

2025 Review of Key Capital Settings

Q1 Do you have any comments on the proposed assessment criteria?

I agree with the proposed assessment criteria although I note the proposed risk weight changes will mean that NZ remains out-of-line with international benchmarks (criteria 7). The Basel Framework provides the global standard for the prudential regulation of banks and provides a globally accepted set of benchmarks. Inexplicably, the RBNZ still proposes higher risk weights which means that NZ banks will continue to report lower unadjusted capital ratios than global peers. Nowhere does RBNZ provide any evidence to support this requirement for higher risk weights. The consultation document notes that Standard & Poors do apply a higher BICRA score for NZ reflecting environmental risks as evidence of higher than average financial system risks. However that does not necessarily mean higher credit risks in each asset class. Those environmental risks would be better reflected via mandating a higher capital ratio than would be calculated via Basel's standardised risk weights. In effect, banks should be required to hold more capital through larger capital buffers and the numerator of the capital ratio rather than inflating the denominator.

The 2019 Capital Review intended the resulting changes would "Increase transparency to enable effective market discipline." That criteria is missing from this consultation review and I believe it should be included to continue to give effect to the Basel Framework's third pillar as a core element of effective regulation. Market discipline requires alignment domestically and internationally in order to provide effective comparisons. That remains largely impossible where RBNZ requires materially different capital calculation factors than those applied across most peer jurisdictions.

Q2 Do you have any comments on the appropriate risk appetite for New Zealand's capital settings?

I agree with the removal of the previous 1:200 year systemic crisis risk tolerance. That risk tolerance appeared during the 2019 review and seems to have been used (ex-post) to justify the increased capital requirement that underpinned that review. The outcome of that review was largely pre-determined with just the means to achieve that outcome being consulted on. The 1:200 year risk tolerance was poorly supported by modelling (it is fundamentally immeasurable) and remains a unique risk appetite expression that stands out unfavourably from international benchmarks.

Various industry solvency and liquidity stress tests undertaken over recent years show that NZ banks would maintain minimum capital levels under the respective 'severe but plausible' scenarios chosen. That outcome was assessed against the lower capital ratios applying at the time those tests were completed. Capital levels are now even higher. These test results show NZ banks already have sufficient capital and I believe the additional capital still required under the 2019 Capital Review cannot be justified under this review's criteria.

A preferred approach would be to adopt an objective measure akin to APRA's 'unquestionably strong' risk appetite which seeks to have their major banks in the top quartile of international banks expressed via globally comparable capital adequacy ratios. The Wyman analysis (page 40 of the consultation document) indicates that NZ bank's existing adjusted Total Capital Ratios (TCRs) would already place

them comfortably in the top 10% of TCR ratios amongst peer regulatory regimes. Meeting an objective measure akin to a 'within the top quartile of peer banks' really requires alignment with the Basel Standardised risk weights otherwise that assessment can't be easily or effectively done.

Q3 Do you have any feedback on our assessment of the impacts of legislative and policy changes since 2019?

I generally agree with the assessment of the impact on capital of those regulatory changes although I would suggest that CCCFA is likely to have more than a minimal impact on future capital ratio movements via tightened debt servicing requirements and lower expected loss rates under most credit stress scenarios. However other legislative and operational changes such as Know Your Customer, Anti-Money Laundering, Cyber Risk management and improvements in bank internal control environments will have reduced the potential for expected losses under these scenarios. If those changes haven't made banks safer then the heavy spending on compliance initiatives over recent years will largely have been wasted.

Q4 Do you have any feedback on our assessment of the new evidence since 2019?

I agree with the assessment of macro environmental risks since the 2019 review and the view that NZ specific risks are largely unchanged.

