Reserve Bank of New Zealand
Te Pūtea Matua

Deposit Takers Core Standards

Summary of Submissions and Policy Decisions for the Capital Standard

25 August 2025

CONSULTATION PAPER

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Introduction

The Reserve Bank of New Zealand – Te Pūtea Matua (the **Reserve Bank**; we) is undertaking a multi-year programme of work to implement the Deposit Takers Act 2023 (the **DTA**). The DTA Standards will replace existing prudential requirements to form a new set of rules for deposit takers.

A significant step in the journey to the new regime was the publication of our Deposit Takers Core Standards consultation paper (the **DTA Consultation Paper**) on 16 May 2024. The core standards are the Capital, Liquidity, Depositor Compensation Scheme (**DCS**), and Disclosure Standards. The core standards will used for licensing existing banks and non-bank deposit takers (**NBDT**s) under the DTA. The Summary of Submissions and Policy Decisions for the Liquidity, DCS and Disclosure Standards was published on 1 May 2025.[1]

We are currently reviewing key capital settings

We initially intended to publish a response to the feedback received on the on the Capital Standard as part of the Summary of Submissions and Policy Decisions for the Liquidity, DCS and Disclosure Standards. However, on 31 March 2025, we announced that we would undertake a review of key capital settings for deposit takers (the **2025 Capital Review**). Given this decision, the publication of the Capital Standard summary of submissions and policy decisions was delayed for the outcome of the 2025 Capital Review to be taken into account.

In the 2025 Capital Review, we are considering whether our capital settings are set at the appropriate level to support a stable financial system – one where resilient financial markets, institutions and infrastructures enable a productive and sustainable economy and ultimately promote the prosperity and wellbeing of all New Zealanders.[2] The 2025 Capital Review will lead to decisions on the overall amount, form and distribution of capital – and any decisions will be integrated into the Capital Standard.

Alongside this response document, we have published a consultation paper as part of that review (the **2025 Capital Review Consultation Paper**).[3] We intend to confirm final decisions on all key capital settings by the end of the year.

This document focusses on technical decisions that are unimpacted by the 2025 Capital Review

This document does not include policy decisions on issues within the scope of the 2025 Capital Review. However, as the Capital Standard is one of the standards that deposit takers will be licensed against, it is important that stakeholders are provided with as much certainty as possible in a timely manner. As such, this document largely focusses on technical policy decisions that we do not expect to change as a result of the 2025 Capital Review.

Where we received submissions on issues that are within scope of the 2025 Capital Review (e.g. size and composition of the capital stack, including the proportionality of the capital stacks

1 The Summary of Submissions and Policy Decisions for the Liquidity, DCS and Disclosure Standards is available here.
2 The full terms of reference for the 2025 Review of Key Capital Settings is available here.
3 The 2025 Capital Review Consultation Paper is available here.

between groups and aspects of standardised risk weights), this paper summarises those submissions. However, any reader interested in proposals in these areas should read the relevant sections in the 2025 Capital Review Consultation Paper. Further submissions on those points are welcome.

Next steps

After decisions have been made on the 2025 Capital Review, the next step is to prepare an exposure draft of the Capital Standard for consultation – expected in June 2026. The exposure draft will bring together the decisions recorded in this document and those from the 2025 Capital Review Consultation.

Figure A below shows our intended approach, and high-level timeframe, for the development of standards.

Figure A: Process for developing capital standard

Contents

Chapter 1

Deposit Takers Core Standards

Summary of Submissions on Introductory Issues relating to the Capital Standard

1.1. Cross-cutting issues - overview

As also described in the Core Standards Summary of Submissions and Policy Decisions document, protecting and promoting the stability of the New Zealand financial systems is the primary objective of the DTA.[4] A stable financial system can be defined as one where resilient financial markets, institutions and infrastructures enable a productive and sustainable economy, and ultimately prosperity and wellbeing. Pursuing financial stability through resilience will at times necessitate decisions that trade off desirable factors, such as fostering competition or ensuring proportionality in the regulatory approach across the sector. At other times, policy choices that enhance the resilience of the system will enhance these factors.

In addition to our financial stability purpose, there are other purposes and principles that we take into account in determining prudential policy. Our DTA Consultation Paper included seven questions relating to the overall approach we have taken to developing policy in this area. This included questions relating to how we have taken into account some of the principles in the DTA and other overall impacts of the standards. (These consultation questions are included in Annex B together with the consultation questions for the Capital Standard.)

In this chapter, we address two cross-cutting issues to which we received capital-specific submissions on the DTA Consultation Paper. This chapter should be read in addition to the cross-cutting issues chapter of the Core Standard Summary of Submissions and Policy Response document which summarised the feedback we received on the cross-cutting issues for the Liquidity, DCS and Disclosure standards.[5]

1.2. Proportionality

Respondents indicated support for our Proportionality Framework.[6] However, some smaller deposit takers provided feedback that we had not sufficiently taken the Proportionality Framework into account in the core standards proposals. Some respondents felt that the proposals relating to capital requirements were inconsistent with the Proportionality Framework.

Response

Proportionality considerations are a key topic that we have considered throughout the 2025 Capital Review consultation that has been published alongside this document.

Regarding our capital requirements, the 2025 Capital Review consultation considers options to strike the right balance between the proportionality principle and the other purposes and principles of the DTA.

1.3. Diversity of institutions

Some respondents provided feedback that the proposed minimum capital requirement may negatively impact the diversity of institutions in New Zealand by making it difficult for new entrants

4 Section 3.1, Deposit Takers Act 2023.
5 The Core Standards Summary of Submissions and Policy Response document is available here.
6 *See* rbnz.govt.nz/hub/news/2024/03/a-proportionality-framework-allows-for-diversity-while-promoting-financial-stability.

to emerge. In particular, this might occur if minimum capital requirements are adopted without exceptions for smaller entities.

Respondents pointed out that the NBDT sector has already seen a trend of consolidation through sales and mergers, with no new entrants emerging under the current regulatory framework. This highlights the need to simplify requirements for smaller deposit takers.[7]

Response

It is desirable to see diversity in institutions operating in New Zealand under the new DTA regime. Our proposed approaches in the Capital Standard and across the other standards do not preclude this. We have calibrated our approach to consider how it applies to both new applicants and incumbent deposit takers at the point of licensing to acknowledge their different characteristics and interaction with our prudential regime.

This includes setting a minimum capital requirement of $5 million for all Group 3 deposit takers. We consider this to be the minimum scale required to operate under the DTA. We discuss this in more detail in section 2.5.5. A $5 million minimum capital requirement is the lower bound of the range we initially consulted on.

There are a range of issues considered in the 2025 Capital Review consultation, particularly those related to standardised risk weights, which may also impact the diversity of institutions.

7 On 6 January 2025 we granted a new entrant NBDT a license under the current regulatory regime. *See* rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/register-of-non-bank-deposit-takers-in-new-zealand

Chapter 2

Deposit Takers Capital Standard

Summary of Submissions and Policy Decisions

2.1. Non-technical summary of responses and decisions

This chapter outlines our responses to some of the consultation feedback received in relation to the Capital Standard. The Capital Standard will set out the minimum capital requirements for deposit takers in New Zealand.

This chapter differs from the previously published summary of submissions and policy decisions for the other DTA standards.[8,9] It is more limited in scope as the responses in this document only relate to topics that are not being reviewed as part of the 2025 Capital Review.

A separate consultation paper - published alongside this document - covers the 2025 Capital Review and addresses possible adjustments to our capital requirements.[10] As such, although the responses we have published in this document are final decisions on the relevant matters, they will be supplemented by later decisions taken as part of the 2025 Capital Review.

The table below summarises the key issues raised by respondents in their feedback about the Capital Standard with our decisions.

Table 2.1: Capital Standard – Key issues raised in feedback and responses

Deposit Taker Group	Key issue	Response
Group 1 and 2	Amend our approach to internal ratings-based (**IRB**) modelling by increasing the output floor to 100%.	Retain the use of IRB modelling and do not move to a 100% output floor. In the 2025 Capital Review consultation, we propose retaining the current output floor. We will finalise our approach to the output floor as part of final decisions on the 2025 Capital Review.
	Review Additional Tier 1 (**AT1**) capital instruments.	In the 2025 Capital Review consultation, we propose to no longer recognise AT1 as eligible regulatory capital. The final decision on this will be taken as part of the 2025 Capital Review. Please see Chapter 4 of the consultation paper for more detail on this issue.
	Consider more granular standardised credit risk weights to align with international approaches.	In the 2025 Capital Review consultation, we propose to introduce more granular risk weights. Please see Chapter 5 of the consultation paper for more detail on this issue. The proposed more granular risk weights will bring us closer to international alignment.
	Provide clarity on how the capital requirements for market risk would work for the banking book.	Update our proposed approach to now have separate requirements for the banking book and the trading book.

8 The Core Standards Summary of Submissions and Policy Decisions is available here.
9 The Non-Core Standards Summary of Submissions and Policy Decisions is available here.
10 The 2025 Capital Review Consultation document is available here.

Deposit Taker Group	Key issue	Response
Group 3	Include a minimum capital level requirement (which we are calling a 'capital base').	Set a minimum capital base of $5 million for all deposit takers.
	Implement changes to the risk weights framework ahead of the standards.	As part of the 2025 Capital Review, we are consulting on five key changes to standardised risk weights. These will increase granularity and aim to better align risk weights with the actual risk of lending. Please see Chapter 5 of the 2025 Capital Review for information on the proposals. We intend to make decisions on the finalised capital settings, including standardised risk weights, by the end of the year. The implementation of any agreed changes will be prioritised following the conclusion of the Review, but the implementation timeline will be announced once the capital settings have been finalised.

2.2. Introduction

The Capital Standard chapter of the DTA Consultation Paper covered the proposed minimum capital requirements for deposit takers in New Zealand.

The capital proposals were 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 sought to 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.

Minimum capital requirements are a critical part of the prudential framework to support the stability of the financial system.

Capital is the buffer that allows a deposit taker to absorb losses while still being able to repay its debt and deposits in full. In the absence of minimum capital requirements, the levels of capital held by deposit takers are likely to be lower than is socially optimal as their choices about capital will not consider wider social costs and benefits.

Without minimum capital requirements the deposit taker's creditors (including depositors) would be insufficiently protected, potentially undermining confidence in the financial system. Minimum capital requirements make the system safer for all New Zealanders and ensure bank owners have a meaningful stake in their businesses.

Capital also reduces the likelihood of a deposit taker failure. This helps reduce the risk of the harmful economic costs and social impacts associated with failures. 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.

By setting minimum capital requirements for deposit takers, the proposed Capital Standard aligns with the main purpose of the DTA. 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)).

The DTA also includes a number of principles that we must take into account. One of the principles is the desirability of taking a proportionate approach to regulation and supervision. We want to ensure that capital requirements are applied in a proportionate way. This is a key factor we have taken into account in the responses to feedback covered in this Summary of Submissions and Policy Decisions document, as well as in the 2025 Capital Review Consultation Paper that we have published alongside this document.

We have specifically taken this principle into account in several ways, including:

- Currently, regulatory capital buffers are larger for Group 1 deposit takers than other deposit takers, reflecting their greater significance for financial stability. Group 2 and 3 deposit takers have smaller regulatory capital buffers and, therefore, require less capital for the same risk weight. Proportionality in the capital buffer settings helps support competition as it lowers barriers to growth for smaller deposit takers and reduces barriers to entry for new deposit takers. As part of the 2025 Capital Review, we are consulting on options which increase the degree of proportionality. Chapter 3 of the 2025 Capital Review Consultation Paper includes the capital buffer proposals.
- The existing requirement that a bank must have a capital level of at least $30 million will be removed. This may help reduce barriers to entry allowing more competition to enter the market over time.
- Group 3 deposit takers will move to the same standardised credit risk weights as larger deposit takers. This will lower the risk weights on their lending and allow them to compete on a level footing with other deposit takers using the standardised credit risk weights.

Taking competition into account is a much wider issue than just for the Capital Standard. It is addressed in various chapters in the already published Summary of Submissions and Policy Decisions documents for the other DTA standards. We consider the proportionate approach will help support competition.

In the longer term, a stable financial system also supports competition by reducing the risk of deposit taker failure, increasing the likelihood that deposit takers remain in operation and thereby providing choices to customers.

Some of the feedback we received in response to the capital proposals in the DTA Consultation Paper covered a range of topics beyond those covered in our 2025 Capital Review consultation paper. For example, some respondents asked for revisions to standardised risk weights and others queried whether buffers were set at appropriate levels. In several areas, respondents sought changes they considered would increase competition or efficiency in the economy.

We have addressed these wider issues in the 2025 Capital Review Consultation Paper. The options covered in that paper would represent significant changes to parts of the Capital Standard that would apply to deposit takers. For example, options include lower and more granular standardised risk weights, as well as reductions in some capital buffers.

The most significant change to capital requirements that we proposed in the DTA Consultation Paper related to the proposed capital settings for Group 3 deposit takers (currently mostly NBDTs). NBDTs are currently subject to the Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010 (the **NBDT Regulations**). The NBDT Regulations have been in place since 2010 and are substantially different from our capital framework for Group 1 and Group 2 deposit takers (currently registered banks).

In the DTA Consultation Paper, we proposed to align the approach to capital requirements for Group 3 deposit takers with Group 1 and 2 deposit takers, but with changes to ensure the requirements are proportionate. The key proposals for Group 3 deposit takers are set out below.

- A minimum total capital ratio requirement of 9% of risk weighted assets (**RWA**). Currently NBDTs have a minimum total capital ratio requirement of 8% of RWA, which increases to 10% or 12% for those that are exempt from a credit rating.
- In addition to the minimum total capital ratio requirement of 9% of RWA, Group 3 deposit takers would be required to have a PCB of 4% of RWA, which increases to a PCB of 5% of RWA for those that are exempt from a credit rating.
- Risk weights would be aligned with the standardised approach. This is the same approach that applies to certain categories of exposures for Group 1 deposit takers and to all categories of exposures for Group 2 deposit takers.[11]
- Additional Tier 1 (**AT1**) and Tier 2 capital instruments would be able to be included in their capital structure.
- Feedback was sought regarding whether to require an absolute minimum capital base.

Based on their current capital holdings, and taking into account the lower average risk weights, we considered that most Group 3 deposit takers should be able to meet the proposed capital policy settings described in the DTA Consultation Paper. The 2025 Capital Review Consultation Paper provides additional commentary on this in the context of the options contained in the 2025 Capital Review.

Consistent with the Proportionality Framework, we proposed that requirements for Group 3 deposit takers will be uniform across all deposit takers in the group. However, we noted that there is a high degree of diversity across Group 3 deposit takers, including in corporate form, ownership model and size. We therefore sought feedback about whether there is a basis to consider varying the application of some requirements across different types of Group 3 deposit takers.

The rest of this chapter summarises the feedback received to each of the 2024 proposals, sets out our analysis of the issue and provides our decision in response to the feedback. Where appropriate, we have also responded to other issues raised in feedback that we did not originally

11 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: available here.

consult on, although many of the substantive themes of that feedback are covered in the 2025 Capital Review Consultation Paper.

2.3. Approach for Group 1 deposit takers – our response to submissions

Our proposed approach for Group 1 deposit takers, as set out in the DTA Consultation Paper, was to carry over most aspects of the existing capital framework that applies to those deposit takers. That proposal was influenced by the refresh of the capital framework through the **2019 Capital Review** which led to a significantly reformed and strengthened capital framework.[12]

However, this is one of the areas we are consulting on in the 2025 Capital Review consultation and, therefore, these proposals have been superseded.

We proposed amendments to three specific parts of the capital framework for Group 1 deposit takers that are not affected by the 2025 Capital Review. These are set out later in this section.

