualitative liquidity requirements. We consider that the qualitative requirements are proportionate in their nature, as compliance must be commensurate with the level and nature of risk. We consider the analysis outlined for Group 1 is applicable to Group 2 deposit takers.

Summary

651. For the reasons outlined above in the Group 1 section, and the reasons outlined in the above analysis section, we consider it is appropriate that the qualitative requirements outlined in the Group 1 section also apply to Group 2 entities.

Q76	Do you consider that Group 2 entities should be subject to the same qualitative liquidity requirements as Group 1 entities? Are there any particular requirements that are not also appropriate for Group 2 entities?

3.2 Quantitative requirements

Preferred option

652. We are proposing that Group 2 deposit takers also be subject to the same quantitative liquidity requirements that apply to Group 1 deposit takers, as set out in subsection 2.2.

Analysis

653. We consider it appropriate to apply the same quantitative requirements for Group 1 deposit takers to Group 2 deposit takers. This is in line with the principle of treating like institutions in a consistent manner. It minimises the complexity of the requirements by avoiding having separate requirements for Group 2. Further, we consider that this approach does not create unnecessary compliance costs, given that Group 2 deposit takers are already subject to existing liquidity requirements in BS13, and our proposed approach is not likely to create significant compliance costs over those in BS13. Finally, given the importance of proper management of liquidity risk to financial stability, we consider that approach furthers the main purpose of the DTA.

654. The proposed quantitative requirements would allow Group 2 deposit takers to operate in slightly different ways from Group 1 deposit takers, if desired. For example, rather than using AAA-rated residential mortgage-backed securities as liquid assets and paying the proposed CLF fee, some Group 2 deposit takers may choose to rely more heavily on other types of liquid assets.

Summary

655. For the reasons outlined above in the Group 1 section, and the reasons outlined in the above analysis section, we consider it is appropriate that the quantitative requirements outlined for Group 1 entities also apply to Group 2 entities.

Q77	Do you consider that Group 2 entities should be subject to the same quantitative liquidity requirements as Group 1 entities? Are there any particular requirements that are not appropriate for Group 2 entities or any negative implications of this approach for Group 2 entities that we should be aware of?

4 Proposed approach for Group 3 deposit takers

4.1 Qualitative requirements

Preferred option

656. We propose that Group 3 deposit takers only be subject to some of the qualitative requirements that we propose applying to Group 1 and Group 2 deposit takers (specifically, those set out in Table AD).

Table AD: Proposed qualitative liquidity requirements for Group 3 deposit takers

Proposed qualitative liquidity requirements for Group 3 deposit takers
Board responsibility for liquidity risk management (BS13 paragraphs 76 and 85) a. A deposit taker's Board of Directors (Board) is ultimately responsible for the sound and prudent management of liquidity risk at the institution. b. Each deposit taker must maintain a liquidity risk management framework, approved by the Board, that is commensurate with, and adequate to manage, the level and nature of liquidity risk exposures (including foreign currency exposures) at the institution. This framework must be reviewed to determine whether it remains appropriate at least every three years, and the outcome of each review must be reported to the Board. The framework must be amended where necessary whenever there is a material change to the deposit taker's liquidity risk, and these amendments must be approved by the Board. c. A deposit taker must have a framework for how its Board will ensure that senior management and other relevant personnel have the necessary knowledge, expertise, and experience to manage liquidity risk at the institution. d. The Board is ultimately responsible for ensuring that the deposit taker is always complying with all liquidity requirements (during the normal course of business).
Liquidity risk management framework (BS13 paragraphs 88 and 89) Each deposit taker's liquidity risk management framework must contain, at a minimum: a. a statement and description of the institution's liquidity risk tolerance; c. the institution's strategy and policies for managing liquidity risk within its tolerance and for complying with minimum regulatory liquidity requirements; d. an effective process for identifying, measuring, monitoring, and controlling liquidity risk.
Senior management responsibilities for liquidity risk management (BS13 paragraph 86) a. Senior management is responsible for developing, maintaining, and updating the institution's liquidity risk management framework in accordance with the Board-approved liquidity risk tolerance for the

institution.

b. Senior management must report at least annually to the Board on the institution's liquidity risk, the performance of its liquidity risk management framework, and notify the Board of any developments that could have, or will have, a material impact on the institution's liquidity risk.

c. Senior management must recommend to the Board any changes to the institution's liquidity risk management framework that would help the institution better manage the impacts of any significant developments (potential or actual).

d. Senior management is responsible for the implementation of the deposit taker's liquidity risk management framework throughout the institution, including any associated policies, procedures, and internal controls.

e. Senior management is responsible for ensuring that liquidity stress testing exercises are conducted, at least every two years, and that these exercises are used for the development and maintenance of the institution's contingent funding plan (that should, at a minimum, address the outcomes of these liquidity stress testing exercises). This requirement is closely related to the requirements under the heading "Liquidity stress testing (paragraphs 103 and 104 of BS13)" in this table.

f. Senior management is responsible for understanding how the institution's liquidity risk interacts with other risks facing the institution, such as credit, market, operational, and reputational risk.

Managing intra-day liquidity positions (BS13 paragraph 91)

A deposit taker must actively manage its intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions.

Liquidity stress testing (BS13 paragraphs 103 and 104)

a. A deposit taker must conduct stress tests, at least every two years, for a variety of short-term and protracted institution-specific and market-wide stress scenarios to identify potential sources of liquidity stress and to ensure that current exposures remain in accordance with its liquidity risk tolerance. A deposit taker must use stress test outcomes to adjust its liquidity risk management framework and its contingent funding plan as needed.

b. Stress test exercises and outcomes must be reported to the Board, and senior management must recommend to the Board any changes to the institution's liquidity risk management framework that would address any shortcomings identified by these stress tests.

Contingent funding plan (BS13 paragraphs 119 to 128)

A deposit taker must have a contingent funding plan (**CFP**), approved by the Board (and re-approved by the Board at least every two years, or earlier as circumstances warrant). The CFP should set out the strategies and actions for addressing a range of liquidity stress events, including short-term and protracted institution-specific and market-wide stress scenarios. The CFP must establish clear lines of responsibility and include clear invocation and escalation procedures.

Analysis

657. Applying our qualitative liquidity requirements in a proportionate manner aligns with our Proportionality Framework and the proportionality principle under the DTA. The proposed approach also supports other DTA principles; in particular, by avoiding the imposition of unnecessary or disproportionate requirements it avoids compliance costs and maintains competition in the deposit taking sector.

658. While these specific qualitative requirements could be new for most Group 3 deposit takers, we have previously indicated that our liquidity policy should contain both qualitative and quantitative requirements (and NBDTs are already required to maintain a risk management plan addressing (amongst other things) liquidity risk). Furthermore, approaches to liquidity stress testing for NBDTs are currently included in our *Quantitative Liquidity Requirements Guidelines* for NBDTs.[103] The requirements are designed to encourage deposit takers to take a holistic approach to their management of liquidity risk (LPR principle 4). We consider that these requirements are proportionate for Group 3 deposit takers, as they promote the safety and soundness of smaller deposit takers while reflect the fact that smaller deposit takers can also be expected to pose less systemic risk. We consider that the qualitative requirements proposed for Group 3 deposit takers also support the principle of the deposit takers effectively managing their liquidity risk.

659. Finally, we believe that the financial stability benefits that would be derived from applying our proposed qualitative liquidity requirements, in a proportionate manner, to Group 3 deposit takers would exceed the costs that Group 3 deposit takers might incur in complying with such requirements. However, we also welcome your feedback on this matter.

660. We seek your feedback on the expected compliance costs of the suite of requirements, as well as the individual requirements being proposed.

Summary

661. We propose that the requirements outlined in Table AD apply to Group 3 deposit takers. By helping to ensure that Group 3 deposit takers prudently manage their liquidity risk, this approach contributes to the purposes of protecting and promoting the stability of the financial system. We seek feedback on the expected compliance costs of the requirements in Table AD.

Q78	Do you agree with our proposed qualitative requirements for Group 3 deposit takers? If not, what changes would you propose to these requirements?
Q79	What compliance costs do you think may result from the proposed qualitative requirements for Group 3 deposit takers?

4.2 Quantitative requirements

662. The decisions on C2 announced in December 2023 included that quantitative liquidity requirements should be applied across deposit takers in a proportionate manner, and that we were inclined to apply a cash-flow coverage ratio (CFCR) requirement to smaller deposit takers (given its greater accuracy in measuring short-term cash-flow obligations relative to a 'simple coverage ratio').[104]

663. In light of these decisions, this section of the Consultation Paper now provides further detail on the proposed:

[103] Reserve Bank of New Zealand. (2010). *Quantitative Liquidity Requirements Guidelines*. Quantitative Liquidity Requirements Guidelines (rbnz.govt.nz)

[104] Reserve Bank of New Zealand. (2023, 5 December). *Key liquidity policy review decisions announced.* https://www.rbnz.govt.nz/hub/news/2023/12/key-liquidity-policy-review-decisions-announced

- structure of a CFCR for Group 3 deposit takers
- eligible liquid assets under this CFCR
- measurement of cash inflows and outflows under this CFCR.

664. This section also sets out our assessment of whether a long-term stable funding requirement for Group 3 deposit takers is necessary.

665. We note that the two registered banks that are Group 3 deposit takers are currently subject to the Reserve Bank's existing liquidity policy. As of May 2024, all NBDTs are Group 3 deposit takers and are currently subject to the Deposit Takers (Liquidity Requirements) Regulations 2010. These regulations require NBDTs to have one or more quantitative liquidity requirements in their trust deeds. In practice, these quantitative liquidity requirements generally take the form of a 'liquidity coverage ratio', which tests whether deposit takers' liquid assets can meet their short-term cash-flow obligations. However, the specifics of these requirements vary from entity to entity. For example, NBDTs' liquidity requirements vary in stringency, some metrics are more simplified than others and cash flows may be measured over different time periods.

4.2.1 Liquidity coverage metric

Preferred option

666. We propose that:

- Group 3 deposit takers be required to comply with a CFCR metric
- the CFCR metric is calculated as:

$$\frac{liquid\ assets}{net\ cash\ outflows} \geq 100\%$$

- liquid assets include demand deposits held with Group 1 and Group 2 deposit takers, as well other high-quality assets outlined further below
- cash inflows and cash outflows be defined in a similar manner for Group 3 deposit takers as for Group 1 and Group 2 deposit takers. But we will allow term deposits held with Group 1 and Group 2 deposit takers to be included as a cash inflow if they mature within the 7-day or 30-day periods (as applicable)
- expected cash outflows arising from deposits be calculated by using either the same size band run off rates as for Group 1 and Group 2 deposit takers, or a single run off rate for insured deposits and a single run-off rate for uninsured deposits. We are seeking feedback on which of these options would be more appropriate
- the CFCR be calculated over both a 7-day and 30-day period, unless the deposit taker solely issues term deposits, in which case the CFCR only be required to be calculated over a 30-day period.

667. By helping to ensure that Group 3 deposit takers can pay their debts as they fall due, our proposals for quantitative metrics for Group 3 deposit takers support the purposes of protecting and promoting the stability of the financial system, promoting the safety and soundness of each deposit taker, and promoting public confidence in the financial system.

Analysis

'Cash flow coverage ratio' or 'simple coverage ratio'?

668. We set out two common types of simplified 'liquidity coverage' metrics in C2 – a 'simple coverage ratio' and a 'cash flow coverage ratio'. The primary difference is that the simple coverage ratio focuses on measuring the amount of liquid assets as a proportion of total liabilities (or total assets), whereas the CFCR more precisely measures whether liquid assets can meet short-term cash flow obligations.

669. Our preferred option is the CFCR, as this more precisely determines whether deposit takers can meet their actual short-term obligations (because it more accurately measures cash inflows and outflows). The simple coverage ratio is too simplistic and does not adequately reflect the liquidity risk on individual deposit takers. For example, a deposit taker with a large amount of long-term funding (like term deposits) can proportionately hold fewer liquid assets that a deposit taker funded by demand deposits.

670. The CFCR also aligns with the current *Quantitative Liquidity Requirements Guidelines* (NBDT Liquidity Guidelines) for NBDTs.[105] The CFCR was also generally supported by NBDTs in their responses to the C2 consultation and similar ratios are currently used in the NBDT sector, reducing expected transition costs for NBDTs.

Structure of the cash-flow coverage ratio

671. We have considered two primary options for the structure of the CFCR.

672. The first would adopt a design similar to Group 1 and Group 2's MMR, which is designed to show whether a deposit takers' liquid assets are sufficient to meet their net cash outflows. Specifically:

$$\frac{liquid\ assets}{net\ cash\ outflows} \geq minimum\ requirement$$

673. The 'liquid assets' numerator in this metric would consist of cash and of assets that can quickly and easily be converted into cash. As a starting point, we consider eligible liquid assets as those provided for in our NBDT Liquidity Guidelines for the CFCR. Specifically:

- notes and coins (NZD)
- on-call balances that in normal circumstances can be called on the day they are required to meet payments.

674. Our current NBDT Liquidity Guidelines also allows the undrawn balance of committed lines granted to an NBDT to be included as a liquid asset if the NBDT and its trustee are satisfied that the line is a sufficiently reliable source of funds, after considering factors including whether the line is irrevocable for a long enough period and whether the provider is sufficiently creditworthy. We seek feedback on whether the undrawn balance of committed lines are sufficiently reliable to be included as a liquid asset or cash inflow for the CFCR.

[105] Reserve Bank of New Zealand.(2010, October). *Quantitative Liquidity Requirements Guidelines*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/non-bank-deposit-takers/requirements/4212995.pdf

675. As previously outlined, for Group 1 and 2 deposit takers we propose that undrawn committed lines should not be an eligible cash inflow for the MMR. Part of the reasoning for this proposal was to reduce the risk of liquidity shortages in one deposit taker exacerbating liquidity risks in other deposit takers (i.e., contagion risk). Group 3 deposit takers, due to their small size, are not expected to have the same impact on the provider's liquidity as Group 1 and Group 2 deposit takers. However, the risk that the provider does not honour the committed line remains. Therefore, we seek feedback on whether (and what proportion) undrawn committed lines could be included as a liquid asset or cash inflow for the CFCR and whether conditions, for example those already contained in the NBDT Liquidity Guidelines, sufficiently mitigate the risk that committed lines are not a reliable source of cash during a liquidity stress.

676. In addition to cash and demand deposits, we also propose eligible liquid assets for the CFCR include the other Group 1 and Group 2 eligible liquid assets: Exchange Settlement Account System (ESAS) balances/Reserve Bank bills (RB bills), New Zealand Government Bonds (NZGBs), Kauri bonds and Local Government Funding Agency (LGFA) securities. We note that most Group 3 deposit takers do not currently hold these securities.

677. We did consider restructuring the CFCR, so cash inflows would form part of the numerator.

678. This option would treat cash inflows and liquid assets in the same way, which may better reflect the operating models of Group 3 deposit takers. However, this structure is not our preferred option as we expect cash inflows to be less reliable for funding short-term liabilities during a stress event than liquid assets, and for this reason are arguably better reflected within net cash outflows in the denominator.

679. Finally, we do not expect Group 3 deposit takers to benefit or use the CLF if they were eligible. Group 3 deposit takers do not currently hold repo-eligible securities, nor do we expect Group 3 deposit takers, due to their size, to have the same effect on market functioning as Group 1 and 2 deposit takers. Therefore, as outlined in Table AC, we propose to restrict access to the CLF to deposit takers that are subject to the MMR and are domestic markets counterparties of the Reserve Bank. We are open to feedback on the benefits and feasibility that Group 3 deposit takers would expect if they had access to the CLF.

Q80	Do you agree that Group 3 deposits takers should be required to comply with a CFCR?
Q81	What are the implications of the different structures for the CFCR?
Q82	Is there a need for a cap on the amount of Kauri bonds and LGFA securities that Group 3 deposit takers may hold as liquid assets under the CFCR?

Minimum requirement under the cash-flow coverage ratio

680. We propose the minimum requirement for the CFCR be 100%, to ensure that deposit takers can completely meet their expected net cash outflows in a stress event. A minimum requirement of 100% would also make it more comparable with the MMR and help depositors and other stakeholders to assess the relative risk of different deposit takers (despite other differences between the two metrics).

681. Currently some credit unions, building societies and finance companies have higher minimum requirements, for example, 110% to 130%. However, in general the quantitative requirement being proposed is not intended to be more light-handed than current requirements placed on Group 3 deposit takers set out in their trust deeds. For example, it involves both 7-day and 30-day measurement periods and adopts a different approach to the treatment of term deposits than some existing trust deeds. In addition, it forms a package with the proposed qualitative requirements, and these qualitative requirements are an important part of our approach to ensuring that deposit takers effectively manage their liquidity.

682. Our proposed CFCR is therefore:

$$\frac{liquid\ assets}{net\ cash\ outflows} \geq 100\%$$

Q83 Do you agree that the minimum requirement under the CFCR should be 100%?

Definition of cash outflows and cash inflows under the cash-flow coverage ratio

683. We propose that cash outflows and cash inflows be defined in broadly the same manner as those for Group 1 and Group 2 deposit takers, apart from the treatment of term deposits as outlined in section 4.2.4 below.

684. This means that cash inflows would cover contractual inflows (that is amounts of principal and interest due within the specified period) but excluding certain matters, for example:

- any amount contractually repayable within the period from outstanding credit card balances and from amounts drawn down under retail overdraft facilities
- principal or interest payments that the deposit taker assesses it is unlikely to receive because the borrower is facing repayment difficulties
- amounts due from receipt of fees and commissions.

685. Cash outflows would cover:

- contractual outflows due within the specified period (i.e., amounts due to be paid out arising from interest payments, and lending due to be drawn down where the draw-down date and principal amount are certain) but excluding certain matters, such as amounts due to be paid in fees and commissions)
- interest and principal on retail deposits applying the run-off percentages outlined below.

Run-off rates under the cash-flow coverage ratio

686. A key feature of the MMR for Group 1 and Group 2 deposit takers is the use of size bands, which apply progressive run-off rates for larger-sized deposits. The size of the deposit is used as a proxy for the depositor's level of sophistication and their potential behaviour in response to a liquidity stress scenario.

687. Our current view is that there are two possible options for setting run-off rates under CFCR.

Option 1: Apply the MMR's 'size band' approach for Group 1 and Group 2 deposit taker run-off rates to Group 3 deposit takers.

688. This approach would mean applying similar run-off rates to Group 3 deposit takers as Group 1 and Group 2 deposit takers under the MMR, which are potentially the run-off rates in Table AE (also being consulted on in this chapter).

Table AE: Proposed run-off rates for non-market funding in calculating the CFCR

Size band	Insured deposits	Uninsured deposits <$5m	Uninsured deposits $5m to $10m	Uninsured deposits $10m to $20m	Uninsured deposits $20m to $50m	Uninsured deposits $50m to $100m	Uninsured deposits over $100m
% to be included	3%	5%	20%	40%	60%	80%	90%
	New						New

689. For the purposes of these bands, 'deposits' would cover both retail deposits (including finance company debentures) and wholesale deposits.

690. In addition, it may not be necessary to simplify or streamline the size bands for Group 3 deposit takers depending on the systems they have in place. In the future they are likely to have systems in place to generate the underlying data required to group aggregate deposits into these bands under the forthcoming SDV requirements (that will be implemented as part of the proposed DCS standard).

Option 2: Apply one run-off rate for insured deposits and one run-off rate for uninsured deposits

691. Given that Group 3 deposit takers may have a limited number of larger-sized deposits (for example. deposits over $5 million), applying separate run-off rates for these larger-sized deposits may be unnecessary (or less necessary). However, if this option were adopted, it is likely that the single run-off rate for insured deposits would need to be higher than the currently proposed 5% rate for uninsured deposits under $5 million. (It may also require an increase to the currently proposed 3% rate for insured deposits.) This is because the proposed run-off rates for Group 1 and Group 2 deposit takers are calibrated for entities with a more diversified range of deposit sizes and funding sources; therefore, a level of conservatism may need to be applied to account for the (generally) less-diversified funding models of Group 3 deposit takers.

692. If we proceed with Option 2, further work will be undertaken on the appropriate single run-off rate for insured deposits and single run off rate for uninsured deposits.

Summary

693. We do not currently have a preference between Options 1 and 2 and would be interested in your feedback on which of these options would be more appropriate.

694. For completeness, we note that we have considered the option of a single run-off rate for all deposits (whether insured or uninsured). However, we do not prefer this option. At a minimum, the SDV standards will require deposit takers to group deposits into insured and uninsured categories and as evidenced during the recent US regional banking crisis,

uninsured deposits generally have a higher risk of flight than insured deposits. We think it is important to draw the distinction between these two types of deposit.[106]

Q84	Do you prefer Option 1 or Option 2 for the treatment of deposit run-off rates?
Q85	What compliance costs do you think may result from Option 1 and Option 2 (including the costs of any necessary system builds)?
Q86	Are the potential size bands in Option 1 appropriate for measuring the potential deposit outflows of Group 3 deposit takers in a liquidity stress scenario?

