Dear Ian


Thank you for the opportunity to provide feedback to the Reserve Bank of New Zealand (RBNZ) in response to its third consultation of the capital review, being the Review of the Capital Adequacy Framework for locally incorporated banks: calculation of risk weighted assets (consultation paper), released on 19 December 2017.

ANZ Bank New Zealand Limited (ANZ) believes the key to the success of the capital review lies in open and on-going engagement between RBNZ and the industry. ANZ appreciates the opportunity to provide feedback to RBNZ, and anticipates more detailed consultation as RBNZ’s proposed policy changes become more defined.

ANZ’s view is that regulatory capital requirements for New Zealand incorporated banks should align with those of the Australian Prudential Regulation Authority (APRA). This message has been consistently conveyed to RBNZ over the course of the capital review to date, and is unchanged for the calculation of Risk Weighted Assets (RWA). New Zealand should develop its RWA reforms alongside the APRA framework that is also currently under consultation; any features specific to New Zealand should build on the APRA framework rather than add unnecessary complexity by going down a different route altogether.

Variances in rating outputs between standardised and Internal Ratings Based (IRB) approaches to credit risk are to be expected, and variances among IRB banks are also to be expected. The size of these variances is clearly a concern to bank regulators; however, ANZ would like to point out that all IRB models used in New Zealand require RBNZ approval. ANZ continues to be willing to work with RBNZ to better understand variances across the industry, and incorporate the findings into the further development and refinement of its IRB rating models.

The following table contains three key messages that ANZ would like to draw to RBNZ’s attention. Appendix I provides more detail around each of the key messages; and Appendix II contains responses to the specific questions from the consultation paper.
Key messages

1. For IRB banks in New Zealand, ANZ supports alignment of the credit RWA framework with that of APRA. This supports a consistent regional approach to the calculation of IRB RWA for credit risk, and in turn better aligns New Zealand IRB banks with global standards.

2. The consultation paper comments that it is unclear how accurately the internal models approaches are picking up risk and suggests that banks may be manipulating rating models to suit desired RWA outcomes. In New Zealand, IRB banks are required to use only models that are approved by the RBNZ, which brings into question the rationale behind RBNZ’s concerns.

3. ANZ considers there is insufficient detail in the consultation paper on the RBNZ’s change proposals; it is difficult to provide substantive responses and not possible to undertake quantitative analysis.

Publication of submission

ANZ consents to the publication of this submission, with certain aspects withheld to protect the privacy of natural persons or on the grounds of commercial sensitivity, under the RBNZ’s publication of submissions policy. ANZ considers that the redacted information should be withheld if a request for it is made under the Official Information Act 1982 on the basis that:

1. The information has been supplied to RBNZ in connection with a consultation on the possible exercise of its powers under Part 5 of the Reserve Bank of New Zealand Act, and therefore may not be disclosed pursuant to sections 105(1)(c) and 105(2) of the Reserve Bank of New Zealand Act 1989.

2. Making available the information would be likely to unreasonably prejudice ANZ’s commercial position, and therefore the information may be withheld under section 9(2)(b) of the Official Information Act 1982.

Contact for submission

ANZ is keen to discuss its responses directly with RBNZ officials. Please contact [redacted] on [redacted] to arrange, or email [redacted].

Once again, we thank RBNZ for the opportunity to provide feedback on the consultation paper.

Yours sincerely

[Redacted]

Bruce Macintyre
Chief Risk Officer

ANZ BANK NEW ZEALAND LIMITED
Appendix I - Key messages

ANZ addresses each of the key messages in turn:

1. **For IRB banks in New Zealand, ANZ supports alignment of the credit RWA framework with that of APRA. This supports a consistent regional approach to the calculation of IRB RWA for credit risk, and in turn better aligns New Zealand IRB banks with global standards.**

Aligning New Zealand’s RWA requirements with the framework being developed by APRA suppo[1]rt[s RBNZ’s Principle 5 “The capital framework should be practical to administer, minimise unnecessary complexity and compliance costs, and take into consideration relationships with foreign-owned banks’ home country regulators”. This also better aligns New Zealand with international standards, being those of the Basel Committee on Banking Supervision (BCBS) standards (including the recently finalised Basel III reforms[2]). ANZ notes that in the November 2016 Financial Stability Report, RBNZ discusses its upcoming capital review and comments that while there is no obligation for New Zealand to follow the BCBS standards, the RBNZ considers these “an important benchmark”.[3]

If RBNZ believes there is insufficient conservatism in New Zealand’s capital adequacy regime, it has ultimate discretion to impose overall higher capital ratios. ANZ considers this a simpler option and certainly easier to unwind or modify according to a changing environment, than bespoke add-ons and granular floors. It also allows IRB banks to continue to develop and refine their IRB risk systems and processes.

