

3 October 2025

Reserve Bank of New Zealand
2 The Terrace
WELLINGTON 6140

By email: capitalreview@rbnz.govt.nz

Kia ora,

Submission of Heartland Bank Limited - 2025 Review of key capital settings: policy proposals

1. Introduction

- 1.1 Heartland Bank Limited (**Heartland**) welcomes the opportunity to submit feedback to the Reserve Bank of New Zealand (**RBNZ**) on the 2025 Review of key capital settings policy proposals dated 25 August 2025 (**Policy Proposals**), which we have read alongside the Oliver Wyman Report comparing New Zealand bank capital ratios to international peers (**Oliver Wyman Report**) and the Summary of Submissions and Policy Decisions for the Capital Standard dated 25 August 2025 (**Response Document**).
- 1.2 We acknowledge the RBNZ's consideration of Heartland's previous submissions on the core standards consultation and note that elements of Heartland's feedback have been addressed in the RBNZ's Response Document.
- 1.3 In respect of the current Policy Proposals, Heartland broadly supports the submission of the New Zealand Banking Association (**NZBA**) as it relates to Group 2 deposit takers, including Heartland. Heartland has also contributed to and broadly supports the submission of the Domestic Bank cohort of the NZBA.
- 1.4 However, there are some points in the NZBA and Domestic Bank submissions that Heartland wishes to reiterate and some additional submissions Heartland wishes to make, particularly on the proposals for more granular standardised risk weights, which are of particular importance to Heartland.
- 1.5 As invited by question 41 of the Policy Proposals, Heartland's submission includes feedback in relation to standardised risk weights that are unique to Heartland and are therefore consulted on in the Policy Proposals in very little detail or not at all. Heartland has therefore provided detailed analysis to support the RBNZ's consideration of these matters, and welcomes bilateral engagement, particularly in this respect.
- 1.6 Heartland submits that if the RBNZ is unable to make final policy decisions on some or all of these matters prior to December 2025, that they are not disregarded and consulted on further in 2026.
- 1.7 This is a relatively unique opportunity for the RBNZ to revisit and reset prudential capital requirements in a way which better aligns New Zealand with international practices and supports improved competition in the banking sector for the benefit of customers and the broader New Zealand economy. Therefore, Heartland submits that all aspects of the RBNZ's prudential capital settings are considered.

2. Overall Feedback

- 2.1 Heartland remains fully supportive of the RBNZ's objective to ensure a resilient and stable financial system that protects depositors and the broader economy. We welcome the Policy

Proposals, which we believe generally strike an appropriate balance, better reflecting the costs and risks associated with different lending groups, and a clear effort to apply proportionality.

- 2.2 Heartland supports the overall policy direction to set a higher risk appetite for New Zealand capital settings and agrees with the Policy Proposals to:
- Lower total capital requirements for Group 2 deposit takers to 14%.
 - Remove Additional Tier 1 capital as a form of regulatory capital.
 - Introduce more granular standardised risk weights for mortgage, corporate and agricultural lending.
- 2.3 However, Heartland believes that the Policy Proposals do not go far enough and continue to penalise lending outside of residential mortgages. The unintended consequence of this is a banking sector that is materially biased towards residential mortgage lending.
- 2.4 This is particularly relevant for Heartland, as a specialist bank that provides specialist products to customers who are traditionally under-served by the New Zealand banking sector.
- 2.5 Heartland would like to see more well-rounded Policy Proposals, which support other forms of lending that enable investment in the productive sectors of the New Zealand economy and provide greater choice to customers. As such, Heartland:
- **Strongly disagrees with the proposal to retain a 100% risk weight for secured personal loans.** Our view is that a risk weight of 75% is better aligned to the underlying risk of secured personal lending, as supported by domestic and international evidence. The consequence of overly conservative risk weights is that high-quality, secured lending is driven outside of the regulated banking sector. Not only does this result in an absence of prudential regulation and the associated capital requirements, but this also means customers are not protected by New Zealand’s conduct laws which are applicable only to consumer lenders who are registered banks and non-bank deposit takers.
 - **Strongly advocates for the adoption of Basel 3 standardised risk weights across all categories,** to ensure capital requirements accurately reflect the underlying risk. This also ensures that standardised ratings are consistent with the requirements used to calibrate internal ratings-based (IRB) models, reducing unfair advantage in categories such as retail lending (outside of residential mortgages), SME, and commercial loans.
 - **Requests that the RBNZ adopt internationally recognised, objective, quantitative analysis – in line with the Basel Committee on Banking Supervision (BCBS).** Risk weights should be based not only on loss given default and probability of default, but also on the correlation of each lending category with the broader economy, given that risk weights are intended to protect against unexpected losses, with expected losses covered by provisioning.
- 2.6 It is critical that capital settings support other forms of lending that enable investment in the productive sectors of the New Zealand economy. This aligns with the main purpose of the Deposit Takers Act 2023 (DTA) to “promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy” as well as the Government’s desired outcome of a financial system that contributes to New Zealand’s economic growth, as set out in the Financial Policy Remit.
- 2.7 As noted in the Oliver Wyman Report, New Zealand’s standardised risk weights are more conservative on the whole relative to international standards and comparable jurisdictions. Heartland supports the submission of the NZBA and Domestic Banks that the RBNZ has not provided a robust, evidence-based rationale for New Zealand’s continued divergence from

international standards. In contrast, Heartland submits extensive data and analysis supporting lower risk weights that are more closely aligned to international standards.

- 2.8 Notwithstanding the above, Heartland recognises that New Zealand faces certain unique risks that the RBNZ is mandated to address. Where the RBNZ identifies such risks within a specific lending category, Heartland expects that any resulting conservatism should be consistently reflected in both the standardised and IRB model frameworks. Where the risks are broader in nature, they should be addressed through proportionally risk-adjusted capital levels (with a preference for gone concern capital for smaller entities) rather than through inconsistent and arbitrary treatment of individual lending categories.
- 2.9 Furthermore, increased reporting requirements, including loan-level reporting from September 2026, provide a strong foundation for further granular analysis and segmentation of risk weights, and remove any benefits of a simplified system. Given the significant undertaking on banks to prepare loan-level data, it should be utilised to improve classification of standardised risk weights.

3. Key Points in Heartland's Submission

- 3.1 Heartland has provided responses across questions 1-42 of the consultation (**Appendix 1**). However we would like to draw the RBNZ's attention to certain aspects of our submission, which we consider to be of highest importance for Heartland, or where we have strong differing views on the Policy Proposals.

Proposal to recalibrate standardised risk weights for secured personal lending [Section 7-15]

- 3.2 Heartland submits that secured personal loans (with loan-to-value (**LVR**) less than 100%) should be assigned a 75% risk weight. This would align standardised risk weights for secured personal lending more closely with international norms and the actual risk characteristics of this asset class. Heartland would also support more granular risk weightings that capture LVR and credit rating on origination.
- 3.3 Heartland's data and broader New Zealand evidence show that economic indicators have limited impact on loss rates for personal lending¹, indicating a low correlation with the wider economy. The RBNZ has effectively accepted this argument through enabling IRB banks to use the Retail correlation coefficient in their internal models. However, this is not considered in the RBNZ's Policy Proposals for standardised risk weights and therefore creates considerable inconsistency.
- 3.4 This misalignment of risk and capital requirements for secured personal lending is especially relevant to Heartland's consumer motor business, which represents 36% of Heartland's total receivables. The impact of these overly conservative risk weights is compounded by the fact that non-bank lenders are not required to comply with the same standards, and subsidiaries of non-Australian foreign banks use IRB models not constrained by New Zealand risk floors, giving them a pricing advantage.
- 3.5 [REDACTED]
[REDACTED]
[REDACTED] This would impact customer outcomes and the range of choices available in the market – an outcome that is at odds with the findings of the Commerce Commission banking market study and the Parliamentary banking inquiry, which recommend that the regulatory environment should better support competition.

¹ To support this position, Heartland has included its multifactor economic sector correlation analysis in the detailed workings.

Proposal to recalibrate standardised risk weights for reverse mortgages [Section 17]

- 3.6 Heartland proposes that reverse mortgage risk weights be aligned with those for investor residential mortgages, while ensuring that tail risks at higher LVRs are appropriately captured.
- 3.7 Specifically, we recommend removing the 20% valuation discount and instead calibrating LVR buckets to reflect severe but plausible house price declines. A more granular LVR-based risk weighting schedule should be adopted. As per our detailed submission we are advocating for increasing capital requirements on reverse mortgages with LVRs greater than 50% to better reflect this risk. This approach would ensure that risk weights are both risk-sensitive and aligned with international best practice, while maintaining prudent capital requirements for higher-risk exposures.

Limitations in cost-benefit analysis [Section 18-20]

- 3.8 We believe that the RBNZ's method for calculating the weighted average cost of capital is transparent and we support the overall method. We also welcome the updates that the RBNZ has made to its assessment in the cost of capital rules.
- 3.9 However, there are assumptions in the cost-benefit analysis utilised by the RBNZ that Heartland would challenge. We elaborate on this in Section 18-20.

Clarification on Total Loss Absorbing Capacity proposals and recognition of foreign-issued capital [Section 21]

- 3.10 Heartland supports options that allow capital issued by regulated foreign subsidiaries to be recognised at the banking group level.
- 3.11 Option 2 of the proposed capital stack options for Group 1 deposit takers implies that New Zealand would begin recognising APRA-eligible Tier 2 capital, a required step to enable single point of entry capital structures. If implemented, we would expect that such instruments should be able to be recognised by other non-internationally owned banks as well. Heartland is in favour of this, with the necessary safeguards such as non-recognition of such issuances to retail investors.

IRB certification for smaller banks [Section 5]

- 3.12 Heartland welcomes the RBNZ's statement in the consultation document that other banks may apply to use IRB models. However, in future consultations, we request that the RBNZ provide clarity on whether model verification will be conducted in a proportionate manner.


[REDACTED]

4. Questions

- 4.1 If you would like to discuss any aspect of this submission further, please do not hesitate to contact Heartland via Andy Wood, Chief Risk Officer and Jeff Rosie, Banking Group Treasurer.
- 4.2 We would welcome bilateral engagement with the RBNZ, noting that the concerns raised around secured personal lending and reverse mortgage risk weights are more significant to Heartland than other deposit takers, and that we have extensive internal data for these segments that the RBNZ may find informative in its final decision making.


Yours sincerely

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Leanne Lazarus
Chief Executive Officer
Heartland Bank Limited

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Bruce Irvine
Chair of the Board
Heartland Bank Limited

Appendix 1: Heartland Bank Limited – Detailed Submission

Responses to:

- **Q1: Do you have any comments on the proposed assessment criteria?**
- **Q2: Do you have any comments on the appropriate risk appetite for New Zealand's capital settings?**
- **Q3: Do you have any feedback on our assessment of the impacts of legislative and policy changes since 2019?**
- **Q4: Do you have any feedback on our assessment of the new evidence since 2019?**
- **Q5: Is there other new evidence not discussed in this section that we should be considering?**

1. Context

- 1.1 In response to these preliminary matters, Heartland supports the NZBA's submission that the adoption of a higher risk appetite for capital settings is appropriate and supported by new evidence, and the legislative and policy changes that have occurred since 2019.
- 1.2 In addition, Heartland would highlight the RBNZ's upcoming loan-level reporting requirements as a relevant policy development supporting further granularity in risk weights and removing any benefits of a simplified system. Given the significant undertaking on banks to prepare loan-level data, it should be utilised to improve classification of standardised risk weights.

Responses to:

- **Q6: Do you have any feedback on this analysis of how New Zealand deposit takers' current and planned capital levels compare to other jurisdictions?**

2. Incompatibility of New Zealand issued capital with Basel 3 standards is not captured in the international comparison

- 2.1 As the RBNZ is aware, the previous capital review resulted in Tier 2 and AT1 instruments that are incompatible with Basel 3 standards due to the prohibition of convertibility features.
- 2.2 While Heartland does not take a position on the conceptual merits of this decision, it does result in capital inefficiencies that increase the cost of capital for multinational banks as capital issued in New Zealand is not recognised in the consolidated group and thus may need to be issued again offshore. It also limits access to offshore markets due to the bespoke nature of New Zealand's capital instruments. For instance, Heartland's subsidiary, Heartland Bank Australia Limited, was able to raise Tier 2 capital in Australia (despite having no prior issuance history) at a lower cost than Heartland could achieve in New Zealand.
- 2.3 Heartland's primary concern is the inability to recognise capital issued by its Australian subsidiary under APRA rules within the consolidated Banking Group. If unchanged this would require additional capital issuance by the New Zealand entity to support the Australian operations, regardless of the Australian bank's strong independent capital position. This presents two key issues:
 - i **Market Depth:** Australian capital markets are significantly deeper, making them the preferred source of funding for the Australian subsidiary.