4.2.2 Time horizon and measurement frequency for the CFCR

Preferred option

695. We propose that:

- Group 3 deposit takers measure the CFCR for both 7-day and 30-day periods (unless the Group 3 deposit taker only issues term deposits, in which case only measurement over a 30-day period is required)
- the CFCR requirements are met by Group 3 deposit takers on an ongoing basis.

Analysis

696. The current MMRs applying to banks are calculated on a weekly and monthly time horizon. As noted in section 2.2, we are proposing that this be adjusted to 7-day and 30-day periods and are requesting your feedback on whether the MMR requirements should be met at all times (that is, continuously) rather than just at the end of each business day.

697. We consider that this approach is also appropriate here. In particular, the use of 7-day and 30-day measurement periods (rather than weekly or monthly measurement periods) supports a consistent approach across all deposit takers, and requiring the CFCR to be complied with at all times rather than at the end of each business day is appropriate in light of the implementation of SBI365 (even though Group 3 deposit takers will generally only be indirect participants in SBI).

698. The one exception to this proposed approach is that we do not consider it necessary to measure the CFCR for a 7-day period where the Group 3 deposit taker only issues term deposits. A 7-day measurement period would appear to serve little purpose in this case because funding solely through term deposits significantly reduces the risk of very-short-term stress events. In addition, we would be interested in your views on whether there are any circumstances in which it would not be appropriate for a Group 3 deposit taker to comply with the proposed metrics at all times (for example, if they were not processing payments on 365 days a year).

[106] Drechsler I., Savov A., Schnabl P. and Wang O. Drechsler et al. (2023, 12 April). *Banking on Uninsured Deposits.* https://www.fdic.gov/analysis/cfr/bank-research-conference/annual-22nd/papers/wang-o-paper.pdf

Summary

699. Our preferred option is that Group 3 deposit takers measure the CFCR for both 7-day and 30-day periods (unless the Group 3 deposit taker only issues term deposits, in which case measurement over a 30-day period is required), and that the CFCR requirements potentially be required to be met by Group 3 deposit takers at all times. We consider that this supports a consistent approach across all groups of deposit takers, is consistent with the risk of a faster run off of deposits in the initial 7-day period and reflects the fact payments are now being settled through SBI on 365 days a year. However, we would be interested in your views on whether there are any reasons why some or all Group 3 deposit takers should not be required to comply with the metrics at all times, on 7 days a week (for example, if they are not processing payments on 7 days a week).

Q87 Do you agree the CFCR should be applied for both 7-day and 30-day periods for Group 3 deposit takers that issue both demand and term deposits, and for only a 30-day period for Group 3 deposit takers that only issue term deposits?

Q88 Do you agree that the CFCR should be met 'at all times' rather than just at the end of each business day? If Group 3 deposit takers were required to comply with the CFCR at all times, what are the expected costs and are there reasons why at all times 7 days a week is not appropriate (for example, if payments are not processed 7 days a week)?

4.2.3 Simplified features of the CFCR compared to the MMR

Preferred option

700. The CFCR is comparable with the MMR, however, key simplifying features proposed include:

- that eligible liquid assets include demand deposits held at Group 1 and Group 2 deposit takers;
- no distinction would exist between 'market funding' and 'non-market funding'; and
- the 7-day CFCR would not apply to deposit takers who do not accept demand deposits.

701. In addition, as noted above we are exploring whether applying different run-off rates based on deposit size bands is necessary for the CFCR, or whether it would be appropriate to apply only two run-off rates – one for insured deposits and one for uninsured deposits.

Analysis

702. Where possible, the intention is to have a strong but simplified metric for Group 3 deposit takers compared to Group 1 and Group 2 deposit takers. This proportionate approach does not mean a weakening of existing requirements, but rather the balancing of the costs and benefits of regulation relative to the size and nature of the businesses of different deposit takers. For example, the lower contagion risk generated by Group 3 deposit takers, due to their size, allows for liquidity policies to be adjusted, including the eligibility for liquid assets to include demand deposits, when weighing up the relevant costs.

703. We recognise the proposed CFCR and MMR have some similarities. The key difference between them is the CFCR does not make a distinction between 'market funding' and 'non-

market funding' (as does the MMR), and that deposits with Group 1 and 2 deposit takers that are callable within the specified timeframe are treated as eligible liquid assets (see discussion on the treatment of term deposits below). In addition, we have explored proportionate approaches in developing a simplified quantitative liquidity requirement for Group 3 deposit takers Specifically, the options of just having a single run-off rate for insured deposits and a single run off rate for uninsured deposits, and not requiring the CFCR to be calculated over a 7-day time horizon for Group 3 deposit takers that only issue term deposits.

704. We would be interested in any other suggestions about how our proposed approach could be further simplified, while still meeting our prudential objectives.

Q89	Do you have any views or suggestions on what further simplifications could be made to our proposed CFCR?

Summary

705. We propose that:

- Group 3 deposit takers be required to comply with a CFCR metric.
- the CFCR is calculated as:

$$\frac{liquid\ assets}{net\ cash\ outflows} \geq 100\%$$

- liquid assets include demand deposits held with Group 1 and Group 2 deposit takers, as well other certain other specified high-quality assets
- cash inflows and cash outflows be defined in a similar manner for Group 3 deposit takers as for Group 1 and 2 deposit takers (but term deposits held by Group 1 and Group 2 deposit takers to be included as a cash inflow if they mature within the 7-day or 30-day periods (as applicable))
- expected cash outflows be calculated by using either the same size band run-off rates as for Group 1 and Group 2 deposit takers, or a single run-off rate for insured deposits and a single run-off rate for uninsured deposits. We are seeking your feedback on which of these options would be more appropriate
- the CFCR be calculated over both a 7-day and 30-day period, unless the deposit taker only issues term deposits, in which case the CFCR only be required to be calculated over a 30-day period.

706. We consider that a CFCR with these features will help ensure that Group 3 deposit takers are able to pay debts as they fall due, and as such supports the purposes of protecting and promoting the stability of the financial system, promoting the safety and soundness of each deposit taker and promoting public confidence in the financial system. A CFCR with these features is also applied in a proportionate manner, avoids unnecessary compliance costs and helps ensure that Group 3 deposit takers are effectively managing their liquidity. By doing these things, we consider that the proposed CFCR also supports the principle of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders.

4.2.4 Treatment of demand deposits and term deposits with other deposit takers

707. Under their trust deeds, NBDTs are often able to treat certain term deposits (with differing maturity profiles) as liquid assets to meet their liquidity requirements. The practice of treating term deposits as liquid assets would neither be consistent with our existing criteria for Primary and Secondary Liquid Assets (PSLA) nor the BCBS criteria for HQLA.

708. However, some NBDTs have submitted that:

- NBDTs are at a disadvantage compared to banks in that they cannot deposit funds (that receive interest) with us.[107] As a result, NBDTs often invest more heavily in term deposits to achieve greater yield
- if term deposits do not qualify as liquid assets, NBDTs should be able to deposit funds with us.

709. We have previously indicated that we will consider term deposits' continued inclusion as a liquid asset under any proposed liquidity requirements for small deposit takers, so long as it can be demonstrated that these term deposits can serve to meet deposit takers' short-term obligations.

Preferred option

710. We propose that Group 3 deposit takers' demand deposits with other Group 1 and Group 2 deposit takers should be treated as liquid assets. We also propose that term deposits held at Group 1 and Group 2 deposit takers are only treated as cash inflows if the term deposit matures during the specified period (7 days or 30 days).

Analysis

711. Regarding the Group 3 deposit takers' demand deposits proposal, demand deposits are strictly a claim on another entity rather than cash or an asset that can be easily sold, and therefore during a stress event there is a possibility that a Group 3 deposit taker would be unable to access their demand deposits. The primary reason a demand deposit could not be accessed is if the other deposit taker is in financial distress. However, in practice, given the relative size of Group 3 deposit takers compared to Group 1 and Group 2 deposit takers, we do not consider there to be a strong contagion risk associated with this proposed approach. We therefore consider it appropriate to take a proportionate approach and avoid unnecessary compliance costs.

712. Regarding term deposits held at Group 1 and Group 2 deposit takers, our starting point is that it should not be possible for these term deposits to be treated as cash inflows (or liquid assets), except where the term of the deposit ends during the 7-day or 30-day period for the CFCR. A deposit taker in a stress event cannot rely on being able to access (or 'break' early) a term deposit to meet its financial obligations, and unlike demand deposits, the Group 1 or Group 2 deposit taker generally has a contractual right to refuse early redemption. This

[107] Banks with ESAS accounts are able to deposit funds with the Reserve Bank and receive interest on these balances. *See* Reserve Bank of New Zealand. (2022, 28 February). *Exchange Settlement Account System.* https://www.rbnz.govt.nz/payments-and-settlement-systems/exchange-settlements-account-system

occurred during the COVID-19 pandemic, as many Group 3 deposit takers were unable to access (or 'break' early) their term deposits.

713. Liquidity requirements currently vary across Group 3 deposit takers. They can result in term deposits with remaining maturity greater than 30 days being treated as liquid assets. Our proposals for the 7-day and 30-day requirement could have significant consequences on Group 3 deposit takers, especially NBDTs that receive a large portion of funding from on-demand retail funding, and thereby have higher expected cash outflows in a stress event. Group 3 deposit takers may be required to shorten their term deposit maturity ladder (to meet the 30-day requirement) and/or hold other types of liquid assets: for example, NZGBs, Kauri bonds or LGFAs. We note this may have flow-on consequences for Group 3 deposit takers' profitability.

714. The largest impacts of the proposals are likely to be on those NBDTs and primarily credit unions that offer transactional accounts. NBDTs that offer transactional accounts are likely to have greater projected cash outflows than deposit takers that primarily receive funding from longer-dated term deposits.

715. We note that one option highlighted by the NBDT sector is to allow Group 3 deposit takers to deposit funds with the RBNZ via an ESAS or 'ESAS-like' account. Another part of the Reserve Bank is currently undertaking an ESAS Access Review, in which we are considering the eligibility criteria for an ESAS account.[108] Decisions will be released in due course. We note that the development of more liquid retail-parcel markets for NZGBs would potentially provide another option for addressing this issue.

Summary

716. For Group 3 deposit takers, we propose that demand deposits held at Group 1 and Group 2 deposit takers be treated as a liquid asset for the CFCR to account for the different size, nature, and business model of most Group 3 deposit takers. This approach differs from the treatment of demand deposits under the MMR for Group 1 and 2 deposit takers but we consider it is an appropriate and proportionate approach.

717. We also propose that term deposits held at Group 1 and Group 2 deposit takers should be treated as cash inflows except where the term of the deposit ends during the 7-day or 30-day measurement period for the CFCR. We consider that this approach adequately reflects the liquidity properties of term deposits and is desirable for Group 3 deposit takers to effectively manage their liquidity risk. We also recognise that this proposal is a change from the current practice for NBDTs and are seeking your feedback on the impact.

Q90	What would be the impact of the proposed treatment of term deposits on your business model, liquidity risk management, and profitability? Please quantify the impacts on profitability where possible.

[108] *See* Reserve Bank of New Zealand (2022, 28 February). *Our policy on access to Exchange Settlement accounts*. https://www.rbnz.govt.nz/payments-and-settlement-systems/exchange-settlements-account-system/our-policy-on-access-to-exchange-settlement-accounts#dlgLI9yjtk61Cznlc3iCtA

Q91 What could mitigate the impacts of the proposed treatment of term deposits? For example, could Group 3 deposit takers hold (more) liquid assets such as NZGBs, Kauri bonds, and LGFAs?

4.2.5 Stable funding requirement

718. As part of the C2 decisions announced in December 2023, Group 1 and Group 2 deposit takers will continue to be subject to the CFR.

719. The CFR helps ensure banks fund a sufficient proportion of their lending with stable sources of 'core funding', such as retail deposits or long-term wholesale funding. Given that banks often lend money on a longer-term basis (such as mortgages with a term over one year), the CFR helps ensure that the money a bank has received to fund this lending will also stay with the bank on a longer-term basis. This helps protect banks from potential disruptions in funding markets, particularly if funding providers choose not to 'rollover' (reinvest) funding with the bank.

720. The formula for the CFR is:

$$\frac{core\ funding}{total\ loans\ and\ advances}$$

721. The standard minimum requirement for the CFR is 75%, and banks must maintain their CFR above this minimum at the end of each business day.

722. For the purposes of the CFR, the amount of 'core funding' is calculated by adding:

- all funding with residual maturity longer than one year, including subordinated debt and related party funding
- 50% of any tradeable debt securities issued by the bank or funding from Reserve Bank facilities, with original maturity of two years or more and with residual maturity of more than six months and not more than one year[13]
- non-market funding that is withdrawable at sight or with residual maturity less than or equal to one year, applying percentages as outlined in our liquidity policy
- Tier 1 capital.

723. Of the Group 3 deposit takers, two banks are currently subject to the CFR requirement, while the NBDTs are not. In C2, we requested feedback on whether smaller (Group 3) deposit takers should be subject to a long-term stable funding requirement.

Preferred option

724. We propose Group 3 deposit takers are not required to meet a quantitative stable funding requirement.

Analysis

725. C2 submitters were generally not supportive of applying a long-term stable funding requirement to Group 3 deposit takers.

726. Group 3 deposit takers tend to have higher levels of stable funding (such as retail deposits) than large internationally active banks (that often obtain a higher proportion of funding from non-retail sources, some of which is on a short-term basis). In our view, this reduces the need for a long-term stable funding requirement for Group 3 deposit takers. On balance, we are currently inclined not to apply a long-term stable funding requirement to Group 3 deposit takers, in order to avoid unnecessary compliance costs. However, it is possible that changes in Group 3 deposit takers' funding composition may suggest that such a requirement be considered in future.

727. Our view is consistent with the intention of taking a simplified and proportionate approach to quantitative liquidity requirements for Group 3 deposit takers, and not imposing new requirements in the liquidity standards unless necessary or desirable for liquidity management.

Summary

728. We propose that Group 3 deposit takers are not required to meet a quantitative stable funding requirement under the DTA liquidity standard. This approach differs from Group 1 and Group 2 deposit takers where we to propose to apply the CFR (with modification). We consider it appropriate and desirable to take a proportionate approach in this regard because the typical funding profile of Group 3 deposit takers is currently judged to present a low level of liquidity risk related to stable funding.

Q92	Do you agree with our proposal not to apply a quantitative stable funding requirement on Group 3 deposit takers?

5 Proposed approach for branches of overseas deposit takers

729. In 2012 the Reserve Bank consulted on proposals to apply certain liquidity requirements to branches of overseas banks.[109] These proposals were not taken forward as policy decisions largely because of competing priorities. The operating landscape for branches has changed considerably since 2012 but liquidity risks remain and we consider that there is a need to apply certain liquidity requirements to branches under the DTA.

730. The Reserve Bank recently published key decisions in its Review of policy for branches of overseas banks ('**Branch Review**').[110] The decisions most relevant to this current Consultation Paper were to limit branches to only conducting business with wholesale investors and to limit dual-registered branches to only conducting business with large wholesale investors. We consider that the outcomes of the Branch Review, once implemented, will serve to constrain the risks that branches pose to the stability of New Zealand's financial system.

731. In 2012, branches of overseas banks represented 15% of total assets in the New Zealand banking system, down from 30% in the early 2000s before the local incorporation policy was

[109] Reserve Bank of New Zealand. (2012). *Consultation Paper: Extending Reserve Bank Liquidity Policy BS13 to overseas bank branches*. https://www.rbnz.govt.nz/regulation-and-supervision/banks/policy/~/media/58ACE88C2EDA4C3484B09FD734240CE4.ashx

[110] Reserve Bank of New Zealand. (2023, 7 November). *Review of policies for branches of overseas banks*. https://www.rbnz.govt.nz/have-your-say/review-of-policy-for-branches-of-overseas-banks

introduced.[111] This figure is now closer to 8% and likely to decrease further as the local incorporation threshold changes from NZD 15 billion in net liabilities to NZD 15 billion in total assets (an effective decrease) and branches are limited to conducting business only with wholesale investors.

732. The activity of branches of overseas banks in New Zealand is typically focused on business sector lending. They represent 14% of total business lending by banks and 3% of total business deposits in the banking system. Branches typically rely heavily on their overseas parent for funding.

733. The key difference between a locally incorporated subsidiary and a branch is that a branch is part of a legal entity incorporated overseas. This means that a default or failure of a branch would be considered a default or failure of the overseas deposit taker, and the overseas deposit taker therefore has strong incentives to manage the liquidity risks of their branch(es). The parent banks of all branches currently registered in New Zealand are also subject to the Basel liquidity framework, which sets a high standard to manage liquidity risks for the entity as a whole.[112]

734. However, we consider that these factors do not fully mitigate the liquidity risks faced by branches, especially short-term liquidity stress events. Under considerable market stress scenarios, branches may be unable to receive the required funding in NZD from the overseas bank in a timely manner. These scenarios include instances when:

- the (overseas) head office, while willing in principle, is temporarily unable to fund cash calls on the branch for various reasons such as time zone differences; temporary disruptions in foreign exchange swap or spot markets; short-term uncertainties that result in the home market prioritising liquidity allocation in the home market rather than in branch markets
- home regulators fail to:
    - apply an acceptable level of scrutiny to a branch's operations in New Zealand
    - take into account the potential economic, fiscal, and social impact of a default and/or failure of the branch in New Zealand
    - notify the Reserve Bank of the problems of the parent entity, to avert potential ring-fencing of the assets of the branch in New Zealand.

735. We recognise that the probability of some of these short-term frictions occurring has decreased over time, including through the availability of better information and communication technology tools. However, the risks remain of branches of overseas banks not holding sufficient NZD-denominated liquid assets to meet their obligations on a given day. And despite their limited direct participation in the New Zealand retail banking sector, if a

[111] This policy is outlined in [Reserve Bank of New Zealand. (2021). *BS1 Statement of principles*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs1-statement-of-principles.pdf]. It sets criteria for local incorporation of branches including systemic importance, home country depositor preference and inadequate disclosure. These requirements for local incorporation will be updated to reflect the outcomes of the Branch Review. *See* Reserve Bank of New Zealand. (2023, November 7). *Review of policy for branches of overseas banks.* https://www.rbnz.govt.nz/have-your-say/review-of-policy-for-branches-of-overseas-banks

[112] *See* Reserve Bank of New Zealand. (2024, February 9). *Registered banks in New Zealand.* https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/registered-banks-in-new-zealand]

branch were to face liquidity problems, some domestic market spillover effects could still occur. As such, ensuring that branches remain stable in the face of liquidity shocks helps support the overall stability of the financial system in New Zealand.

Preferred option

736. The proposed qualitative requirements for locally incorporated deposit takers (see sections 2.1, 3.1 and 4.1) are closely aligned with the qualitative liquidity principles contained in the Basel framework. We consider that certain elements of these qualitative requirements may also be appropriate for branches of overseas banks to help them address the short-term frictions that might prevent the parent bank from providing liquidity to the branch during stress events.

737. We recognise that while the parent banks of all registered branches in New Zealand are subject to the Basel liquidity framework (including qualitative requirements), these may not sufficiently address the particular risks faced by branches. Our aim is to ensure that branches have an internal framework to manage liquidity risk that is adequate and considers their material sources of stress. On balance, our proposed requirements for branches are that the branch must:

- have a New Zealand CEO approved liquidity risk management framework
- have the same New Zealand CEO and senior management responsibilities for the framework as for the board and senior management of Group 1 and 2 deposit takers (see the discussion above in sections 2.1 and 3.1)
- actively manage its collateral positions, if any, and its stock of unencumbered and encumbered assets
- conduct stress tests, at least every two years and use stress test outcomes to adjust its liquidity risk management framework and its CFP as needed
- have a CFP approved by the New Zealand CEO (and re-approved by the New Zealand CEO at least every two years, or earlier as circumstances warrant), that sets out the strategies and actions for addressing a range of liquidity stress events.

738. Given the overall alignment with the Basel framework, we expect that these requirements on branches could leverage the frameworks and documentation required by the branch's home regulator. This would serve to reduce compliance costs for the branch while also maintaining consistency with how liquidity risk is managed across the entire bank that the branch is a part of.

