



**RESERVE  
BANK**

O F N E W Z E A L A N D

# **Type of credit rating for non-bank deposit takers**

*Consultation paper*

February 2009

## Introduction

1. In this consultation paper we propose the type of rating to be set by regulations for the non-bank deposit taker (“deposit taker”) sector under section 157K of the Reserve Bank of New Zealand Act 1989 (“the Act”).<sup>1</sup>
2. The Reserve Bank proposes to recommend to the Minister of Finance that regulations specify local currency, long term, issuer ratings for deposit takers.
3. Under the Act, deposit takers must obtain these ratings from rating agencies approved by the Reserve Bank and hold them from 1 March 2010.<sup>2</sup>

## How to make submissions

4. The Reserve Bank invites submissions on the proposal to use local currency, long term, issuer ratings for deposit takers.
5. Submissions should be made by 9 March 2009 and addressed to:

Type of credit rating for deposit takers  
c/- Alistair Henry  
Prudential Supervision Department  
Reserve Bank of New Zealand  
PO Box 2498  
Wellington  
New Zealand

Or email: [nbd.enquiry@rbnz.govt.nz](mailto:nbd.enquiry@rbnz.govt.nz) with “Type of credit rating for deposit takers” in the subject line.

6. Please note that submissions may be published. If you think any part of your submission should properly be withheld on the grounds of commercial sensitivity or for any other reason, you should indicate this clearly.

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<sup>1</sup> A copy of this Act and other legislation can be obtained from: <http://www.legislation.govt.nz/>

<sup>2</sup> The requirement for deposit takers to hold a credit rating is provided under section 157I of the Act. The commencement of this requirement on 1 March 2010 is provided under section 2 of the Reserve Bank of New Zealand Amendment Act 2008.

## Principles and purpose for credit rating regulations

7. Part 5D of the Act requires deposit takers to obtain a credit rating from an approved rating agency. In prescribing the type of rating a deposit taker must hold, by regulation under the Act, a number of principles must be taken into account. These are set out under section 157F with the most relevant in this case being:
  - the importance of recognising that depositors are responsible for assessing risk in relation to potential investments and for their own investment choices;
  - the desirability of providing to depositors adequate information to enable them to assess risk in relation to potential investments and to distinguish between high-risk and low-risk deposit takers; and
  - the need to avoid unnecessary compliance costs.<sup>3</sup>
8. It is intended that deposit takers will be required to disclose their credit ratings by regulations made under the Securities Act 1978.<sup>4</sup> The Reserve Bank will work with the Securities Commission and other agencies as required to develop the disclosure requirements for credit ratings.

## Overview of options

9. The aim for the type of rating specified by regulation is, in essence, to provide a broad-based measure of deposit taker creditworthiness. The main options to consider for the type of credit rating to be specified by regulation are:
  - long term or short term ratings;
  - issuer or issue ratings;
  - local currency or foreign currency ratings; and
  - global or national rating scales.
10. Aspects of these options are discussed in the rest of this paper but in brief and in relation to the first three points, it is proposed that long term, issuer, local currency ratings be specified for deposit takers by regulation under the Act. In relation to the fourth point, it is proposed that the use of global rating scales by rating agencies be managed under the Reserve Bank's power to approve rating agencies.
11. In specifying local currency, long term, issuer ratings for deposit takers, the proposal in this paper is deliberate in preserving flexibility for other ratings to be used (in addition) by deposit takers according to their business needs. Such other ratings could, for example, include short term, issue, or foreign currency ratings.
12. Although the Act makes it possible for ratings to be required for a deposit taker's borrowing group,<sup>5</sup> it is not proposed to do so at this point in time. Rating agencies will generally take into account the relationships of the deposit taker with its guaranteeing subsidiaries. Rating agencies will typically also take into account relationships with other related parties. For example, guarantees from parent companies or exposures to non-guaranteeing subsidiaries may be reflected in a deposit taker's credit rating.

<sup>3</sup> These are respectively section 157F(2)(b)(ii), (c) and (f).

<sup>4</sup> See also paragraph 55 of the September 2007 Cabinet Paper:

<http://www.rbnz.govt.nz/finstab/nbd/3116779.pdf>

<sup>5</sup> Borrowing group is defined as the deposit taker and any guaranteeing subsidiaries under section 157B.

### Long term ratings

13. Long term ratings provide the best capture of risk and the overall creditworthiness of a deposit taker. The requirement for a deposit taker to have a long term rating would not preclude it from also holding a short term rating.

### Issuer ratings

14. Issuer ratings are preferred for the deposit taking sector because they provide a rating that can be applied widely to all deposit takers and one that is relatively easy for depositors to understand.
15. The main advantage of an issuer rating is that it evaluates the overall position of a deposit taker, rather than the security provided for a particular debt issue. Issuer ratings provide a benchmark rating, while securities issued by the deposit taker can be structured to rate higher or lower than (or equal to) to an issuer's rating.
16. Issuer ratings may be easier for depositors to understand because they do not necessarily relate directly to a particular type of debt (which would then require an understanding of where the debt ranks in order of preference under insolvency).

### Local currency ratings

17. As by definition a deposit taker is a person who offers debt securities to the public in New Zealand,<sup>6</sup> the most relevant rating will be the local currency rating. However, as noted earlier in this paper, requiring a local currency rating by regulation would not limit deposit takers from also holding a foreign currency rating.

### Global rating scales

18. In effect, the type of rating scale used by a rating agency is a matter the Reserve Bank must have regard to in approving a rating agency for deposit takers.<sup>7</sup> Under current practices, long term issuer ratings would be provided on the familiar "triple-A" global scales of Fitch, Moody's, and Standard and Poor's. These scales provide sufficient granularity to meet the objectives for credit ratings and are considered to be appropriate for deposit takers. The comparability of credit ratings is an important consideration in this regard.<sup>8</sup>
19. It is not proposed to specify the use of global scales by way of regulation on the basis that any matters in relation to the rating scales used by rating agencies that arise over time could in the first instance be managed under the Reserve Bank's approval powers.

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<sup>6</sup> See section 157C of the Act for the full definition of "deposit taker".

<sup>7</sup> Section 157J of the Act refers.

<sup>8</sup> The comparability of credit ratings is discussed in the Reserve Bank of New Zealand, Financial Stability Report, November 2006 in box 4 on page 32: <http://www.rbnz.govt.nz/finstab/fsreport/2866314.pdf>