■ [REDACTED]

- 2.4 We note the existing rules create the opposite situation for the Australian banks and any possible international entrant to the New Zealand market, increasing the capital costs of doing so. We have never seen the cost of this capital duplication captured in any analysis of the capital rules. The impact of this also is not captured in the analysis undertaken by Oliver Wyman. Heartland submits that this should be considered.

Responses to:

- **Q7: Do you have any feedback on the two high-level [capital stack] options for Group 1?**
- **Q9: Do you have any feedback on the proposal for Group 2?**
- **Q18: Do you have any feedback on the degree of proportionality across the proposed options and capital stacks?**
- **Q19: Do you have any feedback on the implications for competition from our proposed options?**

3. On the two capital options for Group 1 – Heartland welcomes the broader benefits of Option 2

- 3.1 Heartland has no view on the correct level of capital for Group 1 deposit takers and thus the respective merits of the two capital stack options proposed.
- 3.2 However, Option 2 implies that New Zealand would begin recognising APRA-eligible Tier 2 capital, a required step to enable single point of entry capital structures. If implemented, we would expect that such instruments should be recognised by other non-internationally owned banks as well. Heartland is in favour of this.
- 3.3 We also note that the RBNZ may want to consider whether the reverse, of New Zealand being a single-entry point of capital for New Zealand owned foreign banks is preferable. If so, recognition of Basel-eligible capital would be required as otherwise the capital could not be recognised in foreign jurisdictions.

4. Heartland supports the capital stack proposal for Group 2 deposit takers

- 4.1 Heartland welcomes the proposal for Group 2, which reflects a higher risk appetite and lower capital requirements relative to the decisions made in the 2019 Capital Review.
- 4.2 Heartland supports a reduction in the PCB for Group 2 from 7% under the 2019 Capital Review decisions to 5% under the Policy Proposals. We support the increased scope to use Tier 2 capital and, as described further below, support the removal of AT1 capital.

5. This is the clearest example of RBNZ proportionality to date – but RBNZ must do more to minimise divergence between standardised risk weights and IRB

- 5.1 Heartland welcomes lower capital requirements for Group 2 deposit takers and agrees that this increased risk tolerance results in a more proportionate approach to capital requirements. However, the Policy Proposals do not address the material capital advantage that Group 1 banks have relative to smaller banks through their use of the IRB approach to calculate credit risk weights.
- 5.2 The IRB approach results in such favourable outcomes, the magnitude of which cannot be justified, and creates a significantly unlevel playing field for banks using standardised risk weights. These approaches must be aligned to deliver fair outcomes. This can be achieved by

making the standardised risk weights as granular as possible, ensuring that their requirements are not materially divergent from what conservative internal models would provide, and by ensuring New Zealand does not adopt standardised risk weights that are conservative in comparison to Basel III unless this can be justified by objective, quantitative analysis.

- 5.3 Heartland observes that some of the standardised recommendations appear to be driven by intuition rather than grounded in robust, objective, quantitative analysis. We also note that proposals for these categories, such as retail lending (outside of residential mortgages) and commercial loans, diverge materially from what IRB banks are offered.
- 5.4 Heartland welcomes the RBNZ's statement in the consultation document that other banks may apply to use IRB models. However, in future consultations, we request that the RBNZ provide clarity on whether model verification will be conducted in a proportionate manner.

[REDACTED]

Responses to:

- **Q10: Do you have any alternative proposals**
- **Q13: Do you agree with the proposal of a 1% Counter-Cyclical Capital Buffer for Group 1 and 2 deposit takers under the options proposed?**
- **Q14: Do you agree with the proposal that the Counter-Cyclical Capital Buffer should not apply to Group 3 deposit takers?**

6. Neutral view on the adoption of a smaller Prudential Capital Buffer (PCB) combined with a 1% Counter-Cyclical Capital Buffer

- 6.1 The primary theoretical advantage of a Counter-Cyclical Capital Buffer (**CCyB**) lies in its capacity to enable regulators to increase capital requirements during periods of economic expansion, thereby ensuring that sufficient buffers are available to absorb losses during downturns. This mechanism is intended to enhance the resilience of the banking system and mitigate the pro-cyclicality of credit supply. However, the practical challenge mirrors that encountered in Keynesian counter-cyclical policy: accurately identifying the phases of the economic cycle in real time is inherently difficult, and often only becomes evident retrospectively.
- 6.2 Current conditions illustrate this complexity. Domestically, the New Zealand economy is experiencing significant weakness, which would suggest that a CCyB (if in place) should be relaxed. Conversely, global financial markets, particularly in the United States, exhibit characteristics consistent with asset price bubbles, potentially exceeding those observed in the early 2000s. Implementing a CCyB framework would therefore require the RBNZ to adopt a definitive position on these competing signals. Moreover, a CCyB set at 1% is unlikely to be materially impactful in terms of systemic resilience.
- 6.3 Heartland is therefore largely neutral on whether a smaller Prudential Capital Buffer (**PCB**) combined with a 1% CCyB is adopted, as the practical outcome is expected to be broadly similar.
- 6.4 Nevertheless, as outlined in our full submission, we consider the standardised risk weights proposed by the RBNZ to be overly conservative and not fully supported by empirical asset performance data. We acknowledge, however, that the RBNZ likely views New Zealand as

having a unique risk profile, reflecting its economic structure, geographic isolation, and industry concentration. In this context, Heartland supports the objective of maintaining robust capital levels but advocates for achieving this through mechanisms such as Tier 2 capital, which is more accessible to smaller banks, rather than through elevated risk weights that may overstate underlying risk.

- 6.5 Such an approach would not only strengthen New Zealand's aggregate capital ratios, enhancing perceptions of financial system resilience, but would also ensure proportionality relative to actual risk. If the RBNZ were to adopt this perspective, the CCyB could serve as a flexible instrument to achieve these objectives, potentially at a more meaningful level (e.g., 2%). Furthermore, the CCyB could be designed to address not only cyclical economic fluctuations but also systemic shocks, such as natural disasters, including volcanic eruptions or earthquakes.
- 6.6 We note that Group 3 deposit takers represent the highest risk category due to their limited scale and relatively low levels of capitalisation. However, any failure within this group is also the least likely to result in sustained economic impact for New Zealand. Accordingly, we believe it is for the RBNZ to balance these two factors.

Responses to:

- **Q29: Do you agree that the Reserve Bank should introduce more granular standardised risk weights for mortgage, corporate and agricultural lending?**
- **Q39: Do you think the proposed standardised risk weights more closely align with the actual risk of the underlying lending? If not, where do you think the biggest discrepancies are?**
- **Q41: Is there anything else you think we should consider when contemplating changes to standardised risk weights or analysing their impact?**
- **Q42: Do you think the proposed approach to standardised risk weights aligns with the main purpose of the Deposit Takers Act 2023 (section 3(1)) and the additional purposes (section 3(2))?**

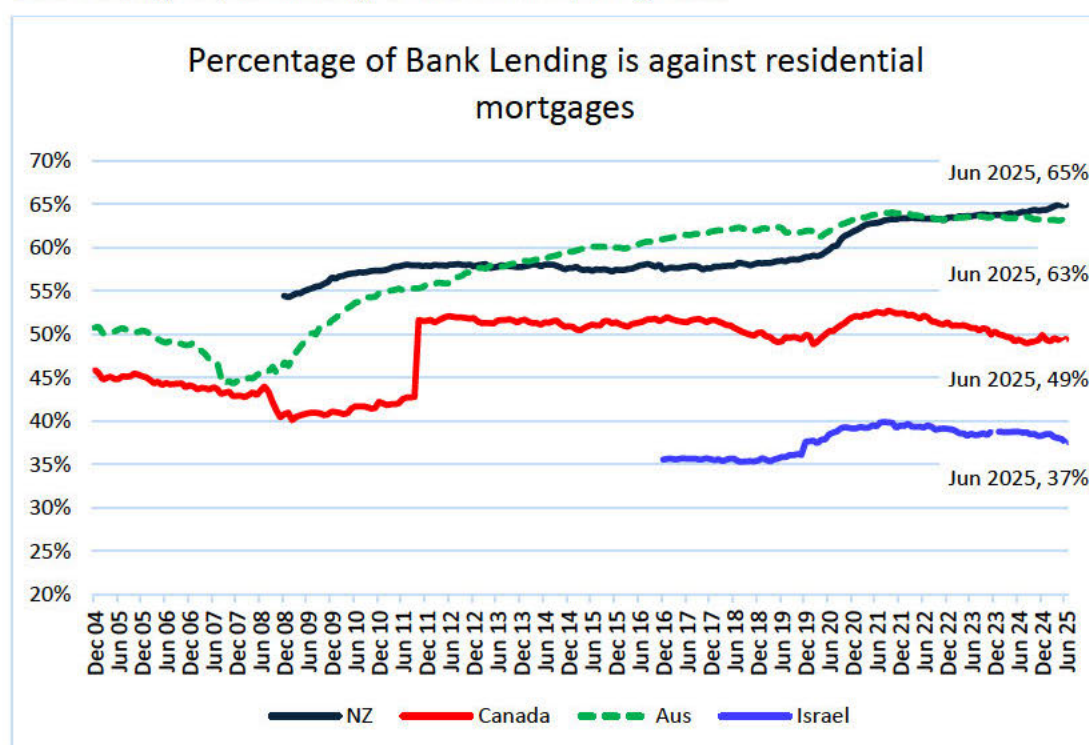
7. Summary

- 7.1 Heartland agrees with the overall direction of the Policy Proposals to introduce more granular standardised risk weights. However, as it stands the Policy Proposals do not go far enough and continue to misalign risk and requirements. We believe this has arisen due to inconsistent consideration of correlation when setting standardised risk weights, with only probability of default (**PD**) and loss given default (**LGD**) being captured.
- 7.2 In Heartland's view the most material discrepancy between the proposed standardised risk weights and actual risk of the underlying lending remains in secured personal lending. Heartland's data and broader New Zealand evidence show that economic indicators have limited impact on loss rates for personal lending, indicating a low correlation with the wider economy. This is not considered in the RBNZ's Policy Proposals. We provide extensive supporting data and analysis to support this position in our response to Q36.
- 7.3 By continuing to penalise lending outside of residential mortgages, the Policy Proposals are inconsistent with the main purpose of the DTA – to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy. The rules are also discriminatory as access to well-priced credit is effectively limited to those who own their own home.

- 7.4 New Zealand's conservative stance since 2008 on non-residential lending risk weights has led to an imbalanced lending portfolio across the banking sector. Residential loans have increased from 55% to 65% of total lending in New Zealand, the highest proportion of all comparable jurisdictions. It is critical that capital settings support other forms of lending that enable investment in the productive sectors of the New Zealand economy.

8. Capital Rules and the Mortgage Bias in New Zealand's Economy

- 8.1 Heartland's submission strongly advocates for a shift towards a risk-based foundation for standardised risk weights (and the associated floor for internal models). This approach would better align with international practice, academic research, and empirical evidence supporting appropriate risk weights based on fundamental principles.
- 8.2 We submit that New Zealand's current capital framework (and the proposals outlined in the consultation document) place disproportionate constraints on lending outside of residential mortgages. It is essential that the banking sector is empowered to support a diverse range of lending products that contribute to New Zealand's goals of enhancing productivity and building a more resilient, inclusive economy. A framework that implicitly favours residential mortgage lending through lower capital requirements (when compared to other forms of lending with similar risk profiles) risks reinforcing house price inflation and inadvertently marginalising borrowers who do not have access to property-backed finance.
- 8.3 New Zealand and Australia share a structural challenge: a significant concentration of bank lending in residential mortgages. This trend, which accelerated following the Global Financial Crisis and the Covid-19 pandemic, has begun to reverse in Australia, notably since the adoption of revised capital rules. Notably, Canada which has fully implemented BCBS risk weights has not experienced an increase in residential mortgage lending as a share of total bank lending, despite similarly elevated house price growth.



