

# BNZ Submission: RBNZ's 2025 Review of Key Capital Settings

3 October 2025

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# 1. Introduction

- 1.1. Bank of New Zealand (BNZ) has prepared this submission in response to the Reserve Bank of New Zealand (RBNZ) 2025 Review of key capital settings (Consultation Paper). We welcome the opportunity to provide feedback on the Consultation Paper.
- 1.2. We support the RBNZ's objectives of ensuring a stable, competitive, and efficient financial system that promotes the prosperity and well-being of New Zealanders. We appreciate the move towards greater proportionality, international alignment, and evidence-based policy.
- 1.3. We acknowledge that material changes and international developments have occurred since the original settings were finalised in 2019. These include New Zealand's experience with economic resilience through the COVID period, reviews of capital settings in comparative OECD jurisdictions, the Commerce Commission's market study and inquiries into efficiency and customer experience in the local banking system, and the introduction of the Depositor Compensation Scheme (DCS) in New Zealand.

## 2. Executive Summary

- 2.1. BNZ acknowledges and supports the RBNZ's initiative to review the capital settings. We believe this review is an important step towards maintaining financial stability in New Zealand, while balancing the impacts of capital costs on the New Zealand economy.
- 2.2. BNZ supports the proposed changes to standardised risk weights and the more granular approach to better align capital costs with risk. We believe the proposed changes will reduce the cost of capital and will be beneficial for New Zealand overall. However, there are a number of important areas where misalignment between capital and risk will continue to exist, which we believe should be reviewed. If not addressed, this misalignment is expected to result in higher cost of credit for New Zealand businesses, while also potentially reallocating domestic bank capital away from the productive sector.
- 2.3. We believe that the most effective way to address this misalignment is by harmonising the output floor to the international Basel standards, from 85% to 72.5%. This change has the benefit of further aligning New Zealand's capital regime with international standards, which was one of the key criteria for the capital review, while also aligning with the Deposit Takers Act (DTA) section 4(d) principle. There are other risk mitigation measures within the capital framework that already adjust for New Zealand's risk profile, including the scalar and absolute capital levels. Given the wide-reaching impacts of the standardised floor, and that New Zealand would be the only jurisdiction with an output floor greater than the 72.5% level prescribed by Basel, BNZ recommends that the RBNZ undertakes a comprehensive cost benefit analysis. This analysis should quantify costs

to borrowers and potential impacts to New Zealand, before a decision is finalised to retain a floor that is different from the Basel standard.

- 2.4. When considering broader capital settings, BNZ supports Option 2 of the proposed capital stack. We believe Option 2 offers a more effective framework for crisis management and resolution and supports the Single Point of Entry (SPE) resolution strategy, where the Australian parent recapitalises the New Zealand subsidiary in a crisis. BNZ also supports the removal of Additional Tier 1 (AT1) instruments from the capital stack. The RBNZ should consider whether there is also benefit from removing layers of conservatism in the underlying components of the capital calculations, risk weights, scalars and the output floor, in favour of applying the required conservatism at the total capital level. This would improve transparency and comparability and minimise the misallocation of capital between asset classes, while maintaining overall capital levels that support stability.
- 2.5. Given the scale and complexity of proposed changes, we recommend that any planned increases in the Prudential Capital Buffer (PCB) under the 2019 capital reforms do not proceed until new rules are confirmed.
- 2.6. Our submission is set out below in three sections. First, we outline a number of areas where we believe further consideration should be given to ensure a successful capital regime. Second, we discuss areas of the proposed regime which we support, covering most of the key proposals in the consultation, and finally we have included a section for other matters, including timeframes and prioritisation.

### 3. Areas for further consideration to ensure a successful Capital Regime

- 3.1. BNZ supports the majority of changes recommended within the capital review consultation paper. However, we suggest that there are four areas that warrant further consideration, to ensure that the RBNZ achieves its objective of ensuring a stable, competitive, and efficient financial system that promotes the prosperity and well-being of New Zealanders. These areas discussed further within this section are:
  - A mismatch between underlying credit risk and capital allocation, which may lead to the misallocation of capital within the economy;
  - Higher costs of credit for business and large corporate entities, which is not linked to credit risk;
  - The potential for regulatory arbitrage, that will disadvantage domestic deposit takers and lead to international bank funding concentration in important segments; and
  - The impact of the capital proposals on specific segments including infrastructure, securitisation, commercial property and personal lending.