S&P's BICRA scores reflect an independent assessment of differing macro-economic risk profiles across a wide range of jurisdictions. However I don't believe that a higher country level risk profile should be reflected in higher risk weights for specific asset classes. Adjusting risk weights is not the appropriate tool to address increased macro-economic risks as risk weights address the potential severity of loss while these economy-wide vulnerabilities would more likely impact the frequency of loss events. Rather, any higher macro level risks should be addressed via adjustments to Prudential Capital Buffers so that NZ has higher TCR or TLAC ratio requirements than those applying in jurisdictions assessed as having a lower macro-economic risk profile. Expanded Counter-Cyclical Buffers (CCyB) are also available if those risks are considered short term such as resulting from specific asset class 'bubbles'. Higher risk profiles identified for a specific bank should continue to be managed through additional capital applied via Pillar 2 adjustments as has occurred over recent years.

I note the implications from the section headed 2023 banking turmoil. The Credit Suisse crisis resulted from a poor internal risk culture and ineffective management practices at Credit Suisse and the owners eventually deciding they would no longer recapitalise the bank for those mistakes. I also note the Swiss regulator continually failed to enforce effective resolution of those poor risk practices. The failure to use the existing bail-in resolution plan was likely because the same poorly performing management team would largely have been left in place. The Swiss regulator clearly determined it was better to let the performing UBS management team resolve those issues from within the merged bank entity. I believe that the continuing failure of the regulator to resolve the cultural and risk management shortcomings at Credit Suisse were a contributing reason, albeit behind the fines and the continuing operational and credit losses which ultimately brought Credit Suisse down.

In the case of the American bank failures, their regulator did not require bond holdings to be marked-to-market which resulted in those banks holding large undisclosed losses against those portfolios as

interest rates rose. That contributed to depositor flight. Again regulatory failure was a major contributing cause.

Q5 Is there other new evidence not discussed in this section that we should be considering?

I agree the growing risks in the global economic and political environment will continue to provide challenges for the NZ economy and constrain efforts to restrain price increases, resume economic growth and raise employment. Stagflation is a significant potential risk for bank management to address in the years ahead.

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

The analysis is consistent with the comparison analysis undertaken by NZBA in 2017 and again during the 2019 Capital Review and with the concerns expressed in many of the submissions made during that Review. Figures 10 and 12 within the consultation document highlight the extraordinary layers of conservatism that have been applied by the RBNZ when requiring banks to calculate their capital ratios. NZ banks' average total capital ratios lift from 16.5% to 26.1% and that is before the additional capital still required to be deployed before 2028. That adjustment gap is a damning indictment on RBNZ's bias to using calculation factors that are not based on evidence and that serve to add ever more capital despite the costs being added onto New Zealanders and moving the country ever further away from international benchmarks.

I am surprised the analysis indicates that, while NZ banks would be in the top quartile for Basel Group 1 banks, the adjusted ratios would only be in the 2nd quartile of Basel Group 2 banks. That raises the question of whether some of those group 2 banks are able to use factors that are less conservative than the Basel Standardised factors such as lower model output floors.

The analysis also highlights the increasing use of loss absorbing capital instruments in other jurisdictions while New Zealand has been limited to the use of AT1 and AT2 instruments which are less attractive (and thus more expensive) to local and offshore investors.

Q7 Do you have any feedback on the two high-level options for Group 1?

Any move towards the use of internal Loss Absorbing Capital (LAC) instruments issued between the NZ bank and its Australian parent is for those banks to respond to. The intricacies of how those options would impact APRA capital adequacy requirements will need to be worked through. In addition, I do wonder how well the introduction of LAC would future proof the industry as those instruments could not be used by Kiwibank and may not be suitable for other group 2 and group 3 banks

At an overall level I support any outcome that pauses the requirement to increase the Total Capital Ratio beyond current levels until this consultation is complete. The international comparisons show NZ bank already have sufficient capital to manage their risks.

Q8 Do you have any alternative proposals?

No additional comments.

Q9 Do you have any feedback on the proposal for Group 2?

I support the proposal for Group 2 banks. As noted above, NZ banks already hold sufficient capital on an internationally adjusted basis. Whether they choose to hold additional capital (via internal management capital buffers) will largely be driven by the risk assessments of the ratings agencies and the risk appetites of professional investors. Market discipline should be allowed to drive the size of those additional management buffers.

Do you have any alternative proposals?

No additional comments.

Q11 Do you have any feedback on the proposal for Group 3?

