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9 June 2017

Ian Woolford  
Manager, Financial Policy  
Prudential Supervision Department  
Reserve Bank of New Zealand  
PO Box 2498  
Wellington 6140

Dear Ian,

**Issues Paper – Review of the Capital Adequacy Framework for locally incorporated banks**

Thank you for the opportunity to provide feedback on the Issues Paper – Review of the Capital Adequacy Framework for locally incorporated banks ('Issues Paper'). This submission has been written on behalf of The Co-operative Bank ('Co-op Bank'), Southland Building Society ('SBS') and TSB Bank ('TSB').

The industry submission from the New Zealand Bankers' Association ('NZBA') outlines the industry's comments on the Issues Paper and is supported by Co-op Bank, SBS and TSB. Further to that submission, Co-op Bank, SBS and TSB would like to make the following comments.

1. Co-op Bank, SBS and TSB support standardising the measurement of risk weighted exposures as part of the denominator review. This would result in all banks holding the same level of capital for the same underlying risks, ensuring a level playing field across the banking sector. This will encourage further competition in the banking system, consistent with the Reserve Bank of New Zealand ('RBNZ') objectives of BS1. There is also a growing body of research that calls into question the use of bank internal models in determining capital adequacy.
2. It is critical for competition and diversification of capital funding that a menu of options is available to all banks, regardless of their size, to raise capital. Raising Tier 1 capital is not straightforward, especially for smaller mutually / Trust owned non-listed banks and it is therefore vital that other options that qualify as Additional Tier 1 and Tier 2 capital are available.

We are also concerned that excluding Additional Tier 1 and Tier 2 capital is not consistent with current practice in other jurisdictions. We believe that capital adequacy requirements should remain comparable with global practice, unless there are important considerations specific to New Zealand.

In other jurisdictions, such as Canada, parliament has enacted legislation that enables co-operatives and mutual organisations to issue alternative instruments that qualify as Tier 1 capital. Co-op Bank, SBS and TSB would support the exploration of such options, which would support the diversification and financial stability of banking providers in New Zealand.

3. Further, all banks need certainty that capital instruments currently on issue, or expected to be issued prior to the completion of this review, will continue to meet the RBNZ requirements. Co-op Bank, SBS and TSB support NZBA's request that if a change is made to the definition of eligible capital following this review, that those changes are applied prospectively.
4. Co-op Bank, SBS and TSB question the need to for a concentration risk add-on for smaller banks. While this add-on is not currently provided for in BS2A, this is captured by the requirement for each bank to have an Internal Capital Adequacy Assessment Process (ICAAP) for assessing their capital adequacy in relation to their risk profile and a strategy for maintaining adequate capital to support risk. Diversification could lead to more risk, especially if the bank involved does not have the necessary capabilities or expertise to operate in this new market. A concentration risk add-on could incentivise banks to lend in areas that they don't fully understand.
5. Finally, Co-op Bank, SBS and TSB consider that the Reserve Bank needs to consider the position of the New Zealand mutually / Trust owned banks separately from those of the others. The market segment in which they operate, their ownership structures and their individual and collective contribution to the New Zealand financial system mean that a one size fits all approach, whether or not based on international practice, may not be the best way forward. We would appreciate the opportunity to be consulted as a sub-group of the New Zealand banks because the implications of some of the issues you have identified do not apply equally to all registered banks.

Once again thank you for the opportunity to provide feedback on this matter.

Kind Regards

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