**Credit risk**

As noted in the consultation paper, approximately 90% of New Zealand banking sector exposures are held by the four IRB banks. With this in mind, alignment of the approach to RWA calculations with those of Australia makes sense and supports simplicity objectives. Alignment with APRA also supports better global consistency. While some areas of divergence may be required to suit the New Zealand environment, these differences should be limited to only those that are absolutely necessary. Otherwise, there is a risk that comparability of risk weights with other jurisdictions cannot be achieved.

Along these lines, ANZ recommends that any RWA floors should be calculated at portfolio level rather than individual exposure or asset class level; a floor should be a total portfolio floor, aligned with APRA and the Basel III reforms. Floors should not be granular. If floors are imposed at individual exposure level they result in overly conservative estimates. Further, implementing exposure / asset class level floors would add unnecessary complexity and such an approach does not support RBNZ’s simplicity objectives.

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For credit risk IRB, ANZ would be comfortable with Option 1 (status quo), however ANZ acknowledges this approach may not remain feasible given the APRA proposals and BCBS standards, as well as RBNZ’s own views which have resulted in the capital review being undertaken. Therefore, from a practical and theoretical standpoint, the principles of Option 2 (follow the BCBS Basel III reforms published December 2017) seem to be the most appropriate way of meeting multiple objectives, i.e. continuing with an advanced internal models approach, reducing the variances between IRB and standardised calculations, and being more aligned to the final Basel III framework. However, ANZ suggests that RBNZ reviews Option 2 in the context of APRA’s proposals released 14 February 2018.

ANZ does not support RBNZ’s proposed options 3, 4 or 5 for IRB banks. These options will result in New Zealand being further out of step with global industry developments. This additional conservatism is unnecessary for New Zealand, as current overlays already produce adequately conservative capital ratios, as illustrated in the October 2017 study by PricewaterhouseCoopers which concludes that New Zealand’s major banks are well capitalised on an internationally comparable basis, and that an upward adjustment of approximately 6% is reasonable to restate their Common Equity Tier 1 (CET1) ratios in a global context.4

**Operational risk**

For operational risk, ANZ prefers Option 3 (follow the BCBS framework but with advanced risk management). This aligns with the APRA framework currently being developed and builds on the level of sophistication achieved to date under the Basel II Advanced Measurement Approach (AMA).

**Market risk**

For market risk, ANZ agrees that the current standardised model is rudimentary and blunt, and that modernising market risk capital requirements is warranted. ANZ acknowledges that moving towards the new BCBS standardised approach is sensible and would align with APRA’s intentions. However, the new standardised models for market risk capital have been delayed until 2022, and are widely expected to require modification before they can be implemented.

ANZ notes that the new BCBS standardised models require full mark to market revaluations on shifted curves, similar to existing global internal models. ANZ suggests that a transitional step of including an internal models approach option would allow smaller banks and supervisors to enhance their understanding of market risk ahead of implementing the more complex BCBS standardised models.

Given the uncertainties surrounding the new BCBS standardised models ANZ prefers Option 1 (retain the current standard model), and recommends supplementing it with an internal models option aligned to actual risk management practice and with APRA’s APS 116 and 117.

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2. The consultation paper comments that it is unclear how accurately the internal models approaches are picking up risk and that banks may be manipulating rating models to suit desired RWA outcomes. In New Zealand, IRB banks are required to use only models that are approved by the RBNZ, which brings into question the rationale behind RBNZ’s concerns.

As part of the approval process for all IRB models, the RBNZ receives all model documentation detailing how the models operate and the various characteristics used for measuring risk. With regard to the inconsistency of risk weights across the industry, ANZ agrees that the underlying risk of large portfolios such as retail mortgages may not be very different; it is the approved models that create the variance.

This is further supported by the RBNZ May 2016 Financial Stability Report, where RBNZ discusses its benchmarking project and that if there are any wide industry variances in capital requirements “it is likely they will be explained by model form”.

ANZ believes RBNZ should not be overly concerned that IRB bank risk weights have reduced over time, as some benefit is to be expected for banks investing in more advanced rating frameworks. In recent years, as the IRB framework has become more mature, IRB banks have been able to increase their focus on managing credit risk and are starting to realise some of the benefits that can be derived from more advanced credit risk management. This is not manipulation.

Further, risk weights would be expected to reduce from 2010 due to portfolio improvement following the impacts of the Global Financial Crisis (GFC). IRB models, which are risk sensitive, reflected the improved asset quality post this event, and subsequently a reduction in risk weights occurred. The RBNZ’s view that a risk weight should stabilise at a certain level is questionable considering the environment is dynamic and the quality of a portfolio can change over time.

The consultation paper does not acknowledge improvements made in the 10 years following Basel II IRB accreditation. Risk management systems and monitoring processes are more sophisticated as a result of this approach. These processes are continually being developed and refined to assess risk based on detailed analysis of each customer. IRB banks are using data and reporting to better manage credit risk, and their processes are continually evolving.