I support the proposal for Group 3 banks. Market discipline should be allowed to take a greater role in total capital levels along with the more intensive RBNZ supervision of these smaller banks to identify any internal management weaknesses which may ultimately impact solvency.

Q12 Do you have any alternative proposals?

No additional comments.

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?

In hindsight, the years 2021 and 2022 would have provided an excellent opportunity to see how effective a Counter Cyclical Buffer (CCyB) might be as imposing a CCyB at the time would have leaned against the massive amounts of stimulus injected into the NZ economy and the resultant rapid increases in house prices. However that opportunity has now passed.

I believe the long-run level of the CCyB should be retained at 1.5% as I do not believe that moving off the proposed lower 1% level would provide enough of an incentive for lenders to extend credit in an uncertain economic environment. The Basel Framework provides for a CCyB of up to 2.5%. Retaining the current 1.5% long-run average is slightly above the middle of that range and provides a little more capital flexibility in times of stress.

I have not been able to identify the successful use of CCyBs in other jurisdictions as the use of other counter cyclical fiscal and monetary measures during and after the pandemic by most governments and central banks appears to have had much greater impacts.

If the end result of this consultation identifies that banks are holding more capital than considered necessary given international comparisons, then a CCyB should be imposed at the appropriate level so that banks, as a whole, aren't able to lower capital levels from those currently applying.

Q14 Do you agree with the proposal that the Counter-Cyclical Capital Buffer should not apply to Group 3 deposit takers?

No. If the CCyB is considered necessary for Group 1 and 2 banks then it should also apply to Group 3 banks. While I acknowledge the potential issues these banks might have if they were required to restore capital levels after a stress event that is a challenge that already exists where those banks try to raise capital levels to meet the 2019 Capital Review requirements as well as to support above system growth. It is not a new problem for these banks.

Q15 Do you have any feedback on our analysis of the proposed options against the criteria?

I support option 2:

1. *Funding costs* - well designed LAC instruments should lower funding costs through both a small reduction in expensive CET1 capital as well as being more investor friendly than AT1 and AT2 instruments
2. *Crisis management* – more scope for these instruments to assist bank crisis resolution
3. *Going Concern Loss Absorbency* - the international comparison shows NZ banks already have more than sufficient CET1 levels to cover expected loss absorbency.
4. *Improved competition* – the proposed total capital levels should remove some of the capital advantages that Group 1 banks currently have when compared to Group 2 and Group 3 banks.

Q16 Do you think it would be preferable from a crisis management perspective to maintain a higher Prudential Capital Buffer or have a lower Prudential Capital Buffer and Loss-Absorbing Capacity for Group 1?

I believe it preferable for the Group 1 banks to have a lower PCB and LAC capacity as set out in Option 2. Adequate capital buffers are necessary but excessive capital buffers incur economic costs on all stakeholders. The international comparisons show NZ will certainly be in the latter position if the requirements of the 2019 Capital Review are not amended.

The analysis in Figure 16 shows NZ bank capital levels would allow them to maintain solvency in all of the identified loss examples except for scenarios applying to Ireland following the GFC and the European banking crisis. Reviews of the reasons for the Irish bank failures show these were largely due to systemic credit risk management failures within those banks, their legal regime, and poor supervision by their regulators. In essence, the bank officers and credit management within those banks ignored basic

credit assessment disciplines as they chased market share and financial incentives. Those problems were exacerbated by legal constraints on recovery options so that many borrowers actively chose to default when they were in financial stress as they could not be ejected from their properties.

Those legal constraints do not exist in NZ and the management and regulatory failures should not be possible where RBNZ and APRA undertake competent intensive supervision of their banks.

Q17 If you consider that one option is preferable, what are the reasons why?

Option 2 as set out in my response to question 15.

Q18 Do you have any feedback on the degree of proportionality across the proposed options and capital stacks?

I am comfortable with the proportionality impacts across the proposed options. I would also note that the ratings agencies and the risk appetite of investors will ultimately drive the size of any management capital buffers that will be applied in practice as well as the funding margins that each bank accepts as it seeks funding. The proposals provide a good starting position and RBNZ should be comfortable allowing the market to provide these capital disciplines on the NZ banks.

