Reserve Bank of New Zealand
Te Pūtea Matua

Capital buffer response framework.

17 June 2021

Purpose and overview

Banks' conditions of registration specify their minimum capital requirement as a percentage of their risk weighted assets (currently 8%, to become 9% in Year 3 of the Transition Period).

The Reserve Bank also expects banks to hold a 'Prudential Capital Buffer' (PCB) above this minimum capital requirement.

Failure to hold the full Prudential Capital Buffer is not a breach of conditions of registration but will result in responses from the Reserve Bank, designed to encourage banks to restore capital. These responses are described as the Capital Buffer Response Framework (CBRF).

Failure to maintain a Prudential Capital Buffer means that a bank is not as resilient as the Reserve Bank would like it to be. Banks will therefore be subject to increasing incentives to restore buffers (in the form of restrictions on distributions) and to escalating supervisory responses, both to encourage restoration of capital levels and to reflect increased risk.

When the PCB is first breached, there is a 'useable band' where distributions are only restricted to 100% of that year's earnings and no supervisory response is specified.

Distribution restrictions and supervisory actions then escalate in three stages.

	No specified response	**Stage 1**	**Stage 2**	**Stage 3**
Limit on CET1 distributions	No more than 100% of earnings	No more than 60% of earnings	No more than 30% of earnings	No distributions allowed
Limit on AT1 distributions	None	None	None	No distributions allowed
Supervisory Action	Normal supervision	Capital restoration plan	Review of capital restoration plan	Recapitalisation plan

This framework comes into force on 1 October 2021.[1]

The capital levels at which the different stages are triggered will change over time as the new capital requirements are phased in and varies between domestic systemically important (D-SIB) and non-D-SIB banks. The trigger levels over time are set out in Appendix 2.

Appendix 1 provides a graphical representation of how the stages will apply when capital reaches its full levels in 2027.

[1] At present, the Reserve Bank has restricted dividend distributions to 50% of a year's earnings until July 2022. Until that restriction is removed, the dividend restrictions in the CBRF will only apply to a bank in stage 2 or stage 3.

Supervisory Actions

Scope of the guidance offered as part of the CBRF

The supervisory actions specified in the CBRF are designed to provide clarity for banks about how the Reserve Bank is likely to respond to declining capital levels and to give clear guidance to supervisors.

However, they do not add to or alter the Reserve Bank's pre-existing enforcement powers. The CBRF will sit alongside broader supervisory policy and will not replace it. It is a response to declining capital, rather than other problems banks may exhibit that require a supervisory response. The supervisory actions set out in the CBRF do not prevent supervisors from taking the same actions (or any other action) at other times, or from taking additional actions at the trigger points set out in the CBRF.

The framework is designed to respond to idiosyncratic problems with banks in 'normal times'. During systemic crisis events the Reserve Bank may take proactive actions ahead of when the response might be triggered in the framework.

Since the reasons for declining bank capital and appropriate strategies for rebuilding capital are likely to vary across banks and over time, the supervisory actions in the framework are set out in terms of broad principles.

Supervisory actions

Stage 1: capital restoration plan

At this point, a bank's decreased capital indicates reduced resilience and increased risk, rather than any immediate danger of insolvency.

The Reserve Bank will require the bank to develop a capital restoration plan. The plan must:

- set out a clear pathway for restoring the bank to its full required capital levels (including all applicable buffers); and
- specify the steps that the bank will take to limit any further deterioration in the bank's capital, and to return the bank to its full capital levels over the medium-term; and
- be approved by the bank's Board; and
- be provided to the Reserve Bank, by the bank's Board, no later than 10 working days following the date at which the bank became aware that the bank's capital fell to the level that triggers a stage one response.

The plan should include clear goals and timelines for those goals, to enable the Reserve Bank to adequately monitor the bank's progress in implementing the plan. The 'medium-term' would ordinarily mean a time-frame within the next 12 months.

The Reserve Bank will review the plan. If it is of the view that the plan will not or will be unlikely to meet the set objectives, it may require the bank to amend the plan.

