

03 October 2025

The Reserve Bank of New Zealand – Te Pūtea Matua
Via email: capitalreview@rbnz.govt.nz

Dear Sir or Madam,

NBS submission - consultation on key capital settings

Introduction

This submission on the Reserve Bank of New Zealand's 2025 Consultation Paper on the Review of Key Capital Settings (**Consultation Paper**) is made by Nelson Building Society (**NBS**). NBS is the largest non-bank deposit taker (**NBDT**) and, as a building society, is a mutual entity owned by its customers.

As a mutual deposit taker that will be classified as a Group 3 entity under the Deposit Takers Act 2023 (**DTA**), NBS welcomes the Reserve Bank's engagement with the sector on the capital settings and, in particular, its consideration of proportionality in the capital framework.

NBS supports the submission made by the Non-bank Deposit Takers Association (**NBDTA**) of which it is a member. The NBDTA submission sets out our sector's position on the capital issues relevant to Group 3 deposit takers under the DTA regime and potential early adoption of these standards. This submission focuses on the issues of specific importance to NBS, primarily relating to proposed changes to the regulatory capital stack and transitional arrangements.

Context and background

NBS is currently governed by the capital rules in the Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010 (**NBDT Regulations**). Under the NBDT Regulations, NBS has benefited from the ability to raise perpetual preference shares (**PPS**) as qualifying regulatory capital, without limitation on the proportion of regulatory capital that can be made up of PPS. This has allowed NBS to grow to meet the demand of our members without being constrained by regulatory capital requirements (which would have been the case if NBS had to rely on retained earnings alone). [REDACTED]

While NBS is not currently subject to the banking capital standards, it has been actively engaged with the RBNZ on these standards since its earlier banking capital review, including the additional consultations on the development of the mutual capital instrument (**MCI**). [REDACTED]

Accordingly, NBS will need adequate runway to transition to the new capital standards where there are limitations on how much PPS can qualify as regulatory capital, and this may be particularly so if PPS will no longer qualify as regulatory capital instruments. Therefore, NBS' submission will focus on responding to the consultation questions relating to the following three points:

- a) the proposed changes to the capital stack for Group 3 deposit takers;
- b) the removal of AT1 capital from the capital stack; and
- c) the approach to transitioning to the new standards.

Proposed capital stack

Question 11: Do you have any feedback on the proposal for Group 3?

No proposed reduction to the Group 3 total capital adequacy ratio, and the proposed increase in CET1 capital requirements will disproportionately impact mutual deposit takers

NBS' feedback on the proposed Group 3 capital stack relates specifically to our mutual structure. NBS notes that one of the purposes of the DTA is to promote a diverse deposit-taking sector. Mutuals contribute to this diversity by offering alternative ownership and governance models that support financial inclusion and community-based banking.

As a mutual organisation, NBS does not have access to traditional equity markets and cannot issue ordinary shares in the same way as shareholder-owned institutions. Raising Common Equity Tier 1 (**CET1**) capital is therefore more complex and constrained for NBS.

While NBS acknowledges that the MCI is now available as a CET1-qualifying instrument, this is a relatively new and untested instrument in the New Zealand market and the investor base for MCIs may be limited.

NBS supports the submission of the NBDTA that the Reserve Bank's increased risk appetite and taking a proportionate approach would favour reducing the proposed total capital adequacy ratio (**CAR**). In addition, NBS notes that an increased total CAR will impact mutual deposit takers disproportionately as it is inherently more difficult for them to raise capital. Therefore, NBS urges the Reserve Bank to consider whether there is any reason that the Basel III requirements (developed for globally systemically important banks) would not be adequate for Group 3 deposit takers.

Therefore, NBS does not support increasing the overall proportion of CET1 capital.

Question 12: Do you have any alternative proposals?

NBS proposes adopting a similar approach to Australia by reducing the total CAR replacing AT1 with additional Tier 2 capital for small banks

NBS recommends that the minimum capital requirements and PCB for Group 3 deposit takers be set at the same level as the internationally recognised Basel III requirements, being 8% of risk weighted assets (**RWAs**) and a buffer of 2.5% RWA (potentially while retaining the addition 1% of RWA for Group 3 deposit takers without a credit rating). The Group 3 sector includes smaller, community-focused institutions with limited access to capital markets. Imposing requirements above the Basel III standard (which again NBS notes were designed for globally systemically important banks) risks placing an undue burden on these deposit takers. Aligning with Basel III would support proportionality in the Reserve Banks proposal, while still ensuring a robust level of resilience. It would also help preserve diversity in the deposit-taking sector, as envisaged by the Deposit Takers Act 2023, by ensuring that smaller, and particularly the mutual, customer-owned institutions, are stable, but not unduly burdened by capital requirements.

Further, while NBS understands the rationale for simplifying the capital stack, NBS believes that if AT1 is to be removed, it would be better to allow this component to be replaced entirely with Tier 2 capital for Group 3 deposit takers. This would provide greater flexibility for mutuals to meet capital requirements in a cost-effective and achievable manner, without compromising financial stability.

Therefore, if the total CAR is reduced, the alternative NBS proposes is to align with the APRA requirements for smaller Authorised Deposit-taking Institutions, being:

- a) Total CAR: 10.5%
- b) CET1: 4.5%
- c) Tier 2: 3.5%
- d) Capital buffer (made up of CET1): 2.5% or 3.5% for un-rated deposit takers.