Banks will naturally look to adopt capital strategies in order to effectively manage their business. The original intent of introducing the IRB approach was to more accurately reflect a bank’s risk profile by using more granular customer ratings and more sophisticated rating methodologies.

A benefit of the IRB approach is that banks have invested in stronger risk management. Through diluting the effect of the IRB approach, an undesired consequence may be that different banks with different risk profiles may end up with a similar capital requirement, removing any incentive for a more conservative risk appetite, and reducing the business imperative for advanced credit risk management and monitoring. It is also worth noting that prudential measures such as Loan to Value Ratio (LVR) restrictions have also contributed significantly in impacting risk weights for both standardised and IRB calculations.

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ANZ is not aware of any evidence to support the accuracy of the standardised risk weights, nor that standardised could be more appropriate than IRB risk weights. A standardised approach is generally sensitive to only one dimension of risk and therefore overlooks other elements of key portfolio risk drivers.

3. **ANZ considers there is insufficient detail in the consultation paper on the RBNZ’s change proposals; it is difficult to provide substantive responses and not possible to undertake quantitative analysis.**

ANZ acknowledges that RBNZ commenced its capital review without the benefit of sufficient definition around BCBS and APRA intentions. The BCBS Basel III reforms have since been finalised, and with the recent release of APRA’s RWA discussion paper on 14 February 2018, ANZ suggests RBNZ should pause and consider its intentions in light of these more defined frameworks.

For key areas of proposed change for RWA calculations, the consultation paper lacks sufficient detail to enable comprehensive feedback in areas such as:

**IRB approach to credit risk RWA**

The RBNZ consultation paper considers five options for the IRB approach to credit risk. However Options 2, 3 and 4 (on page 34) in particular lack specific details on how RBNZ intends to apply the BCBS changes.

**Risk weight floor**

ANZ believes there should be more detailed information provided in relation to a proposed floor methodology for IRB banks, including RBNZ’s intentions regarding the level of floor to be applied, and whether portfolio level or fine-grained. ANZ would expect to see further consultation on this aspect when more detailed proposals are available.

ANZ notes that APRA intends aligning its risk weight floor with the finalised BCBS Basel III reforms.

**Transitional arrangements**

The consultation paper contains no indication of what transitional arrangements might look like if there are to be changes to the calculation of RWA for New Zealand banks. ANZ recommends that any transitional arrangements follow the APRA framework once finalised.
Appendix II – ANZ’s responses to the questions raised in the Consultation Paper: Review of the Capital Adequacy Framework for locally incorporated banks: calculation of risk weighted assets

<table>
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<tr>
<th>#</th>
<th>Question</th>
<th>ANZ response</th>
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| 1  | Questions about issues identified                                         | • The consultation paper focuses on overseas studies of risk weights and Internal Ratings Based (IRB) approaches to models. It does not acknowledge the improvements made in the 10 years since Basel IRB accreditation. As a result of the IRB approach, risk management systems and monitoring processes are more sophisticated. They are continually being developed and refined to assess risk based on detailed analysis of each customer. Banks are using data and reporting to better manage their risk, and the processes are continually evolving. This includes improved risk discrimination ability and the ability to measure appropriateness of model elements via monitoring and model validation; none of which are present in a standardised approach.  
• A strong message signalling support for the IRB approach are the final BCBS Basel III reforms and the recent release of APRA’s Discussion Paper (Revisions to the capital framework for ADIs; dated 14 February 2018) supporting continuation with the IRB approach.  
• The IRB approach supports the decision making process by using the latest information and scenario modelling. Reliance on external ratings or use of the standardised approach could impact the quality of the credit decision making process as external risk grades may not be updated with the latest information.  
• The consultation paper fails to recognise that internal models are calibrated against loss experience. If standardised risk weights were calibrated based on the New Zealand loss experience, as has been done with internal model calibration, the difference between the two approaches might not be so apparent.  
• Prescribing a standardised approach will require the need for a parallel process to drive credit risk decisions which may not necessarily align to the regulatory view of risk. |
<table>
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<tr>
<th>1.2</th>
<th>This paper has commented on studies used by supervisors and other stakeholders to assess the consistency and accuracy of results produced by internal capital models. Do you agree with the Reserve Bank’s conclusions about these studies? Are there other methods for assessing consistency and accuracy which should also be considered?</th>
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<tr>
<td><strong>A standardised approach is generally sensitive to only one dimension of risk and therefore overlooks other elements of key portfolio risk drivers. ANZ is not aware of any evidence to support the accuracy of the standardised risk weights, nor that standardised could be more appropriate than IRB risk weights.</strong></td>
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<td><strong>The RBNZ provide general comments from international studies and comparing IRB to standardised approaches for calculating risk weighted assets.</strong></td>
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<td><strong>The consultation paper discusses potential reasons for lower risk weights under the IRB approach. However, what is not discussed in the consultation paper is that if the RBNZ believes risk weights under the IRB approach are too low, it has powers to implement a risk weight floor if required.</strong></td>
<td></td>
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<tr>
<td><strong>The consultation paper does not mention that as part of the approval process for all IRB models, the RBNZ receives all model documentation detailing how the models operate and the various characteristics used for measuring risk. Accordingly, the understanding of movements under the IRB approach should be transparent. With regard to the inconsistency of risk weights across the industry, ANZ agrees that the underlying risk of large portfolios such as retail mortgages may not be very different; it is the approved models that create the variance.</strong></td>
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<tr>
<td><strong>The consultation paper does not acknowledge that the final BCBS Basel III reforms convey a strong message signalling support for the IRB approach, as do the subsequent APRA proposals contained in its discussion paper (Revisions to the capital framework for ADIs) released 14 February 2018.</strong></td>
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<td><strong>ANZ does not agree that there is deliberate attempt to engineer models to produce lower capital outcome. The models are built on risk drivers that measure risk and provide risk discrimination. These models and resulting capital levels are reviewed and approved by RBNZ prior to implementation (including overlays/conditions on estimates where RBNZ sees necessary). Regular monitoring and validation of the models would highlight any evidence of engineering through changing inputs/outputs.</strong></td>
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<td><strong>Conscious effort by a bank to improve risk profile, and/or prudential changes</strong></td>
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aimed at reducing system risk, are expected to reduce risk weights over time. Efficient use of capital is approached in the context of the risk the bank is willing to take, based on its risk appetite, policies, risk evaluation tools, profitability etc. Excluding regulatory overlays, the decrease in risk weights since 2010 are due to portfolio improvement. IRB models, which are risk sensitive, reflected the improved asset quality that followed the GFC, and subsequently a reduction in risk weights occurred. The RBNZ’s view that a risk weight should stabilise at a certain level is questionable considering the environment is dynamic and the quality of a portfolio can change over time.