- 8.4 Drawing on the Oliver Wyman report, we analysed the proportion of bank lending secured by residential mortgages across several jurisdictions. Using central bank statistical data from each country, we calculated the share of residential mortgage-backed loans relative to total loans

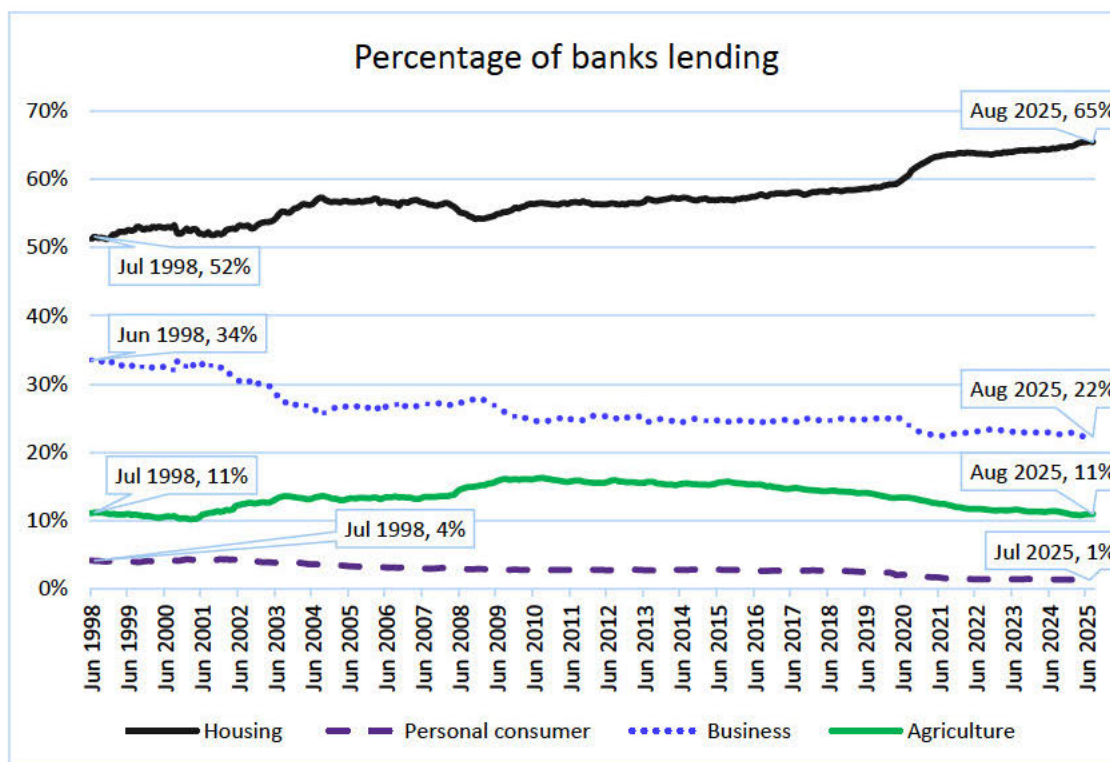
(excluding securities), based on the most recent reporting periods (June or July 2025). The findings highlight that New Zealand and Australia are clear outliers:

Country	Share_%	Primary source
New Zealand	65	RBNZ Registered banks – loans fully secured by residential mortgage (S33)
Australia	63	RBA.gov.au statistic – bank lending classified by sector
Canada	49	Bank of Canada; Chartered bank selected assets – residential mortgages / total loans excluding liquid assets
Hong Kong	34	HKMA Table 3.5: Loans and advances for use in Hong Kong by economic sector – (loans for purchase residential + plus investment / development)/ total loans
Singapore	19	MAS Housing & Bridging Loans (MSB)
Israel	37	Bank of Israel statistics (d020) housing loans / total loans
United Kingdom	54	Bank of England Bankstats (A4.3 M4 money. If exclude FI loans ratio is 71%). ²
Belgium	41	National bank of Belgium “Mortgage Loans”/“Claims on clients”
Sweden	30	Statistics Sweden (Financial Market Statistics); FI mortgage reports
Ireland	58	Central Bank of Ireland Credit & Banking Statistics “Loans for house purchase” (A.5.1) / Loans to private sector (A.5)
Norway	51	Norges Bank banking statistics (with Statistics Norway ORBOF)

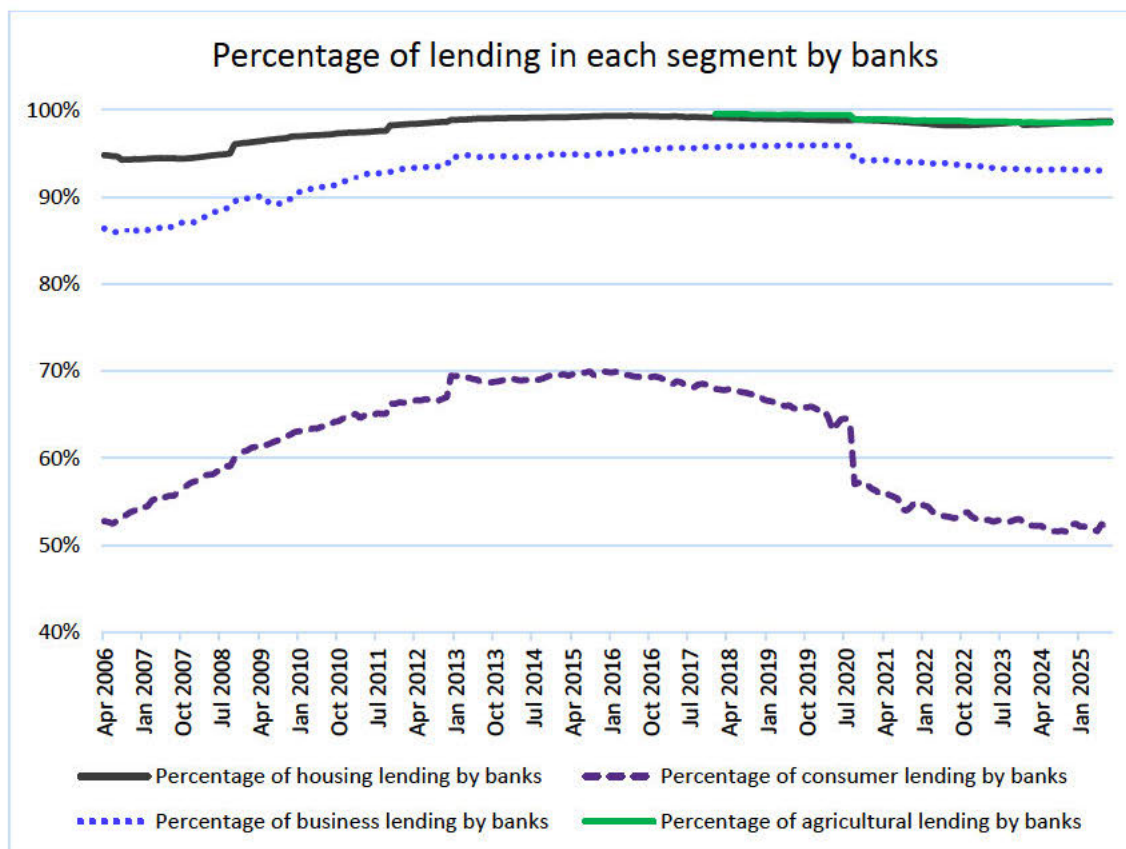
- 8.5 New Zealand has the highest concentration of residential mortgage-backed lending among banks. We believe this is partly driven by the conservative capital requirements applied to non-residential lending in both New Zealand and Australia.
- 8.6 Our view is supported by the RBNZ’s HC5 statistical data³ which shows that residential lending continues to rise, while business and personal lending have declined as a share of total bank lending.

² UK data is presented differently from other sectors and separating liquid assets is more challenging. We have used as the denominator all loans included within “M4” lending category. If loans to other financial corporations were excluded, being a material form of the UK economy, the ratio materially increases.

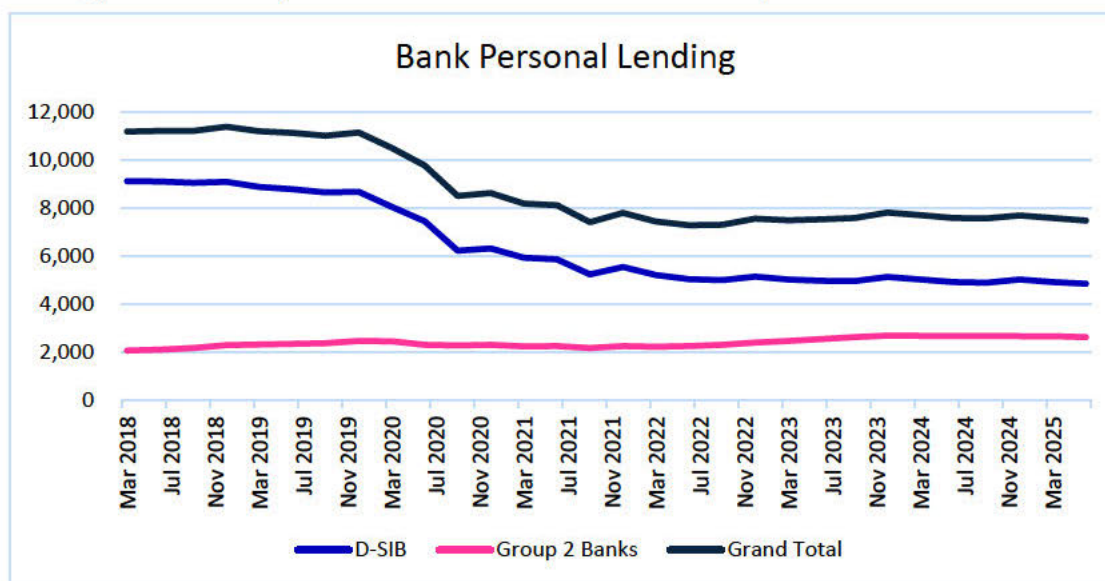
³ We have brought in the share of bank agricultural lending from HS37; hence the proportion does not go as far back.



- 8.7 Using the same data, we examined the proportion of lending by segment. The table below illustrates that retail personal lending has experienced the most significant decline since the current conservative capital rules were confirmed in December 2019, and it has remained subdued ever since.



- 8.8 The data demonstrates that banks have exited substantial volumes of personal lending following the 2019 capital review. This capacity has not been absorbed elsewhere, resulting in an overall contraction in personal lending. For borrowers with property, some of this demand has likely shifted to residential mortgages; however, those without property have either lost access to credit or turned to more expensive and potentially less-regulated alternatives.
- 8.9 This trend is almost certainly linked to the risk floor and heightened capital requirements. Evidence for this lies in the fact that only the D-SIB banks have materially reduced personal lending, whereas Group 2 banks have continued to offer these products.



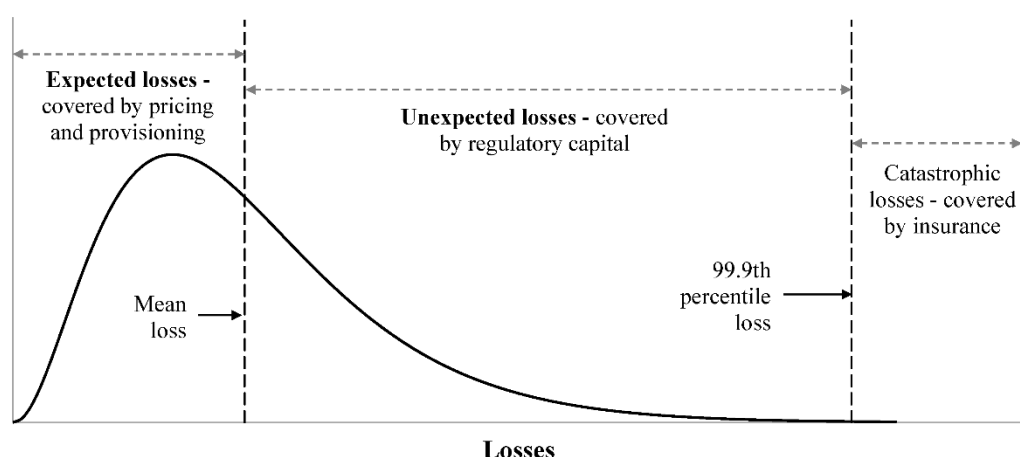
- 8.10 This approach also has equity implications. Borrowers who cannot secure lending against residential property are disadvantaged, regardless of their creditworthiness—particularly under the proposed internal rating floor.
- 8.11 This variation also explains the large differences between capital ratios, and capital coverage ratios as per Q6, as NZ has lower capital coverage ratios due to the predominance of residential lending.

9. RBNZ should adopt a risk-based foundation for standardised risk weighted assets

- 9.1 The BCBS designed the risk-weighted asset framework as the principal yardstick for determining whether a bank holds sufficient loss-absorbing capital. One of its high-level objectives was to align capital with the relative riskiness of exposures, rather than relying solely on a leverage (gearing) test. In essence, riskier lending should require greater capital, allowing lower risk lending to incur less capital cost and thus enable lower borrowing costs.
- 9.2 In this context, the robustness and risk sensitivity of the standardised approaches for credit risk have been identified as central priorities in the Basel III Endgame reforms. These enhancements aim to restore confidence in the credibility and consistency of RWA calculations across jurisdictions.
- 9.3 This concept is crucial, as it ensures the cost of fiscal prudence is borne by those most likely to rely on capital reserves. Standardised risk weights have always been conservative compared to what would be calculated under an internal risk-based model at a macro level. These are necessarily conservative, as they cannot respond to variable characteristics such as changes

in portfolio-level PD or LGD, or other factors like credit quality and LVR ratios.