739. Alternative approaches to apply qualitative liquidity requirements include requiring branches of overseas banks to comply with the same (full set of) qualitative requirements as Group 1 and Group 2 deposit takers or not to apply any qualitative requirements at all. We consider that these alternative options do not present a better net benefit than only applying certain qualitative requirements to branches. The full set of qualitative requirements is likely to be materially more costly and is not likely to lead to better liquidity risk management for the branch compared to the proposed requirements listed above. Not applying any qualitative requirements is undesirable because it does not address the liquidity risks that branches face.

740. International practice varies considerably in terms of how liquidity requirements are applied to branches. For example, in Australia, branches are required to hold a minimum amount of high quality liquid assets and need to have minimum local operating capacity. In the UK, branches are generally required to meet home country liquidity requirements but the PRA has discretion to apply specific requirements if needed. Our preferred option is largely consistent with this international practice that recognises the diversity of branches and applies liquidity requirements in a proportionate manner.

Alternative options

Apply the MMR to branches

741. The 2012 consultation paper proposed applying an MMR requirement to branches. This proposal recognised the existence of certain short-term frictions between the branch and the rest of the bank they are a part of, which could result in a shortfall of liquid assets to meet outflows during liquidity stress events. Note that in 2012, New Zealand was still a relatively early adopter in applying liquidity requirements and the BCBS liquidity framework had not yet been finalised, let alone implemented. All overseas banks with branches registered in New Zealand are now subject to the LCR and NSFR requirements on a consolidated basis, often by virtue of the home regulator being a Basel member.

742. The case for applying an MMR requirement to branches of overseas banks has arguably weakened since the 2012 consultation because of other changes in the operating environment. Branch activity in New Zealand has declined significantly in relative terms, which reduces (but does not eliminate) the likelihood of liquidity stress events from branches leading to system-wide instability. We expect that better information and communication technology (ICT) tools have become available (for example, in real-time data analytics and process automation) that could improve the ability of the bank to provide liquidity support to their New Zealand branch in times of stress. Both factors reduce the benefits of applying an MMR requirement to branches.

Apply the BCBS's LCR to branches

743. An alternative means of requiring branches of overseas banks to manage short-term liquidity risk would be to apply the BCBS LCR instead of the MMR. This would be more coherent for the overseas bank to manage, as they are subject to the LCR through their home regulator. However, it could introduce unnecessary complexity to the Reserve Bank's overall liquidity policy as our policy would then have to include both the MMR and the LCR.

744. Just as with the MMR option above, the case for applying a requirement for branches to reduce short-term liquidity risks has weakened considerably since the 2012 consultation. This is because of changes in the operating environment, as branch activity has declined significantly in relative terms and better technology is available to reduce frictions between the parent and their branch. Both factors reduce liquidity risks for branches and, correspondingly, reduce the benefits of applying the BCBS LCR requirement to branches.

Apply the CFR to branches

745. Locally incorporated banks in New Zealand are required to maintain a CFR of at least 75% to help ensure that banks have sufficient levels of stable funding relative to their loans (with a target duration of at least one year). The CFR addresses longer-term liquidity risks that could

result from having insufficient amounts of stable funding. The rationale for applying a CFR to branches of overseas banks is weak because the main liquidity risk for branches is from very short-term liquidity stress events and from not having access to emergency funding from the overseas bank – as described earlier. Additionally, as long as the overseas bank is complying with the NSFR (the Basel equivalent of the CFR) on a consolidated basis (i.e., has sufficient stable funding on a consolidated basis), a standalone CFR requirement for the New Zealand branch may not be necessary given that the overseas bank could provide any required core/stable funding to the branch if needed. APRA does not apply the NSFR to branches and the 2012 consultation paper did not propose applying a CFR or NSFR to branches.

Seek improved reporting from branches

746. The Reserve Bank collects a range of information from branches of overseas banks about their financial position and performance but relatively little about how liquidity risks are managed. Collecting more information about how branches manage their liquidity could help support better monitoring of liquidity risks in the financial system and inform future policy judgements.

Analysis

747. The main purpose of the DTA is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system. The options for branches of overseas banks serve this main purpose and the additional purposes of promoting the safety and soundness of each deposit taker and promoting public confidence in the financial system.

748. The 2012 consultation did not propose applying qualitative requirements to branches because it was considered too costly to calibrate requirements to their diverse operating models. We consider that the current context – of alignment of international practice on qualitative requirements to manage liquidity risks (and our proposals in this regard for locally incorporated deposit takers) and the fact that our proposal is to apply only certain requirements to branches – changes the balance of costs and benefits such that the benefits of applying certain qualitative requirements now outweigh the costs. In particular, we consider that applying certain qualitative requirements in a proportionate manner and aligned to international practice will avoid unnecessary compliance costs for deposit takers, as generally most overseas entities would be subject to qualitative requirements in their home jurisdiction.

749. The 2012 consultation proposed introducing quantitative liquidity requirements for branches and this was viewed as a finely balanced judgement that most branches supported at that time. Quantitative requirements were ultimately not applied to branches (because of competing priorities) but many of the considerations discussed in the 2012 consultation remain relevant today, albeit with some important contextual changes in the regulatory landscape, the structure of the sector and the availability of better ICT tools. We consider that these contextual changes collectively serve to decrease (but not eliminate) the likelihood and impact of a liquidity risk management failure at a branch and therefore also reduce the benefits of imposing quantitative liquidity requirements on branches to the point where we do not see a clear net benefit. The forthcoming restriction on branches from operating in the retail banking sector (as a result of the Branch Review) will serve to constrain the risks that branches pose to the stability of New Zealand's financial system.

750. Table AF below outlines our views on the costs and benefits of the potential options discussed in the previous section that could be applied to branches to address liquidity risks.

Table AF: Costs and benefits of policy options for branches

Policy options	Benefits	Costs
Apply certain qualitative requirements to branches	Promotes good liquidity risk management practices. Consistent (but proportionate) with approach for locally incorporated banks.	Low-moderate compliance costs. The bank's compliance with Basel qualitative requirements could be leveraged to meet branch requirements.
Apply the MMRs to branches	Addresses short term acute liquidity risks that are relevant for branches. Consistent with the requirements for locally incorporated banks.	Not consistent with the overseas requirements for the parent. Compliance costs are high relative to benefits; not a clear positive net benefit.
Apply the BCBS's LCR to branches	Addresses short term acute liquidity risks that are relevant for branches. Consistent with the overseas requirements for the parent.	Not consistent with requirements for locally incorporated banks. Compliance costs are high relative to benefits; not a clear positive net benefit.
Apply the CFR to branches	Addresses stable/core funding risks. Consistent with the requirements for locally incorporated banks.	Not consistent with the overseas requirements for the parent. Compliance costs are high relative to benefits; not a clear positive net benefit
Seek improved reporting from branches	Better information on liquidity risk management practices would support risk monitoring and policy judgements.	Low–moderate compliance costs for additional reporting.

Summary

751. Based on the analysis of the options we have outlined above; our proposed approach is to apply the following qualitative requirements to branches of overseas banks (but not apply any quantitative requirements). The branch must:

- have a New Zealand CEO approved liquidity risk management framework.
- have the same New Zealand CEO and senior management responsibilities for the framework as for the board and senior management of Group 1 and Group 2 deposit takers (see sections 2.1 and 3.1 above)
- actively manage its collateral positions, if any, and its stock of unencumbered and encumbered assets
- conduct stress tests, at least every two years and use stress test outcomes to adjust its liquidity risk management framework and its CFP as needed

- have a CFP approved by the New Zealand CEO (and re-approved by the New Zealand CEO at least every two years, or earlier as circumstances warrant), that sets out the strategies and actions for addressing a range of liquidity stress events.

752. We believe there is also a need to collect more information from branches of overseas banks on how they manage liquidity risks. We note that our preferred option is largely consistent with international practice, which recognises the diversity of branches and applies liquidity requirements in a proportionate manner.

Q93	What liquidity risk management requirements do you consider are appropriate to apply to branches?
Q94	Do you agree with our assessment of the costs and benefits of applying certain qualitative liquidity requirements to branches of overseas banks?
Q95	Do you agree that we should collect more information from branches on how they manage their liquidity risks?

6 Conclusion

753. We are seeking your feedback on a number of issues related to our revised liquidity standard, including our proposed qualitative liquidity requirements, potential modifications to our MMR and CFR metrics, potential feature and components of the CLF, our proposed simplified quantitative liquidity requirement for Group 3 deposit takers, and our proposal to apply certain qualitative (but not quantitative) liquidity requirements to branches of overseas banks.

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 3

Deposit Takers Depositor Compensation Scheme Standard

Deposit Takers Core Standards Consultation

16 May 2024

CONSULTATION PAPER

Non-technical summary

This standard will cover requirements for two aspects of the Depositor Compensation Scheme (DCS): disclosure and Single Depositor View (SDV).[113]

Disclosure

The DCS disclosure requirements are intended to help depositors understand whether their deposits are protected and the eligibility requirements for coverage under the DCS and whether their deposits are protected.

This consultation paper considers several options for the disclosure requirements and proposes requiring the use of an identifying trademark in advertising and communications related to protected deposits. Accompanying this, the standard would also require deposit takers to make information produced by the Reserve Bank available to depositors.

We anticipate that these disclosure requirements would impose compliance costs on deposit takers and that these costs would be greater when disclosure is made through certain channels (for example internet webpages as compared to banking applications). We seek your feedback on the costs associated with the different DCS disclosure proposals.

Single Depositor View

SDV files refers to data generated by a deposit taker's system that enables the Reserve Bank to determine depositors' entitlements to compensation and make payouts. In addition, aggregate reports based on SDV files may be used for other functions, including levy calculations and to inform the Statement of Funding Approach (SoFA).

This Consultation Paper outlines the proposed content of SDV files and the requirements for the testing and provision of those files. It also outlines the requirements for aggregate reporting of SDV data.

Developing systems to generate SDV files may be costly, but the cost of ongoing testing of those systems and reporting of SDV data should be low.

[113] What we have previously referred to as Single Customer View has now been changed to Single Depositor View to better reflect the content of the file and use of consistent language.

1 Introduction

754. This chapter discusses the proposed DCS Standard, to be made under Part 3 of the DTA. The DCS will pay eligible depositors entitled to compensation up to $100,000 for their protected deposits with each deposit taker in the event of its failure.

755. The proposed standard will require deposit takers to label protected deposits, in addition to having a published list of protected deposits (as required by section 193 of the DTA). This will help depositors to identify products protected by the DCS when they are looking at different deposit products, rather than always having to refer to deposit takers' lists of protected deposits. The intention is to increase depositor awareness of the DCS and enable depositors to make more informed decisions about deposit products.

756. Additionally, the standard will require that depositors have access to information about the other eligibility criteria under the DCS and the limits of coverage.

757. The standard will also require relevant information for the Reserve Bank to calculate entitlements and pay compensation or support resolution.

1.1 Purpose of the DCS Standard

Disclosure

758. The disclosure portion of the standard aims to:

- build and maintain public awareness of the DCS
- provide the public with clear information on coverage under the DCS
- provide depositors with accurate information to help them to make decisions
- reduce the risk of depositors relying upon vague or misleading information about the DCS.

759. These objectives seek to promote financial stability by ensuring that depositors are able to structure their affairs to protect themselves from the risk of deposit taker failure, and to reduce the risk of a run on deposits in the event of deposit taker failure.

760. Disclosure requirements also tie directly to the principle in section 4 of the DTA relating to depositors having access to timely, accurate and understandable information to help them make decisions.

Single Depositor View

761. Single Depositor View (SDV) files contain data that will enable us to determine the compensation entitlements for eligible depositors and to pay those compensation entitlements. The purpose of the SDV portion of the standard is to ensure that these files can be generated by deposit takers' own systems. The aggregated protected deposit amount calculated through the SDV will also be used to help calculate the DCS levies payable by deposit takers and to inform any changes to the SoFA.

1.2 Current Approach

762. There are currently no requirements related to the DCS as we have not yet brought the DCS into effect. Once in force, section 193 of the DTA will require that deposit takers publish a list of their protected deposits on their website.

1.3 Proposed policy development approach

763. In developing this standard, we have drawn on practices of several other jurisdictions, and the International Association of Deposit Insurers (IADI) *Core Principles for Effective Deposit Insurance Systems*[114]. These core principles provide regulators with guidance on the most fundamental elements to be considered when designing and building deposit insurance mechanisms.

764. Core Principle 15 states that:

> *"In order to provide depositors with prompt access to their funds, the deposit insurer … has the authority to undertake advance or preparatory examinations (e.g. on-site and independently or in conjunction with the supervisory authority) on the reliability of depositor records, and has tested member institution's IT systems and data to ensure the capability to produce such records) …"*

765. According to the IADI Survey on Effective Reimbursement Systems conducted in 2012, "lack of access to depositor records in advance of a failure" and "poor quality of depositor records at banks" are ranked as the most critical barriers to an effective deposit compensation system.

766. A standard that promotes effective and efficient data generation and helps to ensure the integrity of reported data supports the operation of the DCS.

1.4 Reserve Bank data and information governance

767. We are committed to protecting all information we collect, process, manage and dispose of when implementing and operating the DCS.

768. For the DCS to be able to pay compensation, it needs personal information on depositors. Specifically, personal information will be prepared by the failed deposit taker into an SDV file and supplied to us. We must then share the information with the alternative deposit taker to support the payout process. Thereby requiring us to receive, store, process and share personal information in the customers of the failed deposit taker.

769. We abide by the New Zealand Privacy Act 2020 in our use and management of personal information (for example, storage in secured systems, clear articulation of what the information will be used for, only using personal information for the purpose it was collected, disposing of personal information when it is no longer needed and lawful to do so).

770. As part of our compliance with the Privacy Act 2020, a Privacy Impact Assessment (PIA) will be completed for the DCS and the SDV file. These PIAs will be living documents and will be updated when there are any relevant major changes.

771. In addition to specific requirements around personal information, we are conscious of the needs of clients that are not natural persons, such as business clients. Protections available to

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[114] International Association of Deposit Insurers. (2014). *IADI Core Principles for Effective Deposit Insurance Systems*. https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf

personal information will also be afforded to information relating to entities that are not natural persons.

772. Furthermore, we apply the New Zealand Government's Protective Security Requirements (**PSR**).

773. We also abide by the principles of Privacy by Design[115] (**PbD**) and Secure by Design (**SbD**) which are best practice in privacy settings. Adhering to these principles means privacy and security are included in design decisions by default and information is secured from the moment it enters our systems until the moment it is destroyed.

1.5 Proposed approach for branches of overseas deposit takers

774. In November 2023, we announced our decision to not allow branches of overseas deposit takers (**branches**) to take retail deposits, restricting them to wholesale business.[116] Once this decision is implemented, we propose exempting branches from the DCS. This is because DCS protection will not be as relevant to their depositors as only a small proportion of the balances of wholesale depositors will be covered. Consequently, we anticipate that we will not need to apply any of the DCS standard requirements to branches.

Part 1: Disclosure

2 Proposed approach for Group 1 deposit takers

775. Disclosure requirements are intended to ensure that depositors can access timely, accurate and understandable information to help them make informed decisions about how they manage their deposits. This supports financial stability and public confidence by ensuring depositors can mitigate their exposure to financial loss in the unlikely event of deposit taker failure.

776. In proposing requirements, we are seeking to build awareness of the DCS in a consistent manner without overemphasising DCS coverage or creating significant compliance costs for deposit takers.

777. Our proposed approach to DCS disclosure requirements focuses on the use of a DCS trademark to identify protected deposits, supported by a requirement to link to (or provide) supporting information that will be hosted and maintained by us. This is broadly similar to requirements internationally.

778. To avoid possible confusion, deposit takers would only be permitted to use the Reserve Bank issued DCS trademark and would not be permitted to create their own.

779. This approach is intended to apply to all deposit takers with protected deposits, except overseas licensed deposit takers.

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[115] New Zealand Government. (2021, 2 December). *Privacy by Design (PbD)*. https://www.digital.govt.nz/standards-and-guidance/privacy-security-and-risk/privacy/manage-a-privacy-programme/privacy-by-design-pbd/

[116] Reserve Bank of New Zealand. (2023, 7 November). *Review of policy for branches of overseas banks*. https://www.rbnz.govt.nz/have-your-say/review-of-policy-for-branches-of-overseas-banks

2.1 Disclosure: broad approach

780. We have identified 3 broad approaches to the DCS disclosure requirements. While these approaches are not mutually exclusive, there are diminishing returns from added compliance cost and potential depositor confusion if 2 or more approaches are combined.

Preferred option

781. Our preferred option for a broad approach to DCS disclosure requirements is the product disclosure approach. Under this approach, the standard would require the DCS trademark to be used on advertising, marketing, and product disclosure statements for DCS protected products (with the possible exception of those loan products with positive balances).

782. We favour the product disclosure approach for the following reasons:

- it most clearly ties the use of the DCS trademark to protected products, so that depositors can identify protected products and make more informed choices. In the longer term this will support financial stability by ensuring that depositors can structure their deposits to maximise their protection under the DCS
- it also makes it easier for depositors to check if they have protected deposits in the event of shocks to the financial system. This helps to mitigate the risk of a run on deposits, further supporting financial stability
- it will be easier to comply with and enforce because of the legislative requirement to publish a list of protected deposits on the deposit taker's website, minimising unnecessary compliance costs
- it would result in less emphasis on the DCS than the general disclosure option (see below).

Alternative options

General disclosure

783. Under a general disclosure approach at deposit-taker level, branding material could be used by deposit takers (if they offer DCS-protected products) without needing to be linked to a specific protected product. Overseas this approach can include stickers on teller desks, branch windows or doors, and posters in branches.

784. This approach raises the profile of the DCS to a greater degree than the alternative options but could also imply that the DCS supports the deposit taker rather than protects products. In the event of financial system stress a run on deposits may be more likely if depositors have significant investments in products that they discover are not protected.

Negative disclosure

785. Negative disclosure would require products that are not protected by the DCS be identified as not being protected. This raises questions around which products should be labelled, without imposing excessive compliance costs on deposit takers or risking the creation of undue distortions in investor behaviour. For example, should retail investment products, including KiwiSaver funds, require identification as not being DCS protected? This option would also

require supporting measures outside of standards to impose similar requirements on 'deposit like' products issued by non-deposit takers.

786. Section 258 of the DTA includes that it is an offence for the issuer, and persons associated with an issuer, of a financial product holding out that a deposit is a protected deposit if this is not the case.[117] This should deter those who offer investment products not covered by the DCS from claiming or implying DCS protection of those products. The Financial Markets Conduct Act 2013 (FMCA) also requires some products to be accompanied by a Product Disclosure Statement that includes information on the key risks applying to an investment. The FMCA prohibits misleading or deceptive conduct when dealing in financial products.

787. Overall, our assessment is that Reserve Bank rules mandating negative disclosure is unlikely to be worthwhile due to the complexity and compliance costs associated with imposing negative disclosure requirements and the risks of distortions in depositor behaviour or other unintentional consequences. This appears to be consistent with the experience overseas, where negative disclosure requirements are rare and do not appear to have much impact on depositor behaviour when included.

Analysis

788. We are concerned that general disclosure may inadvertently lead to depositors assuming a wider degree of DCS protection than is provided. Given the DTA principles emphasise depositors having access to accurate information, we consider that it is important to avoid creating these false assumptions. We recognise that a vast majority of bank deposit products will be protected by the DCS, so the risk of assumed coverage may be minimal. However, most investment products will not be protected by the DCS and there is a risk that depositors will not understand this distinction between bank deposit products and investment products.

789. Our assessment is that mandating negative disclosure is unlikely to be worthwhile because of the complexity and compliance costs associated with imposing negative disclosure requirements and the risks of market distortions or other unintentional consequences. This appears to be consistent with the experience overseas, where negative disclosure requirements are rare and do not appear to have much impact on depositor behaviour when included.

Summary

790. In our view, the product disclosure option is the best approach as it is linked to the covered products and has a lower compliance cost and is less of a burden than other options.

Q96	Do you agree with our preferred approach of disclosure requirements to identify protected deposits?
Q97	Do you agree with our proposal to focus on the product disclosure approach?

[117] Deposit Takers Act 2023 section 258 Offence to hold out that product is protected. (As at 17 February 2024). https://www.legislation.govt.nz/act/public/2023/0035/latest/LMS507774.html

2.2 Disclosure: Detailed requirements

791. Depending on what broad approach is taken, the proposed standard would require the use of a visual identifier in certain places. Under a product disclosure approach, this would be the use of a trademark on advertising, marketing, and product disclosure statements for protected deposit products.

792. We note that it is possible that some credit products would be eligible for DCS protection, to the extent that they hold positive balances (such as revolving home loans with credit balances, or credit cards with credit balances). If these products are eligible for DCS protection, we expect that consumers would relatively rarely select them as deposit products. Because it might be confusing to mark these products as DCS protected, we are considering whether these would be excluded from the requirement to be labelled as protected deposits.