If the total CAR is not reduced, which as noted above, NBS does not consider to be consistent with a proportionate approach and an increased risk appetite, then our proposal would be to swap out AT1 for Tier 2 capital so that the capital requirements would be:

- a) Total CAR: 13%
- b) CET1: 5%
- c) Tier 2: 4%
- d) Capital buffer (made up of CET1): 4% or 5% for un-rated deposit takers.

Removing AT1 from the capital stack

Question 25: do you agree with our proposal to remove Additional Tier 1 capital as a form of regulatory capital?

NBS does not oppose the removal of AT1 capital, but proposes changes to the overall capital stack and transition plan to limit the impact on mutuals

While NBS understands the rationale for simplifying the capital stack, it will remove a simpler, well-understood and lower cost option than the MCI for raising capital. NBS does not oppose the removal of AT1 from the capital stack but, as noted elsewhere in our submission, proposes that AT1 be replaced entirely by Tier 2 and the transition timeframe extended to limit the impact of removing AT1 on Group 3 deposit takers and especially those structured as mutuals.

Question 26: Are there any other factors that we should take into account?

The proposed capital stack will be a significant transition for NBS and the ability for PPS to qualify as Tier 2 capital is our strong preference in order to reduce the transition risk and burden

NBS currently has PPS on issue, which have formed an important part of our capital base. Therefore, NBS supports the Reserve Bank's proposal to allow PPS to qualify as Tier 2 capital under the new framework.

[REDACTED]

The Consultation Paper sets two options for the transition, being that the:

- a) current AT1 instruments are recognised as Tier Two capital from the point the new requirements come into force (the RBNZ's preferred option); or
- b) current AT1 instruments are recognised as tier one capital, but subject to a derecognition schedule.

NBS are of the view that a combination of the above will be the best option for a smooth transition. However, for NBS it is the second option that will be crucial to our ongoing compliance with capital requirements while transitioning out of the NBDT regime, because NBS will need time to build up our CET1 capital to the required level.

[REDACTED] Ongoing recognition of PPS as Tier 2 capital would support a smoother transition and avoid unnecessary disruption to our capital structure, which is already facing significant disruption.

Question 27: Do you have any views on the most appropriate transitional arrangements, including how AT1 capital instruments should be recognised after any possible removal?

Transitional arrangements must apply to instruments that are equivalent to AT1 instruments under the NBDT regime

As noted above, for transitioning from the NBDT regime, recognition as CET1 with an appropriate transition period will most likely be necessary for our ongoing compliance [REDACTED] ongoing recognition as Tier 2 in addition to this would also reduce the transitional burden.

For completeness, NBS notes that our instruments are not AT1 as NBS is currently subject to the NBDT regime. Therefore, it will be important that the drafting of any transitional recognition is wide enough to include AT1 equivalents under the NBDT regime.

Transition

Question 40: 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.

NBS appreciates the Reserve Bank's willingness to consider early adoption of the proposed standardised risk weights to provide a level-playing field for the NBDTs and the banks that use standardised RWA. NBS understands that the proposed implementation of the new RWA is to take place in Q1 of 2027, which will be ample time for us to transition to the new RWAs. While there would be a cost associated with this, this is a cost that NBS will be required to assume in any case, this is just a matter of timing.

However, NBS notes that the Reserve Bank proposes a transition period of only 4 years from the implementation of the DTA. The proposal does not specify how this will incorporate the phasing in of the new capital stack requirements. [REDACTED]

[REDACTED] Therefore, NBS considers a 4-year transition period to be an absolute minimum.

Following the 2019 Capital Review, banks were provided with a seven-year transition period to meet the new capital standards. NBS believes a similar transition period should be afforded to Group 3 deposit takers under the DTA. This would ensure a fair and orderly implementation of the new requirements, particularly given the structural and funding constraints faced by smaller and mutual institutions.

However, in addition to sufficient time to transition it is important that NBS understands the transitional path as early as possible. This kind of undertaking will require significant resource for a smaller financial institution, and NBS needs certainty of the path forward so that NBS can plan the necessary resources and how to manage this against our other priorities. Ongoing uncertainty impacts our ability to plan for growth and to raise capital (which will be necessary to comply).

For these reasons NBS requests that the final policy decisions paper includes not only the decisions on the capital stack but the transitional path to this new capital stack. To NBS, this is as important as understanding what the requirements will be and therefore should form part of the key policy decisions. If NBS are required to wait until the draft standards consultation to understand the transition pathway, this will increase the time needed to transition and the ongoing impact of uncertainty on our business.

Conclusion

NBS supports the Reserve Bank's objectives of promoting financial stability, competition, and proportionality in the capital framework. However, NBS urges the Reserve Bank to consider the unique characteristics of mutual deposit takers and ensure that the final framework, and the transition to this framework, does not inadvertently disadvantage these institutions. In doing so, the Reserve Bank will also be supporting the DTA's purpose of fostering a diverse and resilient deposit-taking sector.

NBS would welcome the opportunity to engage further on these matters if any additional detail on our capital position would be useful and thank the Reserve Bank for its consideration of our submission.

Yours sincerely,

[REDACTED]

[REDACTED]
[REDACTED]