- ANZ believes RBNZ should not be overly concerned that IRB bank risk weights have reduced over time, as some benefit is to be expected for banks investing in more advanced rating frameworks. In recent years, as the IRB framework has become more mature, IRB banks have been able to increase their focus on managing their inputs to credit risk RWA and are starting to realise some of the benefits that can be derived from more advanced credit risk management. This is not manipulation.

- ANZ considers the studies presented in the consultation paper demonstrate differences in capital approaches, but no conclusion is arrived at as to whether one or another approach is correct. ANZ agrees with the RBNZ view that the internal models approach has the ability to take into account many determinants of risk but disagrees that the advantage may not be significant over alternative (standardised) approaches. The current approach to standardised is one-dimensional based on asset class.

1.3 A key issue in this paper is whether or not the differences between risk weights across banks, including those between IRB and standardised banks, are justified by differences in the underlying risk of portfolios. Are you aware of evidence that the underlying risk of portfolios – within an

- ANZ is not aware of any evidence that the underlying risks of portfolios within large assets classes are substantially different across banks. ANZ considers that, for IRB banks, it is the approved models that create the variance in risk weights. ANZ considers that under the standardised approach, risk weight results should be higher than IRB model risk weight results. The standardised approach needs to add conservatism to mitigate the lack of risk sensitivity.

- An important point to consider for differences in risk weights between banks with similar underlying portfolios is a bank’s risk management practice. Sound risk
| 1.4 | This paper has summarised BCBS changes (or proposed changes) to capital requirements for credit risk and operational risk. Do you consider that the summary accurately reflects what has been changed (or proposed)? | • ANZ has no specific comments on this item but recommends the RBNZ capital review be considered in light of APRA’s discussion paper released on 14 February 2018 - ‘Discussion Paper: Revisions to the capital framework for ADIs’. |
| 1.5 | The Reserve Bank has in the past followed Basel standards, but has made exceptions where it has been appropriate for New Zealand’s circumstances. For example, in 2015 the Reserve Bank announced it would drop the F-IRB approach to improve the clarity of the capital standards, because the F-IRB approach was not being used in New Zealand and (even if it were being used) there is flexibility to modify | • ANZ supports alignment of the IRB credit RWA framework with that of APRA. This supports a consistent regional approach to the calculation of IRB RWA for credit risk, and in turn better aligns New Zealand IRB banks with global standards.  
• Aligning New Zealand’s RWA requirements with the framework being developed by APRA supports RBNZ’s Principle 5 “The capital framework should be practical to administer, minimise unnecessary complexity and compliance costs, and take into consideration relationships with foreign-owned banks’ home country regulators”.  
• While some areas of divergence may be required to suit the New Zealand environment, these differences should be limited to only those that are absolutely necessary.  
• Consistent with BCBS and APRA proposals, the introduction of any risk weight floor... |
the A-IRB approach in a way which achieves the same outcomes. Over time these sorts of changes have taken the New Zealand standards somewhat further from the Basel standards. Do you have any comments on the Bank’s approach to adopting the Basel standards?