## Mismatch between underlying credit risk and capital allocations

- 3.2. BNZ supports the proposed changes to standardised risk weights and a more granular approach to better align capital costs with risk, and we believe this will reduce the cost of credit in the economy, while continuing to ensure stability. There will, however, be important business sectors within New Zealand's economy where misalignment between capital and risk will continue to exist, which we believe the RBNZ should look to address within this review.
- 3.3. As outlined later in this section the corporate lending, infrastructure, securitisation, and commercial property sectors will continue to see significant differences between the proposed risk weights and the actual underlying risks as measured by Internal Ratings-Based (IRB) models. This discrepancy represents a significant departure from a risk-based approach for determining how much capital should be held against these exposures and will increase the cost of credit for these businesses beyond that which would be required for the risk they represent.
- 3.4. Misalignment between underlying risk and the amount of capital held, is not consistent with international best practice and can have several adverse effects on the economy. For instance, it can lead to an inefficient allocation of resources, where capital is not directed towards the most productive and growth-oriented sectors. This inefficiency would be likely to stifle innovation and hinder New Zealand's long-term economic growth.
- 3.5. The RBNZ's current proposal to retain the 85% output floor means standardised risk weights will continue to materially exceed IRB risk weights for corporate customers. Standardised corporate risk weights can only cater for externally rated corporates, which represent ~1% of the New Zealand corporate market. For the vast majority of New Zealand's medium and large business, who are not externally rated, there would be little, if any, consideration of the quality of their security or the serviceability of their loans when allocating capital under the standardised approach. This is a blunt measure of risk, which will result in excessive capital and borrowing costs for New Zealand business.
- 3.6. As mentioned earlier, we believe the simplest way to address this issue would be to harmonise the output floor with the Basal standard at 72.5%. This would enable IRB banks to retain accurate risk pricing, rewarding businesses that are well managed and secure, while also harmonising the New Zealand regime with international standards. This would deliver the most efficient loan pricing for customers, while also supporting New Zealand banks when seeking funding in important offshore markets where global comparison of risk and bank benchmarking is important.
- 3.7. Finally, any perceived competitive pricing advantage to IRB banks compared to standardised banks has been addressed through the RBNZ's existing proposal to retain the scalar at 1.2x and increase the overall capital stack for IRB banks, while reducing this for smaller banks. These combined adjustments will create a more balanced and



effective capital regime that supports financial stability, competitiveness, and economic growth in New Zealand.

## Higher costs of credit for businesses and large corporates

- 3.8. New Zealand's medium-sized and corporate businesses play a vital role in New Zealand's economic prosperity. These businesses are the backbone of our economy, driving job creation and economic diversification. As of February 2024, New Zealand has 612,420 enterprises with 2.5 million paid employees. 73% of enterprises do not have any paid employees, whereas there are 2,900 large enterprises with 100 or more employees, employing over 1.2 million people, representing 50% of all employees in New Zealand<sup>1</sup>.
- 3.9. These businesses are central to our economy and supply chains, providing consistent demand for goods and services from smaller suppliers, contractors, and service providers. Their scale allows them to absorb risk, invest in innovation, train skilled workers and create opportunities that help's New Zealanders thrive. While their success on the world stage demonstrates how New Zealand can scale internationally while maintaining strong domestic roots.
- 3.10. The current capital review proposals will result in these businesses paying more for credit than the underlying risks as measured by IRB models suggests is appropriate. The proposals will also not provide for differentiation between business that show different underlying risk profiles. The higher capital requirements resulting from the proposed capital regime will result in higher costs of credit to New Zealand businesses than is otherwise required. BNZ estimates borrowing costs for medium-sized<sup>2</sup> and corporate businesses to be ~20-30bps higher as a result of keeping the output floor above the Basel norm (85% vs 72.5%).
- 3.11. The impact of this is expected to be borne disproportionately by businesses that rely primarily on local bank financing, as they are not large enough to have access to alternative offshore funding sources.
- 3.12. It is worth noting that even the large corporates who have access to offshore funding may face limitations without domestic bank support. International banks have appetite for rated companies but can be wary of lending to unrated ones that operate in a jurisdiction and environment different from their own. In a syndicate, a domestic bank plays a vital role by delivering transaction services, performance monitoring and offering local expertise. Moreover, increased reliance on overseas funding can increase volatility. In a crisis event, offshore parent banks may prioritise 'home' markets and pulling capital back from their offshore entities, thereby reducing the availability of credit in New Zealand. Their appetite for New Zealand exposures can be volatile, influenced by global