793. We will provide and maintain supporting information online and in other forms available to depositors, explaining the details of the eligibility criteria and coverage limits for the DCS. This information would be available to depositors and potential depositors regardless of the channel or point of contact through which they conduct business with a deposit taker (for example, either through a hyperlink on the deposit taker's website, or provided by the deposit taker in brochures as appropriate). The exact nature of the supporting material is being developed as part of the DCS brand strategy but is intended to ensure that depositors understand the extent to which they are protected by the DCS.

794. The proposed standard would define when and how the disclosure requirements need to be met, with the aim of ensuring a consistent level of visibility across different communication channels.

795. As the DCS will start before the standard is in place, we propose that the use of DCS branding in the interim period (2025–28) will be governed by trademarks and terms of use agreements.

Preferred option

796. We propose that a deposit taker:

- must use the Reserve Bank-supplied trademark in any advertisement in which the deposit taker refers to the DCS or a protected deposit
- may use the Reserve Bank-supplied DCS trademark in any other product-related communication so long as the deposit taker is not directly or indirectly holding out that a financial product is a protected deposit when it is not, or that that the holder of the financial product is entitled to compensation under the DCS when they are not
- must not use any sign in a communication to the public invoking the DCS other than "DCS", "Depositor Compensation Scheme" or the DCS trademark.

797. The requirement to label protected deposits could also apply to depositor specific information provided by deposit takers. For example, deposit takers could be required to identify protected deposits in internet banking and on bank statements in a similar manner to in advertising. This would raise DCS awareness with depositors who are not looking at alternative products on an ongoing basis.

Analysis

798. In our view, mandatory use of the DCS trademark will help promote consistency across deposit takers. Consistent use of the DCS trademark can help minimise confusion for depositors and promote public confidence in the financial system. However, we do recognise that it may be costly to make changes to certain channels such as banking applications. We are interested in understanding whether mandatory use of the DCS trademark would be proportionate to the cost of imposing it. We are also interested in understanding if it would be possible to integrate the supporting information on coverage and eligibility into these channels.

799. We have considered whether disclosure requirements would apply when discussing products with depositors as part of sales conversations. Our initial view is that, assuming DCS coverage information is integrated with product information provided to depositors, defining when and how DCS protection would need to be raised in discussions would be excessively complex and likely unnecessary and therefore would not support the principle of avoiding unnecessary compliance costs.

Summary

800. We propose that:

- deposit takers would be required to use the DCS trademark on advertising, marketing, and product disclosure statements for DCS-protected products, with the exception of credit products with positive balances
- deposit takers would need to make supporting information we provide about the eligibility criteria and coverage limits available to depositors.

Q98	Do you agree with the proposal to require the use of a trademark in connection with DCS protected products, except for credit products?
Q99	Is it practical to require deposit takers to make supporting information provided by the Reserve Bank available to depositors?
Q100	Are there any issues with adopting the "advertising" definition in section 434(4) of the DTA for the purpose of the DCS disclosure standard?
Q101	How costly would it be and how long would it take to incorporate DCS brand elements into depositor specific account information such as internet banking, mobile applications and bank statements?
Q102	Do you agree with the proposal not to impose requirements for disclosure in sales conversations?

3 Proposed approach for Group 2 deposit takers

Preferred option

801. We propose that Group 2 deposit takers are subject to the same requirements as Group 1 deposit takers.

Analysis

802. This is our preferred approach because the products that Group 2 deposit takers offer are generally similar to those offered by Group 1 deposit takers and are protected by the DCS in the same way. Therefore, we consider that the DCS disclosure requirements to make sure depositors can identify protected deposits should be the same. We think that a consistent approach to DCS disclosure supports depositors understanding the DCS and reduces the potential for confusion. This supports the principle of depositors having access to timely, accurate and understandable information. We also do not assess the costs associated with this approach to be so significant as to suggest a separate approach, given the wide-ranging benefits of the requirements.

Summary

803. We propose that Group 2 deposit takers have the same broad DCS disclosure requirements as Group 1 deposit takers.

Q103	Do you agree with our assessment that the approach to DCS product disclosure for Group 2 deposit takers should be the same as that for Group 1?

4 Proposed approach for Group 3 deposit takers

Preferred option

804. Our initial view is that the proposed DCS disclosure requirements for Group 1 and Group 2 deposit takers should apply to Group 3 deposit takers.

Analysis

805. This is our preferred approach because Group 3 deposit takers will offer protected deposits subject to the same conditions as Group 1 and Group 2 deposit takers, and the costs associated with this approach do not appear so significant as to suggest a separate approach. Therefore, our view is that their protected deposits should be identified in a consistent manner. Given this, it would require strong reasons to take a different approach for Group 3 deposit takers.

Summary

806. We propose that Group 3 deposit takers have the same broad DCS disclosure requirements as Group 1 and Group 2 deposit takers.

Q104	Are there any products offered by Group 3 deposit takers that are designed differently from bank deposits, that could require a different treatment under the DCS disclosure standard?

5 Conclusion

807. Our proposed DCS Disclosure Standard would require deposit takers to identify protected deposits in advertising for these products, using prescribed brand elements and some prescribed text. This requirement would apply consistently to all deposit takers. We are seeking your feedback on this overall approach and invite comment on the extent to which the standard will need to specify how this general requirement can be met across different advertising channels.

Part 2: Single Depositor View

808. SDV files will be data generated by a deposit taker that will enable us to determine the compensation entitlements for eligible depositors and pay compensation. Maintaining current and accurate records to produce SDV files is critical to ensuring deposit takers can sustain an appropriate level of readiness and provide us with an SDV file when required.

6 Proposed approach for Group 1 deposit takers

6.1 General information

809. This section covers areas relevant to the SDV and is provided to help inform your responses to specific questions on our SDV proposals.

DCS and OBR interaction

810. We will formally consult on the full resolution-standard proposals, including Open Bank Resolution (**OBR**), as part of non-core standards later this year.

811. Our proposed OBR–DCS integrated solution would ensure that deposit takers can identify the estimated DCS-covered balances as well as uninsured balances overnight and then re-open by 9am the next day, providing depositors with access to their DCS-covered funds and (depending on the size of the initial OBR freeze) a portion of their uninsured funds. The deposit taker will then restart depositors' access to their accounts and payment channels.

812. The DCS may contribute to a resolution measure for a deposit taker up to an amount equal to compensation entitlements. In OBR, this contribution may be transferred as a lump sum to the failed deposit taker, rather than into the accounts of eligible depositors.

Treatment of in-flight payments

813. In determining a depositor's entitlement to compensation under the DCS, it is necessary to calculate the aggregate balance of that depositor's protected deposits (or shares of protected deposits) held with a particular deposit taker. These balances must be calculated at the quantification time (which is the specified quantification time in a specified event notice issued under section 194 of the DTA).

814. In some cases (primarily if the protected deposit is a transactional account), the balance at the quantification time may be influenced by whether 'in-flight' payments (initiated but not fully processed at the quantification time) to or from the protected deposit are taken into account.

815. The DTA allows for regulations prescribing how to take into account in-flight when calculating DCS entitlements. In March 2024, we consulted on making regulations that set out the treatment of in-flight payments when calculating protected depositors' entitlements to compensation under the DCS.[118] At this stage we expect that these regulations will closely follow the treatment of in-flight payments in OBR. In particular that:

- "on-us payments" (i.e., payments between accounts at the same institution) be taken into account in determining protected deposit balances
- payments requiring interbank settlement on ESAS should only be taken into account in determining protected deposit balances if the interbank settlement has been completed.

816. However, we expect that the DCS regulations will depart from the OBR approach in which the statutory manager may exercise discretion about the treatment of card payments, as we do not consider that approach is adequate in the context of determining legal entitlements under the DCS.

817. Card payments can be processed and settled in a variety of different ways and over a variety of different timeframes and we are concerned that trying to design specific rules for all these scenarios will introduce excessive complexity. Accordingly, we are proposing to have a single rule for all in-flight payments that are card transactions – these transactions can only be taken into account in calculating protected deposit balances where they have been fully processed at the quantification time.

Apportioning compensation

818. Section 228 of the DTA provides the power to apportion compensation. We expect this apportionment will take the form of a hierarchy, showing the order in which protected deposits are compensated. The same hierarchy will apply to both the DCS and resolution standards.

819. An example of a protected deposit hierarchy would be paying compensation firstly in respect of current accounts, then savings accounts, then term deposits, then relevant arrangements in a specified order (for example, PIE funds, then lawyers and conveyancers trust accounts, etc.).

820. The hierarchy will also provide clarity to deposit takers about which protected deposits will be compensated for depositors with balances over $100,000 over multiple protected deposits.

File transfer

821. The SDV file must be made available in a manner prescribed by the Reserve Bank, in line with the provision of other sensitive information, for example loan-level data.

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[118] Reserve Bank of New Zealand. (2024, 11 March). *Depositor Compensation Scheme Regulations Consultation*. https://consultations.rbnz.govt.nz/dta-and-dcs/dcs-regulations/user_uploads/dcs-regulations-consultation-paper.pdf

6.2 SDV: variables list

Preferred option

822. We have constructed a list of variables that we propose for inclusion in the SDV file. This list has been compiled with the preferred payment mechanism, via one or more other deposit takers, in mind.

823. Where fields are mandatory information must be provided. For non-mandatory fields information is to be provided where the information is held by the deposit taker e.g. the first name field is not mandatory to allow for depositors who only have one name which will be provided in the mandatory 'surname' field. The first name is expected to be provided for all other depositors.

Table AG: Information proposed to be included in the SDV file

No.	Field identifier	Field descriptor	Field attributes	Mandatory
All depositors: depositor details				
1	Unique identifier	This identifier is used to uniquely identify and manage the depositor's profile such as a customer number made up of numbers or letters It should not contain external IDs such as IRD number, or the entity's business number pertaining to the depositor	max length = 100	Y
2	Type of depositor	Describe the type of depositor: • Person: includes a corporation sole, a body corporate, and an unincorporated body, see section 191 of the DTA. A person and a sole trader should be treated as one for the purpose of DCS • Trust • Company: a company registered under the Companies Reregistration Act 1993[119] • Partnership	Factor	Y
3	Depositor ineligibility reason	Provide the reason for marking the depositor ineligible for the DCS. If the depositor is eligible, keep this field blank Select one of the following that applies to the	Factor	Y (for ineligible depositors)

[119] Companies Registration Act 1993. (As at 5 December 2023). https://www.legislation.govt.nz/act/public/1993/0105/latest/link.aspx?search=sw_096be8ed81dfcde4_eligible+depositor_25_se&p=1&id=DLM327492

No.	Field identifier	Field descriptor	Field attributes	Mandatory
		depositor: • a licensed deposit taker, a licensed insurer, or an operator of a designated financial market infrastructure • a bank or other entity that is licensed, registered, or otherwise authorised to accept deposits under the law of an overseas jurisdiction • a government agency • an associated person or director of the deposit taker (unless acting as a trustee for an eligible depositor)		
For Individuals				
4	First name(s) of the depositor	Provide the legal first name(s) of the depositor If the deposit taker records first name and middle name(s) together in their system and are unable to separate the first and middle name(s), then report them using the First name field	max length = 255	N
5	Middle name(s)	Provide the legal middle name(s) of the account holder	max length = 255	N
6	Surname	Surname or single name of depositor. If the depositor has only a single name, use this field to report the single name. Do not report the single name in the First or Middle name fields	max length = 255	Y
7	Date of birth	Date of birth of the depositor	Day-month-year	Y
For non-individuals				
8	Entity name	The entity name	max length = 255	Y
9	New Zealand Business Number	The NZBN is a unique identifier for businesses.	13	N
10	New Zealand Company Number	Provide New Zealand Company Number if available	15	N

No.	Field identifier	Field descriptor	Field attributes	Mandatory
All depositors: contact information				
11	IRD number	Depositor's IRD number	max length = 11	N
12	Withholding tax rate	The tax rate deducted from interest earned for this depositor, includes: resident withholding tax (RWT), non-resident withholding tax (NRWT) and approved issuer levy (AIL)	Decimal: e.g., 0.33 where the tax rate is 33%	Y
13	Prescribed investor rate (PIR)	PIR rate if the depositor has invested in a protected deposit held by a PIE	Decimal: e.g., 0.28 where the tax rate is 28%	N
14	Preferred contact method	Provide the depositor's preferred method of contact, either email or post.	Factor	N
15	Street number with unit	Street/house number and the unit or flat number in the postal address. Unit first then street number: e.g., 3/17 for house number 3 and street number 17	max length = 50	N
16	Street name and type	Street name and type (such as street, road, crescent, etc) of the postal address. This is also the field that will be used for a PO Box or Private Bag for the mailing address	max length = 255	Y
17	Suburb	Postal suburb. In case of a rural address, include the rural delivery (RD) number	max length = 255	Y
18	City/Town	City or town name of the postal address	max length = 255	Y
19	Post code	Post code for the postal address. If overseas, then report ZIP number in this field	max length = 10	Y
20	Country	This is the country for the postal address in ISO 3166-1 alpha-2 code format	max length = 2	Y
21	Email address	Depositor's primary email address	max length = 255	Y
22	Phone number 1	Depositor's primary contact number. Provide the complete phone number with country code: e.g.,+64276115878	max length = 20	Y
23	Phone number 2	Depositor's secondary contact number. Provide the complete phone number with	max length = 20	N

No.	Field identifier	Field descriptor	Field attributes	Mandatory
		country code: e.g., +642XXXXXXX0		
24	Vulnerability	Reason why the depositor is deemed vulnerable, indicating the depositor requires extra care, support or protection to ensure that they are not disadvantaged in any way	Character	N
Account authority (other than the account holder)				
25	Authority on account	Accounts that have legally authorised person(s) to act on behalf of the depositor, such as power of attorney (POA), legal guardian for a minor account etc	Yes: true No: false	Y
26	Type of authority	The type of authority, such as power of attorney (POA), legal guardian for a minor account	Factor	Y (if True)
Where the authority is an individual				
27	First name(s) of the authority	Provide the legal name(s) of the authority If the deposit taker records first name and middle name(s) together in their system and are unable to separate the first and middle name(s), then report them using the First name field	max length = 255	N
28	Middle name(s)	Provide the legal middle name(s) of the authority	max length = 255	N
29	Surname	Surname or single name of the authority If the authority has only a single name, use this field to report the single name. Do not report the single name in the First or Middle name fields	max length = 255	Y
Where the authority is a person other than an individual				
30	Entity name of the authority	For cases where the authority is not a person but an entity, provide the name of the entity: e.g., for a law firm report the entity as per its registration	Max length = 255	Y
For all authorities: contact information				

No.	Field identifier	Field descriptor	Field attributes	Mandatory
31	Authority: Street number with unit	Street/house number and the unit or flat number in the postal address. Unit first then street number: e.g., 3/17 for unit number 3 and street number 17	max length = 50	N
32	Authority: Street name and type	Street name and type (such as street, road, crescent, etc.) of the postal address. This is also the field that will be used for a PO Box or Private Bag for the mailing address	max length = 255	Y
33	Authority: Suburb	Postal suburb. In case of a rural address, include the rural delivery (RD) number	max length = 255	Y
34	Authority: City/Town	City or town name of the postal address	max length = 255	Y
35	Authority: Post code	Post code for the postal address. If overseas, then report ZIP number in this field	max length = 10	Y
36	Authority: Country	This is the country for the postal address in ISO 3166-1 alpha-2 code format	max length = 2	Y
37	Authority: email address	Authority's primary email address	Max length = 255	Y
38	Authority: Phone number	Authority's primary contact number. Provide the complete phone number with country code: eg,+64276115878	max length = 20	Y
All depositors: deposit product information				
39	Product type	The type of product the account is, including all products that the depositor holds. This may also include credit facilities that are designed to hold a positive balance covered under the DCS	Factor	Y
40	Product name	Name of product	max length = 255	Y
41	Protected deposit	Confirm whether the product is a protected deposit using 'Yes' or 'No'	Yes: true No: false	Y
42	Relevant arrangements	Accounts that are relevant arrangements need to be identified	Yes: true No: false	Y
43	Account number	The unique account identification number	max length =	Y

No.	Field identifier	Field descriptor	Field attributes	Mandatory
		linked to the account	25	
44	Number of account holders	Report the number of account holders of an account. If the account has one owner/account holder, then "Account Holder Indicator" = 001. If the account has two owners/account holders, the "Account Holder Indicator = 002"	max length = 3	Y
Balances				
45	Account balance	The account balance is the amount of funds in the depositor's account that is in positive balance	Decimal (12,2)	Y
46	Accrued interest amount	The gross interest accrued but not credited to the account	Decimal (12,2)	Y
47	Tax amount on accrued interest	The tax amount owing on the accrued interest. (This is a derived field)	Decimal (12,2)	Y
48	Accrued interest net of tax amount	Interest amount payable to the depositor net of tax. (This is a derived field)	Decimal (12,2)	Y
49	Aggregate balance	The aggregate balance of the depositor's accounts under their unique identifier. Do not include balances that are relevant arrangements	Decimal (12,2)	Y
50	Aggregate accrued interest amount	The aggregate accrued gross interest of all accounts the depositor is entitled to under their unique identifier	Decimal (12,2)	Y
51	Aggregate tax amount on accrued interest	The aggregate tax owed on accrued interest from all deposit accounts. Do not include balances that are relevant arrangements	Decimal (12,2)	Y
52	Aggregate accrued interest net of tax amount	The aggregate accrued interest, net of tax, owing from all deposit accounts. Do not include balances that are relevant arrangements	Decimal (12,2)	Y
53	Aggregate compensation amount	This is the amount the depositor is entitled to under DCS for accounts that are not relevant arrangements This figure is either the aggregate balance plus aggregate accrued interest net of tax or	Decimal (12,2)	Y

No.	Field identifier	Field descriptor	Field attributes	Mandatory
		$100,00, whichever is the lesser		
Payment hold				
54	Payout hold status	A deposit taker must identify if there is a hold on a depositor or a block on the depositor's account, in which case the Reserve Bank may require further information before paying compensation Below is a list of the holds and blocks we have identified (but not limited to): • dormant account • deceased depositor • bankrupt depositor • depositor (or their account)is under legal dispute or is subject to restrictive measures imposed by national government agencies or international bodies. This will also include Anti Money Laundering (AML) related holds on the depositor • account contains, or may contain, deposits to which the account holder is not absolutely entitled If there is no hold on the depositor or account, then leave this field "blank"	Factor	N
Nominated account				
55	Active nominated account number	The nominated alternative deposit-taker account provided by the depositor, for example to transfer money after their term deposit matures.	Max length = 25	N
56	Nominated account name	The name of the nominated account.	Max length = 255	N

824. We are proposing that the SDV file contains information on all protected deposits held by the deposit taker. Depositors and deposits would be identified in the file as either eligible or ineligible for the DCS. This would allow the SDV file to be reconciled to the deposit taker's balance sheet and ensure all deposits are correctly classified.

825. Deposit takers' suspense accounts are to be included in the SDV file. Suspense accounts may relate to balances of eligible deposit accounts that may be unclaimed monies and/or balances in closed accounts for eligible depositors.

Account authority

826. This is for the identification of persons, other than the account holder, who have authority to operate the account and may be the person who collects the compensation on behalf of the account holder such as a power of attorney, parent/guardian of a minor or authorised persons for a business.

827. This information will need to be included in the SDV file to facilitate compensation payments.

Relevant arrangements

828. Section 191 of the DTA provides for deposits to be held under relevant arrangements, which are deposits held by regulated client money or property services (within the meaning of section 431W of the FMCA) and those that will be prescribed in regulations.

829. Relevant arrangement accounts, where known, will need to be identified in the SDV file.

830. Deposit takers are not required to hold the 'look-through' information on these accounts, except for accounts held by the deposit taker themselves, for example suspense accounts. For suspense accounts, and any other relevant arrangements held by the deposit taker, the look through information for these accounts is to be provided in a separate report at the same time as the SDV file.

Eligibility

831. We have included two variables for eligibility, one at the depositor level and one at the deposit level. This is because there will be eligible depositors, ineligible depositors, providers of relevant arrangements, and trustees (who would otherwise be ineligible depositors, for example, directors of a deposit taker).

Analysis

832. We consider that the each of the proposed variables are necessary to support financial stability by providing for the operation of the DCS.

833. Each of the proposed variables are included in the SDV file for at least one of the following reasons:

- identification of eligible depositors
- identification of protected deposits
- calculation of entitlement to compensation
- facilitation of payment of compensation
- accounting for legal obligations such as the payment of tax.