- 9.4 However, risk weights should not be so conservative that they exceed what internal models would require in a highly stressed scenario, as this undermines the purpose of risk-weighted assets and creates market distortions. Lower-risk borrowers may gravitate towards banks using internal ratings, while higher-risk borrowers use standardised approaches, resulting in undue advantage.
- 9.5 Theoretically, risk weights are derived by calculating the maximum unexpected loss to the 99.9th percentile, considering:
- i Probability of the borrower defaulting (credit quality). (**PD**)
 - ii The **correlation** between the asset class and the overall economy. (**r**)
 - iii Loss severity if default occurs (collateral/recovery). (**LGD**)
- 9.6 We note the RBNZ's view, as outlined in the capital review (particularly portfolio risk modelling), that Basel's IRB approach contains simplifying assumptions, making it unlikely to achieve the 99.9% confidence interval. Additionally, New Zealand-specific factors, such as limited regional diversification, mean these intervals are likely understated. Both the RBNZ and BCBS have sought to mitigate these issues through increased minimum capital requirements (8%) and risk floors.
- 9.7 Heartland's strong view is that tools such as capital overlays are preferable for ensuring adequate capital levels, rather than incorrect relative risk weights.
- 9.8 Banks hold capital against expected losses through provisioning (as required by IFRS 9). As such, risk weights are intended to capture unexpected losses, i.e. those beyond what is covered by provisioning. This concept is illustrated below:⁴



- 9.9 As risk-weights primarily exist for the purpose of unexpected losses, internal models seek to capture the expected variability of the probability of default, measured by:
- i The 12-month probability of default (which is what provisions are required to be held for under IFRS 9).
 - ii The correlation of the asset class with the overall economy.
- 9.10 Heartland submits that this framework should underpin all RBNZ's standardised risk weights. While the consultation document captures risk driven by PD and LGD, the impact of correlation is omitted except for SME Retail and SME Corporate.

⁴ Source *Measurement and Calibration of Regulatory Credit Risk Asset Correlations* by Anton van Dyk and Gary van Vuuren 2023

10. Correlation with the economy must be considered in setting standardised risk weights

- 10.1 Correlation captures the variability of default probability through the cycle for an asset class. Different classes have varying levels of correlation to economic factors such as unemployment, GDP, and interest rates. For example, home loans have high risk-weightings due to strong correlation with the overall economy, creating systemic clustering. Conversely, academic studies show other retail exposures are more dispersed and driven by independent circumstances
- i Calem & Follain, 2003 show that mortgage portfolios exhibit asset correlations around 15%, versus 4–6% for other retail exposures.
 - ii Anton van Dyk and Gary van Vuuren, 2023 demonstrated much higher levels of correlation between residential mortgages and other retail lending, whilst noting Basel 2 correlation levels were too low in severe stress scenarios.
- 10.2 This concept is picked up in the consultation paper to support the lower risk weights for SME Retail and SME Corporate, as less volatility in stress result outputs. However, the lower correlation for both these categories is originally based on the Retail sector outside of home loans, which internationally has always shown the least correlation with the general economy.
- 10.3 The Reserve Bank's own HS50 non-performing loan ratio survey supports this pattern, breaking down non-performing loans by segment (Residential Loans, Personal Consumer Loans, Business Loans and Agricultural loans).
- 10.4 Heartland performed a multifactor regression analysis using 12-month averages of future non-performing loans by category against unemployment, OCR, and CPI (December 2008–July 2025):

Regression Statistics	Residential	Personal Loans	Business	Agriculture	What shows
Multiple R	0.85	0.48	0.92	0.66	Strength of relationship (1 = highest)
Adjusted R Square	0.71	0.20	0.85	0.41	% explained by model with R adjusted to penalise the addition of unnecessary variables
Coefficients					
Unemployment	0.57	0.07	0.69	0.37	Impact for every 1-unit increase on non-performing loans
CPI	0.18	0.07	0.11	0.10	
OCR	0.12	0.02	0.09	(0.07)	
Significance characteristics					
Significance F	0.00	0.00	0.00	0.00	Less than 0.05 model is statistically significant
Standard Error	0.34	0.22	0.26	0.34	On average how off predictions are
Observations	63	63	63	63	Data points used
F	51.51	6.03	116.12	15.51	P value must be less than this to conclude that the regression model fits the data better than the model with no independent variables
P Value					
Unemployment	0.00	0.05	0.00	0.00	Statistically significant as < F value
CPI	0.00	0.00	0.00	0.00	
OCR	0.00	0.37	0.00	0.03	
T Stat					
Unemployment	10.36	2.04	16.18	6.76	>2 = real effect
CPI	6.49	3.61	5.02	3.55	Real except OCR for personal loans.
OCR	3.55	0.89	3.42	2.21	-

- 10.5 The table above shows that:
- i The strength of correlation between the economy and non-performing loans is strongest for business and residential loans, weakest for personal loans, and intermediate for agriculture.
 - ii We have not included commodity prices, however we expect that if commodity prices replaced OCR the correlation for Agriculture would increase significantly.
 - iii Only 20% of non-performing personal loans can be explained by economic factors.
 - iv The weighted average impact (i.e. the coefficient) of the correlation by segment varies materially with:
 - a Residential and business loans averaging 29%.
 - b Agricultural loans averaging 13%.
 - c Personal loans averaging 5% impact.
- 10.6 Correlation as a factor in internal models (r) has a material impact on the calculated risk weighting. This is currently captured in New Zealand's internal risk models (in BPR 133). However, the current standardised risk-weighting framework in New Zealand, and the proposals as drafted, do not apply the correlation principle except for SMEs.
- 10.7 Heartland submits that the existing proposal misaligns risk and requirements. We believe this has arisen due to correlation being ignored and thus only LGD and PD being captured. This is analogous to Australia, where the prudential supervisor focused on the possible loss given default when considering the retail classification.
- 10.8 As such, when setting standardised risk weights Heartland submits that not only should PD and LGD be considered, but the correlation must be too. This is fundamentally what risk weights are for, capturing losses beyond which provisioning models already provide for.

Responses to:

- **Q36: Do you have any comments on increasing risk weights for personal lending?**

11. Summary

- 11.1 Heartland strongly disagrees with the proposal to retain a 100% risk weight for secured personal loans. Our view is that a risk weight of 100% significantly overstates the risk of secured personal lending, is inconsistent with domestic and international evidence, and consequently drives high-quality, secured personal lending outside of the regulated banking sector. Not only does this result in an absence of prudential regulation and the associated capital requirements, but this also means customers are not protected by New Zealand's conduct laws which are regulated by the FMA and applicable only to consumer lenders who are registered banks and non-bank deposit takers (i.e. the entities which will be regulated as deposit takers under the DTA from late 2028).
- 11.2 Both publicly available data and Heartland's internal analysis consistently demonstrate that personal lending exhibits materially lower correlation with economic factors than other forms of lending. Accordingly, risk weights should be adjusted to reflect this lower level of risk.
- 11.3 Heartland proposes that standardised risk weights be calibrated using conservative inputs to the relevant IRB BPR 133 formula, with sufficient granularity.
- 11.4 Heartland submits that secured personal loans (with LVR less than 100%) should be assigned a 75% risk weight. This would align standardised risk weights for secured personal lending

more closely with international norms and the actual risk characteristics of this asset class.

12. International comparisons and current RBNZ approach

- 12.1 Currently, all non-mortgage retail exposures in New Zealand are classified as “other exposures” and attract a 100% risk weighting (or 150% if non-performing and with insufficient provisioning), regardless of security.
- 12.2 The RBNZ’s proposal to retain 100% for secured personal loans and increase to 150% for unsecured loans represents a significant deviation from international standards, where risk weights for comparable exposures range from 45% to 150%.
- 12.3 Internationally, the UK, EU, and US have adopted or are moving towards Basel III guidance, which sets a 75% risk weighting for diversified retail exposures (85% in the US), and lower rates for transactional accounts repaid in full each month. The rationale for the 75% weighting is that retail portfolios are highly diversified, with individual defaults less likely to be driven by systemic economic shocks.

Region	Retail Exposures	Retail Exposures - Credit Cards Paid in Full
BCBS / EU	75%	45%
UK	75%	45%
APRA	100% / 75% SME Retail	75%
US	85%	55%

- 12.4 However, the Basel framework does not currently differentiate between secured and unsecured personal lending, citing the complexity of valuing collateral. Heartland considers this view outdated, given the increased availability of loan-level data and the RBNZ’s own expectations for collateral reporting. If a lender cannot provide sufficient collateral information, the exposure should be treated as unsecured by default.
- 12.5 Australia stands as an outlier, not adopting the full retail category, which has led to high-quality personal loans (such as motor loans) being largely originated outside the banking sector. A similar trend is emerging in New Zealand, with non-bank lenders increasingly dominating the motor vehicle finance market, often outside the scope of prudential and conduct regulation as discussed above.

13. Adopting Diversified Retail Exposure Risk Weights: Rationale and Analytical Support

- 13.1 As noted previously, Heartland believes that risk weights should be grounded in the key academic principles underpinning capital adequacy: the probability of borrower default (PD), the correlation between the asset class and the broader economy (r), and the loss severity if default occurs (LGD). These factors are fundamental to ensuring that capital requirements are appropriately aligned with the true risk profile of lending portfolios, particularly for exposures outside of residential mortgages.
- 13.2 Under BCBS rules, retail lending captures loans that are:
- i Revolving credits and lines of credit, personal term loans, and leases (including auto loans) not covered by a mortgage.
 - ii Maximum aggregated exposure to one counterparty cannot exceed an absolute threshold of €1 million.
 - iii No aggregated exposure to one counterparty can exceed 0.2%.

13.5 Heartland's regression analysis confirms that the strength of correlation between economic indicators and non-performing loans is weakest for personal loans. We have summarised the output below:

Regression Statistics	Residential	Personal Loans	Business	Agriculture	What shows
Multiple R	0.85	0.48	0.92	0.66	Strength of relationship (1 = highest)
Adjusted R Square	0.71	0.20	0.85	0.41	% explained by model with R adjusted to penalise the addition of unnecessary variables
Coefficients					
Unemployment	0.57	0.07	0.69	0.37	
CPI	0.18	0.07	0.11	0.10	Impact for every 1-unit increase on non-
OCR	0.12	0.02	0.09	(0.07)	performing loans

[REDACTED]

[REDACTED]

[REDACTED]

- 13.8 Taken together, both publicly available data and Heartland's internal analysis consistently demonstrate that personal lending exhibits materially lower correlation with economic factors than other forms of lending. Accordingly, risk weights should be adjusted to reflect this lower level of risk.