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<sup>1</sup> New Zealand business demography statistics: At February 2024 | Stats NZ

<sup>2</sup> Medium sized business for this cost analysis was defined using the IRB definition of corporate SME

risk cycles rather than local fundamentals, as was experienced during the Global Financial Crisis (GFC), when evidence of financial strain appeared in large parts of the business sector<sup>3</sup>.

- 3.13. We recommend that as part of this capital review the RBNZ should look to create a regime that better aligns the actual credit risk profile of New Zealand businesses, with the capital that is required to be held against lending to them. This will lower the cost of credit to these businesses, and to the economy more broadly, without reducing overall stability. Similarly, by aligning more closely with international best practice, the rules can help create a more level playing field for New Zealand businesses, lowering funding cost and enabling them to compete more effectively in the global market.

## Potential for regulatory arbitrage

- 3.14. The proposed capital settings risk creating an environment where regulatory arbitrage is likely to occur. Overseas banks, which are not domestic deposit taking institutions, operate under different regulatory frameworks with lower capital requirements. Similarly, providers of private credit operate outside of the direct oversight of the RBNZ. In both instances, where New Zealand's capital regime creates a mismatch between underlying risk and capital, these entities will be able to offer lower borrowing costs than domestic banks and capture a disproportionate share of impacted segments.
- 3.15. For Group 1 banks prior to the 2019 capital reforms, the average capital cost of a corporate loan was approximately twice as high as a mortgage. Post the 2019 capital reforms the average capital cost of a corporate loan was up to three times higher (flat 100% risk weight vs 35% minimum risk weight). The proposed settings will push this gap even wider – up to four times higher (flat 100% risk weight vs 25% minimum risk weight).
- 3.16. While steps have been taken to harmonise mortgage risk weights and align them more closely to internally modelled outcomes, the capital required for corporate loans is proposed to remain unchanged. The widening gap in capital cost will create market arbitrage opportunities in the near term, and will make it increasingly difficult for banks, including those who have been long-time supporters of businesses, to continue to support this part of the market.
- 3.17. Overseas banks, operating under different regulatory frameworks and with lower capital requirements, will be able to offer lower borrowing costs than domestic banks. If capital settings continue to discourage corporate lending, New Zealand risks hollowing out its domestic banking relationships with key sectors, leaving them exposed to a rapid adverse response in a crisis and the changing appetite of offshore capital markets.
- 3.18. Similarly, there is the potential for growth of the private credit market which operates outside the direct regulatory oversight of the RBNZ. Private credit investments are often

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<sup>3</sup> [RBNZ Financial Stability Report May 2009](#)

characterised by higher leverage and greater risk-taking, which can amplify the impact of financial shocks and contribute to systemic instability. This trend, already observed in Australia, introduces financial system risks that must also be considered in the context of the outcomes we are trying to achieve through this capital reform.

- 3.19. This arbitrage can lead to a fragmentation of the financial system, where different segments of the market operate under varying regulatory standards, creating inconsistencies and inefficiencies, and making it more challenging for regulators to maintain oversight and ensure the stability of the financial system as a whole.
- 3.20. Enabling scope for IRB models to drive capital allocation and pricing in this part of the market would help moderate regulatory arbitrage and avoid the flow of financing to less regulated parts of the market (though intrinsically linked to mainstream banking and financing as shown through overseas experience). It will also ensure a more consistent and harmonized regulatory framework, that will enhance the resilience of the financial system, reduce the likelihood of financial crises and help maintain the confidence of investors and other stakeholders in the stability and integrity of New Zealand's financial system.

