

17 June 2021

Dear Chief Executive

## Publication of Banking Prudential Requirements and changes to Conditions of Registration

The Reserve Bank of New Zealand – Te Pūtea Matua has today published the finalised *Banking Prudential Requirements* (BPRs). The BPRs implement the Capital Review decisions from December 2019 and also form part of the roll-out of the replacement for the Banking Supervision Handbook. The BPRs will take effect from 1 October 2021.

The Capital Review implementation marks a significant change in prudential requirements, including the increases in capital buffers that will take place from July 2022 to July 2028. Other changes will be phased in from 1 October 2021 onwards.

The final BPRs reflect the December 2019 decisions, and have been amended in a number of places to incorporate feedback we received on the Exposure Draft consultation that ran from November 2020 until 31 March 2021. Thank you for the input that we received, which we found to be a valuable part of the process.

This letter outlines:

- The list of documents published today.
- The Reserve Bank's processes for you to follow if your bank wants to issue Tier 2 instruments that comply with the new rules in *BPR110: Capital Definitions* in advance of the BPRs taking effect on 1 October 2021.
- Draft changes to Conditions of Registration, which are attached to this letter.
- Next steps, including the future work programme.

### Documents published today

Today we published the following documents on our website:

- Final BPR documents as well as 'red-lined' versions to show changes compared with the Exposure Drafts.
- All submissions received on the Exposure Draft consultation.
- *Response to Submissions* document.
- Two page summary of the Capital Buffer Response Framework (CBRF).
- Guidance Note for *BS16: Application requirements for capital recognition or repayment and notification requirements in respect of capital*, explaining the processes that you should follow you want to issue Tier 2 instruments before 1 October 2021.

- Draft Amending Order for bank disclosure Orders in Council.

### **Process for issuing new Tier 2 instruments before 1 October 2021**

As announced in the May 2021 Financial Stability Report, the Reserve Bank intends to recognise Tier 2 instruments that banks issue in accordance with the new rules, between now and September 30. This provides banks flexibility to raise capital in this form now and helps to embed the new framework in the system.

The BS16 Guidance Note attached to this letter, and published on our website, describes how the process will work, including how we will operate BS16 until the new BPRs fully take effect on 1 October 2021. To summarise, we have taken the following steps:

- Amending Conditions of Registration so that Tier 2 instruments issued under the new rules can be treated as regulatory capital. Draft changes are attached to this letter.
- Changing the approach under BS16 for Tier 2 instruments until 30 September 2021 (at which point BS16 will cease to exist). The main implication of this is that we will consider issuing non-objection notices for Tier 2 instruments issued under the new rules, so long as all processes in the guidance are followed. A copy of the Guidance Note describing this process is attached to this letter.
- Amending Orders-in-Council – we will be seeking the agreement of the Minister of Finance to ask Cabinet to change the Orders in Council that cover bank disclosure processes to incorporate Tier 2 instruments issued in accordance with BPR110. A draft Amending Order is attached as Annex 2. We would welcome any feedback on this by 30 June 2021.

### **Draft changes to Conditions of Registration**

In addition to providing an overview of the documents published today, this letter is also to advise you of changes the Reserve Bank intends to make to your bank's Conditions of Registration to reflect the new processes for issuing Tier 2 instruments under the new rules in advance of 1 October. This is the only change to your bank's Conditions of Registration that is proposed at this time.

I will write to you again in September with draft Conditions of Registration to cover all the changes that take effect when the BPRs begin on 1 October 2021.

Section 74(2) of the Reserve Bank Act provides that the Reserve Bank may, by notice in writing to a registered bank:

- impose conditions of registration (whether or not the registration of the bank is subject to conditions of registration); or
- vary, remove, add to or substitute any conditions of registration.

Under section 74(3) the Reserve Bank must not exercise a power referred to in subsection (2) unless:

- the Reserve Bank gives the registered bank not less than 7 days' notice in writing of the Reserve Bank's intention to do so; and

- the notice contains, or is accompanied by, a statement of the Reserve Bank's reasons; and
- the registered bank has a reasonable opportunity to make submissions to the Reserve Bank; and
- the Reserve Bank has regard to those submissions.

I enclose a copy of your current conditions of registration, marked up to show the proposed changes.

I would welcome any comments you may have about the draft changes to your bank's Conditions of Registration by close of business on 24 June 2021. If you have any questions or require any additional information please contact the Supervisor for your bank in the first instance.

### **Next Steps**

The Reserve Bank will undertake the following steps, in consultation with banks, to ensure the capital adequacy portions of the BPRs are fully implemented by 1 October:

- Now until 24 June: Banks respond to draft Conditions of Registration (attached to this letter) and Reserve Bank confirms final changes after seven-day consultation period.
- September 2021: Reserve Bank will consult with banks on further changes to Conditions of Registration prior to the start date of the new BPRs on 1 October 2021.
- 1 October 2021: New BPRs active from 1 October 2021 onwards.