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[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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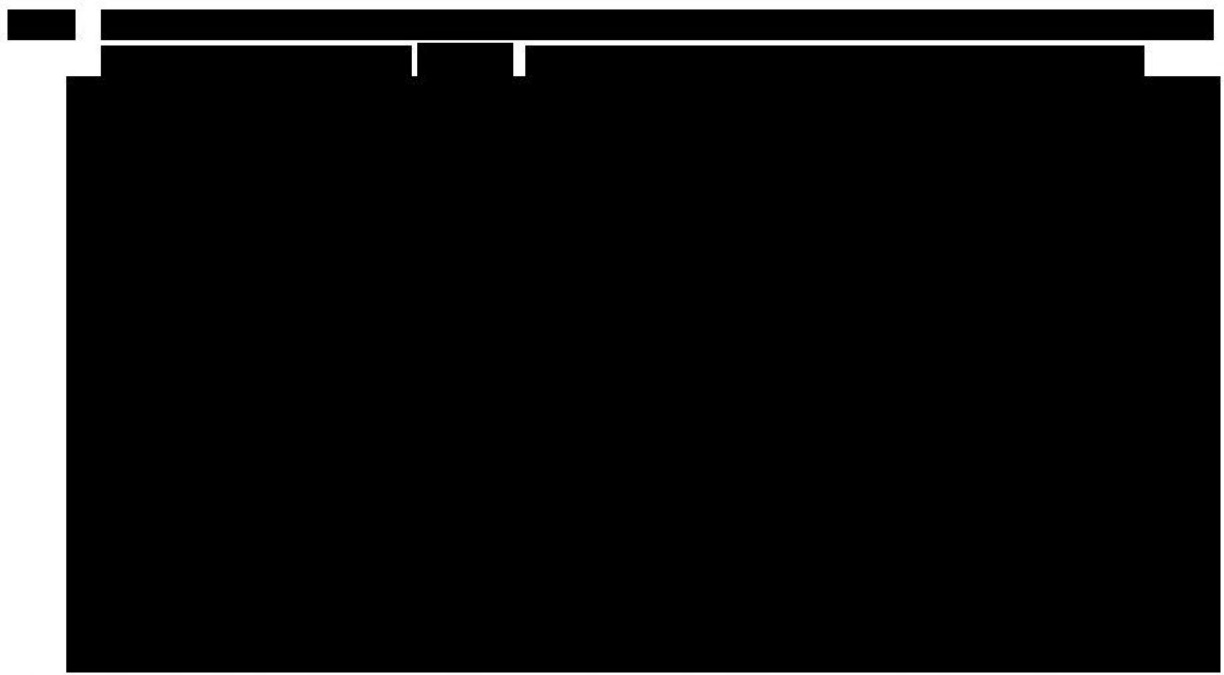
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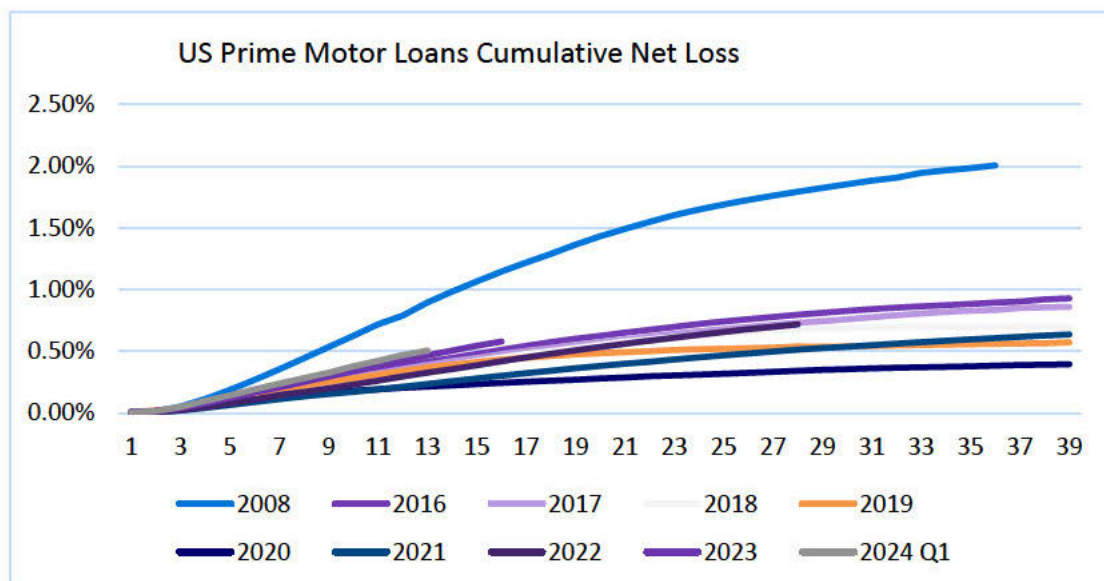
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[REDACTED]

[REDACTED]



13.12 Heartland's data is supported by strong international data supporting low net loss rates over many years, with the fundamentals supporting a risk weighting of less than 75%. For example, the cumulative net loss rate (loan outstanding less recoveries) for non-subprime Motor loans in the US since 2016, including the worst year on record (2008), shows net loss rates below 1%, except in 2008 when they reached 2%. This is demonstrated in the graph below⁷.

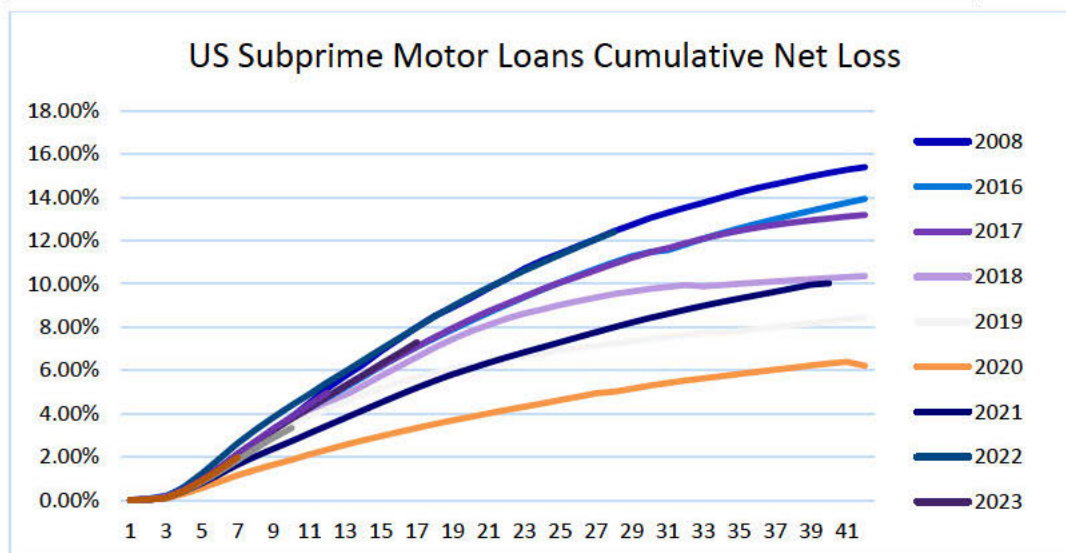


⁷ <https://www.spglobal.com/ratings/en/research-insights/sector-intelligence/interactives/auto-abs-loan-tracker-dashboard>

13.13 Using the provided recovery rate we have derived the following:

Month outstanding	2008	2016	2017	2018	2019	2020	2021	2022	2023	2024Q1
PD (12m)	1.42%	0.73%	0.70%	0.68%	0.66%	0.47%	0.45%	0.55%	0.77%	0.81%
LGD (12m)	55.7%	51.7%	50.8%	48.6%	51.7%	43.1%	46.8%	54.1%	54.7%	57.6%
PD (Life)	4.43%	2.10%	1.95%	1.73%	1.55%	1.16%	1.60%			
LGD (Life)	45.29%	44.29%	44.16%	40.20%	36.97%	33.84%	39.82%			

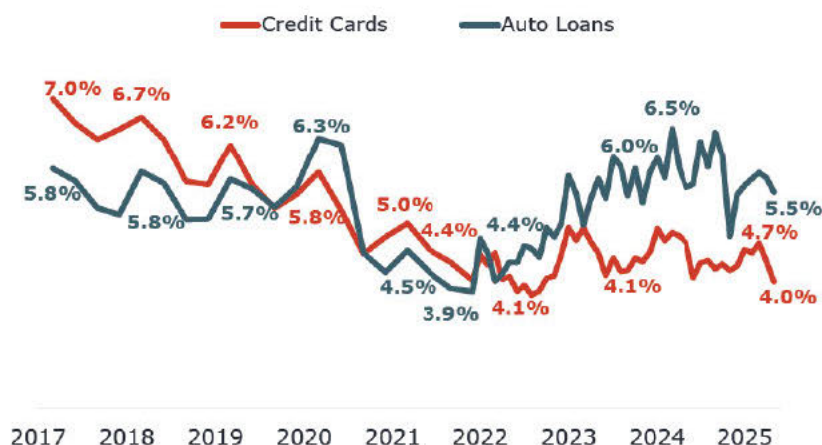
13.14 It is noted that in the US, subprime motor loans exhibit a significantly higher risk profile, with the net loss averaging approximately 10% and reaching a peak of 15.39% during the Global Financial Crisis. The lifetime peak GFC PD stands at 25.4% and LGD at 60.5%, which would result in an Internal Ratings-Based Risk-Weighted Asset (IRB RWA) of 147%. In New Zealand we do not split motor loans into prime and subprime with the values provided being Heartland's weighted book.



13.15 We have also reviewed Centrix's September 2025 report, which includes data up to August 2025, to support the assertion that motor loans present significantly lower risk compared to other unsecured personal loans. The graph below illustrates arrears rates (defined as loans overdue by more than one day) across all credit scores (i.e. without distinction between prime and subprime). It shows that motor loan arrears are broadly aligned with, though less volatile than, credit card arrears.

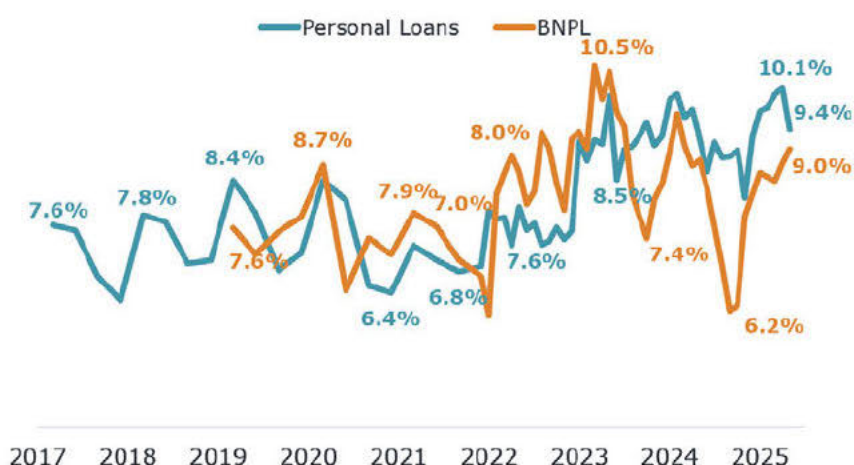
13.16 It is important to clarify that these figures reflect loans that are one day or more past due. In contrast, defaulted loans are those that reach 60 days past due, and their incidence is substantially lower than the overall arrears rate. Furthermore, loans remain classified as in arrears until they are written off, whereas PD metrics are based on the likelihood of a loan defaulting within a 12-month period.

Credit Card & Auto Loan Arrears



13.17 Additionally, Motor and credit card past due rates are significantly below delinquency rates on personal loans shown below.

Personal Loan & BNPL Arrears



13.18 Finally, we have looked at the PD and LGD published in the RBNZ's 2018 publication "portfolio modelling the New Zealand context" table 13. As shown, other retail loans, which presumably reflect unsecured retail loans, have significantly higher 12-month PDs and LGDs than secured loans and credit cards.

Asset Class (survey)	PD	LGD
Retail - Residential	0.89%	20%
Regulatory Retail – SME ⁸	2.14%	41%
Transactor Retail - Credit Cards	1.27%	77%
Retail - Other	4.91%	88%

⁸ The 2018 survey was slightly unclear what fell into this category. We have presumed it aligns with Regulatory retail.

14. Material divergence between IRB and standardised methodologies

- 14.1 As previously noted, risk weights were designed to ensure that 8% total capital could absorb the maximum unexpected loss to the 99.9% percentile. This is achieved by calculating the loss rate at the 99.9th percentile and then multiplying it by 12.5 which reflects the inverse of the 8% capital requirement.

$$\text{Capital requirement} = K = \left[LGD \cdot N \left[\frac{G(PD)}{\sqrt{(1-R)}} + \sqrt{\frac{R}{1-R}} \cdot G(0.999) \right] - PD \cdot LGD \right]$$

- 14.2 The key inputs used are:

- i LGD: Loss Given Default.
- ii PD: Probability of Default in a 12-month period.
- iii R = correlation adjustment: A factor reflecting the systemic risk associated with the type of lending. As previously discussed, retail lending is categorised into three types, each with differing levels of systemic risk.
- iv N = the cumulative distribution function for a standard normal random variable
- v G = the inverse cumulative distribution function for a standard normal random variable.

- 14.3 The correlation categories defined under the current BCBS standards are:

- i **Qualifying revolving retail facilities:** (e.g. credit cards repaid in full each month) correlation of 0.04. This category is currently not recognised in New Zealand.
- ii **Retail residential mortgages:** correlation of 0.15, but under BPR 133 it varies with LVR with 0.15 applying to owner-occupied homes with LVRs below 80%.
- iii **Other retail exposures:** correlation is determined using the following formula which varies with the probability of default.

$$\text{Correlation} = R = 0.03 \cdot \frac{(1 - e^{-35 \cdot PD})}{(1 - e^{-35})} + 0.16 \cdot \left(1 - \frac{(1 - e^{-35 \cdot PD})}{(1 - e^{-35})} \right)$$

- With e = Euler's number / exp function
- N denotes the cumulative distribution function for a standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than or equal to x).
- G denotes the inverse cumulative distribution function for a standard normal random variable (i.e. the value of x such that N(x) = z).

- 14.4 Currently the BPR 133 does not distinguish between qualifying revolving facilities and other retail exposures. Furthermore, retail mortgages are based upon LVR, with 0.15 correlation on residential mortgages restricted to owner occupied residential mortgages with LVRs of less than 80%.