## Impact of Capital Proposals on Specific Segments

### Infrastructure

- 3.21. Borrowers who deliver large-scale public infrastructure, or who operate lifeline utilities (such as water, energy distribution and transmission, gas pipelines and fibre) play a foundational role in the functioning of the economy.
- 3.22. These assets benefit from strong credit enhancement frameworks such as Public Private Partnerships (PPP) and the Infrastructure Funding and Financing Act 2020, which significantly reduce loss severity in default scenarios through structured agreements and legislative support. Additionally, where borrowers operate under a Regulated Asset Base (RAB), regulatory oversight and pricing mechanisms help mitigate default risk, while the essential nature, and defensible value of the assets, further reduce potential losses. Their services are non-discretionary, demand is stable across economic cycles, and these assets are highly secure. This reduces default risk and supports the case for a lower standardised risk weight.
- 3.23. BNZ recommends lowering standardised risk weights for assets with the following characteristics:
  - Lending to support domestic infrastructure development which is subject to revenue streams supported by legislation (i.e. transactions undertaken under the Infrastructure Funding and Financing Act 2020 framework);



- Lending to support the delivery of large domestic public infrastructure assets which are subject to tripartite agreements with Central or Local Government (i.e. PPP transactions); and
- Lending to support the provision of services which are essential to the economy where assets are valued under the RAB framework.

## Securitisation

- 3.24. Securitisation is a key funding mechanism for New Zealand's Non-Bank Financial Institutions (NBFIs), enabling them to offer diverse financial products and maintain competitiveness. Following the GFC and the decline of debenture funding, NBFIs have relied heavily on bank-provided Warehousing Facilities to originate loans, which are later securitised into Residential Mortgage-Backed Securities (RMBS) and Asset Backed Securities (ABS) for broader investor funding.
- 3.25. The internal credit assessment and structural protections for BNZ's Warehousing Facilities are aligned with external rating agency standards. The senior portion of the Asset pools (that are originally funded by Group 1 deposit takers) that is used as collateral for these facilities have consistently achieved AAA ratings when securitised, suggesting that the facilities themselves would likely be rated AAA if externally assessed. We believe the RBNZ should consider the risk weights for this segment, potentially allowing a look through to the underlying loans (i.e. mortgages, auto and personal loans etc.) and aligning the standardised risk weight attributable to these exposures to that of the underlying loans.

## Commercial Property

- 3.26. BNZ supports the proposal for a separate exposure class for commercial property within the corporate asset class as it will provide improved granularity based on the risk profile of the underlying lending. However, it is noted that there are a broad range of commercial property exposures with varying levels of associated risks and risk weights under IRB which could be better reflected in the proposed regime.
- 3.27. We suggest that a 100% risk weight for commercial property does not provide sufficient granularity and that commercial property lending could include an LVR-based banding approach, similar to that proposed for agricultural lending, which would more accurately reflect underlying credit risk. One of the key shortfalls in the standardised methodology is that it does not reflect security value despite this having a direct impact on actual losses incurred.

## Personal Lending

- 3.28. BNZ recommends maintaining a 100% risk weight for all personal lending, rather than increasing unsecured personal lending to 150% as suggested.

- 3.29. The marginal benefit to systemic risk from a higher risk weight is significantly outweighed by the potential adverse impacts on financial inclusion, access to mainstream banking services by vulnerable customers, and therefore customer well-being. The industry long run average non-performing loan ratio is 1.2% for personal lending.<sup>4</sup> Accordingly, BNZ recommends that the current 100% risk weight should be retained as it achieves a more appropriate balance between managing risk and supporting access to responsible, affordable credit.
- 3.30. BNZ broadly agrees with the statement that personal lending, secured or unsecured, is considered to have elevated risk compared to other exposure categories. However, personal lending represents a small proportion of total bank lending in New Zealand and does not pose a material risk to financial system stability. Raising the risk weight to 150% would increase capital requirements by 50% for these products, making personal loans more expensive and potentially reducing access to affordable credit for vulnerable customers. This could inadvertently push borrowers toward less regulated, higher-cost lenders, increasing their financial vulnerability.

