RESERVE BANK OF NEW ZEALAND
TE PŪTEA MATUA

Safer banks = safer society

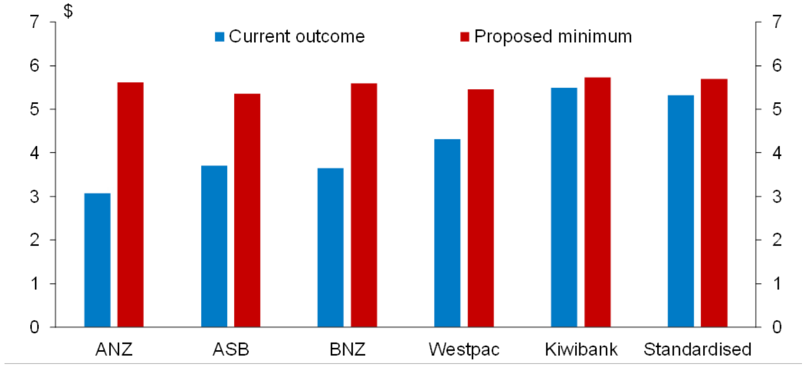
The Reserve Bank of New Zealand is currently consulting on proposals to increase the amount of capital banks must have, to ensure they can withstand shocks. This document explains the proposals, the possible effects on society and banks, and how you can have your say.

What we're trying to achieve

- Stronger banks and stronger banking system – better able to survive large shocks
  - Protect New Zealand from the significant harm that accompanies a banking crisis.
  - Protect depositors and potentially taxpayers from failing banks
  - Maintain investor confidence in New Zealand's banking system

Current rules distort competition. The proposed changes help to level the playing field between large and small banks, encouraging strong, healthy competition for the benefit of consumers.

Figure 1
Estimated Tier 1 capital required per $100 of residential mortgage lending



Why we care

- The Reserve Bank's job is to promote a sound and efficient financial system.
- If a bank fails, then all of society suffers – not just the bank's customers.
- Our tolerance of bank crises has reduced given evidence of enduring, wide-ranging crisis impacts.

- We want banks to have enough capital, and the right quality capital, to withstand significant shocks.
- More capital reduces the likelihood of a bank failure.

What will it mean for me?

- Banks will be safer – the costs and risks of a bank failure are reduced
- Interest rates (borrowing and lending) could change – but we don't expect by much. Lending margins above borrowing cost are likely to expand by 20-40 points.
- Banks make profits from lending. The competitive market will continue and if one bank pulls back in a particular segment of lending, we expect another will step up.

What does it mean for banks?

- They'll have to have more capital, and of better quality (more reliance on equity and not debt funding). So that means banks will be safer – so will likely get cheaper credit.
- The big four banks would have five years to increase their capital ratio from the current 12 percent to 16 percent. We expect a combined increase in capital of around $20 billion for the big four.
- Other banks have to increase their capital ratio from the current average of 14 percent to 15 percent. We expect a combined increase of around $0.9 billion in capital for these banks.
- Banks will keep making their own decisions about how they manage their balance sheets. They have a number of options to raise the capital they need. They could retain more profits over several years (rather than paying out dividends to their owners) or they could raise more capital from shareholders.
  - We estimate the big four banks could get there by retaining 70 percent of their net earnings over 5 years.
  - The small bank sector might take a bit longer, around 7 years.
- Regulators around the world have different approaches to measuring capital, but recent data from the Bank for International Settlements shows Tier 1 capital ratios for non-internationally active banks (categorised as 'Group 2 banks' in the table), such as New Zealand's banks, in the range of 11.1 percent to 16.5 percent.

Fully phased-in CET1, Tier 1 and total capital ratios under the final Basel III standards

In per cent

Table C.10

	Group 1 banks			Of which: G-SIBs			Group 2 banks		
	CET1	Tier 1	Total	CET1	Tier 1	Total	CET1	Tier 1	Total
Max	54.0	56.8	58.3	15.6	18.6	20.1	70.9	70.9	70.9
95th percentile	21.8	22.4	24.0	15.4	17.8	19.9	27.1	30.1	33.1
75th percentile	13.9	15.1	17.2	13.4	15.6	17.8	15.9	16.5	19.7
Median	12.3	13.4	15.1	12.0	13.6	15.5	13.4	13.6	15.4
25th percentile	10.8	11.7	13.3	10.2	11.4	12.7	11.0	11.1	12.3
5th percentile	8.7	9.8	11.0	8.3	9.6	10.9	9.4	9.4	11.0
Min	7.1	7.2	10.0	8.1	8.9	10.6	3.9	4.0	4.0
Weighted average	12.2	13.3	15.2	12.0	13.3	15.1	12.6	13.1	15.1

Source: Basel Committee on Banking Supervision.

- If the proposal is implemented, New Zealand banks would have broadly the same amount of capital as their peers but it would be better quality; i.e. capital that absorbs shocks rather than only to pay out creditors of a failed bank.

- If a bank goes below the proposed capital ratio – it would continue to operate, but with increased supervisory scrutiny and some restrictions.

The consultation is open and submissions are welcome from everyone. The deadline for submissions is 3 May.