Stage 2: review of capital restoration plan

When a bank's prudential buffer ratio falls to, or below, the point at which stage 2 applies, the Reserve Bank will implement a review of the bank's capital restoration plan. A review will also be initiated if Reserve Bank supervisors are concerned about the progress the bank is making in meeting the plan's objectives.

A Reserve Bank review of a bank's capital restoration plan will involve a detailed analysis of the reasons why the bank is continuing to face difficulties in maintaining a sufficient buffer, and how the bank might overcome those difficulties. The review should be seen as a preparation for a more stringent recapitalisation plan.

If necessary, the Reserve Bank may use its powers under sections 93, 94 and 95 of the Reserve Bank Act to gather any further information it requires for its review or to require external expert reports. Such powers would be used to gain a clear view of the bank's difficulties.

Stage 3: recapitalisation plan

When a bank's prudential buffer ratio falls to, or below, the point at which Stage 3 applies, the Reserve Bank will require the bank to develop a recapitalisation plan.

At this point, the bank's position is significantly more precarious than when a capital restoration plan is initially required. Rather than a 'pathway to restoring capital', banks are now required to provide a plan to restore capital rapidly with an overarching focus on ensuring that the bank remains above its minimum capital requirement. (For example, it might be appropriate for a capital restoration plan to involve some investment with a view to restoring capital through future growth. This type of strategy is unlikely to be appropriate for a recapitalisation plan).

The recapitalisation plan must:

- be more stringent and more conservative than the bank's capital restoration plan; and
- contain tangible, measurable targets to enable the bank to increase its capital; and
- deal with all concerns raised by Reserve Bank supervisors, including concerns about the bank's financial situation and governance; and
- be approved by the Bank's Board; and
- be provided to the Reserve Bank by the Bank's Board.

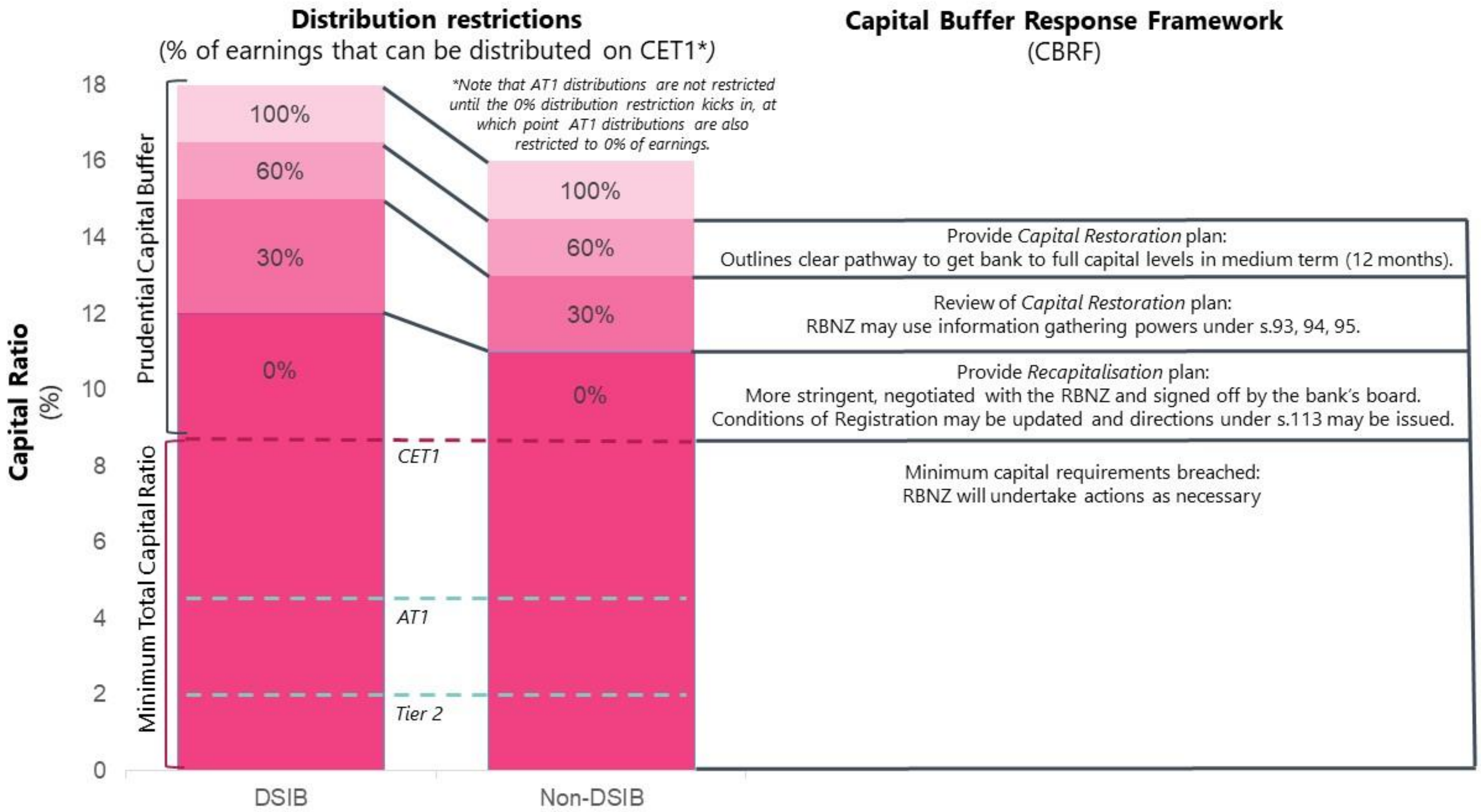
The plan must be developed in consultation with, and agreed to by, the Reserve Bank, and any restrictions imposed by the Reserve Bank must be included in the plan.