Do you have any comments on the Bank’s approach to adopting the Basel standards?

| 2. Questions about options for credit risk |  
|------------------------------------------|------------------------------------------|
| 2.1 Several options are presented for limiting the use of IRB models. Under three of those options IRB models would be replaced by the standardised approach for bank, sovereign, and large corporate exposures. For these exposures do you consider that internal models can provide more information about risk than external credit ratings? Why or why not? | • ANZ believes that internal models provide more information about risk than external credit ratings. Reasons include, but are not limited to the following:  
- Internal rating models are based on detailed historical and projected information for each customer.  
- Banks continually interact with their customers and therefore can identify and respond more quickly to changing circumstances such as liquidity or debt-servicing problems rather than an annual review against generic industry outcomes.  
- An important distinction is that, unlike banks, external rating agencies do not carry credit risk. Therefore external credit rating agencies are not expected to have the same depth of understanding of the New Zealand environment as locally incorporated banks that are managing the day-to-day credit risk.  
- Over-reliance on external rating agencies could have unintended consequences, such as:  
  - Introducing different risks to New Zealand’s banking system, one of which could be the comparability and consistency of the rating agencies’ methodologies, which is just shifting the comparability issue.  
  - If RBNZ chose to adopt a standardised approach based on external ratings for bank, sovereign, and large corporate exposures, ANZ would expect RBNZ to monitor the quality of external ratings (noting that rating agencies... |
are not infallible and were closely scrutinised following the GFC for misrepresenting mortgage based securities).

- Overall, RBNZ should be consistent with APRA’s approach, and aligned with global standards (Basel III) for calculation of RWA for bank, sovereign, and large corporate exposures.

| 2.2 | One of the options for credit risk would also involve removing the IRB approach for retail portfolios, on the grounds that the standardised approach is quite risk-sensitive for mortgages and other retail exposures are relatively small. Do you agree that the standardised approach for mortgages is risk-sensitive? If not, how could it be made more risk-sensitive? Do you agree that other retail exposures are relatively small? Are there other grounds for retaining or dropping the IRB approach for retail exposures? | ANZ disagrees that the current standardised approach for mortgages is appropriately risk sensitive; a standardised approach is, by definition, not risk sensitive. The lack of risk sensitivity is particularly evident at the ends of the ratings spectrum, where there may be relatively high risk weights for what are actually low risk exposures, but conversely there will be exposures where the highest standardised risk weight is not high enough. As an example, for non-default non-investment lending mortgages, the minimum standardised risk weight that can be achieved is 35% and the maximum is 75% (if LVR is less than 100%). Based on ANZ’s experience, an IRB approach can assign a much wider range of risk weights, and therefore produces a more accurate reflection of the risk profile. The standardised approach is generally sensitive to only one dimension of risk, and therefore other elements of key portfolio risk drivers are overlooked. However, bringing other factors into a standardised framework creates complexities and inconsistencies that RBNZ is trying to avoid. In the context of ANZ’s overall portfolio, other retail exposures are relatively small. However, the benefits of IRB are still valid for all retail exposures. ANZ supports retaining the IRB approach for retail exposures, and believes that an IRB approach is particularly useful in proactively managing the portfolio risks for retail mortgages. The benefits of an IRB approach outweigh the challenges. |

| 2.3 | One of the options for credit risk would involve entirely replacing the IRB approach with the standardised approach. This paper notes that the standardised approach is not very risk-sensitive for exposures to corporates | ANZ believes that lack of sensitivity in a standardised approach for unrated corporate exposures would be problematic. The IRB approach is purpose-built to provide the required sensitivity, and significant investment has been made by IRB banks into more advanced rating frameworks. A move to a standardised approach will unwind the benefits of more advanced credit risk management. |
without external credit ratings. Would the lack of sensitivity for unrated corporates pose a significant problem? Why, or why not? How might the lack of sensitivity be remedied within the standardised approach (noting that the BCBS failed to find variables which reliably distinguished risky exposures from less risky exposures)?

- Under its current powers, the RBNZ can control the calibration of outputs if the level of risk weights is a concern.
- ANZ believes that internal models provide more information about risk than a standardised approach, for reasons such as:
  - Internal rating models are based on detailed historical and projected information for each customer.
  - Banks continually interact with their customers and therefore can identify and respond more quickly to changing circumstances such as liquidity or debt-servicing problems.
  - The IRB approach enables individual and/or portfolio credit deterioration to be quickly reflected in a bank’s risk profile.
  - The IRB approach also utilises banks’ industry knowledge and depth of understanding of the New Zealand environment.
- Lack of sensitivity within the standardised approach cannot be addressed without creating unwieldy complexities, which will create as many (and possibly more) issues as RBNZ seeks to solve, and does not align with its simplicity and comparability objectives.
- The lack of sensitivity in the standardised approach could create incentive for banks to increase their risk profile. It would become possible for banks to seek higher returns from riskier customers and lending, without the extra cost of capital.