Q19 Do you have any feedback on the implications for competition from our proposed options?

The proposals should provide a small competitive gain for the group 2 and group 3 banks but that would be enhanced if RBNZ adopts the BIS standardised risk weights rather than the higher levels proposed.

In my 40 years' banking experience there was little sustained change in bank market shares when adjusting for acquisitions. The exception would be ASB which substantially grew its national market share largely due to its branding and its dominance of the Auckland market which was the largest and fastest growing market for much of this period. Bank market shares have been largely static over the last 5 years apart from a small lift in Kiwibank's share.

Moving market shares in a commoditized industry is very difficult but the RBNZ can assist by removing the current capital disadvantages the group 2 and 3 banks face through implementing unadjusted Basel standardised risk weights.

Q20 Do you have any feedback on our analysis of the options against the assessment criteria?

The analysis shows NZ banks would have relatively high capital adequacy ratios under all of the options shown. International alignment should be a more important assessment criteria to help develop more objective criteria on which to assess capital adequacy between banks and across differing jurisdictions. The 2025 review options are still predicated on continuing material methodology differences without explaining why they should remain.

NZ is a small economy which is more exposed to geopolitical and macro-economic influences than larger countries but those additional risks should be addressed specifically via the size of the Capital Conservation and Counter Cyclical Buffers that are set for each group of banks rather than through a series of largely hidden risk weights add-ons and higher output floors and scalars. Transparency and international alignment are critical to enabling effective market discipline.

Q21 Do you have any feedback on our approach to the cost benefit analysis?

These cost benefit analyses are very difficult to comment on. As an example there is an implied cost from more frequent bank failures but that is wholly dependent on a range of other factors. The cost of the Irish banking crisis was made much worse because of the impact of the legal environment, and the actions of the Irish government under pressure from the European Union. Attempting to isolate and measure one outcome from a huge range of possible inputs is a fraught exercise.

Q22 Do you have any feedback about the results of the cost benefit analysis?

Ultimately choosing one option for a capital adequacy regime sufficient to cover a huge range of possible futures requires the exercise of judgement informed by the available information. The RBNZ have provided a limited range of options which I do not believe go far enough to achieve the objectives sought for this review. The RBNZ needs to go further with the changes proposed.

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

No additional comments.

Q24 Do you have any comments about the way that Loss-Absorbing Capacity has been incorporated into the approach?

No additional comments.

Q25 Do you agree with the proposal to remove Additional Tier 1 capital as a form of regulatory capital?

Given APRA is phasing out the use of AT1 capital and, as the Australian owned banks have an 85% share of the NZ banking market, it makes sense for NZ to also consider phasing out AT1 capital. In NZ the use of Open Bank Resolution and the new Deposit Takers Act further complicate the potential use of AT1 for loss absorbency. The development of new loss absorbing capital instruments (LAC) has still to take place but AT2 instruments remain available until the final shape and scale of any those instruments are known. The implications of that change on Kiwibank and the other NZ owned banks should also be considered.

I note that a new Crisis Management Standard is not likely to come into effect until 2029 so there is sufficient time to work through the implications if AT1 capital instruments are to be progressively phased out.

Q26 Are there any other factors that you think we should take into account in making this decision?

No additional comments.

Q27 Do you have any views on the most appropriate transitional arrangements, including how Additional Tier 1 capital instruments should be recognised after any possible removal?

No additional comments.

Q28 Are there any additional factors that should be taken into account for Group 3 deposit takers?

No additional comments.

Q29 Do you agree that the Reserve Bank should introduce more granular standardised risk weights for mortgage, corporate and agricultural lending?

Yes. The requirement for more granular risk weights was recognized internationally following the GFC when actual loss rates largely reflected collateral coverage. Those changes were incorporated into the Basel Committee on Banking Supervision's recommendations known as Basel III. However RBNZ chose not to adopt those international benchmarks at the time and instead implemented a range of far more conservative risk weights. The rationale for doing so was never adequately explained.

