Re: Submission to the Reserve Bank of New Zealand for the Capital Adequacy Review

Thank you for the opportunity to provide input for your Capital Review.

Regulatory Framework
RBNZ. “The aim of the Capital Review is to identify the most appropriate regulatory framework for setting capital requirements for New Zealand banks.”

We at Positive Money New Zealand believe that the best regulatory framework is a Sovereign Money System (explanation attached). Because Sovereign Money is inherently stable Sovereign Money would reduce the pressure on RBNZ to monitor capital ratios because the negative consequences of inadequate capital are mitigated. Funds on deposit in transaction accounts would never be at risk so there is NO risk of a bank failure due to a bank run, NO risk of a tax payer bail-out should a commercial bank fail, NO need for the government to guarantee bank deposits and NO need for the open money resolution. There are many other benefits to Sovereign Money, such as dramatically smoothing out the business cycle and controlling inflation.

Funds in investment accounts would be at risk but the market would help determine capital adequacy because investors would (absent the implicit government guarantee) need to pay attention to the risk rating of the bank they choose to invest with just like other funds in the market. Likewise Banks would need to communicate their risk ratings well in order to attract investor customers. This approach is consistent with RBNZ’s supervisory model “which has stressed the role of self and market discipline with relatively less emphasis on supervisory discipline”.

Under the current system allowing Banks to use their own internal capital models which are difficult and complicated to supervise. Putting the responsibility on the market/bank/investor would reduce the burden on supervisory resources because RBNZ could avoid most of its monitoring of complex internal bank capital calculations.

Capital Ratios Insufficient in Practice
We share the RBNZ’s concern that the capital ratios would be insufficient in practice (i.e. in a bank crisis). Capital ratios might provide adequate buffer if there is a minor incident, such as the

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bankruptcy of a large corporate client of a bank. However, we fear they provide no protection at all against a major crisis and the shareholder would be required to bail out banks.

Cost of Bank Capital
Sovereign Money eliminates your concern on page 11 of your paper, "...banks typically argue that capital is a costly source of funding and that if they had to seek more of it they would need to pass on costs to customers, leading to reduced investment and growth." Sovereign Money will eliminate the cost of new money because new money would be created by the RBNZ and at zero cost and zero interest. Furthermore, money will be directed by the Government of the day into the productive economy, not into existing assets as commercial banks mostly do now causing housing and share bubbles. Finally, because the Reserve Bank would control the quantity of money in the economy the commercial banks' concern about "reduced investment and growth" would be mitigated.

Specific Questions
Regarding your specific questions:

Question 1: For each of the three sections (numerator, denominator, ratio), are there any important topics relating to capital adequacy that we have left out entirely?

We recommend you change the system instead.

Question 2: For each of the three sections (numerator, denominator, ratio), have any important and relevant issues been omitted from the topics that have been discussed?

Have you considered Bank’s reliance on credit ratings agencies for determining risks? Credit rating agencies assessments are a notoriously unreliable measure of credit worthiness in a crunch.

Question 3: Do you have any information (e.g. empirical data) that is relevant to the issues discussed in the paper?

No, but we have more information on the Sovereign Money system and flaws of the current system,

Question 4: Are there particular areas of the review that should be prioritised?

Yes, consider implementing a Sovereign Money System instead.

Don Richards
Co-Founder of Positive Money New Zealand

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