2.4 In the options for limiting the use of IRB models, there would be a floor on risk weights produced by internal models. This floor would be set as a percentage of the corresponding risk weights under the standardised approach. The floor could be set on a portfolio-wide level (average risk weight of all exposures would be higher than some level), by asset class (e.g. average risk weight of residential mortgage exposures would be higher than some level), or by individual

- For global consistency, ANZ favours adoption of the final BCBS Basel III reforms and proposed APRA framework with a portfolio level floor for risk weights produced by internal models. While some areas of divergence may be warranted to suit the New Zealand environment, these differences should be minimised to only what is absolutely necessary. Otherwise, there is a risk of limited comparability of risk weights with other jurisdictions.
- ANZ does not support floors at an individual exposure or asset class levels:
  - These result in overly conservative estimates.
  - Implementing exposure / asset class level floors would be too onerous, and such an approach does not support RBNZ’s simplicity objectives.
| Exposure (actual risk weight of single exposure would be higher than some level). What do you see as the advantages and disadvantages of each of these possibilities? | • ANZ considers the current public disclosure requirements are adequate, and supports leaving the reporting requirements as they are. There is already a significant amount of information publically disclosed. Additional information disclosed would result in increased compliance costs and public confusion.  
• ANZ proposes that the current requirements regarding the provision of detailed information on capital, risk weights and models to RBNZ are sufficient, and notes that RBNZ has powers to request further information as required. New Zealand IRB banks provide this detailed information to RBNZ on a regular basis and New Zealanders should be able to have confidence in the RBNZ supervisory regime.  
• ANZ has concerns over additional disclosure:  
  - Providing more detailed information on the IRB approach for public use will create confusion, increasing the burden on both regulator and banks.  
  - ANZ believes transparency is a shared responsibility between banks and RBNZ in making sure that the information is well understood.  
• ANZ does not support the option of dual reporting:  
  - ANZ is unable to see the benefit in the significant increase in the information required to be disclosed.  
  - The standardised approach provides a standard reporting template, however the risk weights in themselves may reveal little about actual risk differentiation. There is no transparency as to how standardised risk weights have been arrived at.  
  - RBNZ needs to be able to demonstrate that standardised reporting provides a sufficiently robust level of comparability and investor understanding before asking IRB banks to invest in this.  
• ANZ does not support public disclosure of model documentation: |
| --- | --- |
| 2.5 Do you consider that current public disclosure by banks provides enough information / not enough information / too much information about the way in which capital requirements have been determined under the IRB approach? What further information, if any, would be desirable and what would you use it for? If you favour less disclosure or no more than at present, what are your concerns about additional disclosure? Do you have any comments on the Reserve Bank’s preferred option of dual reporting of IRB and standardised outcomes? | • ANZ considers the current public disclosure requirements are adequate, and supports leaving the reporting requirements as they are. There is already a significant amount of information publically disclosed. Additional information disclosed would result in increased compliance costs and public confusion.  
• ANZ proposes that the current requirements regarding the provision of detailed information on capital, risk weights and models to RBNZ are sufficient, and notes that RBNZ has powers to request further information as required. New Zealand IRB banks provide this detailed information to RBNZ on a regular basis and New Zealanders should be able to have confidence in the RBNZ supervisory regime.  
• ANZ has concerns over additional disclosure:  
  - Providing more detailed information on the IRB approach for public use will create confusion, increasing the burden on both regulator and banks.  
  - ANZ believes transparency is a shared responsibility between banks and RBNZ in making sure that the information is well understood.  
• ANZ does not support the option of dual reporting:  
  - ANZ is unable to see the benefit in the significant increase in the information required to be disclosed.  
  - The standardised approach provides a standard reporting template, however the risk weights in themselves may reveal little about actual risk differentiation. There is no transparency as to how standardised risk weights have been arrived at.  
  - RBNZ needs to be able to demonstrate that standardised reporting provides a sufficiently robust level of comparability and investor understanding before asking IRB banks to invest in this.  
• ANZ does not support public disclosure of model documentation: |
2.6 This paper suggests that New Zealand’s standardised approach is already relatively risk-sensitive (“fine-grained”). Do you agree or disagree with this statement?

Are there aspects of the BCBS’ new standardised approach which should be introduced here?

If so, why should they be introduced?

(You might wish to cross-refer to your responses to Questions 2.2 and 2.3, which address specific aspects of the standardised approach which could be relevant for IRB banks).

• ANZ has provided views on sensitivity and appropriateness of a standardised approach in its responses to questions 2.2 and 2.3. Being an IRB bank, ANZ has no additional comments on this.