834. We have tried to minimise compliance costs by requiring variables only for one of the reasons above.

Summary

835. We are proposing that all deposit takers provide the list of variables above in their SDV files.

Q105	Do you have any comments on the proposed list of variables required for the SDV file?
Q106	Do you have any comments on the proposed fields for the variables, especially where they may be currently held as a string rather than individual fields? Would this requirement have any significant negative implementation or data quality impact?

6.3 SDV: file format and data model

836. We propose requiring the SDV file to be in JavaScript Object Notation (JSON) format, to minimise inconsistency. JSON is a lightweight formation for storing and transporting data. *See* Appendix 1 for examples of how we would expect the SDV to look in this format.

837. Appendix 2 shows examples of how we propose the SDV file should look in Excel format. Separate tables are shown for illustrative purpose only. When reporting, it is important to consolidate information into a single sheet.

Q107	Do you have any comments on the proposed requirement to use JSON as the file format?

6.4 SDV: testing

838. Testing of the SDV systems is crucial to ensure that reliable and accurate SDV data can be generated in a timely manner should it be required.

839. Deposit takers would be required to maintain up to date documented internal control processes and procedures for the production and testing of SDV files.

840. Testing of SDV files would require:

- generation of an SDV file that contains all the required variables including aggregate balances
- reconciliation of the SDV file with the deposit takers balance sheet
- a statistically significant check of individual records on the SDV file to ensure the information is accurate.

841. We may also request additional testing should a situation arise in which this is required for a specific reason (but would use this option in a proportionate manner).

842. We have considered three approaches to testing:

- combination deposit taker and regulator testing (our preferred approach)
- deposit taker self-testing
- regulator-led testing.

Preferred option

Combination deposit taker and regulator testing

843. This option would require all deposit takers to test their SDV file every six months. Testing would be as outlined in paragraph 840.

844. Under this approach we may require oversight of a licensed deposit taker's six-month test, to assess whether they are sufficiently prepared for a DCS compensation event.

845. We will require a de-identified SDV file from these deposit takers to enable us to undertake further testing of the end-to-end payment process.

846. We anticipate that no more than 2–4 deposit takers would be tested with our oversight every 6 months.

Alternative options

Deposit taker self-testing

847. This option would require all deposit takers to undertake a test of their SDV files every six months. The scope of the required testing would be as outlined above.

848. Deposit takers would be required to maintain a record of each test and the results. We may request a copy of the results.

849. To enable us to test the end-to-end payment process we may request a copy of the test SDV file. If such a request is made the deposit taker must send a de-identified SDV file to us.

Regulator-led testing

850. We have considered the option of regulator led testing but concluded it is not a viable option given the resource and cost it would entail for both us and the deposit takers.

Analysis

851. We consider that our preferred approach of a mix of deposit-taker self-testing and regulator-led testing would have low compliance costs for industry. A degree of regulator-led testing may lead to more consistent SDV files, and any issues with the quality of the SDV files may be identified earlier. This is important, as accurate and up to date SDV files are necessary to support public confidence in the DCS during a payout event.

Summary

852. We are proposing a mixture of requiring deposit takers to do self-testing and regulator led testing, as outlined above.

Q108	Do you agree that the option of combination deposit taker and regulator testing is appropriate? If not, which option would you prefer?

De-identification

853. Where the discussion above refers to data being de-identified we mean that the data must be altered or transformed in a way that makes it impossible to identify the individuals to whom it relates.

854. When considering whether personal information contained in the SDV file has been de-identified, there are three principles to consider: irreversibility, reasonable means and possibility of re-identification:

- Irreversibility: the de-identification process should be irreversible. Once the personal information is de-identified, it should not be possible to re-identify individuals using the remaining data alone or in combination with other information
- Reasonable means: de-identification should be carried out using reasonable means and methods appropriate to the nature of the personal information and the purpose for which it will be used
- Possibility of re-identification: the likelihood of re-identifying individuals from the de-identified information, considering the available or reasonably likely resources and techniques.

855. We propose that the method deposit takers use to de-identify their SDV file must take these principles into account.

7 Proposed approach for Group 2 and Group 3 deposit takers

Preferred option

856. We propose that Group 2 and Group 3 deposit takers are subject to the same SDV requirements as Group 1.

Analysis

857. We have considered how proportionality could be applied to the SDV. There is already a degree of in-built proportionality in compiling the SDV file related to the size and complexity of the deposit takers. For example, Group 3 deposit takers tend to have simpler systems, a smaller range of protected products and a lower number of depositors making the compilation of an SDV a simpler proposition. In-built proportionality will also carry through to the ongoing testing requirements. We have proposed the same frequency and requirements for all deposit takers as the resource and time required to complete this will reflect the size and complexity of the deposit taker.

858. We consider that the level and quality of testing should be the same so that depositors can receive a timely compensation payment no matter which deposit taker they have chosen to deposit with. We also expect that the compliance costs are likely to be naturally proportionate, as smaller deposit takers have a small depositor base, generally less complex system and simpler products.

Summary

859. We propose that Group 1, Group 2 and Group 3 deposit takers are subject to the same SDV requirements.

Q109	Do you agree with our assessment that the approach to SDV testing for Group 2 and Group 3 deposit takers should be the same as that for Group 1?

8 SDV: quarterly aggregate reporting for Group 1 deposit takers

860. Aggregate reporting for SDV data requirements is essential as it will serve as a critical element of the levy calculation process.

861. While the aggregate reporting is derived from the same sources of data used to produce the SDV file it is required for a different purpose. If executed at the same time the outcomes (aggregates) would be expected to be the same.

862. An aggregate report would contain the following information:

- aggregate balance of all deposits
- aggregate balance of all protected deposits
- total number of depositors
- total number of DCS eligible depositors
- aggregate balance of all 'relevant arrangement' accounts
- number of 'relevant arrangement' accounts.

863. We have identified two options for aggregate reporting.

Preferred option

864. Our preferred option would require deposit takers to build and maintain the capacity to report information on protected deposits at an aggregate level. The balance of aggregate reports would be required to align with SDV files.

865. We propose the aggregate report is produced and submitted to us quarterly.

866. We could consider whether this information is then included as part of another survey template.

Alternative option: Deposit takers to provide aggregate information as part of their SDV file

867. This approach would include the aggregate information as part of the SDV file, which would then be provided to the Reserve Bank twice a year. When an SDV file is being submitted for aggregate reporting purposes the file would need to be de-identified.

Analysis

868. Requiring deposit takers to maintain a system to report aggregate data is our current preferred option as it aligns with other reporting requirements, can be developed alongside the work on the SDV file and does not contain personally identifiable, or de-identified, information.

869. We consider that the alternate option is less appropriate as it would result in deposit takers providing information over and above the necessary aggregate information and contains individual information, albeit de-identified.

870. We are also interested in which approach you believe would have lower compliance costs.

Summary

871. We propose the deposit takers should maintain a system to report aggregate data, but we are interested in the compliance costs associated with this approach.

Q110	Do you agree with our preferred approach of requiring Group 1 deposit takers to maintain a system to report aggregate data? What compliance costs are associated with this approach?

9 Proposed approach for Group 2 and 3 deposit takers

872. We propose that Group 2 and 3 deposit takers are subject to the same requirements as Group 1, because aggregate reports are equally required from all deposit takers for levy purposes.

Q111	Do you agree with our preferred approach of requiring Group 2 and Group 3 deposit takers to maintain a system to report aggregate data? What compliance costs are associated with this approach?
Q112	Can you provide information on the compliance costs associated with aggregate reporting?

10 Conclusion

873. Our proposed DCS SDV standard would require deposit takers to produce an SDV file in line with the variable list provided. The file would need to be tested on a regular basis and quarterly aggregate reports would need to be provided to us.

874. We are seeking your feedback on the content and testing of the SDV file, whether the same SDV requirements should apply across all deposit takers, and the timing and method of aggregate reporting.

Appendix 1: Illustrated JSON data model

#	Field identifier in SDV file	Json variable names
1	Unique identifier	depositor.sdvid
2	Type of depositor	depositor.type
3	Depositor ineligibility reason	depositor.ineligibleReasons
4	First name of the depositor	depositor.firstName
5	Middle name(s) of the depositor (if applicable)	depositor.middleNames
6	Surname of the depositor	depositor.surname
7	Date of birth	depositor.dob
8	Organisation name	depositor.organisationName
9	New Zealand Business Number (NZBN)	depositor.nzbn
10	NZ Company Number	depositor.companyNumber
11	IRD number	depositor.irdNumber
12	Withholding tax rate	depositor.wtr
13	Prescribed investor rate (PIR)	depositor.pir
14	Preferred contact method	depositor.preferredContactMethod
15	Street number with unit	depositor.addresses.streetNumber
16	Street name	depositor.addresses.streetName
17	Suburb	depositor.addresses.streetName
18	City/Town	depositor.addresses.city
19	Post code	depositor.addresses.postCode
20	Country	depositor.addresses.country
21	Email address	depositor.emails.email
22	Phone number 1	depositor.phones.phone
23	Phone number 2	depositor.phones.phone
24	Vulnerability reason	depositor.vulnerableReasons vulnerableReason
25	Authority on account	authorities
26	Type of authority	authorities.type
27	First name(s) of the authority	authorities.firstName
28	Middle name(s)	authorities.middleNames
29	Surname	authorities.surname
30	Entity name of the authority	depositor.organisationName
31	Authority: Street number with unit	authorities.addresses.streetNumber
32	Authority: Street name	authorities.addresses.streetName
33	Authority: Suburb	authorities.addresses.streetName
34	Authority: City/Town	authorities.addresses.city
35	Authority: Post code	authorities.addresses.postCode
36	Authority: Country	authorities.addresses.country
37	Authority: email address	authorities.emails.email
38	Authority: Phone number	authorities.phones.phone
39	Product type	accounts.productType
40	Product name	accounts.productName
41	Product eligibility	account.accountIneligibleFlag
42	Relevant arrangements	account.relevantArrangementFlag
43	Account number	accounts.accountNumber

44	Number of account holders	account.numberAccountHolders
45	Account balance	account.balance
46	Accrued interest amount	account.accruedInterestamount
47	Tax amount on accrued interest	account.taxAmount
48	Accrued interest net of tax amount	account.netAccruedInterestAmount
49	Aggregate balance	depositor.aggregateBalances.aggBalance
50	Aggregate accrued interest amount	depositor.aggregateBalances.aggInterestAmount
51	Aggregate tax amount on accrued interest	depositor.aggregateBalances.aggtaxAmount
52	Aggregate accrued interest net of tax amount	depositor.aggregateBalances.aggNetInterestAmount
53	Aggregate compensation amount	depositor.aggregateBalances.compAmount
54	Payout hold status	depositor.payoutHoldReasons
55	Active nominated account	accounts.nominatedAccount.AccountNumber
56	Nominated account name	accounts.nominatedAccount.AccountName

Appendix 2: Illustrated Excel data model

Unique Identifier	Type of depositor	Depositor ineligibility reason	First name	Middle name(s)	Surname	Entity name	Date of birth	Vulnerability	NZBN
22001	Person		East	Ag	South		1901-01-03		
22001	Person		East	Ag	South		1901-01-03		
22001	Person		East	Ag	South		1901-01-03		
33002	Person		North		Example		1902-05-06	Hearing impairment	
33002	Person		North		Example		1902-05-06	Hearing impairment	
33002	Person		North		Example		1902-05-06	Hearing impairment	
2000003	Company					General Example Ltd			9429034324622
2000004	Government	Government Agency				NZ Crown Example			

NZCN	IRD Number	WTR	PIR	Preferred contact method	Street number with unit	Street name	Suburb	City/Town	Post code	Country	Email address
	123-123-123	0.33		Post	3/xyz	The Texxace	Wevvgdon	Wellington	1234	NZ	east@mail.example
	123-123-123	0.33		Post	3/xyz	The Texxace	Wevvgdon	Wellington	1234	NZ	east@mail.example
	123-123-123	0.33		Post	3/xyz	The Texxace	Wevvgdon	Wellington	1234	NZ	east@mail.example
	124-124-124	0.33		Email	4/abc	Alxxy Way	Chyyton Park	Auckland	4567	NZ	nor.w@mail.example
	124-124-124	0.33		Email	4/abc	Alxxy Way	Chyyton Park	Auckland	4567	NZ	nor.w@mail.example
	124-124-124	0.33	0.28	Email	4/abc	AlxxyWay	Chyyton Park	Auckland	4567	NZ	nor.w@mail.example
	125-125-125	0.28		Email	10/aaa	Example Road	Arox Valley	Westport	7899	NZ	Genl.w@mail.example
				Email	11/sss	Example Road	Arox Valley	Nelson	7890	NZ	Nz.agy@mail.example

Phone number 1	Phone number 2	Authority on account	Type of authority	First name of authority	Middle name(s) of authority	Surname of authority	Entity name	Authority street number & unit	Authority street name	Authority suburb
+64212##67	+6412345y9	No								
+64212##67	+6412345y9	No								
+64212##67	+6412345y9	No								
+642124##55		Yes	POA				Easxt Law	8/dfg	Baxxt Drive	Chstxxt Park
+642124##55		Yes	POA				Easxt Law	8/dfg	Baxxt Drive	Chstxxt Park
+642124##55		Yes	POA				Easxt Law	8/dfg	Baxxt Drive	Chstxxt Park
+6423##999		No								
+6458##567		No								

Authority City	Authority post code	Authority country	Authority email address	Authority phone number	Product type	Protected deposit	Account number	Number of account holders	Payout hold status
					Current Account	Yes	99-9999-01	001	
					Premium Account	Yes	99-9999-02	001	
					Premium Saver	Yes	99-9999-03	002	
Wellington	2589	NZ	Elawz@example.mail	+648952ss4	Premium Saver	Yes	88-8888-01	001	
Wellington	2589	NZ	Elawz@example.mail	+648952ss4	ABC Term Account	Yes	88-8888-02	001	
Wellington	2589	NZ	Elawz@example.mail	+648952ss4	JB C Pie Fund	Yes	77-8888-01	001	
					CDD Term Account	Yes	88-9999-02	001	Court order
					CDD Term Account	Yes	88-6666-05	001	

Relevant Arrangement	Nominated account name	Nominated account number	Account balance	Accrued interest	Accrued interest tax	Accrued interest net of tax	Aggregate balance	Aggregate accrued interest
No			2000.00	10	0.33	9.67	16,000.00	110.00
No			4000.00	0	0	0	16,000.00	110.00
No			10,000.00	100	25.00	75.00	16,000.00	110.00
No			10,000.00	100	5	0	12.500.00	100
No	North West	33-4444-55	2,000.00	0	0	0	12,500.00	0
No			500.00	0	0	0	12,500.00	0
No			500,000.00	500	50	450	500,000.00	500
No			150,000.00	150	20	130	150,000.00	150

Aggregate tax on accrued interest	Aggregate accrued interest net of tax	Aggregate compensation amount
25.33	84.67	16,084.67
25.33	84.67	16,084.67
25.33	84.7	16,084.67
5	95	12,595.00
0	0	12500.00
0	0	12500.00
50	450	100,000.00
20	130	0

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 4

Deposit Takers Disclosure Standard

Deposit Takers Core Standards Consultation

16 May 2024

CONSULTATION PAPER

Non-technical summary

Disclosure requirements are our main regulatory tool to make private information about a deposit taker publicly available. Disclosure contributes to financial stability through enabling market participants to scrutinise a deposit taker's business and then to exert market discipline on the deposit taker.

The proposed Disclosure Standard covers what information deposit takers must make publicly available, and how and when they must do so. The proposed standard will replace the existing prudential disclosure requirements for banks, branches of overseas incorporated banks and NBDTs.

We propose that for both Group 1 and Group 2 deposit takers we largely adopt the current bank disclosure regime. This regime works well with no significant known issues. It requires a bank to (among other things):

- publish full- and half-year disclosure statements as per requirements outlined in the relevant Order in Council (**OIC**) issued under section 81 of the BPSA[120]
- supply information to us under section 93 of the BPSA, of which we publish key prudential metrics in our quarterly Bank Financial Strength Dashboard (the **Dashboard**).[121]

For Group 1 and Group 2 deposit takers we propose 2 options:

- **Option A – the carry over approach** that would see the current bank disclosure regime translated into a Disclosure Standard under the DTA
- **Option B – the carry over with minor revisions approach,** which is the same as the carry over approach except that it also takes the opportunity to make simple tidy-ups and improvements.

We prefer Option B as it makes little change to the compliance costs imposed on Group 1 and Group 2 deposit takers, while more effectively supporting financial stability than Option A.

For Group 3 deposit takers we propose 2 options:

- **Option C – the Dashboard only approach** which is the same as Option B for Group 1 and Group 2 deposit takers except that it only requires disclosure through the Dashboard and does not require the preparation of disclosure statements
- **Option D – the "Bank-lite" approach** which is the same as Option B for Group 1 and Group 2 deposit takers except that it only requires one full-year disclosure statement instead of both half- and full-year disclosure statements.

We consider that both Option C and Option D adequately support market discipline and promote financial stability, but also recognise that Option C presents certain data-quality challenges. We welcome your feedback on how these data-quality challenges for Option C could be addressed.

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[120] Reserve Bank of New Zealand. (2022, 14 December). *Disclosure Requirements.* https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/disclosure-requirements

[121] Reserve Bank of New Zealand. (2023, 31 December). *Bank Financial Strength Dashboard.* https://bankdashboard.rbnz.govt.nz/summary

1 Introduction

875. Our prudential regime is based on the well-established 3 pillars framework of prudential regulation and supervision:[122]

- Regulatory discipline, which refers to the role of our mandated rules and requirements to support the safety and soundness of individual deposit takers and the stability of the financial system as a whole
- Self-discipline, which refers to the responsibility of senior management and directors for a deposit taker's own processes and risk management frameworks
- Market discipline, which refers to the way in which market participants influence a deposit taker's behaviour by monitoring its risk profile and financial position.

876. The internationally recognised Basel Core Principles state that one of the preconditions for effective banking supervision is effective market discipline which depends on timely, accurate and understandable information for market participants, including depositors.[123] In its 2017 FSAP report the IMF found our disclosure regime to be materially compliant with the Basel Core Principles.[124]

877. The proposed Disclosure Standard, to be made under Part 3 of the DTA, will be our main regulatory tool to promote market discipline for deposit takers. Effective disclosures promote financial stability by enabling market participants to scrutinise deposit takers' business activities and incentivise deposit takers to operate in a prudent manner.

1.1 Purpose of the Disclosure Standard

878. Market participants (which include depositors) need access to timely, accurate, and understandable information to make informed decisions in relation to deposit takers, and effectively influence deposit takers' behaviour. However, it is important that our Disclosure Standard does not impose unnecessary costs on deposit takers while still requiring the disclosure of information necessary for market participants to assess a deposit taker's soundness. Furthermore, it is important that we account for the broad range of market participants who may rely upon deposit-taker disclosures.

879. Without regulatory intervention, it would be more difficult for market participants to assess the risks of different deposit takers, and deposit takers could be incentivised to withhold information from market participants if disclosing the information could be detrimental to their business. This disparity in information between deposit takers and market participants is an example of 'information asymmetry' that could cause market inefficiencies or even contribute to failures. Information asymmetries are not just damaging to consumers and public confidence but can also lead to misallocation of an economy's resources and amplify a

[122] For more information on the three pillars of prudential supervision *see* Fiennes, T. (2016, 1 September). *New Zealand's evolving approach to prudential supervision*. Reserve Bank of New Zealand. https://www.rbnz.govt.nz/hub/publications/speech/2016/speech2016-09-01

[123] Bank for International Settlements. (2020, 30 July). *Basel Core Principles*. https://www.bis.org/fsi/fsisummaries/bcps.htm

[124] Reserve Bank of New Zealand. (2022, 28February). *Financial Sector Assessment Programme.* https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/financial-sector-assessment-programme

severe downturn in the real economy. The aim of our Disclosure Standard is to address these information asymmetries.

880. The proposed standard would protect and promote financial stability through enhancing market discipline. With effective disclosure, market participants can make well-informed choices on the financial products and institutions in which they invest. Correspondingly, deposit takers are more likely to take prudent actions (including effectively managing capital, liquidity and risk) to remain financially sound in order to attract that investment. Deposit takers themselves are also market participants and they compete with each other to attract investment, i.e., market discipline can exert itself through competition.

881. We therefore consider that the proposed Disclosure Standard is necessary to address the information asymmetry between market participants and deposit takers that, in the absence of intervention, could otherwise lower the effectiveness of market discipline and create risks to financial stability.

Public disclosure versus private reporting to the Reserve Bank

882. The proposed Disclosure Standard requires a deposit taker to make certain prudential and financial information publicly accessible (**public disclosure**). This differs from the purpose of other information sources and types of disclosure, such as:

- mandatory financial reporting designed to facilitate investors to make informed investment decisions
- director and CEO remuneration disclosure under the corporate governance code recommendations for companies listed on the NZX to foster investor confidence that remuneration is fair and reasonable[125]
- mandatory climate-related disclosures that support the allocation of capital towards activities consistent with transition to a low-emissions, climate-resilient future
- the information currently supplied to us by banks (**private reporting**) under section 93 of BPSA, which provides us with the data we need to supervise and enforce our prudential regulations effectively.

