

Safer Banks for Greater Wellbeing

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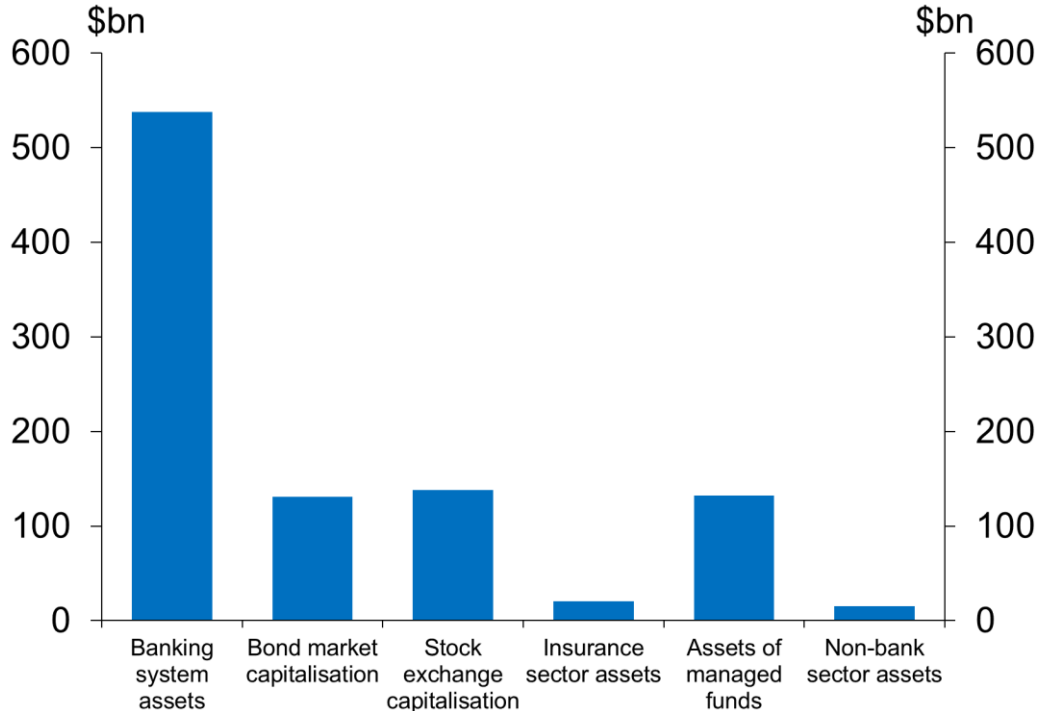
Capital Review

- Started in March 2017
- Three consultation papers issued already
 - Overall issues and framing of capital review
 - Nature and quality of capital
 - Measurement of assets and risk weighting
- Fourth – and current consultation - released on 14 December 2018 proposes a material increase to minimum capital requirements



NZ's financial system

Size of financial sectors in NZ





Why bank safety matters

- If a bank fails, then all of society suffers – not just the bank’s customers.
- Bank crises carry large social costs
 - On average:
 - -23% of GDP, as deviation from trend
 - Public debt +12% of GDP
 - Higher unemployment
 - Negative impacts on health and quality of life
- Our tolerance of bank crises has reduced given evidence of enduring, wide-ranging crisis impacts.

