

3 October 2025

Reserve Bank of New Zealand
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RBNZ's 2025 review of key capital settings

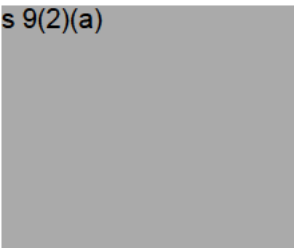
Please find attached our submission on RBNZ's 2025 review of key capital settings.

Our submission primarily relates to concerns about the Cost Benefit Analysis used by RBNZ and therefore the validity of its conclusions and proposals.

We believe the evidence suggests that the big banks will not have their returns on equity materially affected by these proposals or the 2019 capital review decisions. The costs will be borne by their customers (about 90% of New Zealanders) and taxpayers. That is at the heart of our concerns.

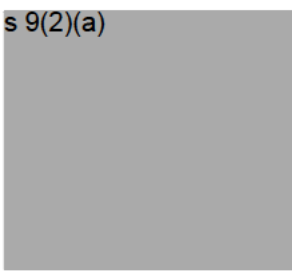
Yours faithfully

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Andrew Body

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Simon Jensen

Submission on RBNZ's 2025 Review of Key Capital Settings

Submitters

1. This is a joint submission on the Reserve Bank of New Zealand (RBNZ) consultation paper reviewing key capital settings.
2. The submitters have provided detailed submissions to both the Commerce Commission in its market study into personal banking services and the Parliamentary inquiry into banking competition on the extent of regulatory failure in prudential bank regulation.
3. They have co-authored several published opinion pieces on the central role of RBNZ's prudential management failures in creating the incumbency of the big four banks and limiting competition and innovation in the provision of banking services in New Zealand.

Background and summary

4. RBNZ's main purpose in its prudential management is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy, by protecting and promoting the stability of the financial system¹.
5. This purpose does not permit RBNZ to pursue the protection and promotion of stability of the financial system at any cost. A balancing of cost and benefit is required to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy.
6. Indeed, the Parliamentary Inquiry into Banking Competition (Inquiry) achieved cross party support for reinstating "market efficiency" as a key objective of the RBNZ in the Reserve Bank of New Zealand Act 2021².
7. We note that RBNZ released its 2025 review of capital settings consultation document (consultation document) on 25 August 2025, without any reference to the Inquiry's report released three days earlier.
8. In our view, RBNZ's cost benefit analysis is unsound, does not withstand scrutiny and cannot be used to assess proposals for capital settings.
9. As a result, RBNZ has not:
 - a. discharged its obligations under its legislation or
 - b. met the expectations of the Minister of Finance or of the Finance and Expenditure committee and the Primary Production Committee when former Chair Neil Quigly and acting Governor Christian Hawkesby announced the review to those committees on 31 March 2025³.

¹ s3(1) Deposit Takers Act 2023

² Page 48 Finance and Expenditure Committee Inquiry into banking competition, presented to Parliament on 22 August 2025

³ <https://vimeo.com/showcase/10758103?video=1069352378>

10. RBNZ is operating outside both its legislative mandate.
11. RBNZ's capital settings proposals rest on a cost–benefit analysis that is not transparent and likely flawed. The analysis relies on assumptions that RBNZ itself has previously rejected, and it disregards robust modelling of regulatory costs. The result is an unbalanced assessment that overstates benefits and understates costs of capital levels well outside international norms.
12. The capital requirement proposals are largely a distraction from the real unresolved issues of RBNZ's 2019 capital decisions that cause higher funding costs, reduced competition, and constrain investment and productivity compared to an efficient outcome.
13. These capital requirement proposals will do little to advance RBNZ's statutory purpose of promoting a productive and sustainable economy.
14. For these reasons, we urge RBNZ to revisit its cost–benefit analysis, abandon the implausible 63% GDP loss assumption, incorporate credible and transparent modelling of regulatory costs, and recalibrate its proposals to align with international practice.
15. Without such revision, the proposed settings cannot command confidence from either policymakers or ultimately most importantly the New Zealand public. As we have reiterated on many occasions, it is New Zealand customers who pay the costs of poorly conceived financial regulation – not the big banks. All the evidence is that the big banks can and have passed on the costs of poor regulation to their customers (and about 90% of New Zealanders bank with them).

