

## **Submission on RBNZ's 2025 Review of key capital settings**

### **Response to Questions 7, 10 and 12**

CTA welcomes the opportunity to provide a submission to the Reserve Bank of New Zealand (RBNZ) regarding the 2025 review of capital settings for deposit takers. We commend the RBNZ's proactive approach to strengthening New Zealand's financial system and ensuring its resilience against potential shocks.

CTA is the industry association for licenced supervisors. Three of CTAs members act as trustee/supervisor for Non-Bank Deposit Takers (NBDTs). NBDTs will become Group 3 deposit takers under the Deposit Takers Act.

CTA supports the suggestion of a minimum capital amount for deposit takers of \$5m. CTA notes that some NBDTs currently have less than this amount of capital. We would welcome the opportunity to engage with the RBNZ regarding the detail of the implementation of the proposed requirement, including timing/phasing and licencing requirements.

Based on our analysis, CTA supports the proposals for Group 1, including Option 2: Loss-Absorbing Capacity (LAC) requirement for deposit takers. We believe that this measure is a critical and necessary step to bolster financial stability, effectively operationalise the bail-in regime, and align New Zealand's prudential framework with international best practices.

CTA suggests that LAC could be used to lower the amounts of Tier 2 capital required for Groups 2 and 3. In particular we note that Group 3 has not had an overall reduction in the required Total Capital, where Group 1 and 2 has. This potentially could be disproportionate and unfair to the NBDTs we supervise. CTA suggests that LAC could be used to reduce the Total Capital requirement, while offering Group 2 and 3 deposit takers an alternative source of funding without increasing the overall risk profile.

CTA challenges the view that LAC could not be marketed by Group 2 and 3 deposit takers. LAC are debt securities which NBDTs have significant experience in marketing under the FMCA. CTA notes that while there are other resolution options for Group 3 in the Deposit Takers Act, LAC would reduce the need for these. CTA notes that its members hold security over almost all NBDT's. As previously discussed with the RBNZ, we could continue to hold first ranking GSA's as security trustee acting on the RBNZ's instruction, adding an additional layer of protection for investors (and the DCS) as well as providing the RBNZ with an additional high quality resolution option.

CTA supports LAC for the following reasons:

**1. Enhancing Financial Stability and Resilience** A LAC requirement creates a pre-positioned buffer of debt instruments that can be converted into equity during a stress event. This provides a transparent and pre-planned mechanism for recapitalising a deposit taker in distress, thereby avoiding a costly and disorderly collapse. By ensuring that a deposit taker has sufficient resources to absorb losses and restore its capital position, the LAC framework significantly reduces the risk of a systemic crisis. This not only protects the wider financial system but also insulates the investors in Deposit Takers. CTA members currently supervise NBDTs.

**2. Supporting an Effective Bail-in Regime** The LAC requirement is a fundamental pillar of an effective bail-in regime. Without a dedicated stock of pre-positioned loss-absorbing instruments, the bail-in process could be complex, slow, and disruptive. LAC instruments, whether internal or external, are specifically designed to be converted to equity in a resolution scenario, making the process of recapitalisation swift and predictable. This clarity is essential for maintaining market confidence and ensuring that the deposit taker can continue to perform its critical functions during and after a crisis. The presence of LAC instruments makes the bail-in process a credible alternative to a taxpayer-funded rescue.

**3. Aligning with Global Prudential Standards** The implementation of a LAC requirement aligns New Zealand's regulatory framework with global standards and trends in prudential supervision. The Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS) have developed Total Loss-Absorbing Capacity (TLAC) standards for Global Systemically Important Banks (G-SIBs). While New Zealand's deposit takers may not be G-SIBs, the principles of pre-positioning loss-absorbing capital are universally applicable and represent a prudent approach to risk management. Adopting this standard signals New Zealand's commitment to a robust regulatory environment and enhances the credibility of its financial sector on the international stage.

**4. Promoting Market Discipline** An external LAC requirement encourages greater market discipline. Investors who purchase these instruments are exposed to a clear risk of conversion in a resolution scenario. This provides a strong incentive for them to carefully monitor the financial health and risk management practices of the issuing deposit taker. The pricing of these instruments in the market can serve as a valuable and independent indicator of a deposit taker's perceived riskiness, providing an additional layer of oversight for both regulators and the public.

**5. Enhancing New Zealand's Capital Markets** The introduction of a well-defined LAC requirement would provide a new class of investment instruments, particularly in the form of external LAC. This would offer a distinct, regulated opportunity for domestic investors to participate in the financial sector's funding, diversifying their portfolios and fostering the development of New Zealand's local debt capital markets. This additional depth and liquidity would enhance the overall sophistication and resilience of the nation's financial landscape.

**6. Providing a Cost-Effective Funding Option** From a deposit taker's perspective, issuing LAC debt instruments is a more cost-effective method of meeting prudential requirements compared to raising common equity. Debt typically commands a lower rate of return than equity, as it holds a higher position in the capital structure and is subject to different tax treatments. This allows deposit takers to build a robust buffer of loss-absorbing capital without the higher cost of equity, ensuring that the burden of enhanced financial stability is managed efficiently.

**7. Protecting the Deposit Compensation Scheme (DCS)** Most importantly, a LAC requirement adds a crucial and primary layer of protection that activates before the Deposit Compensation Scheme (DCS) is called upon. LAC instruments are designed to absorb losses and recapitalise a distressed firm, thereby reducing the probability of a firm's failure to a point that would trigger the DCS. This provides a direct and substantial benefit by protecting government funds, which underwrite the DCS, and helps to keep the levies on deposit takers lower by reducing the overall risk to the scheme.

**8. Quantitative Support from the Cost-Benefit Analysis** The Reserve Bank's own cost-benefit analysis (CBA) provides compelling quantitative evidence in favour of the LAC option. The central estimates presented in Table 25 clearly show that the LAC option has a net benefit of 0.20% of annual GDP compared to a net cost of -0.09% of annual GDP for the 'no LAC' option. This positive outcome is further reinforced by the sensitivity analysis in Table 26, where the LAC option consistently maintains a positive net benefit across all scenarios, while the 'no LAC' option remains negative. This robust analysis confirms that the LAC requirement is a net positive for the New Zealand economy and a prudent choice for financial regulation.

## **Conclusion**

In conclusion, CTA supports the proposals, and considers that the introduction of a Loss-Absorbing Capacity requirement for Group 1 deposit takers, is a crucial and forward-thinking policy decision for the Reserve Bank of New Zealand.

CTA suggests that LAC could also be used to lower the amounts of Tier 2 capital required for Groups 2 and 3.

LAC serves to enhance financial stability, operationalise the bail-in regime in a predictable manner, align with international best practices, and foster greater market discipline. We are confident that this measure will significantly contribute to a more resilient and secure financial system for all New Zealanders.

We appreciate the opportunity to contribute to this important consultation and are available to discuss our submission further at your convenience.