## 4. BNZ Supports Key Aspects of the RBNZ Capital Proposal

### Overall Capital Stack

- 4.1. BNZ supports Option 2 regarding the proposed capital stack, conditional on alignment with Australian Prudential Regulation Authority (APRA) requirements for Australian parent banks. In BNZ's view, this structure enhances crisis resolution through the Single Point of Entry (SPE) strategy favoured by RBNZ and APRA, enabling recapitalisation of the New Zealand subsidiary by the parent in a stress event. To ensure Tier 2 and Total Loss Absorbing Capacity (TLAC) instruments qualify for APRA Prudential Standard APS111 Capital Adequacy: Measurement of Capital (APS111) corresponding deductions, RBNZ capital requirements should align with APRA criteria. BNZ believes the level of Common Equity Tier 1 (CET1) under Option 2 avoids upward pressure on capital costs and lending rates compared to Option 1.
- 4.2. BNZ supports the removal of Additional Tier 1 capital (AT1). This is consistent with APRA's approach and previous BNZ feedback on domestic market constraints. BNZ agrees that AT1 has not proven effective as going concern capital.
- 4.3. BNZ would expect Group 1 capital ratios to be similar to where they are today under Option 2 after allowing for internal buffers (Group 1 Banks' average CET1 ratio in June 2025 was 13.5%). Oliver Wyman's analysis shows the CET1 currently held by NZ banks is one of the highest of the peer jurisdictions supporting the CET1 level of 12% in Option 2

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<sup>4</sup> <https://www.rbnz.govt.nz/statistics/series/registered-banks/banks-assets-loans-by-asset-quality>

without a need to increase this further. Any increase to CET1 levels from where they are today would have additional impacts on the cost of capital and borrowing rates.

## Loan-to-Value-Ratio (LVR) Based Risk Weights for Agricultural Loans

- 4.4. BNZ supports the inclusion of new exposure categories and risk weights for Agricultural loans based on LVR. Based on the current level of collateralisation there is a marked alignment between the IRB and standardised outcomes.
- 4.5. BNZ broadly agrees with the logic applied in terms of the risk weight settings, although further discussion on the final rates is encouraged based on the noted broad disparity in IRB outcomes across banks. Noting for BNZ that security coverage is a key determinant of the risk profile.
- 4.6. Currently, forestry is excluded from the agricultural asset class and therefore does not get the benefit of the proposed standardised risk weight changes for agricultural LVR buckets. BNZ submits that forestry should be included in the agricultural asset class because, like pastoral and horticultural farming, it is fundamentally a land-based enterprise with a similar risk profile. Treating forestry differently in lending terms discourages strategic investment in sustainable land use.

## More Granular LVR for Residential Mortgage Risk Weights

- 4.7. BNZ supports the additional LVR categories and risk weights for mortgage lending. We support introducing more granularity based on security coverage and the proposed risk weights align more closely to IRB outcomes.

## Segmentation of Corporate SME from Corporate

- 4.8. BNZ supports the proposed introduction of two new exposure categories for SME Retail and Corporate SME and the associated risk weights. BNZ submits RBNZ should ensure the definition for SME Corporate is consistent across all standards in the DTA and for all deposits takers, regardless of Group.

## More Granular Risk Weights for Community Housing Providers (CHP)

- 4.9. We recommend adopting Option 2, classifying all lending to housing cooperatives as RML for both standardised and IRB banks. This approach is simple, consistent with international standards and enables accurate measurement of underlying risk.

## Māori Access to Capital

- 4.10. Lending to whenua Māori will benefit from the changes proposed in the review. All the lending categories defined in the review are extended to whenua Māori and there is no difference in the risk weight and capital treatment applied compared to other lending. BNZ does not differentiate between whenua Māori security or other security when lending. Policy in terms of maximum bank values and downturn haircuts are aligned for the determination of Loss Given Default (LGD).
- 4.11. There are no legal, regulatory or policy barriers to lending associated with whenua Māori. The Māori Land Court has created more clarity on the rules or requirements for lending to whenua Māori, which BNZ has included into its lending policy. However, there can be barriers to borrowing associated with reluctance to leverage traditional assets as security for commercial or other loan purposes.
- 4.12. BNZ does not participate in the whenua Māori Lenders Mortgage Insurance underwriting programme. Participation has been considered and has not been pursued to date.