Capital Requirement Proposals: Distraction by smoke and mirrors?

16. RBNZ has offered two capital requirement options that provide minor relief to the IRB banks. The comparison of these options in the consultation document is to the 2019 capital review decisions, not to international norms or the 2018 capital levels.
17. For the IRB banks, that have over 90% of the New Zealand banking market, and their customers that ultimately pay the price of higher capital requirements, the proposals will do little. The cost of higher than efficient levels of bank capital will continue to be borne by customers and our economy.
18. Moreover, the benefit of option 2 (the loss absorbing capital proposal) appears to rely on a funding cost arbitrage, a “free lunch” so to speak, borne of complex multi-jurisdictional regulatory, tax and market dynamics that is by no means certain to continue.
19. The capital requirement proposals represent little more than a distraction by RBNZ away from the issue of what is our banking system risk appetite.
20. It is astonishing that RBNZ has not addressed risk appetite in any analytical way in its consultation paper and undermines the consultation document.

Cost–Benefit Analysis Flaw: Benefit of avoiding of bank failure

21. The consultation paper makes clear that RBNZ has made no changes to its underlying assumptions regarding the economic cost of a bank failure.
22. Most notably, the consultation paper continues to rely on an assumption that a bank failure in New Zealand would impose a cost equivalent to 63% of GDP. There is simply a “throw away comment” that “we continue to use the assumption that a crisis would result in lost output of 63% of GDP”.
23. This assumption is not credible. As we set out in Appendix 7 of our February 2025 joint submission:
 - RBNZ itself has previously criticised this assumption. In its 2012 analysis, RBNZ stated that estimates of this nature tend to be “on the high side,” and it expressly rejected the “permanent scar” theory of financial crises that underpins the 63% figure.
 - At that time, RBNZ concluded that a more realistic assumption for New Zealand would be 10–20% of GDP, reflecting our banking structure and historical experience.
 - Even that range is likely conservative. By way of comparison the total cost of recapitalising the New Zealand banking sector would likely be less than 15% of GDP.
 - ASB set out a range of mitigants in its 2019 submission that seem simply to have been ignored together with some others we provided.
24. It is also important to emphasise that a GDP contraction associated with a banking failure is not caused solely by the failure itself. More commonly, the causality runs the other way: severe economic shocks cause losses in the banking system, which then manifest as failures.
25. To assign the entire GDP cost of a crisis to banking failure is to conflate underlying economic conditions with the direct costs of financial distress. RBNZ itself highlighted this problem in 2012 yet has now chosen to ignore its own caution.
26. This methodological flaw fundamentally undermines the credibility of RBNZ’s cost–benefit analysis. When the central assumption is implausible, the outputs cannot be relied upon. Given the public criticism of the model, it is extraordinary that the same assumptions have been used without question.

Cost–Benefit Analysis Flaw: Cost of prudential regulation

27. In our joint submissions to the banking inquiry in February and April 2025, we provided analysis using the globally recognised GTAP model to quantify the costs of additional capital requirements⁴.

⁴ https://www3.parliament.nz/resource/en-NZ/54SCFIN_EVI_fc430602-f4c3-4b04-957d-08dcb036cf74_FIN3458/bed7f7c65cb26ec34a29529b75cfed5570ffa521

28. GTAP is an accepted and transparent tool for modelling general equilibrium impacts across an economy. In Australia the Australian Productivity Commission uses GTAP extensively to model outcomes from government policies. It is used in New Zealand by government agencies.
29. We estimated the cost of RBNZ's regulatory overreach, including inappropriate capital settings, to be in the order of 2% of GDP per annum. We offered to provide transparency in our modelling to enable critical analysis.
30. Despite this, the consultation paper makes no meaningful attempt to incorporate this type of modelling. Instead, the paper persists with a one-sided approach, heavily weighting assumed benefits of higher capital while minimising or disregarding the regulatory costs.
31. The omission is serious. Excessive prudential conservatism has direct consequences for New Zealand households and businesses:
- Higher capital requirements raise banks' funding costs, which are passed on to borrowers in the form of higher interest rates.
 - As we showed in Appendix 3 of our February joint submission, these costs are not trivial: a 500-basis point excess capital adequacy ratio increases mortgage lending costs by at least 25 basis points, and business lending by 50 basis points.
 - Higher risk weights compound this effect, further raising the cost of funds.
 - These pricing impacts reduce the feasibility of investment projects, depress productivity, and ultimately constrain economic growth.
32. To ignore these costs, or treat them as immaterial, is inconsistent with RBNZ's statutory requirement to support a productive economy.