As identified in the Review document the outcome of RBNZ's imposition of a more conservative calculation methodology is that NZ banks headline capital adequacy ratio is 16.5% rather than 25.1% when adjusted to align with banks internationally. That gap has a cost to NZ'ers and makes the banks here seem less safe when compared to overseas peers. Counter-intuitively it also makes the financial system more risky rather than less as the following example illustrates:

Current RBNZ Risk Weights				
	Credit Loss	Capital	Risk Weight	Capital Ratio
Start		3475	21276	16.3%
year 1	400	3075	21276	14.5%
year 2	400	2675	21276	12.6%
year 3	400	2275	21276	10.7%
year 4	400	1875	21276	8.8%

Using BIS Risk Weights				
	Credit Loss	Capital	Risk Weight	Capital Ratio
Start		3475	18000	19.3%
year 1	400	3075	18000	17.1%
year 2	400	2675	18000	14.9%
year 3	400	2275	18000	12.6%
year 4	400	1875	18000	10.4%
year 5	400	1475	18000	8.2%

In this example I have started with Kiwibank's capital and risk weighted assets from their 2025 Disclosure Statement. I have then assumed a protracted and unreasonable annual credit loss charge based on a 1% pa loss rate on their mortgage portfolio and a 2% annual loss rate on their SME corporate portfolio. These extreme loss measures were chosen purely to see how long Kiwibank's capital would continue to meet the current 9% prudential capital buffer. Using RBNZ existing risk weights those credit loss factors indicate Kiwibank would breach its PCB in a little under 4 years.

I then recalculated the timeframe by adjusting Kiwibank's total risk weighted assets using the standardised credit risk weights under the Basel III's Framework and then degraded capital using the same loss rates as above. Approximating those international benchmark risk weights would give Kiwibank almost an additional year to implement mitigating actions to maintain its prudential buffer requirements. That is another 25% more time to avoid bank failure.

It should be emphasized that these are not reasonable loss estimates. The 2022 stress test reported a cumulative industry-wide mortgage loss rate of 1.9% over 4 years rather than the 1% p.a. I have used. Similarly the stress test's cumulative Corporate/SME loss rate was 6.7-7% over 4 years rather than the 2% p.a. I have used.

While a very simplistic example, it demonstrates that RBNZ's choice of conservative risk weights does not serve to strengthen the financial system. Instead it serves to increase those risks by reducing the time a bank would have to mitigate credit losses and de-risk their credit portfolios.

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

Residential Mortgage Risk Weights

I recommend RBNZ implement the same risk weights as those set out in the BIS Standardised Framework. The differences between what is proposed and the Basel Standardised risk weights for retail mortgages are shown in the two right hand columns below.

Those differences remain substantial.

Type of Lending	Current RBNZ Risk Weight (%)	Proposed RBNZ Risk Weights (%)	Basel Standardised Risk Weight (%)
Owner Occupied			
<50% LVR	35	25	20
50-60% LVR	35	30	25
60-80% LVR	35	35	30
80-90% LVR	50	50	40
90-100% LVR	75	75	50
>100% LVR	100	100	70
Investor			
<50% LVR	40	30	30
50-60% LVR	40	35	35
60-80% LVR	40	40	45
80-90% LVR	70	70	60
90-100% LVR	90	90	75
>100% LVR	100	100	105

The RBNZ have still not provided any actual loss evidence supporting their continued requirement for risk weights that exceed the Basel international benchmarks.

A comparison between the latest disclosure statements for Kiwibank and ANZ, ASB, BNZ and Westpac show the existing differences in risk weights between the current RBNZ internal ratings and their standardized methodologies.