2.7 The Reserve Bank is planning to reconsider the zero risk weight for highly rated sovereign exposures in the standardised approach for credit risk. Do you consider that a zero risk weight is justified?

If so, what is the justification? If not, why not?

Apart from a change in capital

• ANZ is an IRB bank and has no comments on this.
**ANZ Bank New Zealand Limited**

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<th>2.8</th>
<th>Would any of the options for credit risk have consequences that are not discussed in this paper? If you are responding to this consultation paper on behalf of a bank it would be helpful if you would provide quantitative estimates of the effect on capital ratios and other relevant metrics (though a more formal quantitative impact study is also planned for a later stage of the review).</th>
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| **ANZ** | • The consultation paper comments on recently released BCBS Basel III reforms but makes no mention of any potential APRA reforms acknowledging that four banks are accredited for IRB under RBNZ and APRA frameworks. ANZ supports alignment of credit RWA framework with that of APRA. This supports a consistent regional approach to the calculation of IRB RWA for credit risk, and in turn better aligns New Zealand IRB banks with global standards. ANZ suggests RBNZ should pause and consider its intentions in light of the recently released APRA proposals.  
• The consultation paper comments that it is unclear how accurately the internal models approaches are picking up risk and suggests that banks may be manipulating rating models to suit desired RWA outcomes. In New Zealand, IRB banks are required to use only models that are approved by the RBNZ, which questions the rationale of RBNZ’s concerns.  
• ANZ considers there is insufficient detail in the consultation paper on the RBNZ’s change proposals to undertake quantitative analysis. |

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<tr>
<th>2.9</th>
<th>What are your preferred options for the IRB approach (including options for increasing transparency) and the standardised approach for credit risk? Please tell us why you prefer these options</th>
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| **ANZ** | • ANZ supports aligning New Zealand’s IRB RWA requirements with the framework being developed by APRA. This supports RBNZ’s Principle 5 “The capital framework should be practical to administer, minimise unnecessary complexity and compliance costs, and take into consideration relationships with foreign-owned banks’ home country regulators”. This also better aligns New Zealand with international standards, being the recently finalised Basel III reforms.  
• Along these lines, ANZ recommends that any RWA floors should be calculated at portfolio level rather than individual exposure or asset class level aligned with APRA.  
• For the options provided under IRB, ANZ would be comfortable with Option 1 (status quo), however ANZ acknowledges this approach may not remain feasible given the BCBS proposals and RBNZ’s own views which have resulted in the |
capital review being undertaken. Therefore from a practical and theoretical standpoint, Option 2 seems to be the most appropriate way of meeting multiple objectives i.e. having an advanced models approach, reducing the variances between IRB and standardised calculations, and being more aligned to the BCBS proposals. However, ANZ suggests RBNZ needs to reconsider IRB Option 2 for credit risk in light of the final Basel III reforms and APRA proposals.

- ANZ does not support RBNZ’s proposed options 3, 4 or 5 for IRB banks. If RBNZ believes there is insufficient conservatism in New Zealand’s capital adequacy regime, it has ultimate discretion to impose overall higher capital ratios. ANZ considers this a simpler option and certainly easier to unwind or modify according to a changing environment, than bespoke add-ons and granular floors. It also allows IRB banks to continue to develop and refine their IRB risk systems and processes.

- On transparency, ANZ considers the current public disclosure requirements are adequate, and does not support increasing transparency. As provided in 2.5, there is already a significant amount of information publically disclosed. Additional information disclosed would result in additional compliance costs and public confusion. ANZ proposes that the current requirements regarding the provision of detailed information on capital, risk weights and models to RBNZ is sufficient, and ANZ notes that RBNZ has powers to request further information if required. New Zealand IRB banks provide detailed information to RBNZ on a regular basis and New Zealanders should be able to have confidence in the RBNZ supervisory regime.
### 3. Questions about options for operational risk

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<th>The BCBS has replaced AMA with a new standardised approach for operational risk. Do you agree with the BCBS’s assessment of internal operational risk models (i.e. that they have not evolved so that there is an accepted approach which produces accurate and consistent outcomes)? Please explain why you hold this view.</th>
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<td>3.1</td>
<td>• ANZ believes AMA has contributed to advancement of operational risk management. In particular, banks have improved their loss data collection and have set up international consortiums (e.g. ORX) to share loss experiences and knowledge. Operational risk scenario analysis is another area that improved under AMA. ANZ’s observation is that an increasing number of banks are realising the benefits of scenario analysis and there has been a growing trend of developing data driven scenario analysis processes in the industry during the past two years. ANZ recognises the benefits of having advanced operational risk analytics capabilities for better risk management and therefore expect to continue the activities that add value to the business despite the removal of AMA.</td>
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<td>3.2</td>
<td>If the AMA was replaced, banks currently using AMA would not have to meet all the procedural and systems requirements currently contained in that approach (the new standardised approach is essentially formulaic). Do you consider that similar requirements should be imposed in any new approach? Should such a requirement apply only to banks formerly using AMA, or to all banks? Please provide reasons for your view.</td>
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<td></td>
<td>• At this stage ANZ has not conducted a review on this matter to form an opinion. ANZ’s initial observation is that national regulators may choose to retain some of the qualitative requirements currently applied under AMA.</td>
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3.3 Would any of the options for operational risk have consequences that are not discussed in this paper? If you are responding to this consultation paper on behalf of a bank it would be helpful if you would provide quantitative estimates of the effect on capital ratios and other relevant metrics (though a more formal quantitative impact study is also planned for a later stage of the review).