2.3.1. Internal Capital Adequacy Assessment Process requirements

In the DTA Consultation Paper, we proposed to continue to include provisions around the Internal Capital Adequacy Assessment Process (**ICAAP**) for Group 1 deposit takers. We noted that we intend to strengthen ICAAP settings by converting the guidance set out in Banking Prudential Requirements (**BPR**) document *Capital Adequacy* (**BPR100**) into requirements under the new Capital Standard. The main implication of this would be changing the settings from what a deposit taker "should" do into what a deposit taker "must" do.

The DTA Consultation Paper directly referenced ICAAP requirements for Group 1 deposit takers, but it did not reference them for Group 2 or Group 3 deposit takers. This was not our intention and our proposal to include ICAAP requirements in the Capital Standard was to apply to all deposit takers, including Group 2 and Group 3 deposit takers.

A number of respondents requested more information about ICAAP requirements under the Capital Standard, including:

- how the requirements would be applied to Group 2 deposit takers
- how the current ICAAP guidelines will translate into the Capital Standard.

Comment

ICAAP requirements set out the process that deposit takers must follow to ensure they maintain sufficient capital to cover their risks. The ICAAP requires institutions to assess their own capital needs based on their risk profile, business strategy and market conditions.

12 Reserve Bank of New Zealand. (2019, 5 December). *Higher bank capital means safer banking system for all New Zealanders*. rbnz.govt.nz/hub/news/2019/12/higher-bank-capital-means-safer-banking-system-for-all-new-zealanders

Table 2.2: Key components of the ICAAP

Risk identification	Deposit takers must identify all relevant risks.
Capital assessment	This includes an assessment of how much capital is necessary to cover these risks under various scenarios.
Governance and oversight processes	These are integrated into a deposit taker's overall risk management framework and must involve appropriate governance structures.
Reporting	Deposit takers are required to document and report their ICAAP findings to the Reserve Bank, to demonstrate compliance with regulatory requirements.

The ICAAP helps ensure that deposit takers can absorb losses while continuing operations, thereby promoting financial stability in the banking sector. We consider the ICAAP requirements play an important role in the prudential framework to support financial stability.

Application to different deposit taker groups

Our intention is that the ICAAP requirements in the Capital Standard will be applied in much the same way as they currently are in the BPRs for Group 1 and Group 2 deposit takers. The main change is that the requirements covering what a bank "should" do will be strengthened to say what the deposit taker "must" do.

We also expect that ICAAP requirements will apply to Group 3 deposit takers, but this will likely be in a more simplified form – the exact specification will be covered in the exposure draft. We will also likely provide guidance alongside the Capital Standard to help deposit takers apply the requirements in a way that is proportionate to the size and nature of their business.

Detailed ICAAP requirements

Currently, the ICAAP requirements are covered in BPR100. Parts of the requirements say that a bank "must" do a range of activities, including:

- identifying and measuring its other material risks
- determining an internal capital allocation for each identified and measured other material risk.

Other parts of the ICAAP in BPR100 are covered as guidance for what a bank should do, for example:

- The framework should include board and senior management oversight, risk monitoring and reporting processes, and regular independent review.
- There should be credible and consistent policies and procedures to identify, measure, and report all material risks that the bank faces.
- The board should ensure that management establishes a framework for assessing the various risks.
- Bank management should understand the nature and level of risk that the bank takes.

Our assessment is that strengthening the specific requirements of the ICAAP to set what a deposit taker must do will make expectations and requirements more transparent and consistent across deposit takers. This will help contribute to the purposes of the DTA by providing a stronger statement to underpin the way deposit takers manage their capital.

Response

We intend the exposure draft of the Capital Standard to include provisions for ICAAP requirements for all deposit taker groups (not just Group 1 deposit takers).

We intend to include the full ICAAP requirements in the exposure draft. Respondents will have the opportunity to provide feedback on the drafting at that time.

2.3.2. The use of capital overlays

In the DTA Consultation Paper, we proposed including scope for the possible use of capital overlays, either through a sectoral capital requirement (**SCR**) or through entity-specific requirements. This section discusses the feedback received on these two proposals and provides a response that covers both mechanisms, as they will be treated consistently in the exposure draft of the Capital Standard.

Sectoral capital requirements

We proposed the possible use of an SCR for Group 1 deposit takers. While this was not explicitly proposed for Group 2, there may be circumstances where this is also necessary for Group 2.

The role of an SCR is currently covered in our Memorandum of Understanding (**MoU**) with the Minister of Finance about the use of macroprudential tools.[13] 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, the residential mortgage sector), which poses risks for the whole system.

We proposed including 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 at present, and any future implementation would be covered by a separate policy consultation about the details of the approach.

One respondent asked for the scope for an SCR to be removed as they did not consider it necessary given the range of other regulatory mechanisms available and the rising level of capital associated with the 2019 Capital Review decisions.

Entity-specific capital overlays

In the DTA Consultation Paper, we noted that, in addition to minimum capital requirements, there may be circumstances where entity-specific capital overlays are required. This could include situations where a deposit taker is undertaking high exposures to high-risk sectors. This proposal attracted feedback, particularly from deposit takers who are less familiar with the use of overlays.

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13 Reserve Bank of New Zealand. (2021, 2 August). *Macroprudential policy and operating guidelines*. 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

The respondents advised they do not support the use of entity-specific buffers or overlays. Respondents considered that standardised risk weights adequately addressed risks associated with a deposit taker's assets and any high-risk exposures should be managed through credit risk weights. The respondents noted that "any entity specific capital requirements should be implemented in accordance with a transparent framework which should itself be the subject of consultation".

Comment

Sectoral capital requirements

In the DTA Consultation Paper, we mentioned that 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.

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. 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.

An SCR 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.

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%. We intend to include scope for the use of an SCR in the Capital Standard. If we consider it necessary to use the SCR in the future, it would likely be specified by licence conditions. This gives flexibility to apply the SCR to some deposit takers and not others.

Entity-specific capital overlays

The use of entity-specific capital overlays forms a part of the Basel 'Pillar 2' supervisory review framework. While Pillar 1 sets minimum capital requirements, Pillar 2 ensures banks have adequate capital for all their business risks and encourages banks to better monitor and manage risks. This is a well-established feature of the Basel framework. It is also a part of our existing prudential framework, although we tend to use such overlays in rare, specific circumstances, and in a public way.

We consider retaining the use of entity-specific capital overlays under the new regime to be desirable for all groups of deposit takers. Supervisory review (and subsequent interventions) is a key part of our prudential regime. Not having a tool such as entity-specific capital overlays available for all deposit takers could limit our ability to prudently supervise these entities. This part of our prudential framework supports the additional purpose of the DTA, to promote the safety and soundness of individual deposit takers.

Framework for entity-specific capital overlays

One key issue we have considered for all groups is how to draft the Capital Standard to provide for the use of entity-specific capital overlays. Section 92 of the DTA sets out that standards may provide for matters to be specified by conditions. To include entity-specific capital overlays in the Capital Standard, section 92(4) of the DTA requires that a standard:

a. sets an appropriate range or limit within which the requirement or matter may be specified by the condition; or

b. sets out an appropriate manner for the Bank to decide on the terms of the condition (for example, by specifying the matters that the Bank must have regard to, or be satisfied of, when deciding which condition to apply).

We intend to follow the approach in section 92(4)(b) which would allow us flexibility to assess a deposit taker's risks and respond based on a set of principles or a framework. Setting a range or limit as provided for by section 92(4)(a) would be challenging, as an upper and lower bound could again limit our ability to respond appropriately to a deposit taker's unique circumstances.

Response

We intend to retain the flexibility to impose capital overlays, either through an SCR or entity-specific overlay for all groups of deposit taker. The exposure draft of the Capital Standard is intended to provide for the use of a capital overlay. It will set out how we may impose an SCR and what form it may take, as well as how entity-specific capital overlays may be imposed.

We intend to set out a clear framework for the use of overlays and respondents will have the opportunity to provide feedback on this during consultation on the exposure draft of the standard.

2.3.3. The use of internal ratings-based modelling

Risk weights are used to convert exposures into risk weighted assets, which are the denominator in the calculation of capital ratios.

Under the standardised approach, risk weights for different categories of lending are set by the Reserve Bank. For example, for a standard residential mortgage loan, we require risk weights varying from 35% to 100%, depending on factors including whether the loan is for property investment, and the loan-to-value ratio (**LVR**) on the loan. A key feature of the standardised approach is its simplicity, which makes it easier - and less costly - to implement.

Given that standardised risk weights vary according to a limited range of factors, they are limited in how accurately they can reflect the true risk of a deposit takers' lending. Currently, banks accredited to use the IRB approach use internal models to calculate risk weights for individual loans, based on that loan's risk characteristics.

A key aim of the IRB approach is to allow for greater granularity in banks' capital adequacy calculations. This granularity means that risk weights better reflect the risk characteristics of a bank's lending portfolio. However, the IRB approach is significantly more resource intensive, with more data and credit risk modelling required, which makes it more costly to implement than the standardised approach.

In the DTA Consultation Paper, we proposed to retain the use of IRB modelling for accredited banks. This currently includes all Group 1 deposit takers, though deposit takers from other groups can also apply for IRB accreditation. The IRB approach uses inputs from credit models developed internally by the deposit taker in formula specified by the Reserve Bank. We must accredit a deposit taker to use the IRB approach and approve the models it uses in its RWA calculation.

The majority of feedback received on this proposal was from Group 2 deposit takers. We discuss this feedback in this section, because it materially impacts the proposed approach for Group 1 deposit takers.

One respondent made a detailed submission about risk weights and, in particular, the use of IRB modelling by Group 1 deposit takers. This respondent proposed that the IRB output floor for IRB modelling be set at 100% of the standardised outcome, which they say matches the approach used by the US Federal Reserve in one of its capital methodologies.

In support of their submission, the respondent pointed to what they consider to be the main flaw in the proposals, which they state will negatively affect competition. Their central point is that while the domestic systemically important banks' (**D-SIB**) buffer increases the capital ratio faced by Group 1 deposit takers relative to Group 2 deposit takers, this is offset by the use of IRB models. In the respondent's view, this undermines proportionality.

The respondent noted that the 2019 Capital Review changes have largely removed a significant advantage that IRB modelling previously gave the IRB banks. However, in their view, there is still an impact on competition between Group 1 deposit takers who are IRB accredited, and Group 2 deposit takers or potential Group 1 deposit takers who are not IRB accredited.

The respondent noted that this impact on competition is a result of the lower risk weights for IRB accredited banks effectively offsetting the additional PCB requirement for Group 1 deposit takers. The respondent concluded that the end amount of capital – after taking into account the risk weights, minimum capital ratios and PCBs – means that, in effect, the levels of capital are approximately the same for Group 1 and Group 2 deposit takers.

Comment

The feedback provided by one respondent about the use of IRB modelling points to divergent views about the role of IRB models. This subsection sets out our rationale for our intention to continue with our current IRB approach, as we consider IRB modelling to provide a more accurate and granular reflection of risk.

Overview of approach to risk weights

Banks' capital requirements are set in proportion to the riskiness of their lending activities, which is achieved through applying risk weights to the different categories of lending – for example, residential mortgage, rural, commercial property, and general business. The primary purpose of risk weights is to reflect the underlying credit risk that a bank faces; both the probability that a borrower will default on their loan, and the likely losses the bank would face following a default.

Two methodologies are used to determine risk weights: the IRB approach used by the four major banks, and the standardised approach used by all other banks. The IRB approach uses banks' internal data and modelling to create more granular risk weightings which can reflect the assessment of credit risk at an individual loan level, while the standardised approach allocates loans to broad categories determined by the Reserve Bank for risk weighting and is therefore simpler to implement.

The Reserve Bank's IRB and standardised approaches are based on the Basel Committee on Banking Supervision's (**BCBS**'s) Capital Framework, which is used by bank regulators in a wide range of jurisdictions. In both approaches, the aim of risk weights is to ensure that capital requirements are proportionate to underlying risk. Under both approaches, we regularly review the appropriateness of our risk weight calibrations, and the IRB banks' model outcomes, and amend these where we believe they are out of line with the underlying credit risks.

We have work underway to review parts of the standardised approach, which is detailed later in section 2.3.12 of this chapter. This work may have additional impacts on the use of IRB modelling by Group 1 deposit takers.

Features of the IRB approach, including the output floor and scalar

The output floor has been calibrated to a level that we consider is appropriate for New Zealand circumstances. At 85%, it is above the 72.5% output floor in the Basel framework.[14] The setting in New Zealand is based on New Zealand's financial system and will therefore not match approaches in other countries, which have a range of different settings.

We intend to retain IRB modelling for accredited deposit takers and we do not support changing to a 100% output floor. However, we will finalise the approach to the output floor once decisions have been made following the 2025 Capital Review.

Our preference is to have capital requirements to reflect the risk of loans, and to encourage more granular risk management that is available in IRB modelling.

The more granular risk assessment that results from IRB modelling, relative to the standardised approach, means increased granularity in risk weights. This more accurately reflects the underlying risk of exposures, which helps ensure that capital requirements are aligned with risk in the most efficient way. A more granular assessment is also likely to support efforts to manage emerging risks—such as declining insurability due to climate change—as these begin to affect a loan's credit risk profile. A more granular approach is also one of the reasons we are carrying out the 2025 Capital Review, which is discussed further in section 2.3.12 below.

The more granular assessment required in the IRB approach is not without cost. The standardised approach functions as a default option for deposit takers with less capacity to do granular comparisons of risk within portfolios. Less capacity for such comparisons could be due to a range of factors, including data and system limitations and/or limited data histories with which to build robust credit risk models). In our view, the benefits discussed above for risk differentiation are significant and support the continuation of the use of IRB modelling.

14 https://www.bis.org/bcbs/publ/d424.pdf.

Other restraints have been put in place (scalar and output floor) to ensure that the capital benefits are appropriately constrained. Together with the D-SIB buffer, these significantly limit the extent to which IRB modelling leads to overall funding cost advantages for the four largest deposit takers.

We are open to standardised banks applying for IRB accreditation. As part of the new approach under the DTA, we will publish a notice covering the process for those deposit takers applying to be accredited for using IRB models. This process will not be restricted to Group 1, and other deposit takers can apply, as is the case now under current regulations.

Nevertheless, IRB modelling requires a depth of data and sophistication in systems that may not be practical for smaller deposit takers. It is a resource intensive process, with current IRB banks in New Zealand being able to benefit from the expertise and support available from their large Australian parents.

Models must be robust as the output of modelling directly contributes to a bank's regulatory capital calculation. In most jurisdictions, it is common for only a small number of banks to be authorised to use the IRB approach– for example, only the six largest banks in Australia are currently accredited to use IRB models.

Some respondents suggested lifting the output floor beyond 85%. The decision to set the output floor for credit risk RWA at 85% was made after careful consideration and calibration in the 2019 Capital Review.

When the output floor is combined with the scalar (applied to credit risk RWA for IRB banks and increased from 1.06 to 1.2), our analysis indicated this would lead to RWA outcomes for IRB banks being approximately 90% of what would be calculated under the standardised approach. This is an increase from a level of approximately 70% to 75% in prior years. It was also consistent with the purpose of promoting the maintenance of a sound and efficient financial system, as set out in the former Reserve Bank of New Zealand Act 1989 (now the Banking (Prudential Supervision) Act 1989) which was our governing legislation at the time of the 2019 Capital Review.[15] A further increase in the output floor might reduce the differential with the standardised approach to a level that reduces the risk sensitivity benefits of IRB modelling. This could affect the incentives for firms to voluntarily seek IRB accreditation.

We will finalise our approach to the output floor as part of decisions on the 2025 Capital Review. The final settings will be included in the exposure draft.

Impact on funding costs

The 2025 Capital Review Consultation Paper includes an extensive discussion of the funding cost implications associated with the options in that paper.