Residential Mortgage Risk Weights Comparisons (%)								
	Internal Ratings Based Results							
Bank	Exposure Weighted PD	Exposure Weighted LGD	Risk Weight	RBNZ Standardised Risk Weights	Collective Provision Ratio	>80% LVR Ratio	Default Ratio >90dpd	Individual Provision Ratio
ANZ	1.91	18	22	39.0	0.17	8.4	0.93	0.01
ASB	2.87	20	30	38.8	0.23	8.7	0.78	0.06
BNZ	1.97	19	28	42.2	0.21	5.7	0.34	0.02
Westpac	1.82	19	25	38.7	0.28	10.3	0.62	0.04
Kiwibank	-	-	-	37.0	0.09	8.9	0.18	0.02

ANZ NZ reports the lowest average risk weight of 22% calculated using their internal model while the other internal ratings banks range up to 30% average risk weights for essentially similar portfolios. Interestingly those bank's internal models generate average weighted loss given default (LGD) ratios of 20% or less and their median mortgage loan is likely to have a risk weight below 20% which is the risk weight a similar standardised mortgage would be allocated if guaranteed by Kainga Ora, a Government owned entity. I struggle to understand how RBNZ can justify an internal ratings bank holding less capital against a median residential mortgage than one backed by the government.

An alternative view of mortgage portfolio riskiness is provided by the bank's collective provision models which estimate likely future mortgage losses over a range of plausible scenarios. These show the banks have quite different expected loss ratios to those indicated by their capital models with Kiwibank having the lowest ratio while Westpac holds more collective provisions than peer banks which have higher modelled risk weights.

RBNZ's Bank Financial Strength Dashboard for 30 June 2025 provides another view of the actual riskiness between those portfolios. ANZ has 0.93% of its housing portfolio showing as non-performing while Kiwibank's non-performing ratio is 0.18%. In the absence of any reported long term portfolio loss rates I have also included the latest reported individual provisions held by each bank as a proportion of total mortgage exposures to provide a point-in-time estimate of actual losses expected at the end of the reporting period. Again these ratios show the internal models banks expect to lose proportionally more than Kiwibank although every bank expects current losses to be a miniscule proportion of total residential mortgage lending.

Additionally we can look at the nature of the mortgage portfolio itself. The data, and my experience, show that mortgages are relatively homogenous across the banks. The banks have a similar risk profile of mortgages in terms of LVR profiles (although BNZ is somewhat an outlier), geographic distribution, and splits between owner occupiers and investors. That homogeneity is largely shaped by RBNZ's LVR and Debt to Income regulations, the banks distribution reach and use of mortgage brokers. The widespread use of the latter serves to equalize mortgage acquisition criteria as differences immediately impact the flow of new mortgages and refinances from those brokers. More recently, the CCCFA's requirements around proof of debt servicing capacity also reduces any potential differentiation between borrowers' ability to repay. While some banks access Kainga Ora guarantees this has only a minor impact on mortgage volumes and thus loss rates.

Looking at a more comparable risk measure using RBNZ's current standardised risk weights, Kiwibank's residential mortgage portfolio has an average portfolio risk weight of 37% for on balance sheet exposures¹. The internally rated banks actually have slightly higher risk weights for their mortgage portfolios. At the extreme, ANZ's mortgage portfolio appears slightly more risky on RBNZ's standardised risk weights, but they are able to hold 25% less capital against that portfolio because they are able to use an internal model.

The RBNZ's proposed mortgage risk weights may bring Kiwibank's portfolio average risk weight down from 37% to around 32-33% but that level still remains substantially above those the internal ratings

¹ Kiwibank June 2025 Disclosure Statement p83

banks are able to use. The RBNZ's halfway house proposed risk weights will continue to embed a competitive advantage for the Australian owned banks in the residential mortgage lending market.

Given those portfolio similarities and the lack of substantive loss experience it is difficult to argue that there should be any significant difference in risk weights between the banks – whether using internal models or international benchmarks.

The statistician George Box had a wonderfully apt caution against the hubris of relying on models stating “all models are wrong, but some are useful”. In this instance I believe these internal ratings models are useful and their average residential mortgage risk weights in the 25-30% range do fairly represent the credit risks within those portfolios. That level matches the Basel standardised risk weights.