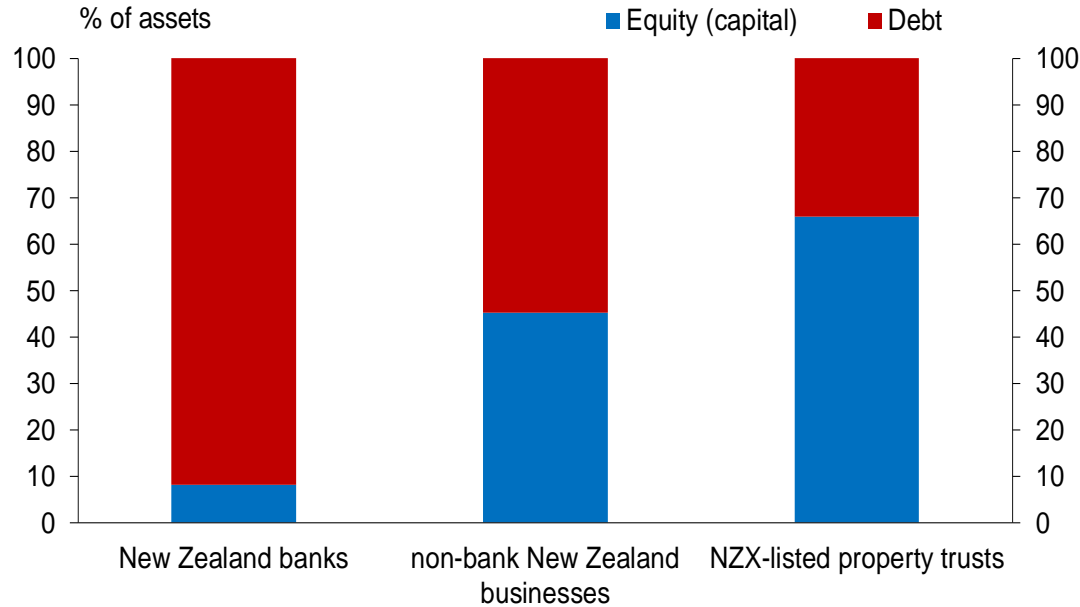


Bank Capital – What is it?

- Banks get their money from two sources:
 1. owners (shareholders)
 2. borrowing (creditors, including depositors)
- Money provided by owners (equity injected or retained from earnings) = bank's capital
- If a bank loses money, it is absorbed by its capital, and capital goes down
- Capital and debt are mixed together and lent to customers
- Banks, in NZ and elsewhere, generally have very little capital relative to debt compared to other businesses



Shareholder Equity to Asset Ratios



Source: Registered banks' *Disclosure Statements*, Statistics New Zealand, company reports



Why does capital matter?

- More capital reduces the likelihood of a bank failure
- The more capital a bank has, the more money it can lose before it fails
- Protect depositors and potentially taxpayers from failing banks
- Maintain investor confidence in New Zealand's banking system
- Higher capital means bank shareholders have more to lose from bank failure, and should constrain the bank's risk taking



Minimum Capital Requirements

- The Reserve Bank, like other banking regulators, sets minimum capital requirements
- Current minimum requirement is 10.5% for total capital (8.5% of which is 'high quality' capital)
- Current Reserve Bank minimums are consistent with international minimums set by the Basel Committee
- NZ banks currently have around 12% of 'high quality' capital