We received a range of feedback about the interaction between the IRB and standardised approaches as they currently operate in the existing framework. While these dynamics will change if parts of proposals in the 2025 Capital Review Consultation Paper proceed, we have included some analysis below that relates to existing policy settings.

15 Reserve Bank of New Zealand Act 1989, section 68 Exercise of powers under this part. (As at 1 January 2016). legislation.govt.nz/act/public/1989/0157/82.0/DLM200336.html

As noted in the DTA Consultation Paper, prior to the 2019 Capital Review changes, differences in the two regulatory capital frameworks could account for approximately 9 basis points of difference in the average funding costs for a residential mortgage. Following the changes to the IRB framework (output floor and change in scalar), this reduces to around 6 basis points. Taking into account the additional D-SIB buffer that applies to the four IRB banks, the difference in average funding costs due to the different capital calculations reduces to nil. The 2025 Capital Review Consultation Paper has a detailed discussion of these interactions in the proposed options.

Other technical points raised in feedback

The intent of IRB modelling is for a deposit taker to use information about the characteristics of its own lending to accurately measure risk. This in turn should contribute to a more granular and more accurate assessment of the underlying risk to feed into risk weights.

In their feedback, one respondent raised specific technical points relating to the use of IRB modelling, including areas where they concluded the evidence regarding risk measurement, risk management and the application to accurately calculating risk weights was limited.

As noted above, banks that are not accredited to use IRB models to calculate credit risk weights must use the standardised approach. We intend to retain this approach in the future. The respondent stated that they are not aware of any evidence that IRB accredited banks manage their risks better than other banks. The respondent raised points that they considered undermined the use of IRB models for calculating credit risk weights. We have addressed this feedback in the table below.

Risk weights are considered in more depth in our 2025 Capital Review Consultation Paper.

Table 2.3 Responses to IRB modelling feedback

Feedback	Comment
Standardised banks report lower levels of troubled loans as a percentage of their portfolios.	Regulatory risk weights and the share of 'troubled loans' at a given bank are not directly related. However, we acknowledge that risk weights may indirectly influence lending standards. This is because risk weights determine banks' capital requirements and the cost of capital of their lending. However, risk weights are not the sole determinant for banks' lending standards. Differences in banks' decision making for a given lending class is driven by their risk appetite, views of the economic prospects of a sector, business strategy and growth plans.
IRB models generated a wide range of risk weighting outcomes across the IRB banks even where portfolios may be largely homogenous.	Portfolio-level risk weights depend on banks' loan origination standards and target markets, in addition to modelling differences. For example, for residential mortgages, the distribution of LVRs and debt-to-income ratios may be quite different when comparing any two banks. IRB models are better able to measure credit risk. Therefore, IRB banks may have a greater range of risk weight outcomes for what might appear to be homogenous portfolios owing to underlying credit risk differences.
RBNZ stress tests imply IRB models have difficulty	Bank industry stress tests serve many purposes beyond the primary benefit of IRB risk weight setting. Banks have different views on how a

Feedback	Comment
accurately measuring tail risks given the wide range of outcomes.	stress scenario will impact on their loan portfolios due to differences in modelling approach, expert judgement and underlying portfolio differences. We do not approve banks' stress testing models as we do with IRB models, leading to the potential for variation in stress test results.

Response

We intend to retain the existing IRB modelling approach. We have carrying out additional work to assess aspects of the standardised approach in the 2025 Capital Review. We will finalise our approach to the output floor as part of final decisions on the 2025 Capital Review and will include them in the exposure draft.

2.3.4. Lending to Community Housing Providers

A number of respondents provided feedback about the treatment of lending to Community Housing Providers (**CHPs**).

One respondent noted that under the model used by most CHPs, the Crown funds community housing under a long-term contract with a CHP committing to payment of a market rent, and in some cases, tops this up with an operating supplement. The term of these contracts is typically for 25 years. The respondent also noted that although the volume of lending to registered CHPs is still relatively small, it is growing. They estimate that there are currently around 13,415 homes under ownership and/or management by CHPs, with an additional 1,500 new homes expected to be added following announcement in the 2024 Budget. The respondent indicated that the expansion in the sector might be associated with around $1 billion of lending requirements.

Respondents generally indicated that they considered that lending to CHPs attracts a higher risk weight than is needed for the risk of the lending. Respondents suggested the following alternative approaches:

- Create a new exposure category that would not be subject to modelling. This would be equivalent to creating a new exposure in the standardised approach to credit risk and requiring all deposit takers - regardless of whether they are accredited to use IRB modelling - to use the specified risk weight.
- Require IRB-accredited banks to treat the exposures as corporate lending but set a prescribed Loss-Given-Default to recognise the Government's participation in the arrangement and to encourage market participation in these arrangements. In this approach, the Probability-of-Default would still be modelled and would be determined by the individual risk factors of the CHPs.

Comment

This topic was also raised during the risk weights consultation we completed during 2022 and 2023.[16] In that work, we noted that we had received feedback suggesting that the risk weights for lending to CHPs were too high. As we stated at that time, under the standardised approach there

16 *See* rbnz.govt.nz/have-your-say/risk-weights#pastconsultation.

may be cases where such a loan can be treated as a residential mortgage loan. Rental income is excluded from the definition of commercial activity for the purposes of defining a residential mortgage loan in the BPR documents. Banks would need to consider loan applications on a case-by-case basis. Under the IRB approach, it is unlikely that such a loan would qualify as a residential mortgage loan. This is because a residential mortgage loan in the IRB approach must meet the definitions of a retail exposure in section B4 of *BPR133 IRB Credit Risk RWAs* (**BPR133**). This includes a requirement that a retail exposure must be to an individual (that is, a natural person) or to a small or medium enterprise.

Response

We are currently reviewing the risk weights for lending for community housing in the 2025 Capital Review. Please see section 5.3 of the 2025 Capital Review Consultation Paper for the detail of the proposed changes.

The final decision on the risk weights for lending for community housing will be confirmed alongside the 2025 Capital Review decisions. It will then be included in the Capital Standard exposure draft. This will cover both the IRB and standardised approaches.

2.3.5. Additional Tier 1 capital instruments

AT1 is one of the forms of regulatory capital that banks can use to meet their Tier 1 requirements. This form of capital was significantly revised as part of the Capital Review to address some of the concerns we had around its effectiveness. The new requirements have been in place since 2021.

However, both bilaterally and in response to the DTA Consultation Paper, deposit takers have asked us to consider changes to AT1, largely to address what they say are significant barriers to using AT1.

Broadly, the feedback revolves around two main themes:

- concern that there is inadequate depth in the domestic market to absorb the amount of AT1 banks would need to issue
- the equity nature of AT1 makes it difficult to sell to offshore (as well as certain domestic) investors.

Comment

As part of the 2025 Capital Review, we committed to considering the role of AT1 capital within the New Zealand regulatory framework.

We have taken account of all the feedback we have been provided about AT1 since the outcome of the 2019 Capital Review, together with information deposit takers have provided us in bilateral discussions and in response to the DTA Core Standards consultation.

We have used the opportunity to look at how AT1 is working in New Zealand and whether it is fulfilling its regulatory objectives. We have also looked at the extent to which it has contributed to one of the goals of the 2019 Capital Review which was to reduce complexity in the capital regime.

In particular, we have considered:

- the effectiveness of AT1 as a loss-absorbing form of capital, bearing in mind international experience
- the form of AT1 capital in New Zealand and how this impacts the investor base
- proportionality and competition aspects
- its potential interaction with the crisis management framework.

These points are discussed in more detail in the AT1 section of the 2025 Capital Review Consultation Paper.

In summary, we do not think there are possible changes to the design of AT1 that would enable deposit takers to issue it more efficiently, increase market capacity and still provide the desired regulatory outcome without also re-introducing complexity.

We also have concerns about whether AT1 meets the regulatory objectives it was designed to achieve. Instead, even if it is used as intended, we have concerns that AT1 will have the effect of exacerbating rather than stabilising a stress situation.

Response

We are proposing to remove AT1 as a form of regulatory capital in New Zealand. Please see the 2025 Capital Review Consultation Paper for more detail about this proposal.

2.3.6. Foreign Currency Translation Reserves

Foreign Currency Translation Reserves (**FCTR**) primarily consist of gains and losses from investments in foreign operations with a different functional currency. *BPR110 Capital Definitions* (**BPR110**) treats these reserves as Tier 2 capital.

We did not propose changing this treatment in the DTA Consultation Paper, but we have received feedback from one respondent suggesting changes. Although this respondent provided feedback in the context of Group 2 deposit taker requirements, our analysis and response are applicable to Group 1 deposit takers as well.

The respondent suggested that FCTR should be treated as CET1 capital, instead of its current treatment as Tier 2 capital. The respondent advises that continuing to treat FCTR as Tier 2 capital results in volatility of CET1 and Tier 1 capital ratios depending on currency movements. They note that this occurs despite no movement between the capital deployed into the foreign operation and associated exposures.

The respondent considers this approach does not reflect the actual risk position of the deposit taker. They also note that the position cannot be hedged as hedging the equity deployed to remove any FCTR will result in volatile capital ratios for all ratios as the risk weighted exposures will revalue whilst, in effect, the capital will not.

Comment

FCTR primarily consist of gains and losses from investments in foreign operations with a different functional currency. As noted above, one respondent has identified that the treatment creates volatility in capital ratios and cannot be hedged. We have used an example provided by the respondent to illustrate this dynamic.

Table 2.4: Illustration of the effect of treating FCTR as Tier 2 capital on CET1 capital ratios

	AUD	NZD	NZD
Exchange rate		0.90	0.96
Risk weighted exposures	10,000	11,111	10,417
Share capital and retained earnings (CET1 capital)	1,600	1,778	1,778
Foreign currency translation reserves (Tier 2 capital)			(111)
Total capital	1,600	1,778	1,667
CET1 capital ratio	16.0%	16.0%	17.1%
Total capital ratio		**16.0%**	**16.0%**

In this example, the change in the exchange rate results in a fall in risk weighted assets in NZD terms. We understand that CET1 capital is not revalued in these circumstances, due to the application of accounting standards. Instead, the $111 fall in the value of the $1,600 investment from the higher exchange rate becomes a negative item for Tier 2 capital. The CET1 capital ratio falls, due to higher risk weighted assets but there is no change in the total capital ratio, due to the decline in Tier 2 capital.

While investment in foreign currency operations have not had a major role in our framework, this is an issue of growing importance in the changing landscape of the New Zealand financial system.

Fluctuations in CET1 capital ratios driven by the exchange rate are not desirable from a prudential regulation perspective. In particular, a fall in the exchange rate could lead to a fall in the CET1 capital ratio, with no change in the total capital ratio. This could lead to a situation where a deposit taker breached the minimum CET1 capital ratio requirement despite no real change in the capital position of the bank. This could trigger a range of supervisory and enforcement actions which would otherwise not be required.

The change proposed by the respondent results in the same total capital ratio, but by allocating the FCTR to CET1 capital it avoids the risk of exchange rate movements driving volatility in the CET1 capital ratio. This is illustrated in Table 2.5 below.

In Table 2.5, as in Error! Reference source not found.4 Error! Reference source not found., risk weighted exposures decrease when the exchange rate increases. However, the level of CET1 capital is adjusted downwards—instead of a reduction in Tier 2 capital in Table 2.4—the net impact is that risk weighted exposures and CET1 capital both change, such that the CET1 and total capital ratios are unchanged.

Table 2.5: Revised illustration of the effect of treating FCTR as CET1 capital (instead of Tier 2 capital) on CET1 capital ratios

	AUD	NZD	NZD
Exchange rate		0.90	0.96
Risk weighted exposures	10,000	11,111	10,417
Share capital and retained earnings (CET1 capital)	1,600	1,778	1,667
Foreign currency translation reserves (Tier 2 capital)		0	0
Total capital	1,600	1,778	1,667
CET1 capital ratio	16.0%	16.0%	16.0%
Total capital ratio		**16.0%**	**16.0%**

This revised approach of treating FCTR as CET1 capital is consistent with the BCBS's approach (CAP10) and with APRA's approach (APS111).[17] For example, APRA requirements note that FCTR are part of "accumulated other comprehensive income and other disclosed reserves" in CET1 capital.

Response

Based on the analysis above, we intend to make the change suggested and treat FCTR as CET1 capital. We intend to include this in the exposure draft of the Capital Standard. This is not affected by any of the options discussed in the 2025 Capital Review Consultation Paper.

2.3.7. Technical amendments to the credit risk framework

The DTA Consultation Paper proposed four minor amendments to the credit risk framework, in response to previous topics identified by stakeholders in other consultations.[18] Each of these is discussed in more detail in section 2.3.8 to 2.3.11 below.

Response

The response to each of the technical amendments are discussed in in section 2.3.8 to 2.3.11 below.

We are reviewing some broader aspects of our credit risk framework as part of the 2025 Capital Review. We have proposed more granular standardised risk weights in specific areas (see chapter 5 of the 2025 Capital Review Consultation Paper).

17 *See* CAP10, section 10.6: https://www.bis.org/basel_framework/chapter/CAP/10.htm?inforce=20191215&published=20200605; APS111, section 37: apra.gov.au/sites/default/files/2021-08/APS%20111%20Capital%20Adequacy%20Measurement%20of%20Capital.pdf

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

In addition to the feedback received to the individual proposals below, some respondents also expressed a strong preference that any technical amendments to the credit risk framework should be implemented before the Capital Standard is issued, through changes to the BPR documents. We are still considering this matter and will provide a response following decisions on the 2025 Capital Review.

2.3.8. Risk weight for longer-term exposures to A-rated banks

In the DTA Consultation Paper, we proposed to reduce the risk weight for longer-term exposures to A-rated banks to 30%. This change would align our ratings framework with the BCBS's approach (CRE20), which has also been implemented by APRA (APS112). It would also better reflect the difference in relative riskiness between a bank with a rating grade of 2 and a bank with a rating grade of 3.

This proposal was supported by all respondents who had a view. No additional feedback was received.

Comment

Based on the support from respondents, we consider that our original assessment of this proposal is still accurate.

Response

We intend to proceed with the proposal to reduce the risk weight for longer-term exposures to A-rated banks to 30%. This is not affected by the 2025 Capital Review.

2.3.9. The effective maturity date of three-month bank bills

In the DTA Consultation Paper, we sought further information in relation to the implications of aligning the effective maturity date of three-month bank bills with New Zealand's financial market's maturity convention. This proposal related to exposures to deposit takers and was intended to remove unnecessary distortion caused by the potential for capital costs to be included by the inconsistency between our framework and a well-established market practice.

Some respondents highlighted the interaction with Part C2.9 of *BPR131 Standardised Credit Risk RWAs* (**BPR131**) which deals with issue-specific short-term ratings. Under that requirement, where a deposit taker has a credit rating which is specific to a particular issuance or programme, as opposed to the credit rating for the deposit taker as a whole, that rating must be used to determine the particular risk weight to be applied. The guidance box in this section explains that '*short-term*' does not denote any particular maturity but refers to the nature of the rating agency credit rating.

Part C2.5(2) of BPR131 makes clear that parts C2.9 to C2.11 will apply where the exposure has an issue-specific short-term rating irrespective of the credit rating of the counterparty deposit taker.

As part of the consultation on the Capital Standard, we sought information to fully assess the impact of the proposed change but had broadly assessed the likely level of change as being negligible. Some information was provided to us but not at a level of detail by which we could determine impact with any accuracy.

One respondent noted that the level of its exposures impacted by the proposed change would not be expected to constitute a significant proportion of overall exposure.

Another respondent suggested all deposit taker short-term issuance programmes have external issue-specific ratings. If this is the case, such exposures would be outside of the scope of the potential change discussed as it would only impact exposures risk weighted by reference to the deposit taker's credit rating.