Restrictions might include amendments to the bank's conditions of registration and directions included under section 113 of the Reserve Bank Act.

The restrictions will vary, depending on the particular issues the bank is facing, but may include, for example, requirements for the bank to change its business plans, to change its governance arrangements, to limit its distributions or bonuses, or to increase its capital or liquidity.

Where necessary section 113 directions might also be used, for example, to require the bank to replace some, or all, of its Board or senior managers, to dispose of assets, to restrict the bank's lines of business, or to require the bank to raise capital.

Appendix 1: CBRF when Capital Review is implemented



Appendix 2

Transitional path for buffer ratio bands

These tables set out the bands of PCB ratios that will be included in banks' CET1 dividend restriction condition of registration (see section B1.3) in each year of the transition period. The bands differ between D-SIB and non-D-SIB banks.

The transition period begins 1 July 2022

Transitional path for D-SIBs

Pre-transition	Transition phase 1			Transition phase 2			Final	Outcomes	
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Limit on CET1 distributions	CBRF Stage
0-0.5%			0-0.5%			0-0.5%	0-3%	0%	Stage 3
0.5-1%			0.5-1%			0.5-3.5%	3-6%	30%	Stage 2
1-2%			1-2%			3.5-5%	6-7.5%	60%	Stage 1
2-2.5%	2-3.5%	2-4.5%	2-4.5%	5-5.5%	5-6.5%	5-7.5%	7.5-9%	100%	None

Transitional path for Non-D-SIBs

Pre-transition	Transition phase 1			Transition phase 2			Final	Outcomes	
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Limit on CET1 distributions	CBRF Stage
0-0.5%			0-0.5%			0-0.5%	0-2%	0%	Stage 3
0.5-1%			0.5-1%			0.5-2%	2-4%	30%	Stage 2
1-2%			1-2%			2-3%	4-5.5%	60%	Stage 1
2-2.5%	2-2.5%	2-2.5%	2-2.5%	3-3.5%	3-4.5%	3-5.5%	5.5-7%	100%	None

Note: There is no change in the buffer ratio bands in Year 3. The 1% increase in the minimum Tier 1 and total capital ratios is planned to take place in Year 3.