Applying PD, LGD and Correlation to Calculate Standardised Risk-Weighting

- 14.5 We have taken the various data points outlined in the PD and LGD analysis above and used them to calculate what the risk weighting would be using the RBNZ's internal rules under BPR

133.

14.6 The formula used for correlation (R) in excel is:

$$=0.03*((1-EXP(-35*PD))/(1-EXP(-35))) + 0.16*(1-((1-EXP(-35*PD))/(1-EXP(-35))))$$

14.7 Similarly, the formula used for capital requirement is:

$$=LGD*NORM.S.DIST((1/SQRT(1-R))*NORM.S.INV(PD)+SQRT(R/(1-R))*NORM.S.INV(0.999),TRUE)-(PD*LGD)$$

14.8 This provides the following output:

Dataset	PD	LGD	Correlation (R) BPR 133	Capital Requirement (K)	RWA (internal)	RBNZ Proposed Standardised	RWA BCBS Standardised
US 2008 Lifetime PD & LGD	4.43%	45%	5.8%	0.053	66%	100%	75%
Peak Motor arrears rate (Centrix)	6.50%	45%	4.3%	0.055	69%	100%	100%
Peak Personal loans arrears rate (Centrix)	10.1%	88%	3.4%	0.119	148%	100%	100%
RBNZ 2008 Survey							
Retail - Residential	0.89%	20%	15.0%	0.019	23%	LVR	LVR
Retail - SME	2.14%	41%	9.1%	0.043	54%	100%	75%
Retail - Credit Cards	1.27%	77%	11.3%	0.069	86%	100%	45%
Retail - Credit Cards (BCBS Method)	1.27%	77%	4.0%	0.028	35%	100%	45%
Retail - Other	4.91%	88%	5.3%	0.104	130%	100%	100%

14.9 Except for personal loans (which we assumed Retail other to be) and Credit Cards (with the lack of the lower correlation offered in the BCBS method), all IRB risk weightings are significantly lower than the BCBS standardised risk weighting.

14.10 This is also the case when:

- Using significantly elevated lifetime PD and LGDs in the place of one-year PDs as is required by internal models.
- Using peak arrears rates which including loans 1 day past due and thus well in excess (double) of default rates.
- Using PD and LGD rates from the US during the GFC.

14.11 Given this evidence, Heartland submits that the RBNZ:

- Introduce a Secured Personal Lending Retail Category:** This category should be aligned with the proposed SME – Retail risk weighting of 75%.
 - Eligibility Criteria:** Loans must be collateralised with tangible property, a legal lien must be attached and identifiable by external parties. Consideration could be made of requiring the collateral value to exceed the loan amount at origination to be

eligible.

- b **System Readiness:** The increased reporting requirements and the maturity of New Zealand's security regime (Personal Properties Securities Act 1999 and Personal Properties Securities Register) make this approach both feasible and robust.
 - ii **Consider differentiating between credit cards and overdrafts paid in full and other forms of unsecured personal lending.** Whilst Heartland does not provide these products domestic and international evidence support them being separated from the main personal lending category due to lower default rates.
- 14.12 This approach would better align capital requirements with actual risk, reduce costs for New Zealand borrowers, and ensure a level playing field between banks and non-bank lenders. It would also bring New Zealand's regulatory framework in line with international best practice and avoid the unintended consequence of driving high-quality secured lending outside the regulated banking sector.

Responses to:

- **Q30: Do you have any comments on the proposed changes to standardised risk weights for mortgage, corporate and agricultural lending?**

15. Support for SME Retail and SME Corporate – but the definitions need to be updated

- 15.1 Heartland supports introducing SME Retail and SME Corporate classifications in New Zealand to align with international practice. These categories are essential because external credit ratings are generally not viable for smaller businesses and, where available, often penalise entities for their size rather than reflecting their aggregate risk. Furthermore, SMEs are widely recognised as key drivers of regional economic growth through investment and innovation, with capital support strongly correlated to their development.⁹
- 15.2 The significance of the SME sector to New Zealand's economy is comparable to that of Europe. According to data from Stats NZ (as at February 2024), 99.7% of New Zealand businesses report annual turnover below NZD 50 million, with 99.2% falling below NZD 20 million. Furthermore, 99% of these businesses employ fewer than 50 staff, collectively accounting for 41.1% of the national workforce.
- 15.3 The RBNZ already provides preferential treatment to SME Retail and SME Corporate exposures, but only under IRB models. This is because the internal model rules allow:
- i **SME Retail:** IRB banks may classify qualifying SME exposures as retail, enabling them to benefit from the lower correlation associated with retail portfolios. This reduces the capital requirement ("k") and the resulting risk-weighted assets (RWA) compared to the corporate lending approach. The existing 75% BCBS standardised risk weight effectively reflects this treatment, which has been recognised in other jurisdictions prior to Basel III.
 - ii **SME Corporate:** IRB models apply a size adjustment within the correlation formula for corporate exposures. This adjustment reduces correlation for companies with income or assets up to NZD 50 million, with the effect increasing as company size decreases. Introducing an SME Corporate category under the standardised approach would replicate, in part, this risk-sensitive treatment currently available only to IRB banks.
- 15.4 [REDACTED] While

⁹ Economic Growth, Increasing Productivity of SMEs, and Open Innovation, 2020, by Batara Surya, Firman Menne, Hernita Sabhan, Seri Suriani, Herminawaty Abubakar and Muhammad Idris.

correlation is somewhat higher than in consumer retail, a well-diversified SME portfolio mitigates systemic risk, supporting the case for differentiated treatment.

- 15.5 Current New Zealand definitions are outdated, have not been adjusted for inflation or market developments, and are inconsistent with international practice. A comparison is provided below:

	SME- Retail	SME-Corporate
New Zealand	Total exposure < NZD1m	Not defined
Australia	Revenue < AUD75m Total exposure < AUD1.5m	Revenue < AUD75m Or If don't know revenue Total exposure < AUD5m
BCBS	Total exposure < EUR1m = NZD2m	
Canada	Revenue < CAD75m Total exposure < CAD1.5m	Revenue < CAD75m
Singapore	Revenue < SGD100m Total exposure < SGD2.0m	Revenue < SGD100m

- 15.6 The two SME segments serve distinct prudential purposes:
- i **SME Retail** mirrors the retail rationale—pooled management, granularity, and diversification leading to lower sensitivity to macro shocks and therefore lower unexpected loss volatility. This is why these exposures qualify for retail treatment under internal models.
 - ii **SME Corporate** recognises that lending at this scale generally lacks external ratings and that agency methodologies can over-penalise size, warranting a calibrated treatment separate from large corporates. A separate treatment is therefore warranted to reflect the greater idiosyncratic risk of smaller firms.
- 15.7 Heartland submits that New Zealand should realign its definitions with international practice and the underlying risk intent of each segment. As a practical starting point, adopting the Australian groupings converted into NZD would provide clear, risk-sensitive thresholds that are consistent with how SMEs operate in this market.
- 16. Support for more granular agricultural lending risk weights**
- 16.1 Heartland supports the RBNZ's proposal to adopt more granular risk weightings for rural lending.
- 16.2 Heartland emphasises that any final risk weightings should be supported by objective quantitative analysis, which consider any unique characteristics of New Zealand's rural sector.
- 17. Reverse Mortgage risk weights should be aligned with the revised ratings for investor residential mortgages**
- 17.1 Reverse mortgages have become an increasingly significant component of the New Zealand lending landscape, providing older homeowners with a means to unlock home equity and support their wellbeing in retirement while staying in their home. Heartland Bank, as the country's leading provider, has assisted more than 27,000 New Zealanders since 2004.
- 17.2 As regulatory frameworks evolve under the DTA, and with the current review of key capital settings, it is timely to consider whether existing risk weighting approaches (particularly LVR

bucketing) are fit for purpose for this product class. Heartland advocates for a risk-sensitive LVR bucketing approach for residential mortgage loans, including reverse mortgages.

17.3 Heartland proposes that reverse mortgage risk weights be aligned with those for investor residential mortgages, while ensuring that tail risks at higher LVRs are appropriately captured. Specifically, we recommend:

- i Removing the 20% valuation discount and instead calibrating LVR buckets to reflect severe but plausible house price declines.
- ii A more granular LVR-based risk weighting schedule should be adopted.

[REDACTED]

Reverse mortgage risk profile and management

17.5 Reverse mortgages differ fundamentally from traditional residential mortgages in that they do not require regular repayments. Repayment is typically triggered when the last borrower leaves the property as the result of a life event or the voluntary sale of the property. Heartland provides a no negative equity guarantee (NNEG), ensuring that if the loan balance ever exceeds the value of the property, the excess is waived. Consequently, the risk of loss arises not from borrower default, but from adverse movements in property values.

17.6 Under the Basel framework, reverse mortgages are classified as residential mortgage lending reliant on property cashflows, a category that aligns with the New Zealand classification of investor residential mortgage lending. As such, Heartland submits Reverse Mortgage risk weights should be aligned with the revised ratings for investor residential mortgages.

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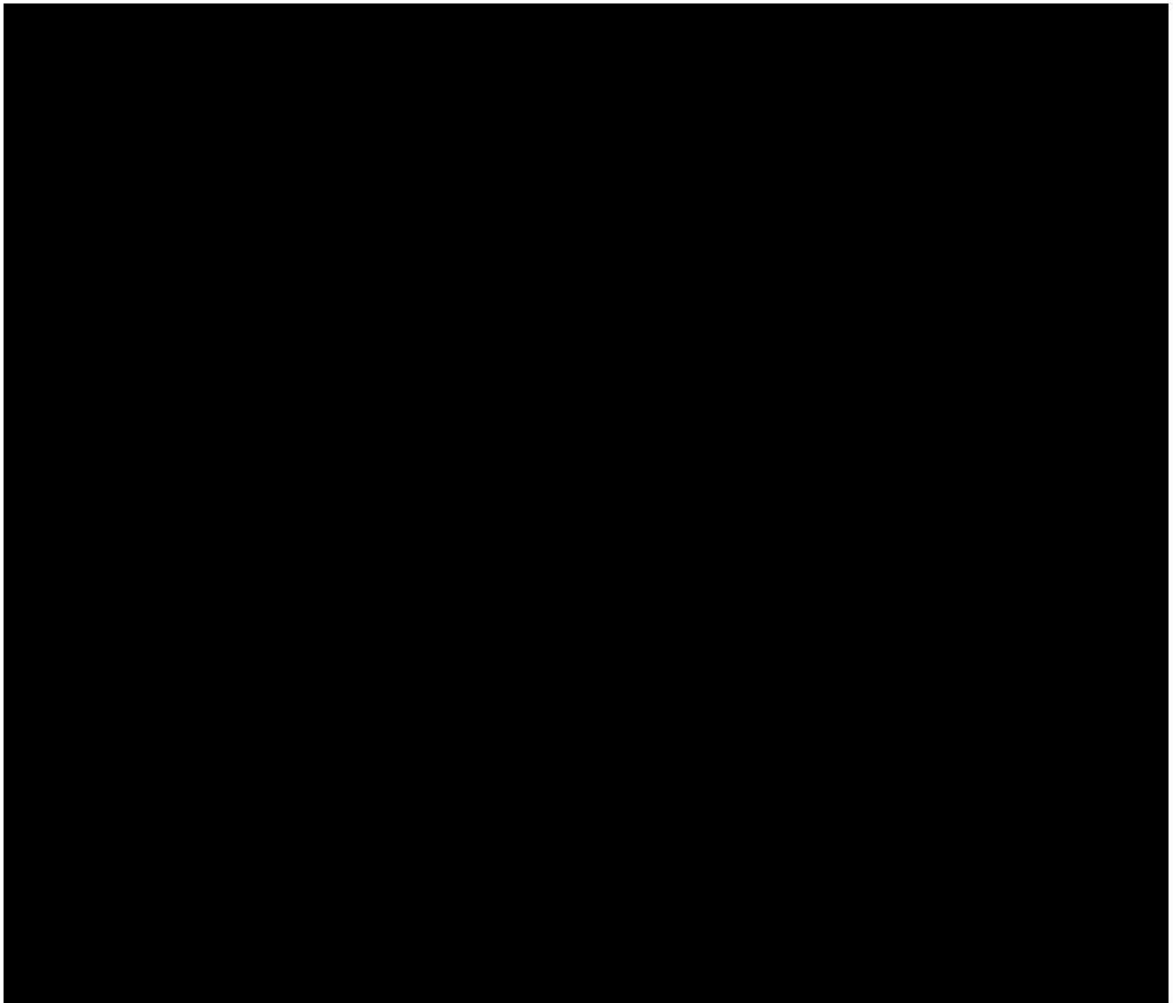
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17.19 To further illustrate the effect of higher starting LVRs, we have repeated the analysis across a range of origination LVRs under a scenario where house prices increase by 2% per annum in line with long term inflation (i.e. there is no real house price growth).