Comment

The impact of our proposed change would be to increase the number of exposures that would be considered as 3-month or less where the deposit taker's credit rating was relevant for determining the appropriate risk weight. We had assessed that the impact of such a change would be negligible. However, from what we have been told, the impact would be even lower than we anticipated.

That notwithstanding, respondents supported aligning the definitions with one respondent commenting that it enables New Zealand to align with international practice as well as supporting a more effective and efficient 3-month bank bill market in New Zealand.

Response

We intend to proceed with the proposal to align the effective maturity date of three-month bank bills with New Zealand's financial market's maturity convention.

2.3.10. Risk weight for exposures to the New Zealand Superannuation Fund

In the DTA Consultation Paper, we proposed setting a specific risk weight for exposures to the New Zealand Superannuation Fund (**NZ Super Fund**) at 20%. In our current risk weights framework, exposures to the NZ Super Fund are treated as 'corporate' exposures and due to not having an external credit rating, attracts a risk weight of 100%.

Our proposal to set a specific risk weight for the NZ Super Fund was intended to reflect what we understand to be more representative of the risk that such exposures present.

This proposal was supported by all respondents who had a view, and no additional feedback was provided.

Comment

Our proposal in the DTA Consultation Paper was based on available data, that strongly suggested 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.

Based on this and the unique characteristics of the NZ Super Fund, we were satisfied that it justified a different risk weight treatment than other unrated corporate exposures.

Response

We intend to proceed with the proposal to create a new risk weight category for exposures to the NZ Super Fund, set at 20%.

2.3.11. Firm-size adjustments for corporate exposures

In the DTA Consultation Paper, we proposed to clarify that 'consolidated' should be interpreted by reference to generally accepted accounting principles in New Zealand (**NZ GAAP**) for the purposes of making firm-size adjustments for corporate exposures when IRB banks calculate their credit RWA under BPR133.

This was intended to ensure that deposit takers are consistent in how they approach determining whether to make the specific adjustment needed to the calculation of an exposure where the counterparty is part of a consolidated group below a certain size.

Nine respondents provided feedback on this proposal, including Group 1 and Group 2 deposit takers, as well as other interested stakeholders (New Zealand Financial Markets Association and New Zealand Banking Association).

This proposal received mixed feedback, with one respondent indicating that the NZ GAAP approach is not necessarily straightforward and so aligning with the NZ GAAP definition will not resolve any perceived inconsistency.

Another respondent suggested we could go further with the guidance and include connected parties as well as consolidated entities in the determination of firm sized adjustments.

Comment

We have assessed the feedback and subsequently consider that there is no need to include any form of guidance about how 'consolidated' should be interpreted. We anticipate that the exposure draft of the Capital Standard will set out the requirements around firm-size adjustments for corporate exposures in a clear and consistent manner.

Response

We do not intend to proceed with the proposal to clarify that 'consolidated' should be interpreted with reference to NZ GAAP.

2.3.12. Reviewing the standardised credit risk framework

In the DTA Consultation Paper, we proposed to not change any credit risk weights outside of the specific changes detailed above.

We received a wide range of feedback from many respondents, particularly Group 1 and Group 2 deposit takers, suggesting changes to the standardised credit risk weights framework. The broad rationale for these suggested changes included:

- our current framework is not aligned with the most up-to-date Basel framework and the changes will bring us closer to international practice
- particular risk weight treatments in the current framework do not accurately reflect the level of risk for those exposures
- particular risk weight treatments can create barriers to lending to certain sectors.

Some respondents asked us to review the full standardised credit risk weights framework, whereas others requested that we review specific aspects of it. We also note the Commerce Commission recommendation in its market study into personal banking services to consider more granular standardised risk weightings.[19]

Comment

The 2025 Capital Review Consultation Paper includes discussion and potential options for changes to standardised risk weights. These areas relate to:

- corporate exposures (including farm lending)
- residential mortgage lending exposures
- the treatment of exposures to CHPs – this may also be relevant for the IRB approach, as suggested by some respondents, and we will also consider whether changes are required to the IRB approach for this type of exposure. Whilst not directly raised by respondents, we will also consider any interactions with cooperative housing arrangements.

These areas cover a majority of exposures in the system.

In addition to these topics above raised by respondents in their feedback, we also intend to consider lending on Māori freehold land. The recent practice note from the Māori Land Court helps to clarify the steps required when dealing with whenua Māori. We will consider whether any other changes are needed in the standardised approach.[20]

Further detail about proposals to change the standardised credit risk framework is included in the 2025 Capital Review Consultation Paper. Once we have received feedback to these proposals we will finalise our standardised credit risk framework approach.

Response

We are currently consulting on possible changes to the standardised credit risk weights. Once final decisions have been made to standardised risk weights we will incorporate them into the Capital Standard exposure draft.

The IRB credit risk weight outcomes are tied to the standardised approach through the use of an output floor and a scalar on IRB calculations. This means it is possible that changes to the standardised approach will have wider-ranging impacts on risk weights, and therefore capital, across the system as a whole.

2.3.13. Quantitative capital requirements for market risk

We consulted on updating our capital requirements to market risk. The current requirements, set out in *BPR140 Market Risk* (**BPR140**), are based on a model developed in 1996 and are now out of date with international regulatory practice and financial market developments.

BPR140 sets out a Pillar 1 market risk charge for both Interest Rate Risk in the Banking Book (**IRRBB**) and market risk in the trading book. This is unusual internationally, with most jurisdictions including market risk in the trading book in Pillar 1, but IRRBB in Pillar 2 (supervisory discretion).

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

20 *See* rbnz.govt.nz/about-us/how-we-work/te-ao-maori/lending-on-whenua-maori.

We consulted on a change intended to provide a more granular measure of deposit takers' market risk by refining the amount of capital that needs to be held against this risk. This change was not to increase the capital that deposit takers need to hold.

The DTA Consultation Paper sought feedback on maintaining a Pillar 1 approach for IRRBB and updating our market risk requirements to the BCBS's simplified standardised approach laid out in MAR40 of the Basel framework. While this framework was designed for market risk in the trading book, our opinion was that it could be expanded to cover of both IRRBB and market risk in the trading by incorporating some elements of BPR140.

Comment

Most respondents supported updating our market risk framework. However, there were concerns about how the banking book could be incorporated into MAR40. Some respondents wanted more detail on how this would happen before they could fully consider the proposal. Their concerns included:

- how this would apply to products which were not considered during MAR40's development
- it may increase capital requirements due to:
  - differences in the interest rate risk approach where BPR140 allows for offsetting within a currency but MAR40 does not
  - the inclusion and calibration of the scaling factors in MAR40 could skew deposit takers' investment and lending decisions to avoid certain factors (e.g. equity carried a scaling factor of 3.5 which would likely push lending away from equity)
- MAR40 has more expansive foreign exchange risk calculations that would be more complex to implement and would likely raise capital requirements
- 'double counting' risk because MAR40 includes specific interest rate risk which is also required in the current credit risk framework
- interpretation challenges applying MAR40 to the banking book as MAR40 uses 'fair value' as the basis for calculations which can be done easily for the trading book, but it is difficult to routinely revalue banking book instruments at 'fair value'.

Response

We agree with respondents that the proposal in the DTA Consultation Paper of applying MAR40 to the banking book would be difficult.

To address feedback, we have updated our market risk approach and intend to have separate requirements for market risk in the trading book and for IRRBB. More specifically:

- The banking book requirements for IRRBB will be based on the current interest rate requirements of BPR140. This will include:[21]

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21 BPR140 is available here.

  - relevant sections of *Part A: Capital requirements for market risk* (i.e. excluding the subsections on currency and equity risk)
  - *Part B: Capital requirements for interest rate risk* narrowed to only cover interest rate risk in the banking book and not the trading book.
- As set out in the DTA Consultation Paper, the trading book requirements will be based on the BCBS's simplified standardised approach in MAR40.[22] We intend to translate MAR40 into the Capital Standard without adjusting it to include the banking book, as we proposed in the DTA Consultation Paper.

The boundary between the banking and trading book

The updated proposal requires clarity on the boundary between the banking and trading books. This is also a requirement for the standardised operational risk capital requirements, which is discussed in section 2.3.21 below. We intend to use the same boundary, set out in the next paragraph, for both operational and market risk requirements.

The boundary between the banking and trading book is intended to be based on the requirement in the RBC25 – Boundary between the banking book and the trading book of the BCBS framework (**RBC25**).[23] RBC25 sets out the instruments to be included for the capital calculation in both the trading book and the banking book.

2.3.14. Excluding a deposit taker's own equity from IRRBB calculations

We currently exclude a deposit takers own equity from the market risk calculation since the potential for change in the value of these instruments due to market risk mirrors the potential for losses captured by the market risk capital requirements.

Comment

Respondents noted that this approach creates a structural long position. This leaves them with an exposure that cannot be hedged which is also larger than any they would voluntarily take on. A respondent also noted that this long position leads to a negative unintended consequence. Which then incentivises deposit takers to shorten the investment term of their capital.

Response

We will allow deposit takers to include their own equity in the market risk calculation using a maturity profile approach. Deposit takers can either use the maturity profile approach for their equity or continue to exclude their own equity from the market risk calculation.

2.3.15. Maintaining a Pillar 1 approach for market risk

As noted above, a Pillar 1 approach for IRRBB is unusual. Australia is the only other country that we are aware of that also uses a similar approach. However, in Australia this requirement is limited to their systemically important authorised deposit-taking institutions (**ADIs**).

22 MAR40 is available at bis.org/basel_framework/chapter/MAR/40.htm?inforce=20230101&published=20201126.
23 RBC25 is available at bis.org/basel_framework/chapter/RBC/25.htm?inforce=20230101&published=20200327.

Comment

Most respondents who commented on this supported maintaining a Pillar 1 approach for both IRRBB and market risk in the trading book. One respondent suggested we adopt the European Banking Authority's Pillar 2 approach to IRRBB.

Response

We intend to maintain a Pillar 1 approach for both the banking and trading books. This is better aligned with our approach to make clear and transparent rules wherever possible, rather than relying on supervisory discretion. As a result, we are not considering changing the IRRBB requirements from Pillar 1 at this time.

2.3.16. Specific risk charge in MAR40

One of the main differences between the current requirements in BPR140 and the requirements in MAR40 is the addition of a specific risk charge for interest rate risk. This adds an extra charge for interest rate securities based on their credit rating. This is in addition to the general market risk charge included in both BPR140 and MAR40.

Comment

Responses noted that the specific risk of trading book requirements is already included in the current credit risk framework which covers both the banking and trading book. If the specific risk charge was included in the market risk framework it would lead to this risk being double counted in the capital calculations.

Response

The current requirement to have specific risk in both the banking and trading books included in the credit risk requirements was appropriate when they applied to both the banking and trading books. As we are now separating the banking and trading book, there should be targeted rules that better suit the risk being measured, namely:

- For the banking book, capital requirements for the specific risk of the interest rate instrument will continue to be calculated as part of the credit risk framework.
- For the trading book, capital requirements for the specific risk of the interest rate instruments will be calculated using the specific risk charges in MAR40. These specific risk charges should be a better measure of the risk these instruments represent for the deposit taker holding them.

2.3.17. Trading book scaling factors in the Simplified Standardised Approach

As noted above, the SSA includes scaling factors that are not included in BPR140. These range from 1.2 to 3.5 for different categories of market risk. To get the final capital requirement under the SSA, a deposit taker first calculates their capital requirement for each type of risk using the rules in the relevant section of the SSA in MAR40 and then multiplies it by the relevant scaling factor.

Comment

Most of the comments we received on the scaling factors were on their impact on the banking book. However, some responses were also concerned about the impact the scaling factors could have on the trading book, and how these would be calibrated in New Zealand.

Response

We intend to implement the current SSA scalars unchanged for the exposure draft. BCBS calibrated the scalars against global loss events like the GFC and the European debt crisis.[24] As New Zealand deposit takers with trading books trade in a global environment, the globally calibrated scalars are also appropriate for New Zealand deposit takers.

We also intend to request deposit takers do a voluntary quantitative analysis on their trading book to assess the impact of the scaling factors. After reviewing this, we can update the scaling factors for the final Capital Standard if required. We will work with participating deposit takers to schedule the quantitative analysis around other regulatory workstreams to minimise the impost.

2.3.18. Frequency of IRRBB calculations

IRRBB calculations are currently done as part of the market risk requirements in BPR140, which covers all market risk in the banking and trading book. This requires the market risk calculation to be done daily so that the intra-peak capital charge can be disclosed.

Comment

One respondent requested we review if the daily calculation requirement could be eased for deposit takers without trading books or only apply to the trading book portion of the market risk calculation. The respondent noted that requiring daily calculations creates unnecessary overhead to run this model daily. They also noted that IRRBB should be less volatile than the trading book, which meant that deposit takers without trading books had limited benefits to running this calculation daily. However, another response noted that their IRRBB was more volatile than their trading book.

Response

International experience is that IRRBB should be less volatile than the trading book. Therefore, as we are now having separate requirements for the banking and trading book, we will decrease the minimum frequency of the IRRBB calculation to 'at least quarterly' while maintaining daily calculations for the trading book. This will allow deposit takers to either move to quarterly IRRBB calculation or to maintain it at the current daily frequency. The additional flexibility will allow deposit takers to either update their systems and processes for quarterly calculations or maintain the current daily frequency if they prefer.

2.3.19. Options treatment

MAR40 treats options differently to BPR140. In BPR140, the options calculation for all options can be done via a delta-equivalent method. MAR40 uses a more complex calculation (a 'delta-plus'

24 *See* https://www.bis.org/bcbs/publ/d457_note.pdf

calculation), which incorporates gamma and delta risk that provides a more granular risk measure which will be required for options held in the trading book.

Comment

One respondent was concerned about the additional complexity of MAR40's 'delta-plus' calculations for options. They also noted that MAR40 has broader coverage than the current BPR140 requirements and includes foreign exchange options.

Response

We intend to continue with the updated options calculation in MAR40 for the trading book. Financial markets have developed since BPR140 was first designed, and the updated option calculation, as well as the fact that it includes foreign exchange risk, provides more granular measurement of risk. This will provide a better measurement of the underlying risk of a deposit taker's options portfolio.

2.3.20. Other market risk issues raised

Respondents also raised a range of specific issues with us which we have set out in the table below.

Table 2.6 Other market risk feedback

Feedback	Comment
There is an inconsistent measurement basis in BPR140. Some of the descriptions need to have different measurement bases due to the range of financial instruments they need to include.	We will work on improving these definitions and providing clarity on these issues through the exposure draft consultation and incorporate our updated wording into the exposure draft.
We were asked whether we will include the definition of structural FX from MAR11.	We will include the relevant definitions from MAR11 *Definitions and application of market risk* as these are required to define the terms used in MAR40 for the updated trading book requirements.
Clarity was sought on how currency risk is managed in the banking book (i.e. if currency risk for IRRBB is included in the banking book, or if all currency risk is managed in the trading book).	We will allow deposit takers to choose to manage their banking book currency risk in either the banking or trading book, as long as it is included in one of the calculations.
Clarity was sought on whether the liquidity portfolio is included in the banking book or the trading book.	We do not intend to have a specific rule for the liquidity portfolio. These assets will be divided between the banking and trading book following the same rules in RBC25 as other assets and liabilities.

2.3.21. Standardised operational risk capital requirements

In the 2019 Capital Review decisions, we intended to adopt the new Basel III standardised approach to operational risk. This is set out in OPE25 of the BCBS framework and replaces the existing standardised and internal models approaches with a new standardised approach.

The DTA Consultation Paper provided an opportunity to consult on moving our capital requirements for operational risk to the BCBS standardised approach in OPE25. As the 2019 Capital Review decisions signalled that we would consult on this change in due course, deposit takers were aware that this change was coming.