Lastly, we should consider the adequacy of Basel's international benchmarks for risk weights and how that relates to loss absorbency. Kiwibank's residential mortgage portfolio generates 52.8% of Kiwibank's total risk weighted assets. That means that 52.8% of Kiwibank's capital is notionally held against the mortgage portfolio - \$1,834.8m of capital against \$31,176m of total mortgage exposures. Kiwibank is therefore holding ~\$6 of capital against each \$100 of mortgage exposure. The 2022 stress test showed the banks experienced a 1.9% loss rate after 4 years of severe credit stress. That means that \$1.90 of capital would be lost over 4 years still leaving sufficient capital to meet their conditions of registration. RBNZ's C35 data on bank's residential mortgages shows an average annual loss rate of 0.02% on mortgage lending over the last 11 years. That is an average loss rate of 0.2cents on each \$100 of mortgages with a peak of 1 cent in 2014. Those loss rates are unlikely to have exceeded 50 cents per \$100 of mortgage lending even following the GFC peak. Actual losses are tiny compared to the required risk weights.

I estimate that reducing RBNZ's risk weights to match Basel's risk weight benchmarks would reduce Kiwibank's total credit risk weights by ~15% and raise their capital ratio to ~19%. Holding their capital at current levels would mean there is no less capital available to provide adequate loss absorbency under a severe and extended financial stress.

SME Risk Weights

I support the proposal to implement differentiated risk weights for the SME asset class but wonder why the use of Basel standardized risk weights are considered by RBNZ acceptable for SMEs but not for retail mortgages.

Agriculture Lending – Risk Weights

I support the proposal to implement differentiated risk weights for agricultural lending. The Basel Standardised Framework doesn't have risk weights specifically for agricultural lending. Rather these are included under Regulatory Commercial Real Estate with a 70% risk weight for LVRs under 60%². While the proposed LVR based risk weights are more generous than the real estate risk weights this will have little impact in practice as there is relatively little agricultural lending undertaken outside the 4 internal ratings banks and Rabobank.

² The Basel Committee on Banking Supervision – Basel Framework section 20.87 p239

Q31 For deposit takers: Can you quantify the overall and sectoral impact that the proposed changes to standardised risk weights for residential mortgage, corporate, and agricultural lending would have on your institution?

Not applicable.

Q32 Would you expect more granular residential mortgage lending risk weights to lead to more differentiation in loan pricing to borrowers?

I believe that would be unlikely for carded mortgage rates i.e. for those mortgage interest rates published by the banks. However I believe that there would be some interest rate discounting based on LVRs where mortgage brokers or customers sought 'sharper' pricing through the bank's customer retention teams.

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?

Not applicable.

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

Yes. The Basel Framework risk weights below should be used for commercial real estate which is reliant on the cashflows generated by those properties. Again RBNZ display an unjustified bias to conservative risk weights which differ from the international benchmarks. Where is the evidence indicating these proposed risk weights should be applied?

Commercial Property	Proposed RBNZ Risk Weights (%)	Basel Standardised Risk Weight (%)
<60% LVR	100	70
60-80% LVR	?	90
>80% LVR	?	110

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?

Not applicable.

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

No additional comments.

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?

Not applicable.

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)?

Not applicable.

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?

I don't agree that the proposed risk weights more closely align with actual risks. The biggest differences remain with the mortgage portfolio but the risks attributed to agricultural and commercial property lending are also substantially over-rated. As indicated previously, the requirement for higher risk weights has not been made and past loss experience along with ever tightening regulatory requirements and enhanced supervision suggest that credit risks have reduced from historic levels (e.g. corporate and commercial property losses following the 1987 sharemarket crash and the subsequent recession).

I support the use of international risk weight benchmarks to better align with global peers and for RBNZ to increase any bank capital requirements via additional buffers rather than inflating the denominator of the capital calculation. Where needed for financial system stability, RBNZ should be adding capital buffers to address their assessment of NZ's macro-economic vulnerability or through pillar 2 add-ons to cover bank specific risks such as repeated poor risk management practices, cyber security weaknesses or the potential impacts of events such as foot and mouth outbreaks on their lending portfolios. That will allow NZ to report globally aligned capital ratios at a level matching RBNZ's explicit risk appetite for capital loss absorbency.

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?

In my experience, these risk weight changes can be implemented relatively simply and quickly (within 6 months). The costs of these changes are not likely to be material.