We will also be working on the following consultations for publication in the first half of 2022:

- Consultation on Standardised Measurement Approach for Operational Risk.
- Consultation on the operational framework for the countercyclical capital buffer.

In addition, there are a number of other topics that have been identified by stakeholders during the Exposure Draft consultation. These topics are described in the Response to Submissions document, and include those listed below, for which we expect to engage with stakeholders during the rest of 2021 and 2022:

- Issuance of CET1 capital by banks structured as mutual societies.
- Risk weights for reverse mortgage loans.
- Categorisation of sovereigns, public sector entities and multilateral development banks.
- Recognition of guarantees as a credit risk mitigant in the IRB risk-weighted assets calculation.
- Voting rights and distribution requirements for Common Equity Tier 1 (CET1) capital instruments.

- Mandatory loss given default rates for security over Māori Freehold Land.
- Revising the *BPR140: Market Risk* framework.

Yours Sincerely

A handwritten signature in black ink, appearing to read 'Geoff Bascand', written in a cursive style.

**Geoff Bascand**  
Deputy Governor/General Manager Financial Stability

**Annex: Draft Amending Order for bank disclosure Orders in Council**

**Registered Bank Disclosure Statements (New Zealand  
Incorporated Registered Banks) Order 2014 Amendment Order  
2021 (No 2)**

Governor-General

**Order in Council**

At Wellington this            day of            2021

Present:

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in Council

Pursuant to section 81 of the Reserve Bank of New Zealand Act 1989, Her Excellency the Governor-General, acting on the advice and with the consent of the Executive Council and on the advice of the Minister of Finance given in accordance with a recommendation of the Reserve Bank of New Zealand, makes the following Order.

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**Order**

- 1 Title**  
This order is the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 Amendment Order 2021 (No 2).
- 2 Commencement**  
This order comes into force on **[X] [X]** 2021.
- 3 Principal order amended**  
This order amends the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014.

#### 4 Interpretation

- (1) This clause amends clause 4(1).
- (2) After the definition of ‘**Basel III**’, insert:  
“**BPR001: Glossary** means the Reserve Bank document entitled “BPR001: Glossary”
- (3) After the definition of ‘**BPR001: Glossary**’, insert:  
“**BPR110: Capital Definitions** means the Reserve Bank document entitled “BPR110: Capital Definitions” with defined terms highlighted in the document having the meanings given in BPR001: Glossary.
- (4) Replace the definition of **Tier 2 capital** with:
  - (a) in Schedule 9, means the sum of—
    - (i) Tier 2 capital as defined in Capital Adequacy Framework (Standardised Approach) (BS2A); and
    - (ii) the value of any Tier 2 capital instrument not included in (i) that meets the requirements for Tier 2 capital instruments in BPR110: Capital Definitions; and
  - (b) in Schedule 11, means the sum of—
    - (i) Tier 2 capital as defined in Capital Adequacy Framework (Internal Models Based Approach) (BS2B); and
    - (ii) the value of any Tier 2 capital instrument not included in (i) that meets the requirements for Tier 2 capital instruments in BPR110: Capital Definitions
- (5) Replace the definition of **Total capital** with:
  - (a) in Schedule 9, is the sum of Tier 1 capital and Tier 2 capital where those terms have the meanings given for the purpose of Schedule 9; and
  - (b) in Schedule 11, is the sum of Tier 1 capital and Tier 2 capital where those terms have the meanings given for the purpose of Schedule 11
- (6) Replace the definition of **Total capital ratio** with:
  - (a) in Schedule 9, has the meaning given by the formula for “total capital ratio” in Capital Adequacy Framework (Standardised Approach) (BS2A), where—
    - (i) the term “total capital” in the formula has the meaning given for the purpose of Schedule 9; and
    - (ii) all other terms in the formula having the meanings given in Capital Adequacy Framework (Standardised Approach) (BS2A); and
  - (b) in Schedule 11, has the meaning given by the formula for “total capital ratio” in Capital Adequacy Framework (Internal Models Based Approach) (BS2B), where—
    - (iii) the term “total capital” in the formula has the meaning given for the purpose of Schedule 11; and
    - (iv) all other terms in the formula having the meanings given in Capital Adequacy Framework (Internal Models Based Approach) (BS2B)

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Clerk of the Executive Council.

### **Explanatory note**

*This note is not part of the order, but is intended to indicate its general effect.*

This order comes into force on **[X] [X]** 2021. It amends the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014, published in a Supplement to the New Zealand Gazette, 21 February 2014, No. 21, at page 452. The purpose of this order is to update disclosure requirements for New Zealand-incorporated registered banks. It adds a new definition of Tier 2 capital to the defined terms in the local order in council to allow Tier 2 capital instruments under the updated regime for the Banking Prudential Regulations to be factored into the definition of the total capital ratio for disclosure purposes.

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This order is administered by the Reserve Bank of New Zealand