"Putting it on the table": Analysis or assertion?

33. In his 31 March 2025 appearance before the banking inquiry, in reference to the competing evidence (including ours) of the impact of capital requirements on loan rates, former RBNZ chair Neil Quigley said:

That's the reason to have a review.

It is actually to ask them to put on the table the way in which they've calculated their much higher estimates and, and see whether we got it wrong or, or whether in fact that they are overweighting their calculations.

(fillers removed)

34. And acting Governor Christian Hawkesby said in the same meeting, in relation to evidence provided to the banking inquiry about the cost of capital requirements:

Our observation is that some of the evidence that you've been provided in this committee has analysis backing it. Other things that have come to this committee are more assertions, that they don't have analysis backing them.

(fillers removed)

35. We have provided our analysis in some detail. However, RBNZ has not. Like its work in 2019, RBNZ's modelling summarised in tables 25 and 26 of the consultation document is not transparent. It is impossible to provide any critical analysis of RBNZ's modelling which amounts to little more than quantifies its "assertions".

36. Such critical analysis is an important part of the intellectual rigour that RBNZ must provide to commentators and critics alike to rebuild public confidence in the exercise of its mandate.

International Alignment and Basel Consistency

37. RBNZ has presented the proposed key capital settings as being consistent with international standards and aligned with Basel. However, even after the adjustments now proposed, many of the same concerns that were raised following the 2019 Capital Review remain valid.

38. In practice, New Zealand's framework continues to be substantially more conservative than Basel minima and materially more onerous than the regimes in comparable jurisdictions.

39. For example:

- CET1 measurement. While RBNZ has refined some elements of capital measurement since 2019, the fundamental divergence remains. PwC's earlier analysis showed that harmonising New Zealand's CET1 measurement calculations with Basel rules would add more than 11 percentage points to capital ratios. Even under the new settings, New Zealand banks are still reporting capital levels that are far above international requirements, with CET1 ratios measured on a Basel-harmonised basis exceeding 20% against a Basel minimum of 10.5%.
- Risk weights. The proposed settings preserve very conservative risk weights relative to both Basel and APRA. As shown in recent APRA benchmarking, New Zealand's IRB mortgage risk weights remain significantly higher than those in Australia and well above Basel reference points. The same is true for corporate and agricultural lending, which raises the cost of credit in precisely those parts of the economy most reliant on bank finance.
- Treatment of defaulted and specialised loans. Despite the opportunity to bring New Zealand into line with international best practice, RBNZ has not adopted Basel provisions on defaulted loans or on lending to housing cooperatives and other

specialised housing vehicles. This continues to penalise restructuring, discourage innovation in housing finance, and push banks towards more conservative recovery strategies that are costly for borrowers.

40. RBNZ has described the new framework as “simpler” and “more aligned”. In reality, the underlying conservatism remains largely intact, and the key criticisms from the 2019 review—excessive deviation from Basel, material divergence from comparable jurisdictions, and negative impacts on competition and credit availability—remain valid.

Other Material Issues

41. Two further issues require mention in this submission:

(a) Open Bank Resolution (OBR)

For more than a decade, OBR has been positioned as a substitute for bail in capital—effectively loss absorbing capital. It is therefore inconsistent for RBNZ to now introduce loss absorbing capital without acknowledging this overlap. If higher loss-absorbing capital is to be pursued, then OBR should be reviewed and, in our view, scrapped. This would again be more consistent with international practice – where no other country has an open bank resolution equivalent.

(b) Simplification and Tier 2 Calibration

While simplification of the capital framework has some merit, the removal of Alternative Tier 1 creates a gap that should be filled by properly calibrated Tier 2 capital. International norms suggest are for an allowance of up to 1.5% AT1 and 2% Tier 2. If AT1 is to be scrapped the new combined allowance for Tier 2 capital should be 3.5%. To disregard these norms risks weakening the effectiveness of the overall framework under the guise of simplification.