Submission

to the

Reserve Bank of New Zealand

on the

Review of the Capital Adequacy Framework for locally incorporated banks: Calculation of risk weighted assets

19 March 2018
About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following seventeen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - Bank of Tokyo-Mitsubishi, UFJ
   - China Construction Bank
   - Citibank, N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - Industrial and Commercial Bank of China (New Zealand) Limited
   - JP Morgan Chase Bank, N.A.
   - Kiwibank Limited
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Background

3. NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand (RBNZ) on the consultation paper Review of the Capital Adequacy Framework for locally incorporated banks: Calculation of risk weighted assets (Consultation Paper) and acknowledges the work that has gone into developing the Consultation Paper.

4. If you would like to discuss any aspect of the submission further, please contact:
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New Zealand banks are well capitalised

5. As noted in the Consultation Paper, New Zealand banks use different measures of exposure to risk:
(a) ANZ, ASB, BNZ and Westpac New Zealand are accredited to use the internal model approaches.

(b) All other locally incorporated banks are required to use the standardised approaches.

6. Accordingly, it is neither possible nor appropriate, for NZBA to express an industry view on a number of the matters set out in the Consultation Paper. Many of NZBA’s member banks will therefore be submitting individually on the Consultation Paper.

7. One area of commonality to note, however, is the industry view on conservatism in risk exposure.

8. NZBA agrees that New Zealand’s capital framework should be conservative in relation to its international counterparts. However, as noted in PwC’s report, New Zealand’s approach to risk is already conservative in relation to similar jurisdictions:

This study concludes that the New Zealand major banks are well capitalised relative to banks in many other overseas jurisdictions. An upward adjustment of approximately 6% is reasonable in order to restate the Common Equity Tier 1 (CET1) ratios of the NZ major banks to an internationally comparable basis.

9. We are not aware of any equivalent study undertaken in relation to the standardised banks, however, the fact that RBNZ has applied similar additional overlays to Basel’s standardised risk weights suggests that New Zealand’s standardised banks would also see a material uplift in capital ratios compared to standardised banks in other jurisdictions.

10. Further, we note that RBNZ concluded in its November 2017 Financial Stability Report that, based on its 2017 bank stress tests, “[New Zealand] banks currently have significant buffers of CET1 above minimum requirements”. That view was also expressed following RBNZ’s 2015 Internal Capital Adequacy Assessment Process stress test (using a severe macroeconomic downturn scenario); “[New Zealand banks] would remain well away from the point of economic failure”.

11. We note the lack of detail in the Consultation Paper means it is not possible at present to undertake quantitative analysis. Accordingly, once there is more definition around the proposed framework, NZBA considers it imperative that RBNZ completes a Quantitative Impact Study (QIS) to ensure that a thorough and considered assessment is undertaken as to the effects and potential unintended consequences of the proposed changes to the calculation of risk weighted assets and the definition of capital.

Operational risk

12. We support a standardised approach to operational risk.

13. NZBA’s members have different perspectives on the shape that standardisation should take based on their risk profiles, size and maturity. Accordingly, RBNZ should consider banks’ individual submissions and undertake bilateral discussions with them in order to understand those diverse views.

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1 PwC (2017), International comparability of the capital ratios of New Zealand’s major banks.
14. NZBA’s members may also support some form of additional explicit requirements for advanced operational risk management processes and systems as an extension to standardisation. However, we stress that care and further consultation would be needed to ensure that any such proposals are workable.

Market risk

15. NZBA notes that RBNZ considers the review of capital requirements for market risk is a lower priority than other work related to capital requirements. NZBA agrees that the status quo should be maintained in the meantime. However, we consider that market risk should be the subject of a more detailed consultation in due course.

16. A future consultation on capital requirements for market risk should consider replacing the current approach with a standardised methodology. The current methodology places reliance on accounting concepts rather than best practice for managing market risk. RBNZ should consider whether a standardised approach for the trading book and the interest rate risk in the banking book should be consistent with the approach advocated by the BCBS, with the objective of creating a cohesive framework that supports good market risk practice.