883. Each of these examples requiring disclosure of otherwise privately held information is done for its own purpose and typically for the benefit of different primary audiences. Despite these differences, they can often be used to support the same outcomes. For example, information from disclosure statements complements our private reporting requirements, and so both help us to supervise entities.

884. For the purposes of this Consultation Paper, our proposed Disclosure Standard focuses solely on public disclosure, though we discuss the legal mechanism of the Dashboard in section 1.3 below. Determining what private reporting may be required under the DTA will be consulted on during the exposure draft consultation phase, including what specific power under the DTA (through a standard or other legislative mechanisms) would be most appropriate to use to facilitate private reporting.

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[125] NZX. (2023, 1 April). *NZX Corporate Governance Code*. https://www.nzx.com/regulation/nzx-rules-guidance/corporate-governance-code

1.2 Current approach

Current disclosure regime for banks

885. Apart from the Dashboard and breaches registers, our current disclosure regime for banks was introduced in 1996. We require certain prudential and financial information be disclosed to market participants (see summary in Table AH below). Specifically, we require banks to:

- publish full- and half-year disclosure statements as per requirements outlined in the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (or the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014)[126]
- publish their disclosure statements (including its Conditions of Registration) on their websites and make these available in hard copy when requested[127]
- supply information to us under section 93 of the BPSA (some of which we use to publish key prudential metrics in our quarterly Dashboard)[128]
- if there has been a material breach of their Conditions of Registration disclose this in their Disclosure Statements (and in addition, we publicly record this on our Material Breaches Register[129] or Enforcement Register[130] (as appropriate)).

Table AH: Summary of the current state of the disclosure regime for banks

	The Dashboard*	Disclosure Statements
How is the information disclosed?	Information supplied to us by banks is then published by us on our Dashboard website	Disclosure statement document
How is data quality assured?	No assurance required	External review for half-year statements; An external audit for full-year statements; and Director attests to its accuracy

[126] Reserve Bank of New Zealand. (2022, 14 December). *Disclosure Requirements.* https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/disclosure-requirements

[127] Banks disclosure statements are also linked in our Bank Register. *See* Reserve Bank of New Zealand. (2024, 9 February). *Registered banks in New Zealand).* https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/registered-banks-in-new-zealand]

[128] Reserve Bank of New Zealand. (2023, 31 December). *Bank Financial Strength Dashboard..* https://bankdashboard.rbnz.govt.nz/summary

[129] Reserve Bank of New Zealand. (2024, 6 March). *Material breaches of key bank prudential requirements.* https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/how-we-regulate-and-supervise-banks/material-breaches-of-key-bank-prudential-requirements

[130] Reserve Bank of New Zealand. (2024). *Enforcement Register.* https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/enforcement/enforcement-register#sort=%40computedsortdate%20descending

	The Dashboard*	Disclosure Statements
What information is disclosed	~110 key prudential metrics[131]	Comprehensive quantitative and qualitative information as per requirements in the relevant OIC under section 81 of the BPSA
When is information disclosed?	Quarterly; and Published by us on our Dashboard website 40 working days after quarter end. There are operational timing requirements banks must meet during this 40 working day period	Semi-annually – one half-year and one full-year disclosure statement; and Published within 3 months of reporting date for full year disclosure statements and within 2 months of reporting date for half year disclosure statements

* Note: the Dashboard requirement is only applicable locally incorporated banks.

Current disclosure regime for branches

886. The disclosure regime for branches is the same as for locally incorporated banks except branches do not have their information published on the quarterly Dashboard. We also require slightly different information in branches' disclosure statements compared to locally incorporated banks' disclosure statements.[132]

Current disclosure regime for NBDTs

887. The disclosure regime for NBDTs is set out in the FMCA, which requires preparation and publication of Product Disclosure Statements (PDSs) for the financial products they offer (as well as the publication of certain information on the Disclose Register administered by the New Zealand Companies Office). PDSs include certain prudential disclosures (for example, about capital and related party exposures), alongside the information that all issuers of debt securities are required to disclose under the FMCA.

888. NBDTs provide information to us under Part 3 of the NBDT Act. Separately, NBDTs report to trustee supervisors as required under Part 4 of the FMCA. The current state of the disclosure regime for NBDTs is summarised in Table AI below.

889. These current FMCA requirements will not apply to any licensed deposit taker including those that were formerly NBDTs.

[131] All the current metrics can be downloaded from the Dashboard website under "Just give me all the data". Linked here: [Reserve Bank of New Zealand. (2024). *Bank Financial Strength Dashboard Data.* https://bankdashboard.rbnz.govt.nz/datafiles/Bank-Financial-Strength-Dashboard-Data.xlsx]

[132] Working copy linked here: Reserve Bank of New Zealand. (2022, 14 December). *Disclosure Requirements.* https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/disclosure-requirements]

Table AI: Summary of the current state of the disclosure regime for NBDTs

	Information supplied to trustee supervisors	Information supplied to the Reserve Bank	Product Disclosure Statements
How is the information disclosed?	Reporting requirements in the trust deed.[133] Reporting requirements under the FMC Act.[134]	Prudential Monitoring Survey for NBDTs	PDS documents (as well as the Disclose Register entries)
How is data quality assured?	No regulated requirements.	No assurance required.	No assurance required (although the financial statements need to be prepared in accordance with financial reporting requirements which require an audit).
What information is disclosed	Some financial metrics are required.	~129 prudential metrics.	Some entity-based quantitative metrics, and comprehensive qualitative and some quantitative information about the debt securities being offered.
When is the information disclosed?	Monthly; and	Monthly; and	As and when offering certain debt securities to investors.
	Within 30 days of month-end.	Within 20 days of month-end.	

1.3 Proposed policy development approach

890. We propose that Group 1 and 2 deposit takers and branches have the same disclosure regime while Group 3 deposit takers have a simplified version of that same regime.

Consideration of the Proportionality Framework

891. There is a natural alignment between the Proportionality Framework's 3 Groups of deposit takers and the current disclosure regimes for banks and NBDTs. Groups 1 and 2 comprise the banks captured under the current bank disclosure regime, excluding the 2 smallest banks. Group 3 comprises the NBDTs captured under the current NBDT disclosure regime, plus the 2 smallest banks.

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[133] *See* Financial Markets Conduct Regulations 2014 (as at 15 March 2024), clause 74 *Trust deed for debt security must provide for certain matters*. New Zealand Legislation. https://www.legislation.govt.nz/regulation/public/2014/0326/latest/DLM6293223.html

[134] *See* Financial Markets Conduct Regulations 2014 (as at 15 March 2024). clause 76 *Reports by NBDT*. New Zealand Legislation. https://www.legislation.govt.nz/regulation/public/2014/0326/latest/DLM6293225.html

892. Having two distinct disclosure regimes for deposit takers is not desirable in terms of consistent treatment of similar institutions and because it could impede competition by making information less comparable and understandable for market participants (including depositors). We consider it desirable to have a single coherent regime across all deposit takers rather than maintaining 2 distinct regimes. This is also consistent with international good practice, in particular with the Basel III Guiding Principles 1 and 5 for disclosure[135] which notes that any regime should be clear and comparable across deposit takers. We have assessed this approach (see discussion below on the proposed options for Group 3) as not imposing a significant increase in compliance costs, given the existing disclosure requirements for Group 3 entities. Therefore, we propose using the current bank disclosure regime as a starting point for all deposit takers from which to develop our approach proportionately.

Approach to options analysis

893. We used 4 factors to compare the key differences between Disclosure Standard options:

- Mode is concerned with how information is disclosed
- Assurance sets the acceptable level of quality checking for the information disclosed
- Content answers what information is disclosed
- Timing covers when information is disclosed and includes both the frequency and timeliness of disclosure.

894. While these 4 factors allow us to calibrate a Disclosure Standard for different Groups of deposit takers, we also consider that consistency and comparability in treatment of disclosures is necessary to ensure effective market discipline. We consider that the international standard of disclosure being 'clear and comparable' across deposit takers is a key aspect of making disclosure understandable. We think it is desirable to improve clarity and comparability, which will also improve access to understandable information to help depositors in their decision making. To help achieve this, we propose to streamline the set of available options considered to better accommodate the Proportionality Framework. We propose that the Disclosure Standard:

- is an entity-based regime: we use the term 'entity-based' in the sense that the current bank disclosure regime is 'entity-based' (i.e., it requires information about the deposit taker). This is in contrast to the 'product-based' regime for NBDTs under the FMCA (that requires a PDS for offers of financial products instead)
- focuses on a combination of the disclosure statement and Dashboard for the mode
- depending on the mode, requires the same level of assurance, content and timeliness (but not necessarily frequency) for that mode. Assurance factor settings are discussed in more detail below.

[135] The Basel III Guiding Principles 1 and 5 for disclosure *see* Bank for International Settlements. (2021, 11 November). *DIS - Disclosure requirements*. https://www.bis.org/basel_framework/chapter/DIS/10.htm]

895. This approach allows us to treat all deposit takers consistently and coherently and helps avoid unnecessary compliance costs. It also ensures that disclosures made by different deposit takers are clear and comparable (as per international good practice).

896. Under this approach the only differences in disclosure requirements between Groups 1, 2 and 3 deposit takers will be the mode and frequency of disclosure.

Assurance settings

897. We use the concept of assurance to refer to the process of checking the quality, accuracy and precision of prudential disclosures. In the current bank disclosure regime, there are 2 'assurance' mechanisms that we rely on to achieve our desired level of assurance: external audits and reviews, and director attestations. For all deposit takers, we propose that the Disclosure Standard's assurance settings:

- require an external audit of full-year disclosure statements and a review for half-year disclosure statements (as are currently required for disclosure statements)
- not include requirements for director attestations on the accuracy of public disclosure and compliance with prudential requirements (instead we will rely on the directors' and New Zealand chief executive officers' due diligence duty under subpart 3 of Part 3 of the DTA, which imposes a duty on directors to ensure compliance with prudential requirements and imposes and penalty on directors for failure in relation to the duty)
- include new requirements (*see* Appendix 3 change item 6 for Groups 1–3 and Appendix 4 change item D for branches) for deposit takers to:
    - produce a board-approved disclosure policy about internal controls and procedures
    - internally review the disclosure policy on a 3-year cycle and whenever there is a material change in circumstances that might affect the appropriateness of the policy.

898. This approach to assurance settings:

- improves the clarity of assurance requirements (which avoids unnecessary compliance costs)
- supports consistency of treatment across deposit takers
- helps focus directors on strategic issues and oversight of management which supports sound governance of deposit takers
- likely lower compliance costs through removing director attestations. (We expect this to represent a net decrease in costs even with the addition of a periodically reviewed and board-approved disclosure policy).

899. Having these assurance settings helps ensure the reliability of disclosed information and consistency in treatment of disclosures across all Groups of deposit takers (which in turn improves depositors' access to understandable information). For example, where full-year disclosure statements are required, we consider it is desirable that they are prepared in a consistent manner for all relevant deposit takers.

900. Under this approach, assurance settings for different groups of deposit takers will depend on whether deposit takers in those groups are required to produce both a disclosure statement and information for the Dashboard or just one of these modes.

Q113	How frequently and to what standard should we require a review of the proposed board-approved disclosure policy for deposit takers?

Operation of the Dashboard

901. Currently, we use the Dashboard to publicly disclose the information supplied to us by banks under section 93 of the BPSA, which will be repealed at the commencement of the DTA. We intend to consult on whether to rely on our private reporting powers under the DTA or to require reporting via a standard to support the operation of the Dashboard as part of the exposure draft consultation phase in 2025.

2 Proposed approach for Group 1 deposit takers

2.1 Group 1 options

902. We propose that the Disclosure Standard requirements for Group 1 deposit takers is a choice between 2 options:

- Option A – the carry over approach, which would see the current bank disclosure regime[136] carried over into the proposed Disclosure Standard. It would also see the Dashboard continue as currently.
- Option B – the carry over with minor revisions approach, which is the same as the carry over approach except that it also takes the opportunity to make minor additions and technical improvements to existing requirements.

Preferred option

903. We prefer Option B, to translate the current bank disclosure regime into a standard while also making minor and technical revisions to both the disclosure statement and Dashboard requirements. Where necessary, we will also incorporate any changes to disclosure to align with the other standards (for example, a change in capital requirements may influence what capital information should be disclosed). Table AF below illustrates Option B against our 4 factors. The main alternative for Group 1 is Option A, the current state, but issued under the DTA as a standard instead of OICs under the BPSA. Table AD above illustrates Option A as it is effectively identical to the current bank disclosure regime.

904. Our proposed minor and technical revisions in Option B are summarised in Appendix 3. They are cross-referenced to the current OICs if they have an equivalent clause.

905. The minor revisions found in Appendix 3 would require deposit takers to:

[136] Set out in the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014

- link to the Dashboard on their website and to note in disclosure statements where the Dashboard can be accessed (the URL) (see change item 1)
- note in disclosure statements that historical financial statements are available via the Dashboard (see change item 2)
- use a standardised template or style for presenting the information in disclosure statements (see change item 3 (and item A in Appendix 4))
- disclose the remuneration of a deposit taker's CEO and executive management (see change item 4 (and item B in Appendix 4)[137]
- disclose a small number of additional metrics in the Dashboard and in disclosure statements, including (see change item 5 (and item C in Appendix 4))
    - credit risk indicators, such as debt-to-income measures and the flow of new mortgage lending commitments (consistent with the LVR policy)
    - more detail for measuring compliance with the proposed Liquidity Standard under the DTA, including period highs and lows for the core funding ratio and mismatch ratios.

Table AJ: Summary of the preferred Option B for Group 1 deposit takers.

Factors		**Carry over with minor revisions**	
Mode		Dashboard and	Disclosure statements
Assurance		No assurance required (no change proposed)	External review for half-year statements An external audit for full-year statements (no change proposed).
Content		About 110 key prudential metrics + minor revisions (as per Appendix 3)	Minor revisions to the current OICs (as per Appendix 3)
Timing	Frequency	Quarterly (no change proposed)	Semi-annually – one half-year and one full-year (no change proposed)
	Timeliness	Published 40 working days after quarter end (no change proposed)	Published within 3 months of the reporting date for full year disclosure statements and within 2 months of the reporting date for half year disclosure statements (no change proposed)

[137] Note that for those deposit takers listed on the NZX or subject to APRA's regulations, disclosure of director and executive remuneration may already be required (in some manner).

Analysis

Proportionality Framework

906. When applying the Proportionality Framework to the current bank disclosure regime we conclude that it is both strong and comprehensive, as per Option A in Table AK below. As the current bank disclosure regime works well already, we believe that it will remain a proportionate approach for Group 1 deposit takers. Therefore, we consider that both Option A or B provide an appropriate balance between the compliance costs of the disclosure regime and the potential risks to financial stability posed by Group 1 deposit takers.

Table AK: Group 1 deposit taker options compared with the Proportionality Framework's dimensions

Options	Strength dimension	Comprehensiveness dimension
A – The pure carry over approach	Strong	Comprehensive
B – The carry over and minor revisions approach	Strong	Comprehensive

Costs and benefits

907. We consider that the existing disclosure requirements for Group 1 deposit takers are generally fit for purpose. The IMF in its 2017 FSAP report found that our disclosure requirements are committed to achieving high-quality public disclosure by banks in line with international standards and practices. Since that review we have introduced the Dashboard to further support depositors and other market participants with access to understandable information to support their decision-making. We therefore consider that the existing compliance costs are justified as they support the accessibility of information for depositors.

908. We expect Option B for Group 1 deposit takers will result in minimal changes to long-run compliance costs relative to the long-run costs of current disclosure requirements. This is because we are not proposing any significant changes or additions to the existing bank disclosure regime, so most of the information required for the preferred option is already being disclosed. In our view the compliance costs of this option would not be significant and would mostly arise from one-off costs associated with incorporating the changes into Group 1's existing disclosure processes. The continuing compliance costs thereafter would be similar to current costs.

909. We consider that the preferred option presents some meaningful benefits to market discipline over the alternative option because the proposed minor and technical revisions (including standardising the presentation of disclosure statements and general revisions) are expected to improve access to timely, accurate and understandable information for market participants (including depositors). The proposed additional metrics for the Dashboard and disclosure statements are also expected to increase the benefits to market discipline at the margin.

Summary

910. In summary, we consider that our preferred Option B implies little change in the compliance costs imposed on Group 1 while increasing the benefits to market discipline and hence financial stability. We consider that this carry over with minor revisions option is appropriate given our view that current disclosure settings for registered banks are working well and there are no significant known issues with them.

Q114	Do you agree we have the right set of options for Group 1 deposit takers?
Q115	Do you agree with our assessment of the costs and benefits of these options for Group 1 deposit takers?

3 Proposed approach for Group 2 deposit takers

911. Our preferred option for Group 2 deposit takers is Option B, the same as for Group 1 deposit takers.

912. When applying the Proportionality Framework to the current bank disclosure regime we consider that it is both strong and comprehensive, as per Option A in Table AK above. As the current bank disclosure regime works well already, we believe that Option B (which carries over the current regime with some enhancements) is an appropriate approach for Group 2 deposit takers. Therefore, we consider it proportionate and desirable to apply the same disclosure regime to Group 2 deposit takers as we propose for Group 1 deposit takers.

913. In summary, our preferred Option B implies little change in the costs imposed on Group 2 deposit takers while providing meaningful benefits to market discipline and hence financial stability. We consider that this carry over with minor revisions option is appropriate given our view that current disclosure settings for banks are working well and there are no significant known issues with them.

Q116	Do you agree with our proposal to have the same approach to disclosure requirements for Group 2 deposit takers as we propose for Group 1?

4 Proposed approach for Group 3 deposit takers

4.1 Group 3 options

914. We consider that the Disclosure Standard requirements for Group 3 deposit takers could be one of the 2 options summarised below. Specifically, either:

- Option C – the Dashboard only approach, which is a proportionally adjusted version of our preferred Option B for Group 1 and Group 2 deposit takers that only requires disclosure through the Dashboard and no requirement for any disclosure statement document.

- Option D – the 'Bank-lite' approach, which is a proportionally adjusted version of our preferred Option B for Group 1 and Group 2 deposit takers that only requires one full-year disclosure statement instead of both half- and full-year disclosure statements. The proposed Dashboard requirement under this approach remains the same as in Option B.

915. Under both Options, the same minor additions and technical improvements proposed for Option B would also be included. These changes are discussed in Appendix 3 and paragraphs 904 and 905 above.

916. For Group 3 deposit takers we consider that Options C and D adequately support market discipline and promote financial stability, but also recognise that Option C (the Dashboard only approach) presents certain data quality challenges. We welcome your feedback on how these data quality challenges for Option C could be addressed.

917. Regardless of our final decision, we would also incorporate any changes needed to disclosure requirements in order to align with any changes in Group 3 prudential requirements under the other DTA standards where necessary. For example, changes to capital requirements may create the need to change the capital information that is disclosed.

Analysis

918. The analysis presented here compares Options C and D against the Proportionality Framework and our 4 factors to provide a sense of the relative costs and benefits that we consider are relevant for calibrating a disclosure standard for Group 3 deposit takers (*see* Tables AL and AM). Our approach shows the relative differences between Options C and D and compares them with the current NBDT regime.

Proportionality Framework

919. We compare the Group 3 options and Group 1 and 2 options against the Proportionality Framework's dimensions in Table AL below.

920. We have considered applying Options A or B to Group 3 deposit takers rather than Options C or D but consider that they would be disproportionate to the risks Group 3 deposit takers pose to financial stability (whereas Options C and D are more proportionate to those risks).

921. We also note that regardless of the option chosen Group 3 deposit takers may voluntarily comply with the higher Group 1 and 2 requirements if they so wish. For example, this might be done to provide additional assurance to market participants or as an indicator of their future growth aspirations. Alternatively, any deposit taker may disclose information above and beyond our proposed requirements if they so choose and so long as the information is not false or misleading (as is the case under the current bank regime).[138]

[138] Reserve Bank of New Zealand. (2022, December 14). *Disclosure Requirements.* (Part 2, subpart 1, clause 14(b)). https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/disclosure-requirements

Table AL: Group 3 deposit taker options compared against the Proportionality Framework's dimensions

Options	Strength dimension	Comprehensiveness dimension
A – The pure carry over approach	Strong	Comprehensive
B – The carry over and minor revisions approach	Strong	Comprehensive
C – The Dashboard approach	Medium	Simple (>Minimum)
D – The Bank-lite approach	Strong	Medium

Mode

922. In comparing options C and D with the current requirements for NBDTs, we consider that the Dashboard and PDS are functionally similar as they both present financial and prudential information. The PDS has more qualitative information about the product and the entity while the Dashboard present more prudential information about the entity. They also differ in their focus: the PDS is focused on consumer protection at a product level, while the Dashboard is focused on disclosure of prudential information at an entity level for financial stability purposes. Although a direct comparison is difficult, we think the Dashboard is at least as effective as the current PDS-based regime in supporting market discipline. Depending on the frequency of changes to the PDS it is possible that the compliance costs for the Dashboard may be lower and we would welcome your views on this.