Comment

We did not receive many specific responses across the deposit taker groups on our proposed update to the capital requirements for operational risk. The responses we did receive largely supported the proposal to align with OPE25. All but one respondent supported updating our operational risk calculation at this time as part of the Capital Standard process.

Respondents raised specific issues to address before the exposure draft of the Capital Standard is published. We have summarised these points, our comments and our responses to them in the table below:

Table 2.7: Summary of feedback and comments about standardised operational risk requirements

Topic	Feedback	Comment and response
Business Indicator (**BI**) definition	Respondents requested that the BI be clearly defined and align with accounting standards.	The BI definition in OPE25 is based on International Financial Reporting Standards (**IFRS**) accounting standards. As New Zealand banks already use IFRS accounting standards, we intend to follow the same approach and use the definition in OPE25.
BI coefficients	One respondent favoured static coefficients for the BI, but another wanted these to be periodically increased with inflation.	We intend to include static BI coefficients in the exposure draft. It is likely that these will be adjusted over time for changes, including inflation, but we have not yet determined the timing of the reviews.
Calculation frequency	Respondents asked us to clarify whether the calculation is based on annual or quarterly data.	OPE25 is based on annual data, and we intend to follow the same approach. This also aligns with what the respondent suggested.
Internal Loss Multiplier (**ILM**)	Respondents agreed with our proposal to set the ILM at 1. However, some wanted the ability for this to be changed over time to account for 'good' operational risk behaviour.	In the DTA Consultation Paper, we included our reasons for wanting to set the ILM at 1 due to some limitations in the measure. For example, it is backwards looking and only raises capital after a loss event. These reasons are still applicable, and so we intend to set the ILM at 1 and not vary it. The proposed

Topic	Feedback	Comment and response
		Operational Resilience Standard sets out qualitative requirements around operational risk management and can be better targeted towards risks than the ILM.
Implementation timeline	One respondent did not want the operational risk updates to happen at the same time that the Capital Standard comes into force. They felt that the change would have minimal impact on capital and would like to see this delayed to enable them to focus their resources on the other changes required before standards come into force.	We are sympathetic to the amount of work required for the overall DTA project, especially for smaller Group 2 deposit takers. However, we do not intend to change the implementation timeline. This change has been signalled since 2019, and the components of the operational risk calculation are all accounting inputs that a deposit taker will have available. If the operational risk updates are not included as part of the current Capital Standard work, this change would not be able to be completed until after 2028.

Response

We will use the exposure draft of the Capital Standard to clarify the technical points raised in feedback. We intend to proceed with setting the ILM to 1, noting our initial rationale for this proposal is still valid and the Operational Resilience Standard requirements better target qualitative operational risks.

The changes to the quantitative operational risk requirements will be incorporated into the exposure draft of the Capital Standard to align with our signalled implementation timeline. As discussed at section 2.3.13 of this chapter, the boundary between the banking and trading book will be based on RBC25 of the BCBS framework.

2.4. Approach for Group 2 deposit takers – our response to submissions

In the DTA Consultation Paper, we proposed that we would carry over the existing capital settings for Group 2 deposit takers to the new Capital Standard. As for our proposed approach for Group 1 deposit takers, this proposal was influenced by the 2019 Capital Review which recalibrated the capital framework.

As mentioned for Group 1 deposit takers, we are currently reviewing the capital framework as part of the 2025 Capital Review. The 2025 Capital Review Consultation Paper sets out proposals for key capital settings for Group 2 deposit takers. This section sets out decisions on the more detailed proposals from the DTA Consultation Paper.

There are a number of topics raised in feedback where our response for Group 2 deposit takers is the same as for that of Group 1 deposit takers. Therefore, we have not repeated our comments on those areas in this section. These topics are summarised in Table 2.8 below – please refer to Section **Error! Reference source not found.** of this chapter for detailed analysis and responses.

Table 2.8: Responses to feedback about the Group 2 capital requirements that are the same as for the Group 1 capital requirements

Topic	Section	Summary of intended response
ICAAP requirements	Section **Error! Reference source not found.**	Apply ICAAP requirements to all groups of deposit takers. Specify the exact requirements in the exposure draft of the Capital Standard.
Capital overlays through SCR or entity-specific requirements	Section **Error! Reference source not found.**	Retain the flexibility to apply capital overlays for all deposit taker groups and set out a clear framework for their use in the exposure draft of the Capital Standard.
Use of IRB modelling	Section 2.3.3	Retain the current approach to IRB modelling, with calibration of the output floor to be finalised once 2025 Capital Review decisions have been made.
AT1 capital instruments	Section 2.3.5	Remove AT1 as a form of regulatory prudential capital in New Zealand.
FCTR	Section 2.3.6	Treat FCTR as CET1 capital instead of the current treatment as Tier 2 capital.
Risk weight for longer-term exposures to A-rated banks	Section 2.3.8	Reduce the risk weight for these exposures to 30%.
The effective maturity date of three-month bank bills	Section 2.3.9	Align the effective maturity date of three-month bank bills with New Zealand's financial market's maturity convention.
Risk weight for exposures to the NZ Super Fund	Section 2.3.10	Create a specific risk weight for exposures to the NZ Super Fund, set at 20%.
Firm-size adjustments for corporate exposures	Section 2.3.11	Not proceed with the proposal to clarify that 'consolidated' should be interpreted with reference to NZ GAAP.
Reviewing the standardised credit risk weights framework	Section 2.3.12	The 2025 Capital Review Consultation Paper includes proposed changes to the standardised credit risk weights framework. Any changes will be included in the exposure draft.
Quantitative capital requirements for market risk	Section 2.3.13	Separate the requirements so that requirements for the banking book follow the approach in BPR140 and the requirements for the trading book follow the approach in MAR40. Follow the same detailed design approach as for Group 1 deposit takers.

Topic	Section	Summary of intended response
Standardised operational risk capital requirements	Section 2.3.21	Clarify the technical aspects of the requirements in the exposure draft. Continue with the proposal to set the ILM at 1. Implement the changes to our approach to quantitative operational risk requirements through the Capital Standard.

When we discussed the proposed capital requirements for Group 2 deposit takers in the DTA Consultation Paper, we took into account the relevant principles from section 4 of the DTA. The remainder of this section discusses the cross-cutting feedback we received about these principles. This is in addition to any comments included earlier in section Error! Reference source not found. of this chapter which relate to specific technical topics.

2.4.1. Taking a proportionate approach and maintaining competition

There was divergent feedback regarding competition and proportionality from Group 1 and 2 deposit takers. The issues cited by respondents were largely the same for proportionality and competition, so these topics are discussed together in this combined subsection.

Some respondents, largely made up of Group 1 deposit takers, indicated that they considered that the proposals appropriately reflected competition and proportionality perspectives.

Other respondents had the opposite view. This subset of respondents, consisting of Group 2 deposit takers, provided strong feedback indicating that they considered that the proposals in the DTA Consultation Paper will damage competition and are applied in a disproportionate way. They stated this would lead to an outcome that is contrary to the principle of the DTA requiring that we take into account the need to maintain competition. These respondents have stated that the proposals are unbalanced, with the consequence of detrimental impacts on competition.

To support these arguments, respondents pointed to a number of the proposals from the DTA Consultation Paper that they consider will restrict competition and are not proportionate. These are:

- the compliance burden for Group 2 deposit takers
- the divergence between risk weights in the standardised approach and the IRB modelling approach
- the capital resulting from minimum ratios and risk weights
- the existing equity design of AT1 limits the ability of domestically owned banks to compete, as they cannot sell AT1 to a parent bank making it harder for them to raise capital and grow their market share.

As set out in section 2.3.3 of this chapter, one respondent made a detailed submission on risk weights and the use of IRB modelling.

Group 2 deposit takers suggested some alternative proposals for risk weights that they consider would encourage competition and would result in a more proportionate response. These are to both:

- implement more granular standardised risk weights, with the expectation this results in lower overall risk weights
- increase the output floor to 100% of the standardised outcome, to mitigate the fall in capital in the system).

Comment

A number of respondents consider that we have not sufficiently taken into account the competition and proportionality principles in the DTA. There is no suggestion that we are not meeting the purposes of the DTA – just that the way we are proposing to deliver these purposes does not sufficiently take the principles into account.

Risk weights

The central point made by these respondents is that the outcome of the proposed (and current) approach to risk weights and buffer requirements effectively equalises the capital between Group 1 and Group 2 deposit takers. In the respondents' view, this means that, although Group 2 deposit takers pose substantially lower risks to financial stability than Group 1 deposit takers, nevertheless they must have the same amount of capital as Group 1 deposit takers for the same set of exposures.

Effectively, the key question here is whether IRB risk weights accurately reflect risks. If the IRB risk weights do reflect actual risk, then, to the extent that risk weights are lower in the IRB approach, this is reflective of the risk of the exposures. In this scenario, it makes sense that these deposit takers have less risk and consequently comparatively lower risk weights. This flows into the amount of capital required. However, some respondents are clearly sceptical about the use of IRB models and the extent that they address risk.

As discussed in section 2.3.3 of this chapter for Group 1 deposit takers, we consider IRB modelling to be an important tool for assessing the risk in a deposit taker's portfolio of exposures. This means that the risk weights calculated in IRB modelling (which are often lower than those in the standardised approach), are based on the specific risks in that deposit taker's portfolio. Connecting the risk weights to the specific risks faced by that deposit taker helps ensure that capital is calibrated accurately, supporting the soundness of that deposit taker and financial stability more widely.

We will take the proportionality and competition principles, as well as the other DTA principles, into account as part of the 2025 Capital Review. This includes carrying out work on standardised risk weights. Any changes to standardised risk weights will be incorporated into the Capital Standard exposure draft.

Some of the feedback pointed to the long-run impacts of IRB modelling prior to the Capital Review decisions. These respondents provided feedback that the significant historic advantage from lower risk weights for IRB-accredited banks had significantly reduced the competitive capacity of other banks.

We acknowledge that the previous approach to risk weighting did mean that IRB-accredited banks could generate substantially lower risk weights, driving lower funding costs for their capital and therefore scope for lower interest rates to customers. This advantage no longer exists due to the combination of the 85% output floor and the IRB scalar, which together take the IRB outcome to around 90% of the standardised outcome.

We disagree with feedback from respondents that suggested that IRB modelling does not meaningfully affect risks. Our analysis in section 2.3.3 of this chapter provides more detail about why we disagree with respondents.

As a result, at this time we do not intend to modify the approach to IRB risk weights and the output floor, but final settings will be confirmed at the conclusion of the 2025 Capital Review.

Response

We have carefully considered the feedback, especially the feedback from respondents that the proposals were contrary to the competition and proportionality principles in the DTA. We will consider these points when making 2025 Capital Review decisions.

2.5. Approach for Group 3 deposit takers – our response to submissions

2.5.1. Capital ratio requirement – Prudential Capital Buffer

In the DTA Consultation Paper, we proposed a proportionate approach to capital buffer ratio requirements.

Table 2.9: Proposed minimum requirements for Group 3 deposit takers

Capital Ratio Requirements		Prudential Capital Buffer*	
Minimum CET1 capital	4.5%	Minimum CET1 capital	4%
Minimum Tier 1 capital	7%	Minimum CET1 capital *(if credit rating exempt)*	5%
Minimum total capital	9%		
Compared to:		**Compared to:**	
Group 1	Same as above	Group 1	9%
Group 2		Group 2	7%

The 2025 Capital Review consultation includes some alternative risk weights, capital ratios and PCB proposals for all groups of deposit takers.

For Group 3, the main feature of the new proposals in the 2025 Capital Review are further changes to the standardised approach to risk weights to provide more granular settings. On average this will further reduce the risk weights faced by Group 3 deposit takers. Please see the 2025 Capital Review Consultation Paper for details on this proposal.

The 2025 Capital Review Consultation Paper includes an assessment of impacts of these proposals on Group 3 deposit takers. However, we consider it is helpful to respond to some of the points raised by respondents to the DTA Consultation Paper, especially regarding the shortfall analysis that we carried out.

As part of our analysis, we assessed the impact that the proposals in the DTA Consultation Paper would have on existing NBDTs, by modelling the impact of the proposed changes to risk weights on their existing requirements and comparing the resulting capital ratios with the existing capital ratios of those deposit takers.

The outcome of the shortfall analysis was that most Group 3 deposit takers would not face a shortfall of capital, but a small number (two to three deposit takers) might need to raise capital.

We set out an overview of the feedback on the capital ratio requirements in the table below. Most respondents generally supported the proportionate approach to capital requirements for Group 3 deposit takers, but support for the proposed approach was not universal.

Table 2.10: Overview of feedback about the Group 3 capital ratio requirements

Issue	Feedback
Capital ratios	Broad support for proportionate approach for Group 3 deposit takers.
Lower PCB for credit unions and building societies	Some feedback suggested setting a lower PCB of 2% for not-for-profit deposit takers (building societies and credit unions), but without creating a separate 'Group 4'. Other Group 3 deposit takers would have the higher PCB of 4%. It was suggested this alternative would have little impact on financial stability but would help support better financial inclusion outcomes for a diverse range of New Zealanders.
Shortfall analysis understated	Feedback suggested the shortfall analysis was difficult to follow, which appears to be due to the aggregated information we published in the DTA Consultation Paper to ensure data confidentiality. The shortfall analysis was broadly considered too optimistic. A higher proportion of investment lending or past due loans would lead to larger shortfalls.

Comment

The two key issues that we have addressed in our response to the feedback are:

- updating the shortfall analysis to respond to feedback
- assessing the suggestion that Group 3 building societies and credit unions should have a 2% PCB rather than the 4% PCB that would apply to the rest of Group 3 deposit takers.

Updated shortfall analysis

We have updated the shortfall analysis making three key changes based on the feedback received. We have:

- included an allowance for 'past due' non-residential mortgage loan exposures, which we have set at 5%, and 'past due' residential mortgage loan exposures have been increased to 5% (compared with 2% in the DTA Consultation Paper)
- incorporated a higher allowance for residential mortgage property investment loans (50% of residential mortgage loans compared with 20% in the DTA Consultation Paper)
- included the $5 million minimum capital base (which is discussed in more detail in section 2.5.5 below).

The shortfall analysis is based on the capital option in the DTA Consultation Paper and does not include the proposed changes in the 2025 Capital Review consultation. The other assumptions underpinning the analysis also remain the same as the analysis in the DTA Consultation Paper, including:

- existing exposures have been assigned the relevant risk weight in the standardised approach
- using the most recent available data (September 2024).

These revisions result in higher risk weighted assets than we estimated in the DTA Consultation Paper, but still lower than the status quo. Further reductions in risk weights may take place depending on the outcome of the standardised risk weights work as part of the 2025 Capital Review.

Based on the feedback we received, we consider the revised analysis to be more accurate. The impacts are covered in the tables below, including a comparison with the numbers from the original analysis in the DTA Consultation Paper.

Table 2.11: Comparison of total risk weighted assets and capital ratios against those in the policy consultation[25]

	Risk weighted assets ($m)			Capital ratio (% of RWA)		
	Sept 2024 (actual)	Consultation estimate	Revised estimate	Sept 2024 (actual)	Consultation estimate	Revised estimate
Total	**2,345**	**1,975**	**2,092**	**14.2**	**17.0**	**15.9**

It should be noted that, while the analysis indicates a reduction in risk weighted assets, not all deposit takers will see the same impacts. The actual impacts for each individual deposit taker will depend on their own mix of exposures. For example, a deposit taker with fewer exposures in the areas where risk weights fall the most would see a smaller fall in their risk weighted assets.

25 Note that in the DTA Consultation Paper we only published aggregate data to reduce the risk of identifying individual deposit takers.

Using higher risk weights (compared to those used in the DTA Consultation Paper) results in lower estimated capital ratios.