- The BCBS paper discusses pillar 1 capital and is silent on pillar 2 requirements. It is unclear at this stage whether banks are expected to maintain separate operational risk capital models for calculating the operational risk economic capital. ANZ would like to obtain more clarity from RBNZ on their expectation around pillar 2 capital under the new requirements.

3.4 What is your preferred option for operational risk? Please tell us why you prefer this option.

- ANZ’s preference is to have a consistent approach to calculate regulatory capital across all regions which ANZ operates. Given that most countries are expected to adopt Basel’s new Standardised Measurement Approach (including Australia), ANZ’s preference is to remove all internal models for operational risk (i.e. regulatory and economic) and follow the new Standardised Measurement Approach of BCBS with additional requirements to ensure banks maintain their advanced risk management frameworks (i.e. option 3).

4. Questions about options for market risk

4.1 New Zealand’s market risk standard is rudimentary and quite old. Do you have any specific concerns about risks the standard is omitting, or under- or overstating? Would the new standardised approach recently introduced by the BCBS be an improvement?

- The current standard model does not represent risk in the way it is managed and the rudimentary nature of the broad repricing time buckets leads to cliff effect movements in risk weighted assets that are not related to actual risk changes. This can mislead a reader into believing a bank has taken more (less) risk when no additional transactions have occurred and all that has happened is a cash flow has changed repricing buckets.
- Generally, ANZ finds that the standard model does not reflect some specific risks the bank is exposed to (for example basis risk), however, overall the standard gives a materially higher capital requirement.
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<th>4.2</th>
<th>The new standardised approach introduced by the BCBS requires more complex calculations than the current New Zealand approach. In your view, would it be practical to apply it in New Zealand? (e.g. would the necessary information and expertise be available to undertake the calculations?). Would you have the same view about the simplified standardised approach?</th>
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<tr>
<td>4.3</td>
<td>Would any of the options for market risk have consequences that are not discussed in this paper?</td>
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- The new BCBS Standardised Approach (SA) is understood to be complex to implement and has been delayed to allow time to address multiple issues. Given these issues ANZ believes that adopting the new approach at this stage would place New Zealand banks at a disadvantage to overseas banks.
- However ANZ believes that moving towards the new standardised models, as issues are addressed globally, would be an improvement in market risk measurement.
- Larger banks (which may trade option products) typically have the capability to run the new SA Model which requires mark to market revaluations on shifted curves, however for smaller banks this will be a material step up in capability, which they are currently not prepared for. For smaller banks with no exposure to option products, the increased complexity of the new SA model is unnecessarily burdensome.
- The simplified SA is easier for banks to implement and is a more appropriate model for less sophisticated banks.
- The new market risk standards have been delayed internationally for regulators, with the BCBS stating implementation will now be no earlier than 1 January 2022.
- Adopting the new standard ahead of a global implementation may place New Zealand banks at a disadvantage to overseas banks. There is also a risk that the new standard is modified or revised before other jurisdictions are required to implement it.
| 4.4 | What is your preferred option for market risk?  
        Please tell us why you prefer this option. | • As indicated in initial feedback for the capital review ANZ favours the addition of an option to calculate market risk capital on an internal models basis aligned to APRA’s APS 116 (trading book) and APS 117 (banking book). This is consistent with capital review guiding principles, especially Principle 5, and is more aligned to how risk is measured and managed.  
• ANZ has concerns with the new BCBS standard model given the complexities the international banking community is experiencing and recommends it would be appropriate to see how these issues play out before considering implementation in New Zealand, noting that the implementation date has been delayed to be no earlier than 1 January 2022.  
• Consequently, ANZ’s preference for market risk is to retain the current, rudimentary, standard model and supplement it with an internal models option aligned to actual risk management practice and APRA’s APS 116 and 117. ANZ believes there is advantage in taking this approach as a transitional step toward the new BCBS standard which includes a modified internal model and would allow interested parties (including supervisors and smaller New Zealand banks) to increase their understanding of mark to market revaluations on shifted curves ahead of tackling the greater complexity of the new BCBS standard. |