923. The only practical difference between Options C and D is the requirement for a disclosure statement. Under Option D, we would not expect a significant difference in compliance costs arising from producing an annual disclosure statement compared to the preparation and publication of PDS for the financial products NBDTs offer under current requirements (see paragraphs 887 and 888).

Table AM – Summary comparison of the 2 options proposed for Group 3 deposit takers

Factors	Option C – Dashboard only approach	Option D – Bank-lite approach	
Mode	Dashboard	Dashboard and	Disclosure statement
Assurance	No assurance required	No assurance required	An external audit for full-year statement

Factors		Option C – Dashboard only approach	Option D – Bank-lite approach	
Content		About 110 key prudential metrics[139] plus minor revisions (as per Appendix 3)	About 110 key prudential metrics[140] plus minor revisions (as per Appendix 3)	Minor revisions to the current OICs (as per Appendix 3)
Timing	Frequency	Quarterly	Quarterly	Annual only – one full-year statement only
	Timeliness	Published 40 working days after quarter end	Published 40 working days after quarter end	Published within 3 months of balance date

924. We consider requiring that Group 3 deposit takers to use either or both the Dashboard and a disclosure statement to disclose prudential information will improve consistency of treatment across all deposit takers and improve depositors' access to understandable information to help them to make decisions, as noted in paragraphs 899 and 900. Additionally, the Dashboard would improve accessibility to this information for market participants (including depositors) when compared to the current NBDT disclosure regime by consolidating information about all deposit takers in one place. We therefore consider that both options would have little to no impact on the diversity of the deposit-taking sector and access to financial products and services for New Zealanders.

Q117	Are we correct in our comparison of relative costs between our proposed disclosure options for Group 3 deposit takers and the current disclosure regime for NBDTs? Please provide quantitative evidence to support your position.

Assurance and data quality

925. We consider that data quality is important to the effectiveness of disclosures in supporting market discipline and promoting financial stability. One effective way of assuring the quality of data is through external audits.

926. We consider that an external audit of the full-year disclosure statement – under Option D – would contribute to high quality information being published on the Dashboard. This audited information provides an anchor point to test the Dashboard's prudential data against and incentivises deposit takers to ensure high-quality prudential disclosures through self- and market discipline. We acknowledge that this level of assurance comes with additional compliance costs but note it is only additional with regards to the prudential information. This is because our proposed disclosure requirements have significant overlap with the already audited information required for mandatory financial statement reporting.

[139] All the current metrics can be downloaded from the Dashboard website under "Just give me all the data". *See* Reserve Bank of New Zealand. (2024). *Bank Financial Strength Dashboard Data.* https://bankdashboard.rbnz.govt.nz/datafiles/Bank-Financial-Strength-Dashboard-Data.xlsx]

[140] See footnote above.

927. We acknowledge that Option C does have an assurance anchor point but only for the data that overlaps with a deposit taker's externally audited annual financial statements. This gives a high level of assurance of the quality of financial information but not the additional prudential information, such as capital and liquidity metrics, that would be disclosed on the Dashboard. However, we also acknowledge that deposit takers have strong incentives to provide high quality data with the awareness that the data would be published on the Dashboard.

928. An alternative approach under Option C, would be to require an annual external audit of the Dashboard data to provide an independent assurance of its quality. This means that we would not need to rely on an externally audited annual disclosure statement as an anchor point (as in Option D). However, we think introducing an external audit requirement for the Dashboard data might make Option C's costs and benefits practically indistinguishable from Option D.

929. Other methods to ensure high quality data is provided for the Dashboard include direct engagement between us and deposit takers about our reporting requirements and data quality expectations. We could also consider an escalated response using enforcement-like options (such as temporarily requiring external audit reports) if we are concerned that there were a pattern of low-quality data being reported.

930. We consider that the trade-off between the level of assurance that the two options provide, along with the associated compliance costs, are the key issues in determining the preferred approach going forward.

Q118	What assurance methods other than regular external auditing of the data provided for the Dashboard should we consider? Please provide specific evidence of the costs and benefits relative to Option D's externally audited annual disclosure statement.

Content

931. Our analysis shows that over half of the Dashboard's current 110 metrics are likely to be directly transferable or derivable from the data NBDTs already privately report to us, and it is likely that the Dashboard's other metrics can also be derived from data supplied by NBDTs.[141] On this basis, it is likely that the compliance costs of providing metrics for a Dashboard are broadly similar to current costs of private reporting to us.

932. As noted earlier, disclosure statements are comprehensive and focused on quantitative prudential information about the deposit takers in contrast to PDS requirements which are mostly qualitative information on offers of financial products. Although Group 3 deposit takers may need to disclose somewhat different information for a disclosure statement under Option D (compared to the current NBDT disclosure regime), this new information is also likely to be similar to information already supplied to us by NBDTs. This suggests that the change in content that a Group 3 deposit taker may be required to publish in a disclosure statement compared to a PDS might not result in significantly increased compliance costs.

[141] All the current metrics can be downloaded from the Dashboard website under "Just give me all the data". *See* Reserve Bank of New Zealand. (2024). *Bank Financial Strength Dashboard Data.* https://bankdashboard.rbnz.govt.nz/datafiles/Bank-Financial-Strength-Dashboard-Data.xlsx]

933. Also, it is possible that the average Group 3 deposit takers' disclosure statement would not require the same level of complexity as that of a Group 1 deposit taker despite the content requirements being nominally the same. This is because not all content requirements will necessarily be applicable to a Group 3 deposit taker's business or it may require less additional qualifying information to meet the requirement. We have seen this inbuilt proportionality at work in current disclosure statements too – D-SIBs typically have longer and more complex disclosure statements than other banks despite having identical content requirements albeit this is not consistent across all banks.

Summary

934. We see both Options C and D as enhancing the effectiveness of market discipline and promoting financial stability by providing depositors and other market participants with access to timely, accurate and understandable information. We consider that neither option imposes compliance costs that are disproportionate or unnecessary. We also consider that the options do not result in unacceptable impacts through affecting the diversity of institutions in the financial system and so should maintain access to financial products and services. For the 2 smallest banks included in Group 3, the effects are similar but with a potential decrease in overall compliance costs as we propose shifting from requiring 2 disclosure statements a year to just the single full-year statement under Option D and even more so under Option C.

935. Relative to Option C (the Dashboard only approach), we expect that the additional disclosure statement requirement in Option D (the Bank-lite approach) could result in higher quality information being provided on the Dashboard (due to the external audit requirement for annual disclosure statements providing an assurance anchor point for the data published on the Dashboard). However, Option D imposes higher compliance costs relative to Option C (but not necessarily higher costs when compared to the current NBDT PDS requirements) as financial statements already require external auditing. We seek your feedback on how to ensure high quality data would be disclosed under Option C.

5 Proposed approach for branches of overseas deposit takers

936. We propose the same preferred option, Option B, for branches as for Group 1 and Group 2 deposit takers but excluding the Dashboard requirements (just as they do not currently apply to branches).

937. We believe that the existing disclosure regime for branches already takes a proportionate approach as it requires branches disclose a subset of the information that must currently be disclosed by banks. We consider it proportionate to apply the same basic disclosure regime to branches as we propose to apply to Group 1 and 2 deposit takers (which acknowledges that the specific information disclosed by branches will be largely a subset of the information disclosed by Group 1 and Group 2 deposit takers).

938. The minor and technical revisions applicable to branches are summarised in Appendix 4 and compared against the disclosure OIC for branches where relevant. Table AJ above provides a summary of Option B (but the Dashboard is not applicable to branches).

939. In summary and as per analysis for Group 1 earlier, our preferred Option B implies little change in the costs imposed on branches while maintaining (or even increasing) the benefits to market discipline and hence financial stability. We consider that this carry over with minor

and technical revisions option is appropriate given our view that current disclosure settings for banks are working well and there are no significant known issues with them.

6 Conclusion

940. We consider that our proposed Disclosure Standard is necessary to address the information asymmetry between market participants and deposit takers that, in the absence of intervention, could otherwise lower the effectiveness of market discipline and correspondingly could increase risks to financial stability. In addition, the Disclosure Standard would protect and promote financial stability through enhancing market discipline. It would also directly support depositors having access to timely, accurate and understandable information to help them in making decisions about placing funds with deposit takers.

941. Having assessed the options we consider that there is a natural alignment between the Proportionality Framework's grouping of deposit takers and the current disclosure regimes for banks, branches and NBDTs. Subject to minor revisions, we propose that we will keep the current bank disclosure regime for Group 1 and Group 2 deposit takers and for branches. For Group 3 deposit takers, we propose to have a proportionally adjusted version of that same disclosure regime. We consider that this would support comparability across deposit takers and align with international good practice and improve depositors' access to understandable information to help them make decisions.

942. In summary, our preferred option for Group 1 and Group 2 deposit takers and branches implies little change in the costs imposed on them, but also effectively supports market discipline and hence financial stability.

943. We have proposed two options for Group 3 deposit takers, that are proportionally adjusted versions of our preferred option for Group 1 and 2 deposit takers. We recognise that Option C is less costly than Option D but also has less robust built-in assurance mechanisms around data quality. We are seeking your feedback on how to ensure high quality data would be disclosed under Option C.

Q119	Does our proposed Disclosure Standard overall meet the needs of depositors to make well-informed choices on the financial products and institutions in which they invest? Do our proposed requirements assist depositors to have access to timely, accurate and understandable information to help them to make these decisions?

Appendix 3 – Proposed changes to existing disclosure requirements for New Zealand incorporated registered banks

The proposed minor and technical changes are cross-referenced to the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014[142] if there is an equivalent clause or is relevant to the Dashboard.

Change item reference	Applicable to Disclosure Statements (clause reference) or the Dashboard or both	New requirement	Proposed change compared with the current requirement
Proposed new requirements			
1	Disclosure Statements (N/A clause)	Dashboard linking Requires link to the Dashboard on the entity's website and inclusion of the Dashboard URL in disclosure statements	This links the Dashboard and disclosure statements more closely together as parts of a single coherent disclosure regime that improves accessibility and comparability of prudential information. This access to understandable information helps depositors to make decisions
2	Disclosure Statements (N/A clause)	Historical financial statements Requires deposit takers to note that historical financial statements are available via the Dashboard	Historical financial statements will no longer be required in disclosure statements as per change item 12 below. This new requirement will point market participants to where they can be found on the Dashboard instead. It also links the Dashboard and disclosure statements more closely together as parts of a single coherent disclosure regime
3	Disclosure Statements	Standardised template for disclosure statements	This increases the accessibility and comparability of prudential

[142] Working copy *see* Reserve Bank of New Zealand. (2022, 14 December). *Disclosure Requirements.* https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/disclosure-requirements

Change item reference	Applicable to Disclosure Statements (clause reference) or the Dashboard or both	New requirement	Proposed change compared with the current requirement
	(N/A clause)	Prescribes a standardised template for presenting the information in disclosure statements.	information and thus improves depositor access to understandable information. It also improves consistency of treatment across deposit takers. It is also consistent with international practice where the use of templates is required under the Basel Committee for Banking Supervision (BCBS) Basel Framework Disclosure requirements.[143]
4	Disclosure Statements (N/A clause)	Remuneration of the CEO and executive management team Requires disclosure of the remuneration (including any long-term incentives) of the deposit taker's CEO and executive management team.	In the IMF's 2017 FSAP report they recommended we align with international standards in requiring disclosure of remuneration and associated policies. Note, this proposed requirement may be closely related with any non-core governance standard and, if so, we will seek to ensure they are consistent with each other.
5	Both (multiple clauses)	Credit risk, liquidity and other indicator Prescribes additional disclosure of credit risk and liquidity indicators in a particular format to be determined. Indicators included are: • debt-to-income measures (consistent with any final requirement) • the flow of new mortgage lending commitments (consistent with the LVR policy)	These are some of the content requests we have received from market participants since we released the Dashboard and we agree that disclosure of this information would likely enhance market discipline. They also include indicators to match the most recent policies for our macroprudential tools and the standards.

[143] Bank for International Settlements. (2021, 11 November). *DIS – Disclosure requirements*. https://www.bis.org/basel_framework/chapter/DIS/10.htm

Change item reference	Applicable to Disclosure Statements (clause reference) or the Dashboard or both	New requirement	Proposed change compared with the current requirement
		• period highs and lows for the core funding ratio and mismatch ratios (consistent with the Liquidity Standard) • D-SIB scores • interest bearing assets, interest bearing liabilities, agricultural lending data and related-party exposures data (consistent with any relevant standards)	
6	Disclosure Statements (*see* change item 11 below)	Disclosure policy and annual audit Prescribes a deposit taker to have a board-approved 'disclosure policy' covering internal controls and procedures for producing information for disclosure. Also requires this disclosure policy to be internally reviewed on a 3-year cycle and whenever there is material change in circumstances that may affect the appropriateness of the policy. Reports on the conclusions of these reviews to be provided to the board.	See paragraph 897 to 899 for the rationale for this requirement. Note, it is linked with change item 11 below.
Proposed terminated requirements (found in the main text of the 2014 Order)			
7	Disclosure Statements (clause 10)	Delivery to Reserve Bank Requires delivery of the disclosure statement to the Reserve Bank (in a format determined by the Reserve Bank) on the day a bank publishes it	Instead, we can access this information from a deposit taker's website when they publish it or request a copy if need be.
8	Disclosure Statements (clause 11)	Request for copies Prescribes banks to direct customers inquiring after a copy of	Terminate much of its SLA-type requirements.

Change item reference	Applicable to Disclosure Statements (clause reference) or the Dashboard or both	New requirement	Proposed change compared with the current requirement
		their disclosure statements to their website and to offer a printed copy by some other method of delivery including SLA-type timeframes for the bank to meet.	
9	Disclosure Statements (clause 14 vs. schedule 2 clause 16 (2.16) and schedule 3 clause 11 (3.11))	Disclosure statement not to be false or misleading (clause 14) vs. Other material matters (clauses 2.16 and 3.11) Clause 14 states the directors may decide to include any other information if they consider it appropriate to disclose. Clauses 2.16 and 3.11 prescribe that any other information that would materially affect the decision of a person to accept the bank's debt security offer, and is not already included in the disclosure statement, must be disclosed.	Legislated under DTA section 175 False or misleading declarations, representations, or other information.
Proposed terminated requirements (found in schedules 2 and 3 – Full & Half Year: information to be included in disclosure statement)			
10	Disclosure Statements (clause 2.15)	Historical summary of financial statements Prescribes disclosure of a summary of the financial statements for the five most recent consecutive full year accounting periods, among including other details. No equivalent requirement under Schedule 3 – Half year.	Equivalent information is covered by the Dashboard already change item 2 above will point market participants to where historical financial statements can be found on the Dashboard instead.
11	Disclosure Statements (clauses 2.17 and 3.12)	Director's statements Requires director attestations on the veracity of the disclosure statement.	Instead, we will rely on the directors' due diligence duty under the DTA, part 3, subpart 3. Also, change item 6 above requires a deposit taker to have a board-approved 'disclosure policy' and to internally audit this annually.

Change item reference	Applicable to Disclosure Statements (clause reference) or the Dashboard or both	New requirement	Proposed change compared with the current requirement
Proposed terminated requirements (found in schedules 4 and 5 – Full and Half Year: additional financial disclosures)			
12	Disclosure Statements (clauses 4.1 and 5.1(1)(a), (b))	Additional information on statement of financial position Requires disclosure of specific metrics on interest-earning and discount-bearing assets and liabilities.	We seek your views on whether market participants find this information useful.
13	Disclosure Statements (clauses 4.3 and 5.5)	Additional information on interest-rate sensitivity Requires disclosure of an interest-rate repricing schedule in addition to the sensitivity analysis required under NZ IFRS 7.	We seek your views on whether market participants find this information useful. If not, we might remove this requirement but currently intend to retain it.
Proposed terminated requirements (found in schedule 7 – Full Year and Half Year: asset quality)			
14	Disclosure Statements (clauses 7.4 to 7.6)	Movements in individually impaired assets (7.4) and in balances of total individual credit impairment allowances (7.5) and collective credit impairment allowance (7.6) Prescribes banks that follow NZ IAS 39 to disclose information on related balance movements.	NZ IAS 39 no longer applies.
15	Disclosure Statements (clauses 7.6A and 7.6B)	NZ IFRS 9 metrics re: loss allowances Prescribes disclosure of reconciled opening and closing balances of financial instrument loss allowance and explanation regarding changes in gross financial assets but only for those banks that follow IFRS 9. (Until recently, IFRS 9 was not mandatory).	NZ IFRS 9 is now applicable to all banks. Also, incorporate additional clarification to address the definition of an individually impaired asset and the components of loss allowance as a result of adopting NZ IFRS 9.

Change item reference	Applicable to Disclosure Statements (clause reference) or the Dashboard or both	New requirement	Proposed change compared with the current requirement
16	Disclosure Statements (clause 7.8)	Other asset quality information Prescribes disclosure of undrawn balances of counterparties that are already individually impaired and the amount of other assets under administration.	We seek your views on whether market participants find this information useful.
17	Disclosure Statements (clauses 7.3 to 7.8 generally)	In general: Asset quality information.	Revise requirement to account for impairment changes in NZ IFRS 9 and expanded disclosure requirements in NZ IFRS 7.
Proposed terminated requirements (found in schedules 9 and 11 – Full Year and Half Year: capital adequacy under the standardised approach, and regulatory liquidity ratios, and capital adequacy under the internal models based approach, and regulatory liquidity ratios)			
18	Disclosure Statements (clauses 9.5 and 11.7)	Credit risk mitigation Prescribes disclosure of on- and off-balance sheet exposures covered by collateral, and by guarantees or credit derivatives broken down by exposure class.	We seek your views on whether market participants find this information useful.
Proposed terminated requirements (found in Schedule 17 & 18 – Full & Half Year: Risk management policies)			
19	Disclosure Statements (clause 17.9)	Additional information about operational risk Prescribes for banks using the Advanced Measurement Approach (AMA) to operational risk to disclose the methodology used and if they use insurance to mitigate operational risk.	The AMA approach is no longer available.

Appendix 4 – Proposed changes to existing disclosure requirements for overseas incorporated registered banks

For clauses that are common to both OICs, see Appendix 3.

The proposed minor and technical changes are cross-referenced to the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014[144] where it has an equivalent clause or is relevant to the Dashboard.

Change item reference	Applicable to Disclosure Statements only (clause reference)	Requirement	Proposed change compared with the current requirement
Proposed new requirements			
A	(N/A)	Standardised template for disclosure statements Prescribes a standardised template for presenting the information in disclosure statements.	See rationale for change item 3 in Appendix 3.
B	(N/A)	Remuneration of the CEO and executive management team Requires disclosure of the remuneration (including any long-term incentives) of the deposit taker's CEO and executive management team.	See rationale for change item 4 in Appendix 3.
C	(N/A)	Credit risk indicators Prescribes disclosure of credit risk indicators, such as debt-to-income measures and the flow of new mortgage lending commitments (consistent with the LVR policy) in a particular format yet to be determined.	See rationale for change item 5 in Appendix 3.
D	(N/A)	Disclosure policy and 3 yearly review Prescribes a deposit taker to have a board-approved "disclosure policy" covering internal controls and procedures for producing information for	See rationale for change item 6 in Appendix 3.

[144] Reserve Bank of New Zealand. (2022, 14 December). *Order in Council working copy: Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended).* https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/oic-locally-incorporated-amended-december-2022.pdf

Change item reference	Applicable to Disclosure Statements only (clause reference)	Requirement	Proposed change compared with the current requirement
		disclosure. Also requires this disclosure policy to be internally reviewed on a 3-year cycle and whenever there is material change in circumstances that may affect the appropriateness of the policy (and reports on the conclusions of these reviews to be provided to the board).	
Proposed terminated requirements (found in Schedule 2 & 3 – Full & Half Year: Information to be included in disclosure statement)			
E	(2.19 & 3.14)	Directors' and New Zealand chief executive officer's statements Prescribes attestations by the branch directors and CEO regarding the branch and (where also having a New Zealand-incorporated subsidiary) its banking group having systems to monitor and control material risks, and the branch complied with its conditions of registration.	Instead, we will rely on the DTA's due diligence duties under sections 93 and 94 and the director liability regime under section 176. Also, the new addition change item D requires a deposit taker to have a board-approved "disclosure policy" and to internally audit this every 3 years.