Although the estimated capital ratios are still above the actual September 2024 capital ratios, we expect that the actual increases in capital ratios resulting from the final settings in the Capital Standard will be smaller than we have estimated. However, it is worth highlighting that this may be offset by the proposed risk weight changes in the 2025 Capital Review consultation.

Shortfalls are shown in more detail in Table 2.12 below.[26] This analysis suggests there would be three deposit takers with shortfalls relative to the 13% capital ratio (made up of the 9% minimum capital ratio and the 4% PCB).

Two of these estimated shortfalls are due to not completely meeting the 4% PCB, despite meeting the 9% minimum capital ratio. However, this analysis does not include the risk weight changes proposed in the 2025 Capital Review consultation – which may reduce the number of entities with a shortfall.

The remaining shortfall is due to not meeting the $5 million minimum capital base.

We also estimate that two or three other deposit takers would be quite close to a shortfall.

Table 2.12: Revised shortfall analysis

	DTA Consultation Paper analysis	Revised estimates
Number of shortfalls	One	Three
Total size of shortfall	**$2 million**	**$8 million**

Assessment of a smaller PCB for building societies and credit unions

Prior to the consultation on the Capital Standard, we considered whether we should set a smaller PCB for the smallest subset of Group 3 deposit takers. This option was discounted based on concerns it would undermine the Proportionality Framework, by effectively creating a fourth deposit taker group. We were also concerned that a smaller buffer would be insufficient to provide an adequate 'runway' for recovery interventions.

Following feedback, we have reassessed the merits of a reduced buffer, which would substantially remove the shortfalls discussed above, with the exception of shortfalls caused by the minimum capital base requirement of $5 million. Our assessment is that it would not be possible to make this variation for a subset of Group 3 deposit takers without completely creating a new Group 4 category, as all other Group 3 requirements would not be varied in this way.

The relevant subset of Group 3 deposit takers (credit unions and building societies) is also the same group of deposit takers with shortfalls.

We have considered the impact of reducing the PCB on the purposes of the DTA.

26 These estimates are dependent on a range of assumptions. Altering those assumptions could led to different shortfall results.

Our assessment is that a smaller PCB for a subset of Group 3 deposit takers is unlikely to have a material impact on financial stability and, therefore, unlikely to negatively affect the main purpose of the DTA. In our assessment:

- Six of the existing 15 Group 3 deposit takers would be affected, with total assets of $2.4 billion.
- Failure of any one of these is likely to be contained, albeit with some contagion to other small deposit takers.

Nevertheless, halving the size of the buffer to 2% of RWA would affect the safety and soundness of individual deposit takers which is contrary to the purpose in section (3(2)(a) of the DTA. These deposit takers would be less resilient to losses, as they would have less scope to absorb these losses and remain solvent.

As a result, there could be reduced confidence in the financial system which is contrary to the purpose in section 3(2)(b) of the DTA.

We would have fewer opportunities to intervene and take recovery activities via the Capital Buffer Response Framework (**CBRF**) that might help keep the deposit taker solvent.

In addition, after accounting for lower risk weights, a 9% minimum requirement plus 2% buffer would be lower than existing requirements for NBDTs, resulting in a weakening of capital requirements.

That said, a reduction in the PCB may support reasonable access to services by increasing the range of service providers. However, this positive impact on the additional purpose regarding reasonable access (section 3(2)(c) of the DTA) is only possible at the risk of negative impacts on the additional purposes as discussed above.

As a result, we consider that a lower PCB would be contrary to the DTA and have not made the reduction suggested by respondents.

Response

We agree with feedback from respondents that suggested the estimates of shortfalls in our DTA Consultation Paper were too optimistic. We have incorporated revised assumptions based on the feedback, including higher allowance for past due loans, more residential mortgage property investment lending (50% instead of 20%) and the impact of the minimum capital base.

Although our revised estimated shortfalls indicate a small number of deposit takers will be close to, or below, the minimum ratios, we do not consider this sufficient reason to modify the requirements. In addition, the proposals in the 2025 Capital Review Consultation Paper are likely to reduce shortfalls further.

Whilst the DTA’s additional purpose of supporting reasonable access might be met by a lower PCB for building societies and credit unions, this is only achieved by decreasing the stability and soundness of these same deposit takers. This could also diminish confidence in the financial system.

The 2025 Capital Review Consultation Paper proposes we continue with the original proposals of a 9% minimum total capital ratio requirement plus a 4% PCB that applies to all Group 3 deposit takers, with a 1% add-on for credit rating exemption where relevant – as well as more granular and, in some places lower, risk weights.

We will confirm the Group 3 capital requirements once decisions for the 2025 Capital Review have been made. We will include the finalised requirements in the Capital Standard exposure draft.

2.5.2. Additional buffer for those who are exempt from a credit rating

In the DTA Consultation Paper, we proposed that Group 3 deposit takers who are credit rating exempt would have an additional 1% added to their PCB requirement. This would mean the PCB for those entities would be 5%, instead of the 4% proposed for Group 3 deposit takers with a credit rating. At present, NBDTs without a credit rating are subject to an additional 2% (for those with liabilities less than $20 million) or 4% (for those with liabilities between $20 million and $40 million).

The feedback we received indicated the key issues were around the need to review the exemption eligibility threshold and to provide greater clarity about the process and criteria.

Comment

We are undertaking work to clarify the technical details regarding credit rating exemptions. This includes:

- reviewing the eligibility threshold
- setting out the notification process (likely to be similar to that in the current Non-bank Deposit Takers (Credit Ratings Minimum Threshold) Exemption Notice 2016 and related disclosure conditions)
- confirming the form of the exemption.

Response

We intend to continue providing a class exemption for small entities, similar to the current NBDT class exemption. The class exemption will set out the specific requirements for credit rating exemptions and respondents will have an opportunity to provide feedback at that stage.

2.5.3. The use of capital overlays

In the DTA Consultation Paper, we noted that there may be circumstances where entity-specific overlays are required, in addition to minimum capital requirements. We intend to retain this aspect of our prudential framework for all deposit takers. We discuss our general approach to the use of capital overlays and the way we intend to incorporate them into the Capital Standard in section **Error! Reference source not found.** of this chapter, which includes comments on entity-specific capital overlays.

We received feedback from Group 3 deposit takers that they do not support the use of overlays and that standardised credit risk weights sufficiently manage any risks associated with a deposit taker's exposures.

Comment

As discussed in section Error! Reference source not found. of this chapter, we consider that it is desirable to retain the flexibility to use capital overlays for all deposit takers under the new regime. This would be only in particular circumstances, according to a clear and transparent framework– our current use of overlays is rare but also public. Not having such a tool available for all deposit takers (including Group 3 deposit takers) could limit our ability to prudently supervise these entities. This aligns with the additional purpose of the DTA to promote the safety and soundness of individual deposit takers.

Response

We will incorporate the use of capital overlays into the Capital Standard exposure draft. In some cases, this might also include overlays that limit the capacity of a deposit taker, or even all deposit takers, to make dividend payments. For example, a similar approach was taken during the onset of COVID-19 in 2020 when we restricted banks from making dividend payments.

We will set out a clear framework for the use of overlays and consult on this as part of the exposure draft consultation.

2.5.4. Capital Buffer Response Framework

In the DTA Consultation Paper, we described our intention to use the CBRF to set out the supervisory responses that would follow if a Group 3 deposit taker was not meeting minimum capital ratios or buffers.

In their feedback, respondents asked for more information about how the CBRF would be applied to Group 3 deposit takers.

Comment

The existing CBRF does not apply to NBDTs. The proposal to extend the CBRF to Group 3 deposit takers as part of the Capital Standard is intended to support financial stability by specifying the actions that we will take in circumstances where a deposit taker is not meeting the full PCB. The actions are designed to maximise the likelihood that a deposit taker remains solvent and, therefore, avoid the costs associated with failure. This supports financial stability and the soundness and stability of individual deposit takers.

Failure to hold the full PCB would lead to supervisory responses from the Reserve Bank, designed to encourage deposit takers to restore capital. These responses are described as the CBRF. Responses become much more intensive when the deposit taker is not meeting the 9% minimum capital ratio, with viability and solvency at severe risk.

Response

The details of the CBRF will be finalised once the 2025 Capital Review concludes.

2.5.5. Additional requirement: minimum capital levels (now referred to as a minimum ‘capital base’)

In the DTA Consultation Paper, we sought feedback in relation to introducing a minimum capital base with an indicated range of $5 million to $10 million. We also sought feedback in relation to:

- general support for a minimum capital base
- any other proposals that might address the concerns
- how we have proposed calibrating requirements to ensure individual entity soundness
- the initial estimated calibration range of $5 million to $10 million
- future size and scale of group 3 deposit takers and the impact any minimum requirement would have.

We received mixed views from respondents including having no requirement, excluding existing NBDTs from the requirement, setting higher requirements for new entrants and setting requirements using an asset threshold. In relation to calibration, respondents generally considered $5 million as being an appropriate level if it was to apply to all entities.

Comment

Setting a minimum capital base would complement the minimum capital ratio requirements that Group 3 deposit takers would be required to comply with as part of their regulatory prudential requirements. In most instances, the minimum capital base for a given deposit taker would be dictated by the minimum capital ratio requirements, but for the smallest deposit takers, it would set a floor.

We considered alternative options put forward by respondents which we have summarised in the table below:

Table 2.13: Alternative options considered for the minimum capital base

Option	Comment
Some respondents suggested **minimum requirements should only apply to new entrants**, given the existing cohort has a track record of compliance with prudential requirements.	In our view, a historical track record for existing deposit takers in relation to a different prudential regime has limited value to assessing ability to comply with a new regime. In addition, the risks for a small deposit taker do not materially change by the existence of a track record. Small entities generally have less capacity to withstand external events such as significant interest rate increases which is a factor in our analysis of this proposal.
A number of respondents suggested the application of a **higher ($10 million) requirement to new entrants could be time limited before reducing requirements** to the same level for incumbents ($5 million or nil).	New entrants are naturally more vulnerable and have higher set up costs. Setting a higher initial requirement could have the unintended consequence of increasing the risk of business failure (due to the inability to meet this requirement) in comparison with the risk where the requirement was lower (and consistent with existing deposit takers).
One response included the suggestion that a minimum capital base requirement should only be	Setting a minimum asset threshold means we would accept the risk of failure for the smallest of

Option	Comment
set for deposit takers with assets above a minimum threshold.	deposit takers. However, this is inconsistent with one of the additional purposes of the DTA which is to promote the safety and soundness of each deposit taker.

Response

We will set a minimum capital base of $5 million. Whilst the capital base will establish a minimum level, we have set it at the lower end of the range we consulted on.

We are proposing that the capital base will form part of the eligibility criteria that a new market entrant will have to satisfy to be issued with a licence. Criteria will require an applicant to have existing capital of $5 million, together with the ability to maintain that capital base.

However, once a licence has been issued, as with failure to meet the PCB, failure to have at least $5 million in capital would trigger supervisory responses and distribution restrictions (in accordance with the CBRF as discussed above) to ensure that the deposit taker lifts capital to get back to $5 million.

This approach acknowledges the increase in operational (including compliance) costs that a newly licenced deposit taker may face (particularly if it is also a new business) but would not immediately lead to the exit of a deposit taker that fell below the $5 million threshold.

We discuss the shortfall analysis in section 2.5.1 above in which we have taken account of the capital base. We have identified that the number of shortfalls in the revised analysis is not significantly impacted by this new requirement which supports our view that calibrating the capital base at $5 million is reasonable. This level was also broadly acceptable to respondents.

We will provide detailed material about the interaction between minimum capital ratio and minimum capital base requirements once the 2025 Capital Review concludes.

2.5.6. Composition of capital

In the DTA Consultation Paper, we proposed retaining the eligibility criteria for CET1 (including mutual capital instruments (**MCI**)), AT1 and Tier 2 capital instruments currently contained in the BPR documents and extending their use to Group 3 deposit takers. We considered that allowing Group 3 deposit takers to issue the same capital instruments as Group 1 and Group 2 deposit takers would be beneficial for capital flexibility.

The key area where we sought feedback was in relation to credit unions, who are governed by the Friendly Societies and Credit Union (**FSCU**) Act 1982. Our initial assessment was that the relevant sections of the FSCU Act, particularly section 107A relating to credit union securities, could potentially create practical barriers for credit unions trying to issue MCI, AT1 and Tier 2 instruments.

Most Group 3 respondents did not provide any feedback on the use of different capital instruments to meet their proposed capital ratio requirements. One respondent noted that the nature of its business means it relies solely on retained earnings to meet CET1 requirements and, therefore, different instruments would not be relevant. We also received detailed feedback on the ability of credit unions to issue capital instruments such as MCI and AT1 instruments.

Comment

Mutual capital instruments

From a policy standpoint, we consider it is desirable for MCI to be available for all mutually-owned deposit takers, including credit unions. These instruments were designed to provide mutual banks another avenue to raise CET1 capital and compete on a more even playing field. We consider this would provide current mutual NBDTs with a similar benefit. However, there are both some practical and technical barriers for credit unions to issue MCI (see Table 2.14 below). These primarily relate to the FSCU Act which provides that credit union securities are transferable only between members and confer no voting rights.[27]

AT1 and Tier 2 instruments

Based on the limited feedback received, the availability of the MCI for credit unions is of a greater priority than AT1 and Tier 2 instruments. Additionally, respondents have advised their capital would be composed totally of CET1 capital. Therefore, while Group 3 deposit takers are not prevented from issuing Tier 2 instruments, they are unlikely to so.

In the 2025 Capital Review Consultation Paper, we are consulting on removing AT1 as a form of eligible regulatory capital for Group 1 and 2 deposit takers. If we remove it from the capital stack for Group 1 and 2 deposit takers, it will also not be available for Group 3 deposit takers.

Nevertheless, the practical barriers discussed below apply equally to AT1 and Tier 2 instruments.

Table 2.14: Barriers to issuance of capital instruments

Barrier	Comment
Technical barrier - voting rights Section 107A of the FSCU Act creates barriers for credit unions to issue MCI, relating to the criteria that the MCI requires holders to have full voting rights.	The current requirements for MCI set out in BPR110 state that “holders of the mutual capital instrument have full voting rights arising from the ownership of the instrument”. Guidance clarifies that “mutual entities that adopt a ‘one member, one vote’ rule are not, merely through the adoption of that rule, prevented from satisfying this condition”. This is because if members of credit unions are each allocated one vote and this is reflected in its rules, then, like building societies, credit unions would not be prevented from satisfying the condition that holders of the MCI have full voting rights. Section 106(8) of the FSCU Act states that every member shall generally be entitled to vote and have 1 vote only. Further, although section 107A(2)(b) specifies that credit union securities would confer no voting rights, this does not breach the voting rights requirement, because credit union securities can only be sold to credit union members. Through their membership, those members already have the right to vote.

27 Section 107A(2), Friendly Societies and Credit Unions Act 1982.

Barrier	Comment
	The MCI would not confer any additional voting rights, which is in line with how we consider the voting rights of MCI holders in general.
Practical barriers - members-only investor pool Credit union securities can only be issued to members of the credit union. This challenge is unique to credit unions as other mutual entities can issue instruments such as MCI to non-members who, by holding the instrument, become members of the mutual entity.	Restrictions limiting eligible holders to credit union members significantly constrain the investor pool for capital instruments. In addition, in one respondent's experience, only credit union members who would also qualify as wholesale investors are realistic options for any capital issuance. This would continue to be the case for the instruments proposed as part of the Capital Standard. Whilst the FSCU does not prevent credit unions from being able to issue capital instruments, it appears the structural barriers within the legislation impact demand.
Practical barriers - transaction size We understand standard market practice requires a minimum transaction size of $50 million which may exceed what a Group 3 deposit taker is likely to need.	Due to the sizes of current NBDTs, Group 3 deposit takers are unlikely to require that level of funding. This, coupled with the limits on eligible holders, may further reduce the likelihood of capital instruments being issued as credit union securities.

