

Non-Bank Deposit Takers Consultation Document: Proposed Capital Ratios and Related Party Exposures Regulations

The Reserve Bank invites submissions on the draft regulations by 12 March 2010

Submissions and enquiries about the consultation should be addressed to:

Norman F. Miller
Advisor, Financial Systems Policy
Prudential Supervision Department
Reserve Bank of New Zealand
PO Box 2498
Wellington 6140
Email: norman.miller@rbnz.govt.nz

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.

Non-Bank Deposit Takers Consultation Document: Proposed Capital Ratios and Related Party Exposures Regulations

I. INTRODUCTION

1. The passing of the Reserve Bank of New Zealand Amendment Act 2008 established a new Part 5D of the Reserve Bank of New Zealand Act 1989 (the Act). Part 5D provides the Reserve Bank with powers to develop a prudential regulatory regime for the purposes of:
 - (a) promoting the maintenance of a sound and efficient financial system; or,
 - (b) avoiding significant damage to the financial system that could result from the failure of a deposit taker.

2. Section 157S of the Act enables regulations to be made to require that trust deeds include a capital ratio. The regulations may:
 - a) provide for the capital ratio to be calculated in respect of –
 - (i) the deposit taker; or
 - (ii) a borrowing group of which the deposit taker is part;
 - b) provide for the capital ratio to be set at a specified minimum level for a particular deposit taker or a class of deposit takers;
 - c) prescribe the framework in accordance with which the capital ratio must be calculated;
 - d) provide for variation (whether as to content or otherwise) of the framework to apply to particular deposit takers or classes of deposit takers;
 - e) incorporate by reference a framework published by, or on behalf of, any body or person in any country –
 - (i) in whole or in part; and
 - (ii) with modifications, additions, or variations specified in the regulations.

3. Section 157V of the Act enables regulations to be made to require that trust deeds include a maximum limit on exposures to related parties. The regulations may:
 - a) provide that the maximum limit on exposures to related parties is relative to –
 - (i) the capital of the deposit taker; or
 - (ii) the capital of the borrowing group of which the deposit taker is part;
 - b) provide that the maximum limit on exposures to related parties applies in respect of exposures of the deposit taker or exposures calculated across the borrowing group of which the deposit taker is part;
 - c) require every deposit taker and trustee to ensure that the trust deed includes a specified maximum limit on exposures to related parties;
 - d) require every deposit taker and trustee to ensure that the trust deed includes a maximum limit on exposures to related parties that is fixed by agreement between the deposit taker and the trustee (subject to section 157ZD).

4. Under section 157F of the Act, the Reserve Bank must take into account a number of principles in recommending regulations to the Minister under Part 5D of the Act. These are as follows:
- (a) the desirability of consistency in the treatment of similar institutions, regardless of matters such as their corporate form;
 - (b) the importance of recognising–
 - (i) that it is not the purpose of this Part to eliminate all risk in relation to the performance of deposit takers or to limit diversity among deposit takers; and,
 - (ii) that depositors are responsible for assessing risk in relation to potential investments and for their own investment choices;
 - (c) 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;
 - (d) the desirability of sound governance of deposit takers;
 - (e) the desirability of effective risk management by deposit takers;
 - (f) the need to avoid unnecessary compliance costs; and
 - (g) the need to maintain competition within the deposit taking sector.

II. PURPOSE OF PRESENT CONSULTATION

5. The Reserve Bank has now developed draft regulations (attached) in relation to capital ratios and related party exposures under sections 157S and 157V (taking into account the principles in section 157F). This was done following the public consultation that was carried out at the end of 2008 and during 2009, and having regard to the submissions that were made as a result of this.
6. The purpose of this paper is to inform the NBDT sector of the regulations that have been developed and to draw attention to the more substantive changes that have been made since the issue of the earlier consultation paper. Comment is invited on the proposed regulations, in particular, on any issues that might be seen to arise in relation to their application at a technical level and/or their workability. We do not seek to re-open the discussion on matters of underlying policy such as risk weights, exposure categories, or other policy matters already approved by Cabinet.

III. RISK WEIGHTS

7. A number of changes have been made to the risk weighting of various items. These are detailed in the table overleaf.

Exposure Category	Consultation Document	Final NBDT regulations
Insured Loans	No Recognition	Housing NZ Corpn Welcome Home Loans 20%
Residential Mortgage Loans		
LVR > 70% and not exceeding 80%	100%	50%
LVR > 90% and not exceeding 100%	100%	125%
Defaulted Loans	Add 50 percentage points to risk weight	No addition to risk weight
Property Development Loans		
First ranking security LVR not exceeding 60%	No recognition	150%
First ranking security > 60% and not exceeding 100%	300%	200%
Other loans with qualifying security over land and/or buildings		
First mortgage over land and/or buildings LVR not exceeding 70%	No recognition	100%
First mortgage over land and/or buildings with LVR > 70% but not exceeding 100%	No recognition	150%
Loans against qualifying movable machinery		
LVR not exceeding 70%	No recognition	PPSA: 100%
Personal Loans		
A loan to an individual not exceeding \$40,000	No recognition	PPSA: 100% No PPSA: 150%
Other Loans (not previously captured)	150%	PPSA: 150% No PPSA: 200%
Operating Leases	No recognition	175%
Other assets	500%	350%

IV. INSURANCE BUSINESS

8. In the earlier consultation, we proposed that NBDTs that also undertake insurance business would be required to deduct insurance assets from capital when calculating their capital ratio. Recognising that it would be difficult to separately identify insurance assets we have decided not to proceed with this. We will however be looking to address this in another way. A possibility is to require insurance business to

be carried out by a separate legal entity, perhaps as a condition of licensing in the second stage of the NBDT law (currently under policy consideration). This will be consulted on in due course.

V. RELATED PARTY DEFINITION

9. The related party definition set out in the Act is being extended. Under the extended definition if the deposit taker is part of a borrowing group, persons who are related to any member of the borrowing group are also treated as related parties of the deposit taker. The extended definition also includes:
 - sister entities of the deposit taker or of a group member;
 - other persons in whom the deposit taker or a group member has a substantial interest;
 - persons with whom the deposit taker or a group member (or anyone with a substantial interest in the deposit taker or group member) have interlocking boards (40% or more common membership).

The regulations restate the statutory definition of related party in section 157B of the Act and bring in the additional classes of related party.

VI. GOVERNANCE REQUIREMENTS

10. Governance requirements are set out in section 157L of the Act. All NBDTs that are companies or building societies must have at least two independent directors. The chairperson cannot be an employee of either the NBDT or a related party. The requirements also state that if a NBDT is a subsidiary, the constitution of the NBDT must not include any provision under which the directors of the NBDT may act otherwise than in the best interests of the NBDT. It is proposed that these requirements will come into force at the same time as the attached regulations.

VII. CREDIT RATINGS

11. Credit rating regulations have already been passed and will become operative on 1 March 2010. This is by virtue of the Deposit Takers (Credit Ratings) Regulations 2009. These require a current rating of a NBDT's creditworthiness to be a local currency (New Zealand dollar), long term, issuer rating (from an approved rating agency). These requirements will be subsumed by the attached regulations when they become effective.

VIII. DEFINITIONS

12. It is worth noting that some of the terms used in the attached regulations are defined in the Act rather than in the regulations themselves. Examples include the definition of borrowing group and the definition of guaranteeing subsidiary.

IX. COMMENCEMENT

13. The intention is to bring the attached regulations into force in September 2010.