Final remarks

944. There is much to do to prepare for this change to continue to evolve as a modern prudential regulator, and we seek your help to create a cohesive and effective prudential framework. We also hope this document provides some clarity on the process ahead. Please take the opportunity to engage with us in this process, by written submissions, workshops or through bilateral meetings. We look forward to working with you in developing the new framework for prudential regulation in New Zealand.

Annex A: Glossary

Term	Meaning
ADI	Authorised Deposit-Taking Institution
AGI	Adjusted Gross Income
AMA	Advanced Measurement Approach
ANZIC	Australian and New Zealand Standard Industrial Classification 2006
APRA	Australian Prudential Regulation Authority
ASA	Alternative Standardised Approach
ASIC	Australian Securities and Investments Commission
AT1	Additional Tier 1
Basel Core Principles	the Core Principles for Effective Banking Supervision issued by the Basel Committee for Banking Supervision
BCBS	Basel Committee for Banking Supervision
BI	Business Indicator
BIC	Business Indicator Component
BKBM	Bank Bill Benchmark Rate
BPSA	Banking (Prudential Supervision) Act 1989
BPR	Banking Prudential Requirements
BPR100	BPR100 Capital Adequacy document
BPR131	BPR131 Standardised Credit Risk RWAs document
BPR140	BPR140 Market Risk document
BPR150	BPR150 Standardised Operational Risk document
BPR151	BPR151 AMA Operational Risk document
Branches	Branches of overseas deposit takers
BS13	Liquidity policy for banks, implemented in 2010 by the Reserve Bank
BS13a	Liquidity policy for banks, Annex of Liquid Assets
CCyB	Counter-Cyclical Capital Buffer
CET1	Common Equity Tier 1

Term	Meaning
CFCR	Cash-flow coverage ratio
CFP	Contingent Funding Plane
CFR	Core Funding Ratio, a quantitative liquidity metric
CLF	Reserve Bank's Committed Liquidity Facility
CoFR	Council of Financial Regulators
Company	Has the same meaning as in section 2(1) of the Companies Act 1993 and includes an overseas company within the meaning of that Act
CoR	Conditions of Registration
C1	First consultation paper for the liquidity policy review, released in February 2022
C2	Second consultation paper for the Liquidity Policy Review, released in February 2023
C3	Third round of consultation being undertaken for the Liquidity Policy Review
D-SIBs	Domestic systemically important banks
Dashboard	Bank Financial Strength Dashboard published by the RBNZ
DCS	Depositor Compensation Scheme, has the same meaning as in Part 6 of the Deposit Takers Act 2023
DTA	Deposit Takers Act 2023
ESAS	Exchange Settlement Account System
FMA	Financial Markets Authority
FMCA	Financial Markets Conduct Act 2013
FPR	Financial Policy Remit
FSAP	Financial Sector Assessment Programme
FSCU	Friendly Societies and Credit Unions Act 1982
GAAP	Generally accepted accounting practice, has the same meaning as in section 8 of the Financial Reporting Act 2013
GFC	Global Financial Crisis
GI	Gross Income
HQLA	High-quality liquid assets
IADI	International Association of Deposit Insurers
ICAAP	Internal Capital Adequacy Assessment Process
ICT	Information and communication technology

Term	Meaning
IIB	Inflation-indexed bond
ILM	Internal risk multiplier
IMF	International Monetary Fund
IRB	Internal ratings-based
IRRBB	Interest rate risk in the banking book
Issuer	Has the same meaning as in section 11 of the Financial Markets Conduct Act 2013
JSON	JavaScript Object Notation
LCR	Liquidity Coverage Ratio
LDC	Loss Data Collection
LGFA	Local Government Funding Agency
Licensed NBDT	Has the same meaning as in section 4(1) of the NBDT Act
LPR	Liquidity Policy Review
MBIE	Ministry for Business, Innovation and Employment
MCI	Mutual Capital Instrument
MM	Modigliani & Miller theorem
MMR	Mismatch Ratios, a quantitative liquidity metric
MoU	Memorandum of Understanding
NBDT	Non-bank deposit takers, has the same meaning as in section 5 of the NBDT Act
NBDT Act	Non-bank Deposit Takers Act 2013
NBDT capital regulations	Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposure) Regulations 2010
NBDT liquidity regulations	Deposit Takers (Liquidity Requirements) Regulations 2010
Non-D-SIBs	Banks that are not domestic systemically important banks
NSFR	Net Stable Funding Ratio
NZD	New Zealand Dollar
NZGB	New Zealand Government Bond
NZ Super Fund	New Zealand Superannuation Fund
OBR	Open Bank Resolution
OCR	Official Cash Rate
OIA	Official Information Act 1982
OIC	Order in Council

Term	Meaning
ORC	Operational Risk Capital
PBD	Privacy by design
PCB	Prudential capital buffer
PDS	Product Disclosure Statement
PIA	Privacy Impact Assessment
PPS	Perpetual Preference Shares
PRA	Prudential Regulation Authority
Proportionality framework	*Proportionality Framework for Developing Standards under the Deposit Takers Act*, published by the Reserve Bank on 14 March 2024
PSLA	Primary and Secondary Liquid Assets
QIS	Quantitative Impact Statement
RBA	Reserve Bank of Australia
RB bill	Reserve Bank bill
Registered bank	Has the same meaning as in section 2(1) of the Banking (Prudential Supervision) Act 1989
Reserve Bank	The Reserve Bank of New Zealand – Te Pūtea Matua
RIA	Regulatory Impact Assessment
RPPS	Redeemable Perpetual Preference Shares
RWA	Risk weighted assets
SBI	Settlement Before Interchange payment system
SBI365	Settlement Before Interchange 365 payment system
SCO	sectoral capital overlay
SCR	sectoral capital requirement
SCV	Single Customer View
SDV	Single Depositor View
SMA	Standardised Measurement Approach
SME	Small and medium-sized enterprise
SoFA	Statement of Funding Approach
SRW	Sectoral risk weights
SSA	Basel Simplified Standardised Approach
Standards	Refer to the four core Deposit Taker Standards to be made under the Deposit Takers Act 2023

Term	Meaning
SVB	Silicon Valley Bank
T-bill	Treasury bill
VaR	Value-at-risk

Annex B: Consolidated consultation questions

Introduction

Q1	What do you think the cumulative impact of the proposed standards will be on the relevant principles?
Q2	What do you think of the way we have taken into account the proportionality principle in developing the proposed standards?
Q3	What do you think the implications of the proposed standards will be on the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services and on financial inclusion more generally? If possible, please provide specific feedback on how these requirements might impact the accessibility and affordability of financial services.
Q4	What do you think the impact of the proposed standards will be on the Māori economy, in particular on: a) the role of the financial system and deposit takers in supporting the Māori economy b) Māori customers, iwi and individuals and Māori businesses, trusts and entities?
Q5	What do you think the cumulative impact of the proposed standards will be on competition? How do you think competition should be factored into our broader analysis of the principles?
Q6	Do you think that this approach to developing standards is appropriate? Is there anything else we should take into account when developing the prudential framework?
Q7	What transitional arrangements would be appropriate? Are there any particular requirements that would take longer to comply with than others?

Chapter 1: Capital

Q8	Do you agree with our proposed overall approach to capital requirements for Group 1 deposit takers?
Q9	What impacts would you expect the proposals to have?
Q10	Do you agree with our proposal to reduce the risk weight for longer-term exposures to A-rated banks to 30%?
Q11	If we aligned the effective maturity date of three-month bank bills with New Zealand's financial market's maturity convention, what implications would this have from both accounting and tax perspectives?

Q12	What other market protocols might be impacted and what would those impacts be?
Q13	What level of exposures do deposit takers have which would be affected by this change?
Q14	Do you agree with our proposal to create a specific risk weight for exposures to the NZ Super Fund?
Q15	Do you agree with our proposal to set the risk weight for exposures to the NZ Super Fund at 20%?
Q16	Do you agree with our proposal to clarify that 'consolidated' should be interpreted by reference to NZ GAAP?
Q17	Do you agree with our proposed approach to capital requirements for market risk for Group 1 deposit takers?
Q18	Is there additional information that would help monitor market risk developments?
Q19	Can potential Group 1 deposit takers provide us, on a confidential basis, information about banking book and trading book exposures on a normal day and on an OCR decision day?
Q20	Do you agree with our proposal to use the Business Indicator proxy metric to calculate operational risk exposures?
Q21	Do you agree with our proposal to convert the Basel III Business Indicator ranges to NZD when calculating the Business Indicator marginal coefficient?
Q22	Do you agree with our proposal to set the Internal Loss Multiplier to 1?
Q23	Do you agree with our proposed approach to operational risk capital calculation for Group 1 deposit takers?
Q24	Do you agree with our proposed overall approach to capital requirements for Group 2 deposit takers?
Q25	Do you agree that proposals 2.1.1, 2.1.2 and 2.1.3 should also apply to Group 2 deposit takers?
Q26	Do you agree with our proposed approach to capital requirements for market risk for Group 2 deposit takers?
Q27	Can potential Group 2 deposit takers provide us, on a confidential basis, information about banking book and trading book exposures on a normal day and on an OCR decision day?
Q28	Do you agree with our proposed approach for Group 2 deposit takers to have the same operational risk capital requirements as Group 1 deposit takers?

Q29	Do you agree with our proposal to set the minimum total capital for Group 3 deposit takers at 9% with a 4% prudential capital buffer, to align with the requirements for Group 1 and Group 2?
Q30	Do you agree with our proposal that Group 3 deposit takers that are exempt from a credit rating should face an additional buffer of 1%?
Q31	Do you support the introduction of a minimum capital requirement for Group 3 deposit takers?
Q32	Do you have any other proposals that would address the concerns laid out for the smallest deposit takers?
Q33	Do you support our proposed approach to calibrating the minimum capital requirements to ensure individual entity soundness?
Q34	Do you have any feedback on the initial assessment of our estimated calibration range of $5 million to $10 million?
Q35	Can current NBDTs and potential Group 3 deposit takers confidentially inform us of their planned future size and scale, and any impact an absolute minimum requirement would have?
Q36	Do credit union securities provide a useful capital-raising tool for CET1 (MCI), AT1 capital or Tier 2 capital?
Q37	Does the requirement to be a member of the credit union, or the lack of voting rights, make credit union securities an unattractive CET1 (MCI) proposition?
Q38	Do credit unions have the capacity and powers to enter transactions creating MCI, AT1 capital or Tier 2 capital other than through credit union securities?
Q39	Do you agree with our proposed capital composition for Group 3 deposit takers?
Q40	Do you agree that simplifying the capital issuance process would be useful for Group 3 deposit takers?
Q41	Is the MCI a relevant instrument for credit unions and, if included, what would be the impacts of removing the voting rights requirement that currently applies for MCI for banks in the BPR?
Q42	Do you agree with our proposed approach to risk weighted assets for credit risk for Group 3 deposit takers?
Q43	Do you agree with our proposal to separate the operational risk calculation from the market risk capital calculation for Group 3 deposit takers?
Q44	Do you agree with our proposal to include a secondary threshold to move a Group 3 deposit taker to Group 2 for market risk requirements?

Q45	At what level (either dollar value or percentage of assets) do you think the secondary threshold should be set?
Q46	Do you agree with our proposed approach to capital requirements for market risk for Group 3 deposit takers?
Q47	Do you agree with our proposed approach to capital requirements for operational risk for Group 3 deposit takers?
Q48	Can potential Group 3 deposit takers provide us, on a confidential basis, information about banking book and trading book exposures on a normal day and on an OCR decision day?
Q49	Do you agree with our proposed transition path for Group 3 capital requirements or are there alternatives that would better balance the factors discussed above?
Q50	Do you agree with the conclusions in the shortfall analysis?

Chapter 2: Liquidity

Q51	Do you have any comments or suggestions on the proposed qualitative liquidity requirements for Group 1 deposit takers?
Q52	Do you have any views on our intention to supplement our qualitative liquidity requirements for Group 1 deposit takers with qualitative liquidity guidance?
Q53	Do you have any comments or suggestions on the proposed qualitative liquidity guidance for Group 1 deposit takers included in the standards, as opposed to through non-binding guidance?
Q54	Do you agree with our assessment of the costs/benefits of our proposed qualitative liquidity requirements for Group 1 deposit takers?
Q55	Do you agree with our assessment of the potential benefits of our overall proposed modifications to the MMR and CFR?
Q56	What are the expected costs of implementing these proposed modifications to the MMR and CFR? Are there any proposed modifications that would be particularly costly to implement, relative to the potential benefits?
Q57	Do you agree that both the MMR and CFR metrics should be restructured so that they each have a natural minimum of 100%?
Q58	Do you agree that we should add insurance companies and superannuation funds to our definition of 'market funding' under our liquidity standard?
Q59	Do you have any comments on what the impacts (quantitative or otherwise) might be of the addition of insurance companies and superannuation funds to our definition of 'market funding'?

Q60	Do you have any suggestions for how entities could be captured under 'market funding' without using ANZSIC codes?
Q61	Do you agree with our proposed treatment of insured deposits under the MMR (where they would have a run-off rate of 3%) and CFR (where they would have a factor of 95%)? If not, what alternative treatments might be appropriate?
Q62	Do you have any views on what the appropriate run-off rate for uninsured deposits less than $5 million should be under our revised liquidity standard? Is the existing 5% run-off rate still appropriate, or should this rate be recalibrated?
Q63	Do you agree with our proposal to introduce a new size-band category of funding for deposits over $100 million in both the MMR and CFR?
Q64	Do you have alternative views on the appropriate threshold and calibration for this potential new category of funding?
Q65	Do you consider that there are any issues with requiring the grouping of deposits under the liquidity policy to be based upon the same rules used to generate SDVs?
Q66	What are your views on whether the MMR should eliminate the inclusion of amounts from undrawn committed lines as a cash inflow?
Q67	Do you agree with standardising/changing the period of the 'one-month' MMR to 30 days?
Q68	Do you agree that the one-week/7-day MMR should be retained?
Q69	If retained, should the 7-day MMR apply higher run-off rates than the 30-day MMR? If so, to which category(ies) of funding should any higher run-off rates apply?
Q70	Do you agree that funding received from tradeable debt securities should qualify as core funding when its residual maturity falls between six months and one year (at the existing discount factor of 50%), regardless of its original maturity?
Q71	Do you agree with the removal of the provision that allows a deposit taker to make any reasonable simplifying assumption in calculating its quantitative ratios?
Q72	Do you have any views on whether, in the normal course of business, we should require deposit takers to comply with their quantitative liquidity requirements 'on an ongoing basis', 'at all times', or 'continuously'? What would be the expected costs and implications of such a requirement?
Q73	Do you have any views on whether we should require deposit takers to calculate their MMRs and CFR seven days a week? What would be the expected costs and implications of such a requirement (e.g., potential staffing requirements over weekends)?

Q74	Do you have any views/comments on the potential features/components of the CLF outlined in this Table AC?
Q75	Do you have any views on whether the CLF should be operated as a completely new facility, or via an existing facility with additional documentation as required?
Q76	Do you consider that Group 2 entities should be subject to the same qualitative liquidity requirements as Group 1 entities? Are there any particular requirements that are not also appropriate for Group 2 entities?
Q77	Do you consider that Group 2 entities should be subject to the same quantitative liquidity requirements as Group 1 entities? Are there any particular requirements that are not appropriate for Group 2 entities or any negative implications of this approach for Group 2 entities that we should be aware of?
Q78	Do you agree with our proposed qualitative requirements for Group 3 deposit takers? If not, what changes would you propose to these requirements?
Q79	What compliance costs do you think may result from the proposed qualitative requirements for Group 3 deposit takers?
Q80	Do you agree that Group 3 deposits takers should be required to comply with a CFCR?
Q81	What are the implications of the different structures for the CFCR?
Q82	Is there a need for a cap on the amount of Kauri bonds and LGFA securities that Group 3 deposit takers may hold as liquid assets under the CFCR?
Q83	Do you agree that the minimum requirement under the CFCR should be 100%?
Q84	Do you prefer Option 1 or Option 2 for the treatment of deposit run-off rates?
Q85	What compliance costs do you think may result from Option 1 and Option 2 (including the costs of any necessary system builds)?
Q86	Are the potential size bands in Option 1 appropriate for measuring the potential deposit outflows of Group 3 deposit takers in a liquidity stress scenario?
Q87	Do you agree the CFCR should be applied for both 7-day and 30-day periods for Group 3 deposit takers that issue both demand and term deposits, and for only a 30-day period for Group 3 deposit takers that only issue term deposits?
Q88	Do you agree that the CFCR should be met 'at all times' rather than just at the end of each business day? If we require Group 3 deposit takers to comply with the CFCR at all times, what are the expected costs and are there reasons why at all times 7 days a week is not appropriate (for example, if payments are not processed on 7 days a week)?

Q89	Do you have any views or suggestions on what further simplifications could be made to our proposed CFCR?
Q90	What would be the impact of the proposed treatment of term deposits on your business model, liquidity risk management, and profitability? Please quantify the impacts on profitability where possible.
Q91	What could mitigate the impacts of the proposed treatment of term deposits? For example, could Group 3 deposit takers hold (more) liquid assets such as NZGBs, Kauri bonds, and LGFAs?
Q92	Do you agree with our proposal not to apply a quantitative stable funding requirement on Group 3 deposit takers?
Q93	What liquidity risk management requirements do you consider are appropriate to apply to branches?
Q94	Do you agree with our assessment of the costs and benefits of applying certain qualitative liquidity requirements to branches of overseas banks?
Q95	Do you agree that we should collect more information from branches on how they manage their liquidity risks?
Chapter 3: Depositor Compensation Scheme	
Q96	Do you agree with our preferred approach of disclosure requirements to identify protected deposits?
Q97	Do you agree with our proposal to focus on the product disclosure approach?
Q98	Do you agree with the proposal to require the use of a trademark in connection with DCS-protected products, except for credit products?
Q99	Is it practical to require deposit takers to make supporting information provided by the Reserve Bank available to depositors?
Q100	Are there any issues with adopting the "advertising" definition in section 434(4) of the DTA for the purpose of the DCS disclosure standard?
Q101	How costly would it be and how long would it take to incorporate DCS brand elements into depositor-specific account information such as internet banking, mobile applications and bank statements?
Q102	Do you agree with the proposal not to impose requirements for disclosure in sales conversations?
Q103	Do you agree with our assessment that the approach to DCS product disclosure for Group 2 deposit takers should be the same as that for Group 1?

Q104	Are there any products offered by Group 3 deposit takers that are designed differently from bank deposits, that could require a different treatment under the DCS disclosure standard?
Q105	Do you have any comments on the proposed list of variables required for the SDV file?
Q106	Do you have any comments on the proposed fields for the variables, especially where they may be currently held as a string rather than individual fields? Would this requirement have any significant negative implementation or data quality impact?
Q107	Do you have any comments on the proposed requirement to use Json as the file format?
Q108	Do you agree that the option of combination deposit taker and regulator testing is appropriate? If not, which option would you prefer?
Q109	Do you agree with our assessment that the approach to SDV testing for Group 2 and Group 3 deposit takers should be the same as that for Group 1?
Q110	Do you agree with our preferred approach of requiring Group 1 deposit takers to maintain a system to report aggregate data? What compliance costs are associated with this approach?
Q111	Do you agree with our preferred approach of requiring Group 2 and Group 3 deposit takers to maintain a system to report aggregate reporting data? What compliance costs are associated with this approach?
Q112	Can you provide information on the compliance costs associated with aggregate reporting?

Chapter 4: Disclosure

Q113	How frequently and to what standard should we require a review of the proposed board-approved disclosure policy for deposit takers?
Q114	Do you agree we have the right set of options for Group 1 deposit takers?
Q115	Do you agree with our assessment of the costs and benefits of these options for Group 1 deposit takers?
Q116	Do you agree with our proposal to have the same approach to disclosure requirements for Group 2 deposit takers as we propose for Group 1?
Q117	Are we correct in our comparison of relative costs between our proposed disclosure options for Group 3 deposit takers and the current disclosure regime for NBDTs? Please provide quantitative evidence to support your position.

Q118	What assurance methods other than regular external auditing of the data provided for the Dashboard should we consider? Please provide specific evidence of the costs and benefits relative to Option D's externally audited annual disclosure statement.
Q119	Does our proposed Disclosure Standard overall meet the needs of depositors to make well-informed choices on the financial products and institutions in which they invest? Do our proposed requirements assist depositors to have access to timely, accurate and understandable information to help them to make these decisions?