Response

We acknowledge the potential constraints against Group 3 deposit takers, in particular credit unions, issuing capital instruments such as MCI, AT1 and Tier 2 instruments.

However, as noted in section 2.3.5 we are proposing to remove AT1 as a form of regulatory prudential capital in New Zealand. Please see Chapter 4 of the 2025 Capital Review Consultation Paper for more detail on the proposed change.

We consider that the technical barriers can be resolved to enable credit unions to issue MCI and are working on simplifying the requirements for the exposure draft of the Capital Standard. We consider it is feasible to draft the requirements for MCI in the Capital Standard that allows credit unions to satisfy the full voting rights condition.

However, we are cognisant that practical barriers, largely arising from the FSCU Act, may be more meaningful constraints for credit unions issuing capital instruments.

We continue to engage with industry and other stakeholders on ways that will support reducing barriers to credit unions issuing capital instruments.

2.5.7. Approach to risk weighted assets: credit risk

In the DTA Consultation Paper, we proposed that Group 3 deposit takers use the same set of standardised risk weights that apply to Group 2 deposit takers, and for non-modelled categories of exposures for Group 1 deposit takers.

This has been supported by all respondents, with several also asking us to amend the existing NBDT Regulations so that this change can be fast-tracked.

Comment

We are currently consulting on parts of the standardised credit risk framework in response to feedback. We consider that any changes would be made to more accurately reflect the level of risk associated with certain exposures. This would not be detrimental to Group 3 deposit takers.

Response

The proposal to use a consistent set of standardised credit risk weights for all deposit takers is well supported and we plan to incorporate this into the exposure draft of the Capital Standard.

We are currently consulting on possible changes to the standardised credit risk weights as part of the 2025 Capital Review and any changes would apply to all deposit takers in a consistent manner. We will incorporate any changes to standardised risk weights that arise from the 2025 Capital Review into the Capital Standard exposure draft.

2.5.8. Approach to credit risk mitigation

In addition to the general approach to credit risk weights discussed above, the DTA Consultation Paper also considered the use of credit risk mitigation (**CRM**) by Group 3 deposit takers.

CRM covers a range of approaches that are available to deposit takers to reduce the risk that a borrower will default on their obligations. For example, it can cover tools that reduce the possibility that a borrower does not meet their payment obligations and causes a loss to the deposit taker.

In our proposals for Group 1 and Group 2 deposit takers we included the existing approach to CRM, set out in BPR131, as part of the existing policy settings that we plan to translate into the new framework. In the proposals for Group 3, we proposed that CRM could be approached in the following ways:

- Exclude CRM from the Capital Standard for Group 3, on the basis that it would simplify the requirements, reducing compliance costs.
- Replicate the approach for Group 1 and 2 deposit takers to provide flexibility for Group 3 deposit takers to take advantage of CRM and reduce risk weights if this is useful for them.

Most of the mechanisms for Group 1 and 2 deposit takers are dependent on the use of relatively complex tools each of which have a detailed set of requirements that must be met. These include:

- collateral, including cash, various forms of securities financing transactions (SFTs) and derivatives
- on-balance sheet netting of loans and deposits
- guarantees provided to the deposit taker and credit derivative purchased by the deposit taker.

The associated requirements provide a range of options for adjusting risk weighted assets, depending on the type of CRM used.

One respondent noted that the approaches to CRM for Groups 1 and 2 are complex. They consider it unlikely that the Group 3 deposit takers will see sufficient benefits to invest in systems to accurately implement the forms of CRM that are available to Groups 1 and 2 deposit takers. They suggested keeping CRM as an option, but one that deposit takers could voluntarily use. They also suggested that Credit Valuation Adjustments and off-balance sheet items are not common for Group 3 and, therefore, unnecessary.

Few other respondents directly commented on this proposal. However, in bilateral meetings some respondents have indicated that, although they see CRM as useful, they were uncertain whether the Group 1 and Group 2 framework is workable.

Comment

Alternative option

Our revised assessment is that the Group 1 and 2 approaches to CRM are unlikely to be suitable for Group 3.

Most of the mechanisms for Group 1 and 2 are dependent on the use of relatively complex tools and financial instruments. There is no reason why these should not be available for Group 3. However, the complexity of some of these arrangements means that a deposit taker needs robust processes in place to ensure that they are accurately complying with the requirements.

As an alternative to the two proposals included in the DTA Consultation Paper, we have considered adding a form of CRM for Group 3 deposit takers that is line with existing approaches for NBDTs. We have set out analysis out in the table below.

Table 2.15: Comparison of CRM across prudential frameworks

CRM in current banking requirements (BPR132 Credit Risk Mitigation (BPR132))[28]	CRM equivalent in the NBDT Regulations[29]
Collateral, including cash, various forms of securities financing transactions (**SFTs**) and derivatives.	For a loan where a deposit taker holds a deposit as security, the deposit taker may deduct the deposit from the book value of the loan before calculating the risk weighted asset. This deduction can only be done if there is a written contractual agreement between the deposit taker and the depositor that provides that the deposit taker has direct, unconditional, and irrevocable recourse to the deposit security.
On-balance sheet netting of loans and deposits.	No equivalent in the NBDT Regulations.
Guarantees provided to the deposit taker and credit derivative purchased by the deposit taker.	A deposit taker may only exclude a loan, or any part of a loan, from the calculation of its risk-weighted amount for on balance sheet exposures where the deposit taker (or guaranteeing subsidiary) has entered into a sub-participation transaction. [30]

28 rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bpr132-credit-risk-mitigation-1-july-2024pdf.pdf.

29 legislation.govt.nz/regulation/public/2010/0167/latest/DLM3032713.html.

30 Sub-participation means a transaction in which the sub-participant places a deposit with the deposit taker or the guaranteeing subsidiary (A) in the amount of its participation in respect of a loan (the underlying loan) by A to a third party (the borrower) on terms under which A’s obligation to repay the sub-participant depends on the borrower repaying A under the underlying loan agreement.

The key issue that this leaves unresolved is whether Group 3 deposit takers should also be able to use the other forms of CRM allowed for Groups 1 and 2 deposit takers, or only the simplified version. This is a relevant consideration since two current banks will be classified as Group 3 under the Proportionality Framework.

Those two banks can currently use CRM as set out in BPR132. However, under our revised preferred option, Group 3 would not have access to the more complex forms of CRM currently available. This would have two implications:

- They would need to calculate capital requirements in a different way
- They could no longer use netting for related party exposures (which they can currently use under *BS8: Connected Exposures Policy*).

To manage this, we will allow Group 3 deposit takers to choose to use either the approach to CRM that will apply for Groups 1 and 2, or to use the simplified approach described above for Group 3. This will provide maximum flexibility for Group 3 deposit takers to choose the approach that best matches their business model and preferences.

Assessment

A simplified approach to CRM for Group 3 substantially reduces compliance costs for Group 3 deposit takers and provides a form of CRM that they are already familiar with. Additional flexibility is provided by the ability to use Group 1 or 2 CRM, at the choice of the deposit taker. Overall, this leads to a proportionate outcome.

The use of CRM has implications for some requirements in the Related Party Exposures Standard. Regardless of whether a Group 3 deposit taker chooses to use the simplified CRM for capital adequacy purposes, or the more complex CRM available to Groups 1 and 2 deposit takers, they will need to use the same approach for the purposes of the Related Party Exposures Standard.

Response

The revised proposal is focused on reducing compliance costs by simplifying the requirements for Group 3. This is primarily achieved by providing them an option to continue using their existing forms of CRM. Lower compliance costs may also help support competition and diversity. We do not expect any detrimental impacts on the DTA purposes relating to financial stability or promoting the soundness of individual deposit takers.

2.5.9. Approach to risk weights: market risk and operational risk

In the DTA Consultation Paper, we proposed carrying over the existing requirements for market and operational risk in the NBDT Regulations to the Capital Standard for Group 3 deposit takers. This entails a simple calculation based on total assets and RWA for credit risk:

$$Capital\ requirement\ for\ market\ risk = \frac{Total\ assets + RWA\ for\ credit\ risk}{2} \times 0.175$$

We consulted on one change to separate this into two separate calculations for operational risk and market risk with scalars of 0.125 and 0.05 respectively instead of 0.175, giving the same result.

The separation was to allow us to add a secondary threshold for market risk if the deposit taker held a large trading portfolio. If the threshold is reached, we would require a Group 3 deposit taker to follow the market risk requirements for Group 2 deposit takers.

We did not specify a specific threshold in the consultation but asked for feedback on what level would be appropriate. Only a small number of respondents provided comments on operational or market risk for Group 3 deposit takers. Those that did respond, agreed with the approach but wanted further details around the level where the secondary threshold for market risk trading book risk would be set. Some were also concerned that if they crossed the threshold once, they would need to immediately (i.e. that day) change to the Group 2 requirements.

One respondent provided feedback on the secondary threshold level and noted that a percentage level secondary threshold would not necessarily accurately reflect the level of market risk exposure of a deposit taker. They suggest that a more granular metric such as basis point sensitivity would be a more appropriate secondary threshold as it better measures the materiality of market risk exposures.

Comment

We will proceed with the consulted option and intend to set the level for the secondary threshold for Group 3 deposit takers that have significant trading books. We do not think that this would currently impact any Group 3 deposit takers, but it will be in place if any of them establish or develop significant trading books in the future.

We intend to set the secondary threshold when the value at risk (**VaR**) in the trading book accounts for more than 2% of RWA for credit risk. The secondary threshold would be based on either the 95% one-day VaR or the 95% one-month VaR breaching the threshold.[31]

Our reasons for using the 95% VaR as the threshold include:

- VaR is a simple calculation that deposit takers with trading books are likely doing as part of their internal risk management procedure – and even if they are not, they can add it relatively easily. Moreover, this calculation forms the basis for the Group 1 and Group 2 market risk calculations.
- Ideally, we would use risk weighted assets for the asset base, but as Group 3 are not calculating their RWA for market risk this would add unnecessary complexity to the calculation. Therefore, we have based this on total assets.

The 2% of RWA for credit risk threshold is set at a level where the size of the trading book relative to overall assets would be larger than for most Group 2 deposit takers. At this point, the existing Group 3 capital requirements will be underestimating the market risk in the deposit taker. The 2% threshold is high enough that a deposit taker shouldn't breach this until either the trading book has grown to a relatively large size, or it is taking on significant risk in the trading book. In either case, it is appropriate for them to move to more granular market risk calculations to assess this risk.

We also considered how we will move the Group 3 deposit taker to the Group 2 requirements for market risk if the secondary threshold for the size of the trading book is triggered. Some

31 An explanation of VaR and how to calculate it is available at investopedia.com/terms/v/var.asp.

respondents were concerned that this would happen immediately or very quickly. A Group 3 deposit taker could also breach the threshold unintentionally in high-volatility market conditions.

Therefore, we are setting the threshold such that, if a deposit taker's 95% VaR breaches the 2% threshold in two months out of any six-month period, the deposit taker will have 12 months from the earlier breach before they need to comply with the Group 2 requirements for market risk in the trading book. This will give them the time to update their systems and processes for the more complex calculation that will then be required.

As we are now splitting the requirements for market risk in the banking and trading book for Groups 1 and 2, we now have the option to make the secondary threshold only apply to market risk in the trading book. In other words, if a Group 3 deposit taker breached the threshold, they would be subject to the Group 2 requirements for the trading book, but the banking book requirements would continue to be the simplified Group 3 calculation.

The simplified calculation is currently made up mostly of IRRBB. (It is likely that it is entirely IRRBB, but we do not have details on the existence and size of trading books for Group 3 deposit takers.) Therefore, we propose to keep the current market risk calculation unchanged as a measure of IRRBB if the secondary threshold is reached and then add the Group 2 trading book capital requirements on top.

Response

We intend to set the secondary threshold to move Group 3 deposit takers to Group 2 requirements at when the VaR in the trading book exceeds 2% of RWA for credit risk.

It would not be practical to require immediate compliance with Group 2 requirements if the threshold was crossed. We have addressed this concern expressed by respondents by setting a tolerance (breaching the 2% threshold in two months out of any six-month period) and then allowing time for the deposit taker (12 months from the first breach) to update their systems and processes for the new requirements. The details of this will be set out in the exposure draft.

As discussed above, we intend to include an additional change to simplify requirements for Group 3. We intend to move to separate requirements for market risks in each of the banking and trading books for Group 1 and 2 deposit takers. Therefore, for Group 3 deposit takers, only the trading book risk will move to the Group 2 requirements if the secondary threshold is reached. IRRBB will continue to be subject to the simpler Group 3 calculation.

We will also define what goes into the banking book and what goes into the trading book for Groups 1 and 2 deposit takers. This will be relevant for Group 3 deposit takers to help them determine what should be counted in the trading book.

2.5.10. Transition path

In the DTA Consultation Paper, we did not propose any changes to requirements until the Capital Standard takes effect under the DTA in 2028. This means that, for the period to 2028, existing NBDT requirements would remain the remain as they are now.

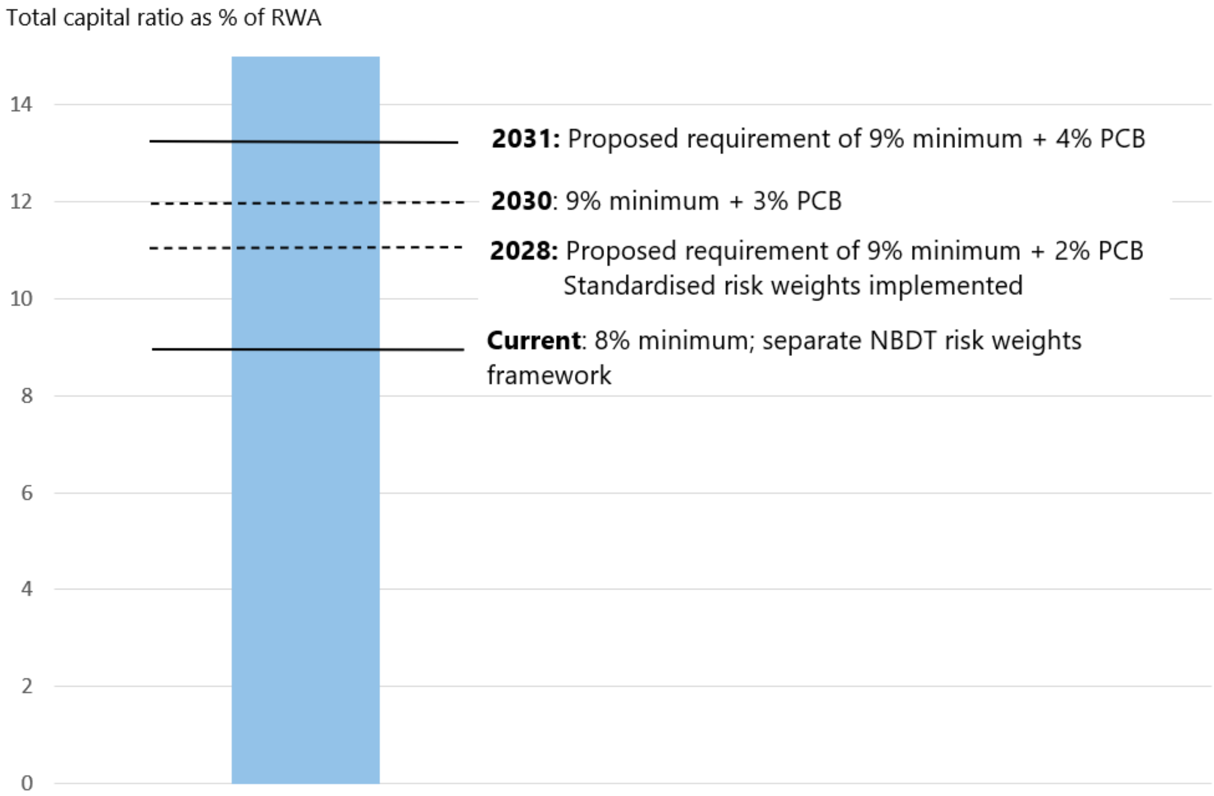
We proposed that, once the Capital Standard takes effect in 2028, the increases in capital requirements would be gradually phased in for Group 3 deposit takers. Conversely, the standardised risk weights would apply to Group 3 immediately upon the implementation of the

Capital Standard. On average, this would mean a reduction in risk weights for most classes of exposure upon implementation.