Q41 Is there anything else you think we should consider when contemplating changes to standardised risk weights or analysing their impacts?

The impact on the use of lower standardized risk weights to calculate the capital floor for internal ratings banks needs to be better assessed as this could otherwise lead to lower capital levels for these banks. This could be managed through adjustments to their capital floors so that their capital ratios remain at or close to current levels. As noted in my assessment of the risk weight differences for mortgage portfolios, the real problem here is how such a large risk weight differential on very similar asset portfolios can continue to be justified.

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))?

As long as there is no overall reduction in the levels of capital currently provided then I believe these changes satisfy the main purpose of the DTA.

Q43 Do you agree with the proposed approach for risk weights on lending for Community Housing Providers and housing co-operatives? Will this approach accurately reflect the risk of that lending?

I agree with option 3. These properties are likely to have credit risks more akin to residential property investors. However, rather than create a new asset class I recommend they are included under the investor category of residential mortgages. The only advantage of having a new asset class is for data tracking purposes but that comes with additional system costs and data collection and compliance costs for deposit takers.

Q44 Do you think the proposed approach for risk weights on lending for Community Housing Providers and housing co-operatives aligns with the main purpose of the Deposit Takers Act 2023 (section 3(1)) and the additional purposes (section 3(2))?

Yes. This approach will support community housing providers with lower cost funding which will benefit low income NZ'ers through increased community housing volumes and improved housing quality.

Q45 How has the Māori Land Court whenua Māori practice note altered borrowing and lending decisions?**Q46 For deposit takers: How do you treat lending where whenua Māori is the security? Does this affect your assessment of risk?****Q47 Does lending secured by whenua Māori have different risk characteristics than other lending, and if so, how should this be incorporated into prudential requirements? Is this relevant for residential mortgage lending, and/or other forms of lending?****Q48 Will lending secured by whenua Māori benefit from the other changes proposed in this Review?**

Q49 Are there other aspects of the prudential framework that could be addressed to more accurately align risk weights with actual risk for lending secured by whenua Māori?

Q50 What are the barriers to borrowing lending when whenua Māori is used as security?

Q51 For deposit takers: Do you participate in the whenua Māori Lenders Mortgage Insurance underwriting programme run by Kāinga Ora?

I have no experience of the impact on access to lending following issuance of the Maori Land Court practice note in 2024. Previously, lending against Maori land had a different risk profile as there was no collateral that could be sold to offset defaulted loans. As a result there was little bank lending against Maori Land.

I support any moves the RBNZ might take to improve access to lending against whenua Maori. That clearly satisfies the purpose of adding to the well-being of NZ'ers.

Q52 Do you support excluding lending for property development from the proposed approach to risk weights for lending to Community Housing Providers and housing co-operatives?

Yes. Refer answer to Q53.

Q53 Are the risks during the property development and construction phase different from providing accommodation in finished dwellings?

Yes. Property development has a very different risk profile to completed properties owned by Community Housing Providers. The former has all the development risks around contract pricing, price inflation, completion timeframes, remediating construction errors, weather impacts and unexpected ground conditions as well as the costs of finally achieving code of compliance. Community Housing Providers and housing co-ops essentially only have debt servicing, maintenance and insurance risks.

Q54 Do you support excluding lending to third-party providers (who intend to lease to Community Housing Providers or housing co-operatives) from the proposed approach to risk weights for lending to Community Housing Providers and housing co-operatives?

I agree with the proposal to exclude lending to 3rd party providers from the risk weights available to CHPs and housing co-ops. Conceptually the risks of lending to a 3rd party provider with a lease to a CHP or housing co-op are the same as lending directly to the CHP or co-op. However it is unlikely the 3rd party provider is a single property entity and it is likely to have other lines of business or developments underway. On that basis the risk profile would differ. There is also risk the lease, or the risks of recovery under the lease, may be ineffective which also supports them having a different risk profile.

Q55 Are the risks of lending by third-party borrowers different from lending directly to Community Housing Providers?

Yes. 3rd party borrowers have all the property completion risks as well as potential challenges of finding and retaining an operator for the property for the lifetime of any lending.