<i>Years Past</i>	<i>5</i>	<i>8</i>	<i>10</i>	<i>12</i>	<i>15</i>	<i>18</i>	<i>20</i>
LVR Origination	LVR with 2% annual house price growth						
15%	21%	25%	29%	33%	40%	48%	55%
20%	28%	34%	38%	44%	53%	64%	73%
25%	35%	42%	48%	54%	66%	80%	92%
30%	41%	50%	57%	65%	79%	96%	110%
35%	48%	59%	67%	76%	93%	113%	128%
40%	55%	67%	77%	87%	106%	129%	146%
45%	62%	76%	86%	98%	119%	145%	165%
50%	69%	84%	96%	109%	132%	161%	183%
60%	83%	101%	115%	131%	159%	193%	220%
70%	97%	118%	134%	153%	185%	225%	256%
80%	111%	134%	153%	174%	212%	257%	293%

17.20 As shown the impact is unsurprisingly non-linear. This is for three reasons:

- i The higher the LVR, the more rapidly the LVR increases if property prices remain stagnant or decline in real terms.
- ii The higher the LVR, the greater the likelihood that an economic event will result in a loss if the loan is repaid during that period.
- iii The higher the LVR, the greater the potential severity of any resulting loss.

17.21 Additionally, we have modelled a scenario involving an initial 20% reduction in house prices (reflecting a severe stress event), followed by 2% real house price growth with inflation at 2%.

<i>Years Past</i>	<i>5</i>	<i>8</i>	<i>10</i>	<i>12</i>	<i>15</i>	<i>18</i>	<i>20</i>
LVR Origination	LVR with 4% annual house price growth following 20% fall						
15%	24%	27%	30%	32%	37%	43%	47%
20%	31%	36%	39%	43%	49%	57%	62%
25%	39%	45%	49%	54%	62%	71%	78%
30%	47%	54%	59%	65%	74%	85%	93%
35%	55%	63%	69%	76%	87%	99%	109%
40%	63%	72%	79%	86%	99%	113%	124%
45%	71%	81%	89%	97%	111%	128%	140%
50%	78%	90%	98%	108%	124%	142%	155%
60%	94%	108%	118%	129%	148%	170%	186%
70%	110%	126%	138%	151%	173%	198%	217%
80%	126%	144%	158%	173%	198%	227%	248%

17.22 The net of the above conservative scenarios shows:

- a No losses are expected to be incurred on LVRs of 30% or less.
- b Losses on loans with starting LVRs 30% to 40% are expected to be very minor due to 87% of loans being expected to be repaid within 15 years.
- c Risk grows materially above 60% LVR.

Stress testing

17.23 Heartland Bank undertakes quarterly actuarial analysis to assess both the fair value of its reverse mortgage portfolio and the fair value of the no negative equity guarantee (NNEG). This analysis employs a Monte Carlo simulation, running 1,000 iterations per scenario, and incorporates key variables such as life expectancy (with a maximum assumption of 111 years), voluntary exits, expected interest rates, and conservative assumptions including full drawdown of available facilities. The simulation calculates the expected NNEG liability over the life of the loans, alongside the fair value of the loan book, capturing future revenue, costs, interest income, and potential NNEG losses.



Historical house price losses

17.25 The most significant nominal and real house price declines across Australia and New Zealand over the past century is detailed below. We have also captured the largest international falls.

Region	Worst Period (Approx.)	Price Decline	Drivers
New South Wales (Sydney)	1950–1953	–25% real (–around 20% nominal)	Post-WWII price control lift overshot the market; prices rocketed then corrected sharply.
Victoria (Melbourne)	1974–1978	–24% real (nominal flat)	Inflationary 1970s boom collapsed; high inflation hid nominal losses, but real values fell nearly a quarter.
Queensland (Brisbane)	2010–2013 (flat nominal)	~–10% real (approx.)	Long stagnation after 2008 GFC; prices barely moved nominally for 5+ years, amounting to a real decline.
Western Australia (Perth)	2014–2019	–16.1% nominal (–20% real)	End of mining investment boom led to sustained downturn; nearly half of Perth homes sold at a loss by 2020.
South Australia (Adelaide)	1990–1993 (no nominal drop)	–5% to –8% real (est.)	Early '90s recession saw affordability improve slightly; Adelaide's prices slowed but did not crash.
New Zealand (National)	2007–2012	–11% real (–0% nominal)	Global Financial Crisis halted the 2000s boom; five years of essentially no nominal growth (inflation made this a real decline).
New Zealand (National)	2021–2023 (latest)	–17% nominal (–20% real)	Rapid rate hikes after pandemic boom. Largest drop in NZ in decades but leaves prices still above 2020 levels.
1890s Depression (c. 1890–1895)	up to 50% drop (AUS)	Global credit crunch (1890 Baring Crisis); widespread bank failures.	Australia, New Zealand (severe); U.S. and some of Europe (moderate)

Great Depression (1929–1933)	~45% average drop (U.S.) with up to 67% high-end	Stock Market Crash of 1929 and ensuing economic collapse fuelled by protectionist policies; Mass unemployment & income loss; deflation; bank credit freeze (loan supply dried up)	U.S. (nationwide); Canada; Germany; UK/Australia (milder declines due to deflation offset)
Japan's Asset Bubble Burst (1991–2001)	~70% drop in land values ~50%+ drop in home prices (est.)	1980s credit and asset bubble; extreme price overshoot (price-to-income); Central bank rate hikes in 1989–90 popping bubble; followed by banking crisis (credit crunch) and deflation (liquidity trap).	Japan (national) – especially major cities (Tokyo, Osaka)
Early 1990s Crises (1989–1993)	~20% drop (UK) ~25–30% drop (Sweden) ~50% drop (Finland, peak to trough)	Late-80s credit boom and speculation; inflation and monetary tightening (late '89); banking crises in Nordic countries; recession in early '90s.	Scandinavia (Finland, Sweden, Norway); UK; some regional US/Canada markets;
Asian Financial Crisis (1997–2000)	~50% drop (Hong Kong); 30–40% drops in Thailand, Malaysia	1990s credit boom with currency pegs, then speculative attack on currencies (1997); skyrocketing interest rates, regional recession; investor panic.	East Asia (Hong Kong, ASEAN countries, S. Korea)
Global Financial Crisis (2007–2012)	~20–30% drop (U.S.) ~50% drop (Ireland, Baltic states) ~35% drop (Spain) 15–20% drop (UK)	Subprime mortgage bubble (excess leverage, poor lending standards); housing overbuilding; securitisation spreading risk; central bank rate hikes 2005–07; 2008 banking panic (credit crunch)	U.S. (esp. Sunbelt states); Europe (esp. Ireland, Spain, UK, Eastern Europe); parts of Middle East.

17.26 As shown, outside of exceedingly rare and extreme events a very severe event can result in around a drop in house prices of 20% to 30%. As such we believe our scenario of a 20% fall then muted future price increases based on historical and current expected trends reflects a conservative base scenario.

17.27 Considering the evidence, Heartland Bank proposes that reverse mortgage risk weights be aligned with those for investor residential mortgages, while ensuring that tail risks at higher

LVRs are appropriately captured. Specifically, we recommend:

- i Removing the 20% valuation discount and instead calibrating LVR buckets to reflect severe but plausible house price declines.
- ii A more granular LVR-based risk weighting schedule should be adopted.

RBNZ Proposed Investor category	Proposed Reverse Mortgage Category	Proposed RWA	Existing RWA (RM)
LVR ≤ 50	LVR ≤ 25%	30	40
LVR 50.01 – 60	25% < LVR ≤ 30%	35	40
LVR 60.01 – 80	30% < LVR ≤ 40%	40	50
	40% < LVR ≤ 50%	50	50
LVR 80.01 – 90 (no LMI)	50% < LVR ≤ 60%	70	50
LVR 90 - 100	60% < LVR ≤ 80%	90	80
LVR > 100	> 80%	100%	100%
	> 100%	100% and Capital deduction beyond 100%	100% and Capital deduction beyond 100%

Responses to:

- Q21: Do you have any feedback on our approach to the cost benefit analysis?
- Q22: Do you have any feedback about the results of the cost benefit analysis?

18. RBNZ weighted average cost of capital methodology

- 18.1 We believe that the RBNZ's method for calculating the weighted average cost of capital is transparent and we support the overall method. We also welcome the updates that the RBNZ have made to their assessment in the cost of capital rules. In particular, we welcome splitting the calculation on the cost of borrowing between more than one segment.
- 18.2 We acknowledge that certain items in the 2019 methodology have not been reviewed on pragmatic grounds, including what is the cost of capital and the Modigliani-Miller offset, however Heartland makes the following comments:
 - i With regards to the cost / benefit to the economy the total computed costs in the 2019 analysis were divided by all interest-earning assets, which if done in the current analysis would include \$33.7bn of cash predominantly held at the RBNZ risk free and thus with no associated capital, and \$58bn of securities of which approximately 60% are Government bonds, and a significantly remaining chunk 0% RWA kauris and thus also with no capital associated with them. These assets are all held for liquidity purposes, are unaffected by capital levels, and non-responsive to covering capital costs. As such, they shouldn't be included in the denominator. Adjusting for this increases the overall impact by 1.2bps – 2.0bps on lending costs which should increase the impact the GDP by 0.012% - 0.02% as well.
 - ii The different capital levels of Group 1 and Group 2 deposit takers are captured in the cost analysis of a future crisis (at a ratio of 90:10) but not the different cost of capital for each group. We believe the cost of capital should capture a similar split of 90% D-SIB and 10% domestic in establishing the weighted average cost of capital for New Zealand. The 10%

would need to capture:

- a Lower capital ratios.
 - b Higher risk-weights as a percentage of lending due to the use of standardised risk models.
 - c Higher costs of capital for both CET1 and Tier 2.¹²
 - d Reduce or remove the impact of Modigliani-Miller offset to align with recent findings by Clark, Jones, and Malmquist's most recent 2023 article "Leverage and the cost of capital for U.S. banks" showing the lack of an offset for banks with less than \$50bn of assets.
- iii It is unclear whether the weighted risk weights used to reflect residential and agricultural loans capture risk weighting costs beyond direct risk weights. However, risk weights should also capture associated operational risk, market risk, and off-balance sheet exposures as these materially increase the base risk weights when calculating the impact on different lending types of the different capital stacks. Below approximates the impact of these charges on the total risk weighting.

	Secured Personal Loan Current	Secured Personal Loan @ 75%	Residential Home Loan	Livestock	Rural Loans	Rural Loans @70%
On B/S RWA%	100.0%	75.0%	35.0%	101.4%	100.0%	70.0%
Off B/S RWA%	0.3%	0.2%	2.4%	17.8%	2.5%	1.8%
Liquid Assets at 11.6% RWA ¹³	1.2%	1.3%	1.6%	1.8%	1.3%	1.4%
Operational Risk	7.1%	7.1%	7.2%	7.4%	7.1%	7.1%
Market Risk	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%
Total RWE	111.7%	86.7%	49.3%	131.5%	114.0%	83.3%

19. Operating Costs

19.1 The calculation makes no consideration of operating costs as it is based on the premise that capital is not scarce and can be raised at the correct price. Whilst likely correct at a long-term macro level, at a micro level it is not the case. Banks' costs and capital levels are relatively fixed. As such, the risk weighting of a loan affects the return required to cover costs, as it impacts how much we can lend.

19.2 To give a simplified example:

- i If you had:
 - a \$10 of fixed costs,
 - b \$1,000 of CET1 equity,
 - c and a 12% required CET1 capital ratio
- ii You could lend

¹² We have current estimated cost of equity from our advisors which we can separately share. We note other local New Zealand banks generally are unable to raise capital due to their structure, but we would envision if they could their cost would be similar except for Kiwibank.



- a \$8.3k if the assets were 100% risk weighted, or
- b \$23.8k if the assets were 35% risk weighted.
- iii This means to cover your operating costs you would need to charge
 - a 4bps if all your lending was 100% risk weighted, or
 - b 12bps if your lending was all 35% risk weighted.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Responses to:

Q23: Do you have any other evidence that should be considered in the cost benefit analysis?

20. Modigliani-Miller Theorem - Offset

20.1 Modigliani-Miller Theorem essentially states that the composition of funding between debt and equity does not affect the overall cost. The applicability of Modigliani-Miller offset to banking is the topic of multiple studies. One key formula in calculating the cost of increased capital comes from Firestone, Simon, Amy Lorenc, and Ben Ranish's (2017) article titled "*An Empirical Economic Assessment of the Costs and Benefits of Bank Capital in the US*". The authors of this study arrived at a 50% offset based heavily upon the findings of Clark, Jones, and Malmquist (2015), which demonstrated a 65% to 100% offset.