## 5. Other Matters for Consideration

- 5.1. In addition to the key recommendations and support for specific aspects of the RBNZ capital proposal, there are several other matters that we suggest the RBNZ address. These include pausing any changes to capital levels that are currently in transition, allowing the grandfathering of existing Additional Tier 1 (AT1) capital instruments, and sequencing these capital changes and prioritisation alongside or ahead of other DTA reforms. Addressing these matters will ensure a smooth transition and effective implementation of the proposed capital regime changes.

### Pausing Changes to Capital Levels Currently in Transition

- 5.2. Given the scale and complexity of the proposed changes, including the removal of AT1 and introduction of new loss-absorbing instruments, it is critical RBNZ adopts a realistic and flexible implementation timeline. The banking sector will require sufficient time to assess existing capital instruments and engage with investors, parent entities and RBNZ regarding the issuance or redemption of capital instruments. The banking sector will also require sufficient time to update management buffers and capital planning processes to reflect the new prudential requirements.
- 5.3. BNZ supports a smooth transition and reasonable implementation timeline noting the material increase in T2 and TLAC required to be issued under Option 2. BNZ recommends RBNZ moves quickly on the terms of eligible T2 and TLAC instruments to

give banks certainty to be able to issue qualifying capital instruments ahead of first optional call dates of capital instruments in 2026.

- 5.4. The current implementation of capital changes from the 2019 Capital Review includes a further 1% increase in the Prudential Capital Buffer (PCB) for major banks scheduled for 1 July 2026. Considering the scope and extent of changes proposed in this review we recommend that this planned increase does not proceed at this time. The consultation paper itself acknowledges that the proposed changes are likely to reduce overall capital requirements relative to the 2019 framework. Proceeding with the scheduled PCB increase before these changes are finalised risks exceeding the desired level of system resilience signalled by the consultation.

## Grandfathering of Existing AT1 Capital Instruments

- 5.5. BNZ supports the proposal to remove AT1 from the capital stack. It is important the RBNZ closely manages communication to the market regarding the removal of AT1 to ensure transparency, mitigate any adverse signalling effects and investor uncertainty.
- 5.6. The RBNZ should define for outstanding AT1 instruments, a clear and structured grandfathering process, including that there be no amortisation of capital value until after the first optional call date.
- 5.7. Grandfathering existing AT1 capital instruments will help ensure that banks can continue to meet their capital requirements without having to raise new capital immediately. This will reduce the risk of financial instability and support the resilience of the financial system.
- 5.8. Furthermore, allowing the grandfathering of existing AT1 instruments will help maintain investor confidence and support the ongoing stability of the financial markets. By providing this transitional relief, we can ensure that the implementation of the new capital regime is smooth and orderly.

## Capital Definitions under Deposit Compensation Scheme

- 5.9. BNZ acknowledges the recent changes to the RBNZ's capital policy may have downstream implications for the risk score under the DCS. Given that the scoring matrix places relatively greater weight on total capital performance compared to the other four metrics, any changes to what qualifies as total capital under this ratio could materially affect a bank's risk score. Under Option 2, it is fundamental that the total capital percentage, including TLAC, will be recognised as contributing to performance under the capital metric as the TLAC provides further loss absorbing capacity to protect deposits.

## Sequencing Capital Changes and Prioritisation

- 5.10. BNZ recommends careful sequencing of the proposed capital changes and prioritisation alongside or ahead of other Deposit Takers Act reforms. This approach will ensure that the implementation of new capital requirements is coordinated with other regulatory changes, minimizing potential disruptions and allowing banks sufficient time to adjust to the new requirements and raise the necessary capital.

## 6. Conclusion

- 6.1. BNZ appreciates the opportunity to provide this submission to the Reserve Bank of New Zealand. We are committed to supporting the RBNZ's objectives of ensuring financial stability while fostering a competitive, productive, and growing economy. We acknowledge RBNZ's initiative in undertaking this review of the capital framework and support the overall direction of the proposed changes. Our overriding view is that the proposed changes are likely to be successful in delivering an improved balance of risk and borrowing cost in the system, provided that the standardised output floor is reduced to 72.5%.
- 6.2. We are available to meet and discuss the content of this submission further and look forward to continuing our collaborative efforts to strengthen New Zealand's financial system.
- 6.3. Should RBNZ have any questions in relation to this submission, please contact Paul Hay at s 9(2)(a) [REDACTED] .