As illustrated by Figure 2.4 below, the transition path we proposed for current NBDTs to become Group 3 deposit takers in relation to meeting their minimum capital ratio was:

- **Upon implementation in 2028**: facing a minimum total capital requirement of 9% of RWA, with a PCB of 2% of RWA. We estimated 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.
- **In 2029**: We proposed no increases.
- **In 2030**: We proposed the rest of the PCB to be phased in in 2030 (an additional 1% PCB).
- **In 2031**: The final 1% of the PCB would be required.

Figure 2.4: Proposed transition path for existing NBDTs to become Group 3 deposit takers



This would mean that current NBDTs would have the full proposed total minimum capital ratio of 9% of RWA and PCB of 4% of RWA in place by 2031.

We intend to treat the $5 million minimum capital base a little differently by making it take effect immediately.

The diagram in Figure 2.4 is based on the capital framework as proposed in the DTA Consultation Paper. Any changes to the capital stack as a result of the 2025 Capital Review will be phased in and we will provide an updated transition path once the outcome is published.

Comment

The majority of respondents, including the majority of NBDTs, were supportive of the proposed transition path. However, one respondent suggested that NBDTs should meet the full capital requirements earlier. This respondent suggested that the deadline for Group 3 deposit takers to meet the full capital requirements (proposed to be by 2031) should have aligned with the start of the DCS (mid-2025) to reduce system stability risk.

Response

We intend to set the transitional pathway for the capital ratio requirements for existing NBDTs to be phased in, as proposed, by 2031. If we change the capital stack as part of the 2025 Capital Review, we will also phase this in and will provide an updated transition path.

New entrants will need to comply with the capital ratio requirements upon application to reduce unnecessary complexity. Following 2031, all Group 3 deposit takers will be subject to the same capital requirements.

The $5 million capital base requirement will take effect immediately (i.e. in 2028) for all Group 3 deposit takers as discussed above.

2.5.11. Proportionality

Most of the feedback supports the way that the proportionality principle has been taken into account for the proposals for Group 3 deposit takers.

However, there are a couple of areas where there is not widespread support.

- One respondent suggested that lower capital requirements for not-for-profit NBDTS (such as credit unions) would better reflect proportionality than the original proposals.
- A number of respondents consider the regulatory compliance burden, across the standards, to be disproportionate.

The view among these respondents is that more proportional approaches are justified and that the risks to financial stability are limited due to the small size of the deposit takers.

However, one respondent did note that while small deposit taker failure does not create large risks to the system, the risk of contagion to other small deposit takers could, if widespread, create systemic risks.

Response

We have considered the proportionality perspectives related to overall capital requirements in section 2.5.1 of this chapter. The cumulative compliance burden for Group 3 deposit takers is discussed in section **Error! Reference source not found.** of this chapter.

2.5.12. Maintaining competition

Respondents had mixed views about the impact on competition from the proposals for Group 3 deposit taker capital requirements.

A joint response from several Group 3 deposit takers included some brief comments regarding competition.

- The existing NBDT risk weighting requirements create a competitive disadvantage to competing against the larger deposit takers.
- Proposed changes to risk weights will help address the competitive disadvantage.
- The changes to risk weights should be made as soon as possible, rather than waiting for the Capital Standard to take effect.
- A minimum capital base requirement of $10 million would not be an unreasonable barrier to competition, provided that it only applies to new entrants, expires after 3 years and is replaced by a minimum requirement of $5 million.

Submissions from individual Group 3 deposits takers indicate a range of alternative views.

- One respondent suggested that the competition impacts would depend on how the Capital Standard is implemented, to avoid risks of unintended consequences that damage competition.
- Another respondent suggested that lower capital requirements for not-for-profit NBDTs (such as credit unions) should be considered to support competition. They suggest that competition is unlikely to change because of the proposals, and that there should be a metric to lift competition and reduce dominance of the four largest banks.
- Several respondents state that the cumulative impact of changes will be to reduce competition due to higher regulatory hurdles. To manage this, some respondents suggest that we should consider exemptions and/or simplification where possible.
- One respondent suggested that the minimum capital dollar requirements will damage competition, unless the smallest deposit takers (assets below $100 million) are excluded from the requirements.

Comment

Overall, the general view from respondents is that the proposals will reduce competition or be neutral for competition. Respondents suggested that if any negative impact does arise, it would be from the requirement relating to the minimum capital base and the overall impact of the regulatory burden on small deposit takers.

This chapter does not assess the overall regulatory burden or the impact on competition, as this goes beyond the scope of the Capital Standard. Section **Error! Reference source not found.** of this chapter provides some analysis on the overall regulatory burden. It is also covered in more detail in the previously released Summaries of Submissions and Policy Response documents for the core and non-core standards.

Our assessment remains that there are a range of factors in the Capital Standard that are likely to have impacts on competition. These are dynamic and sometimes work in opposite directions.

The factors relating to the impact of the compliance burden are perhaps the most straight-forward to address. Our assessment is that the changes to our original proposals relating to credit risk mitigation and capital instruments that we have discussed in this document, should have a small positive impact on competition by slightly reducing compliance burdens.

Most of the remaining negative competition impacts discussed by respondents relate to the capital ratio requirements and minimum capital dollar level proposals contained in the DTA Consultation Paper.

Alternative proposals relating to capital ratio and minimum capital base requirements are discussed in the relevant sections of this document. The key conclusions relating to competition are:

- Lower minimum capital and/or lower PCBs might have a positive impact on competition, but our assessment is that a possible increase in competition through the channel of lower capital buffers would come at the cost of risks to financial stability and a reduction in the stability and soundness of individual deposit takers. These settings are currently being consulted on as part of the 2025 Capital Review and have not been finalised.
- Ultimately, the risks to financial stability and a reduction in soundness of individual deposit takers would detract from competition.
- Setting a minimum capital base (of $5 million) consistent for all deposit takers (although noting it will only have a practical impact on Group 3 deposit takers) and to be maintained on an ongoing basis, will avoid the possible distortion to competition that would eventuate from different settings.

Response

We have taken account of the competition principle in the DTA in our assessment of the feedback we received on the Capital Standard proposals. We agree that the Capital Standard is likely to affect competition.

Our assessment of the likely impacts of the Capital Standard on competition is set out in the DTA Consultation Paper. In particular, we concluded that there were some factors that support competition and other factors that might limit competition. The 2025 Capital Review covers a more complete assessment of competition, updating the assessment from the 2024 Consultation Paper in light of the new options for Group 1 and 2 deposit takers.

However, from the perspective of impacts on Group 3, policies that support the soundness and stability of Group 3 deposit takers support competition by ensuring that these Group 3 deposit takers remain solvent and continue providing services to their customers. At the same time, requirements of any sort can limit market access for new competition and affect the capacity of Group 3 deposit takers to grow and to compete with larger deposit takers.

Our assessment is that the changes to Group 3 requirements covered in this *Response* document should help limit the negative competition impacts discussed in the feedback by respondents. In addition, options proposed for Group 1 and 2 in the 2025 Capital Review may also affect competition among deposit takers, and this is discussed further in the 2025 Capital Review Consultation Paper.

However, the revised approach for Group 3 in this *Response* document is unlikely to have the large positive impact on competition that respondents have asked for. This might be more possible with substantial reductions in minimum capital ratio requirements and/or a lower prudential buffer. We consider that such reductions would come at the expense of financial stability and risks to the soundness of individual deposit takers, which is contrary to purposes of the DTA. Further discussion of competition, Group 3 and the impacts of revised options within the 2025 Capital Review are discussed in that Consultation Paper.

We have carefully considered whether a further loosening relative to the original proposals for Group 3 would be consistent with the DTA. Although our assessment is that lower minimum capital would not be consistent with the main purpose of the DTA, we note that standardised risk weights are being consulted on as part of the 2025 Capital Review, which would further reduce requirements for Group 3. In addition, the 2025 Review also covers options relating to the capital stack and the PCB.

2.5.13. Diversity of institutions

Only a small number of respondents provided views on the question regarding diversity among Group 3 deposit takers. However, the view of those that did respond is that the proposals may negatively impact the diversity of institutions providing access to financial products and services to a diverse range of New Zealanders.

Respondents consider that the primary cause of the likely negative impact is the proposed minimum capital base. A range of alternative proposals were included in feedback from respondents, as discussed in section 2.5.5 of this chapter.

Comment

The general view of respondents that commented on this issue was that the proposals may negatively impact the diversity of institutions able to provide access to financial products and services to a diverse range of New Zealanders.

Respondents see the minimum capital base requirement to be the key driver of this impact.

The changes proposed in section 2.5.5 will have little impact on system wide financial stability but will support a small increase in diversity. This impact primarily arises through two key changes:

- Simplification of requirements relating to capital instruments and credit risk mitigation will help reduce compliance costs and reduce the regulatory burden. These changes help address one factor that might discourage new entrants which could act as a barrier to entry.
- We have set the minimum capital base requirement at $5 million, which is at the bottom of the range we signalled in the DTA Consultation Paper.

This closely relates to the minimum level of capital. The rationale for this changed proposal is discussed in more depth in section 2.5.5. The key factors supporting the minimum level are:

- A minimum level helps support the soundness and stability of individual deposit takers, as set out in the additional purpose in the DTA.
- By setting the capital base at the lowest level we consulted on, we can ensure that any impact on diversity is minimised.

While the risk of negative impacts on diversity is minimised, it will nevertheless have a larger impact on diversity than if we proceeded without a minimum level.

We have assessed this alternative carefully and, although we consider it to be a feasible alternative, it brings a higher risk to the soundness of individual small deposit takers. It would increase the risk of failure of the small subset of deposit takers that would be more immediately impacted by the requirement (although such failures would have little impact in system wide stability).

Response

We are making a number of changes to the proposals in the DTA Consultation Paper. We have taken the diversity of institutions into account when considering the revised policy settings. We expect the revised proposals to be more supportive of the diversity of institutions principle than the original proposals. The main changes are:

- a revised approach to CRM to reduce the compliance burden and reduce barriers to entry
- to the level at which we set the minimum capital dollar requirements.

2.5.14. Avoiding unnecessary compliance costs

The general consensus from respondents is that the proposals across the standards will increase the compliance burden on Group 3 deposit takers in a disproportionate way. Respondents expect this will discourage new entrants and create a large burden for existing deposit takers, without a significant lift in financial stability.

This feedback is wider than just for the Capital Standard. Respondents provided limited examples of changes to the Capital Standard that would help mitigate this increased compliance burden.

However, respondents asked us to consider simplification or exemptions for Group 3 deposit takers to help reduce compliance costs.

Response

Our assessment is that there are a range of areas where it is possible to simplify the requirements for Group 3 deposit takers, without affecting any of the purposes of the DTA. We have proposed simplification of requirements in the following areas:

- credit rating exemptions (*see* section 2.5.2).
- approach to capital instruments (*see* section 2.5.6).
- credit risk mitigation (*see* section 0).

2.6. Minor and technical issues

In this section, we address certain discrete technical topics that were included in the consultation on the Capital Standard or that have been raised by respondents.

Table 2.16: Minor and technical issues for the Capital Standard

Issue	Response
Low uptake of lenders' mortgage insurance	Developing the market for lenders' mortgage insurance is outside the scope of the Capital Standard.
Bring forward requirement for technical risk weights	We are considering the implementation deadline for technical risk weights as part of the current consultation for the 2025 Capital Review.

We also received feedback about a number of other components of the approach to IRB risk weights where respondents are seeking changes.

Use of supervisory slotting

One respondent asked us to consider changes to the supervisory slotting approach in place for IRB banks for specialised lending, including income producing real estate. This respondent suggested that our approach is out of step with international treatment where advanced IRB banks can model risk factors for most groups of specialised lending.

Another respondent asked us to consider more alignment with international approaches and make a more immediate change to remove the requirement to apply the scalar to slotted exposures, as they consider the slotted risk weights to already be conservative.

Recoverable value of carbon credits as eligible collateral

One respondent asked us to consider the approach to carbon credits for the purposes of determining Loss Given Default (**LGD**) in the calculation of risk weighted assets.

This respondent suggested that further actions are needed to support transition to a low/lower carbon economy in relation to regulatory capital requirements. As a specific example, the respondent suggest we consider the approach that APRA has adopted under APS113 to include the recognition of the recoverable value of carbon credits and allowances as eligible collateral in the determination of LGD as part of the credit risk weighted asset calculations.[32]

Domestic Large Infrastructure Assets

One respondent suggested that we consider the APRA approach to domestic large infrastructure. To ensure that ADIs can support the development of public infrastructure projects in Australia, APRA allows for a 25% LGD for operators of domestic large public infrastructure assets and utilities that have a tripartite agreement with the Australian Government. This LGD treatment recognises that the underlying infrastructure assets support recovery values in the event of default.

The respondent noted that in Australia, this treatment has recently been updated (with effect from September 2024) to also cover government-owned enterprises that act as operators. Under our current capital requirements, this type of arrangement is classified as an unsecured exposure - resulting in higher LGD. The respondent considers this treatment does not accurately reflect the

32 apra.gov.au/sites/default/files/2021-11/Final%20Prudential%20Standard%20APS%20113%20Capital%20Adequacy%20-%20Internal%20Ratings-based%20Approach%20to%20Credit%20Risk.pdf.

underlying risk and may discourage growth in this area hence suggesting we reconsider our LGD treatment for such exposures.

Response

We have not concluded our assessments of these topics in the time available. We will continue to consider these topics and may include changes in the exposure draft if we consider this to be warranted.

Annex A: Glossary

Term	Meaning
APRA	Australian Prudential Regulation Authority
AT1	Additional Tier 1
BCBS	Basel Committee for Banking Supervision
BI	Business Indicator
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
BPR151	BPR151 AMA Operational Risk document
Branches	Branches of overseas deposit takers
CET1	Common Equity Tier 1
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
D-SIBs	Domestic systemically important banks
DCS	Depositor Compensation Scheme, has the same meaning as in Part 6 of the Deposit Takers Act 2023
DTA	Deposit Takers Act 2023
FMA	Financial Markets Authority
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
ICAAP	Internal Capital Adequacy Assessment Process
ILM	Internal risk multiplier
IRB	Internal ratings-based
IRRBB	Interest rate risk in the banking book
Licensed NBDT	Has the same meaning as in section 4(1) of the NBDT Act
MCI	Mutual Capital Instrument
MoU	Memorandum of Understanding

Term	Meaning
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
NZD	New Zealand Dollar
NZ Super Fund	New Zealand Superannuation Fund
OCR	Official Cash Rate
OIC	Order in Council
Proportionality framework	*Proportionality Framework for Developing Standards under the Deposit Takers Act*, published by the Reserve Bank on 14 March 2024
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
RWA	Risk weighted assets
SCO	sectoral capital overlay
SCR	sectoral capital requirement
SRW	Sectoral risk weights
Standards	Refer to the four core Deposit Taker Standards to be made under the Deposit Takers Act 2023
VaR	Value-at-risk

Annex B: Consultation questions

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?

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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?