20.2 However, the most recent article published by the same Clark, Jones, and Malmquist found in their 2023 article "Leverage and the cost of capital for U.S. banks" that:

For large banks, there is a significant positive relationship between leverage and both CAPM betas and Fama-French expected returns. In contrast, there is no evidence of a significant positive relationship for small and medium-sized banks in the full sample period. For banks in the largest asset-size class, we find pre-tax MM offsets of 49.1% when using the CAPM betas and of 22.3% when using the Fama-French expected returns. For small and medium-sized banks, the pre-tax MM offsets are substantially smaller. For medium-sized banks, the pre-tax MM offsets are 17.7 and 5.1% using CAPM betas and Fama-French expected returns, respectively. The pre-tax MM offsets for the smallest banks are 15.0 and 2.5% using the CAPM betas and Fama-French expected returns, respectively.

20.3 This is a markedly different position. The details of this recent study are shown below with the outputs of large banks (greater than \$250 billion) and small banks (less than \$50 billion) having very different results:

Table 3
The cost of equity capital and leverage (Assets/Tier-1): full sample period by bank asset-size class.

Variable	Dependent Variable: CAPM Beta			Dependent Variable: FF E[R]		
	< \$50	\$50-\$250	> \$250	< \$50	\$50-\$250	> \$250
Leverage _{t-1}	0.0110 (1.75)	0.0164 (1.24)	0.0408 (2.21)	-0.0003 (-0.46)	0.0006 (0.61)	0.0026 (1.97)
LLR _{t-1}	0.0132 (0.50)	-0.0021 (-0.05)	-0.0509 (-0.85)	-0.0026 (-1.51)	0.0024 (0.66)	0.0025 (0.53)
Liquidity _{t-1}	-0.0659 (-1.32)	-0.0895 (-2.72)	-0.1167 (-2.71)	-0.0057 (-3.77)	-0.0041 (-1.47)	-0.0065 (-1.88)
Assets _{t-1}	0.0645 (1.83)	0.0526 (0.89)	-0.0090 (-0.20)	0.0061 (2.09)	0.0057 (1.04)	0.0012 (0.30)
Intercept	0.7213 (9.02)	0.9231 (6.10)	0.6089 (2.33)	0.1172 (19.16)	0.1446 (11.37)	0.1276 (7.06)
No. Observations	16,983	2258	1045	16,983	2258	1045
No. BHCs	371	43	17	371	43	17
Within R-Sq.	0.101	0.170	0.199	0.113	0.139	0.204
MM Offset (%)	15.0	17.7	49.1	-2.5	5.1	22.4

The dependent variable for the first three columns is the Scholes-Williams CAPM equity beta, estimated using the CRSP value-weighted market index. The dependent variable for the last three columns is the expected return derived from a Fama-French three-factor model, estimated using daily returns with the CRSP value-weighted market index and daily Fama-French *SMB* and *HML* factors. Results are reported for fixed-effects (within estimator) panel regressions using a one-way (bank ID) classification plus macroeconomic factors to control for changes in the macroeconomic environment over time. The estimation period is 1996:Q2–2019:Q4. The column headings represent the asset size ranges of the BHCs used in the estimation. The numbers in reported parentheses are t-statistics computed using Driscoll-Kraay robust standard errors. All macroeconomic and bank-specific control variables, except for leverage, are standardized to have a zero mean and standard deviation of one. The pre-tax MM offsets are calculated using the methodology presented in Appendix B.

20.4 The reason for this is summarised by authors of this same study, which notes:

The smallest publicly traded banks, which hold on the order of \$1 billion in assets, are however very different institutions from the so-called too-big-to-fail (TBTf) institutions, whose assets are roughly three orders of magnitude greater. In addition to benefiting from stronger liability guarantees, large banks are significantly more complex on both sides of their balance sheets, not just in terms of size but also in terms of the composition of their assets and liabilities. For example, they invest in more diverse and complex asset classes, such as derivatives, and tend to carry much larger trading books. On the liability side, the largest banks carry the most non-deposit debt, making their liability structures less like that of a traditional bank in the sense of Diamond and Dybvig (1983), Diamond and Rajan (2000), and DeAngelo and Stulz (2013). This suggests that traditional demand-for-liquidity models, which show that high leverage is optimal for banks, are less applicable. Additionally, the level of asymmetric information is likely to be greater for smaller institutions, which could increase the cost of equity they bear and, hence, their WACCs, with increased capital requirements.

20.5 For completeness, it is important to note James Cummings' observation in his 2024 article "Impact of Additional Equity Capital on Bank Funding Costs: Australian Evidence". He states that the offset is not significantly influenced by the size of the bank. However, his sample includes only four banks for the entire period, which he did not classify as large. Notably, the largest among these, Macquarie, exceeds the size of New Zealand's largest bank (based on tier one capital) and has a more complex business. The remaining banks are approximately 50% the size of New Zealand's other major banks and nearly twice the size of Kiwibank.

Bank	Tier One Capital \$m
Macquarie Bank	A\$21,004
Suncorp-Metway	A\$4,824
Bendigo and Adelaide Bank	A\$5,042
Bank of Queensland	A\$4,956
ANZ NZ	NZ\$16,354
Westpac NZ	NZ\$10,375
Kiwibank	NZ\$2,929
Heartland	NZ\$602

Responses to:

- **Q24: Do you have any comments about the way that loss-absorbing capacity has been incorporated into the analysis?**

21. New Zealand vs BCBS capital including loss absorbing capital

- 21.1 A significant omission from the cost–benefit analysis is the impact of capital inefficiencies arising from the current regulatory framework. Under existing rules, Tier 2 and AT1 capital issued in New Zealand is not recognised in Australia on consolidation, and conversely, capital issued in Australia by an Australian subsidiary of a New Zealand bank is not recognised in New Zealand.
- 21.2 This lack of mutual recognition can require offshore parent entities either to double-fund capital requirements or to allocate a greater proportion through CET1. The underlying issue is that the parent must hold capital against these exposures but cannot recognise instruments issued by its subsidiary due to incompatibility between the regimes as the result of the presence of convertibility features or lack thereof. The reverse scenario also applies; for example, Heartland’s Australian subsidiary’s Tier 2 capital is not recognised at the consolidated banking group level.
- 21.3 This inefficiency increases the weighted average cost of capital without delivering any corresponding reduction in risk. We raise this point because the RBNZ’s proposal for Australian banks to adopt a single-point-of-entry capital stack would require this inconsistency to be addressed for them. If so, we believe the same flexibility should be extended to New Zealand banks – namely, the ability to issue BCBS-compliant capital instruments and have them recognised accordingly. We note that the RBNZ could limit recognition to instruments not offered to retail investors, which would mitigate concerns regarding bail-in clauses causing wider market panics.
- 21.4 Allowing BCBS-compliant issuances would eliminate capital inefficiencies, reduce the weighted average cost of capital, and broaden capital-raising options by enabling New Zealand banks to issue familiar products to a larger pool of offshore investors.
- 21.5 Finally, we note that in the UK and Europe, Loss-Absorbing Capital (LAC) instruments outside the main capital stack rank senior to subordinated debt, being senior unsecured debt with bail-in clauses and subordinated only to operational liabilities. These instruments are typically cheaper than Tier 2-eligible subordinated debt. However, APRA does not currently recognise LAC, and its treatment will determine how Australian banks fund this requirement. If APRA views LAC as regulatory capital in nature, it will effectively require funding through Tier 2 capital; otherwise, such issuance will result in a CET1 deduction.

Responses to:

- **Q25: Do you agree with the proposal to remove additional tier 1 capital as a form of regulatory capital?**
- **Q26: Are there any other factors that you think we should take into account in making this decision?**

22. Support removing Additional Tier One Capital

- 22.1 Heartland fully supports the RBNZ’s proposal to remove Additional Tier 1 (**AT1**) capital from the capital stack, based on the current proposal that sets CET1 capital requirements (including

prudential buffers) at 12% for non-D-SIB banks.

- 22.3 The current AT1 perpetual note structure presents significant challenges for issuance by smaller banks and, as a result, has not yet been adopted in the New Zealand market, other than by Kiwibank which is government owned. This effectively increases the CET1 capital burden on smaller institutions.
- 22.4 Several factors contribute to the impracticality of AT1 instruments:
- i **Investor Limitations:** The coupon structure, which includes imputation credits, deters many fixed income investors—particularly charities and offshore investors—who cannot benefit from these credits.
 - ii **Fund Eligibility Constraints:** As AT1 instruments are classified as equity in both legal and accounting terms, they fall outside the investment mandates of both fixed income and equity funds, including KiwiSaver schemes.
 - iii **Accounting Treatment:** Entities such as life insurers are unable to invest due to accounting rules that require equity investments to be marked to market through the P&L, rather than through other comprehensive income.
 - iv **Credit Rating Impact:** Credit rating agencies apply a four-notch downgrade to AT1 instruments, compared to a two-notch downgrade for Tier 2. This is even though many Tier 2 issuances by local banks are the most subordinated instruments in their capital structure. Consequently, AT1 instruments issued by New Zealand banks (excluding Kiwibank) would likely be rated deep sub-investment grade affecting marketability to retail investors.
 - v **Capital Rating Floor:** Increases in capital levels have not translated into improved overall bank credit ratings. This is because rating agencies primarily assess bank size, lending profile, and profitability, with a floor set at the previous RBNZ minimum capital level.
- 22.5 Accordingly, we support the RBNZ proposals as this adjustment would significantly reduce capital-related barriers for smaller banks, enhancing their competitiveness. It would also align with APRA's recently adopted supportive measures for smaller Australian banks.

Responses to:

- **Q33: For deposit takers: Can you provide a lending breakdown for your institution by the following corporate sectors: rating, small and medium-sized enterprise retail, small and medium-sized enterprise corporate, and other unrated corporate?**
- **Q38: For deposit takers: Can you provide a lending breakdown for your institution for the following sectors: commercial property (investment, development, and a loan-to-value ratio breakdown within these categories), and personal lending (secured, unsecured, credit card and other)?**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Responses to:

- **Q31: For deposit takers: Can you quantify the overall and sectoral impact that the proposed changes to standardised risk weights for residential mortgages, corporate and agricultural lending would have on your institution?**
- **Q35: For deposit takers: Can you quantify the impact that a 100% risk weight under the standardised approach on all unrated commercial property lending would have on your institution?**
- **Q37: For deposit takers: Can you quantify the impact that a 100% risk weight on secured personal lending and a 150% risk weight on unsecured personal lending would have on your institution?**

- 24.3 Beyond the classification we note that a risk-weighting of 100% on secured personal lending will likely have the same long-term result as in Australia; secured personal lending will move out of locally registered banks.

Responses to:

- **Q34: Do you agree with creating a new risk weight category for all unrated corporate commercial property lending?**

25. Heartland supports the adoption of BCBS categories for corporate lending, with both purpose and LVR taken into consideration.

- 25.1 Heartland does not engage in lending for corporate property. However, we maintain a consistent position that risk weights should be evidence-based and reflective of actual risk. The current proposal does not meet this standard. It fails to differentiate between types of commercial lending (e.g. property development, commercial landlords, and businesses owning their own premises) and their respective risk profiles, nor does it incorporate LVR considerations. We believe any standard should address these distinctions.

Responses to:

- **Q40: For deposit takers: Is there a desired lead-in time to adopt the proposed standardised risk weight categories and updated minimum capital ratio? What are the expected costs (and their magnitude) to systems and processes of the proposed standardised risk weight categories?**

26. Adopt updated minimum capital ratios ahead of planned step-ups under the 2019 Capital Review

- 26.1 Heartland welcomes clarity on minimum capital ratio decisions and recommends adoption prior to the next planned capital step up under the 2019 Capital Review on 1 July 2026.

27. Standardised risk weighting settings

- 27.1 Heartland acknowledges that we are requesting a greater degree of granularity in standardised risk weightings than the RBNZ has previously contemplated. We consider this refinement to be critical for the reasons outlined in our submission. However, we also recognise that a comprehensive assessment of these proposals within the RBNZ's current timeline for December decisions may not be practicable. Accordingly, we submit that achieving accuracy in these classifications should take precedence over strict adherence to the existing timeline.
- 27.2 Notwithstanding this, it is imperative that the RBNZ articulates its overarching framework. Doing so will enable standardised banks to make informed lending and investment decisions, as well as to undertake the necessary development of systems, processes, and data capabilities.
- 27.3 The loan-level data reporting requirements provide a robust foundation for revising standardised risk weightings. Where feasible, we recommend that the implementation of these revised weightings aligns with the same timeline (from September 2026). This alignment would allow both initiatives to be designed and implemented concurrently, thereby promoting efficiency and consistency.

End of submission