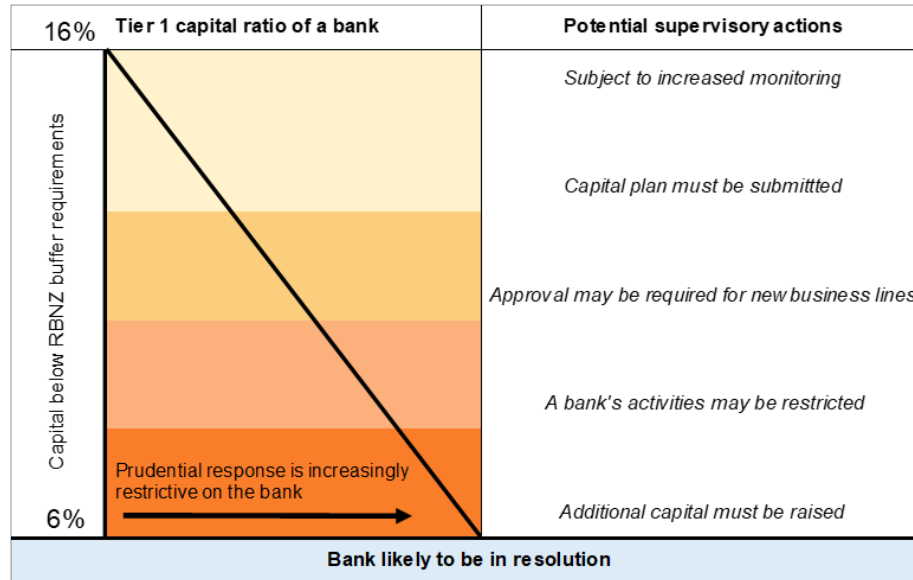


Our proposals ...

- Minimum total capital requirement would be increased from 10.5% to 18% (for large banks) and 17% (for small banks)
- Minimum 'high quality' capital requirement would be increased from 8.5% to 16% (for large banks) and 15% (for small banks)
- Other more technical changes that would increase capital for large banks (for example, a capital 'floor')
- Five year transition period
- Total minimum capital requirement would be comparable internationally, but minimum requirement for 'high quality' capital would put us near the top of international peers

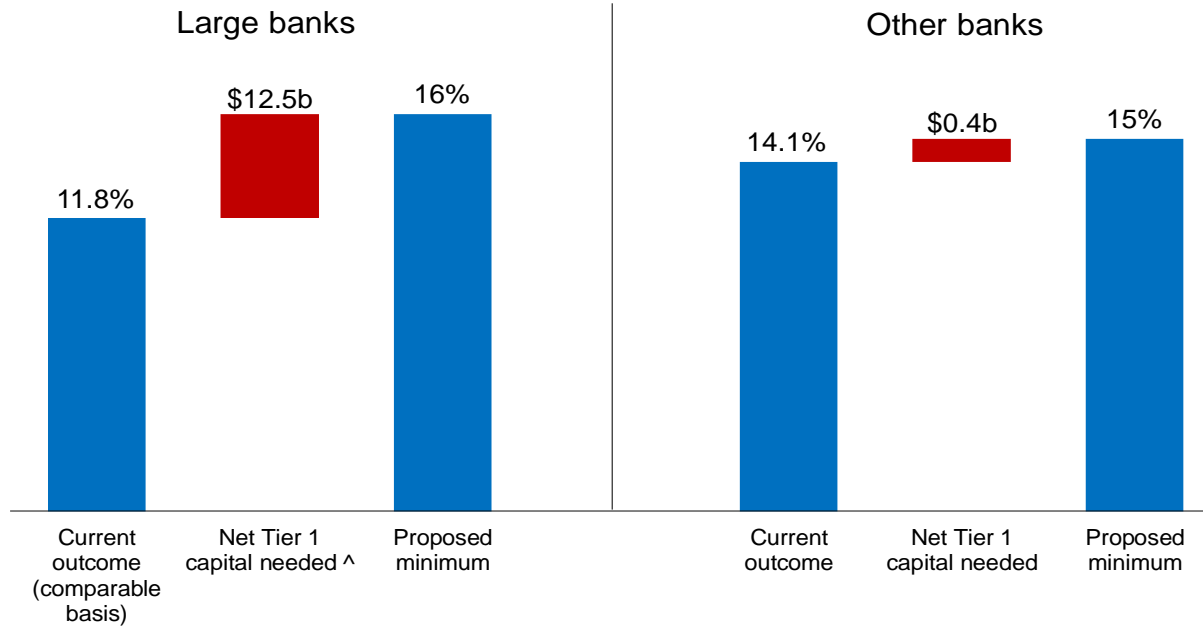
Clarity on regulator-regulated relationship

- More efficient model approval process
- Escalated Supervisory Response (ESR) – greater clarity about supervisory actions with a graduated buffer approach





New Tier 1 Capital Needed



Source: RBNZ Balance Sheet Survey, RBNZ estimates



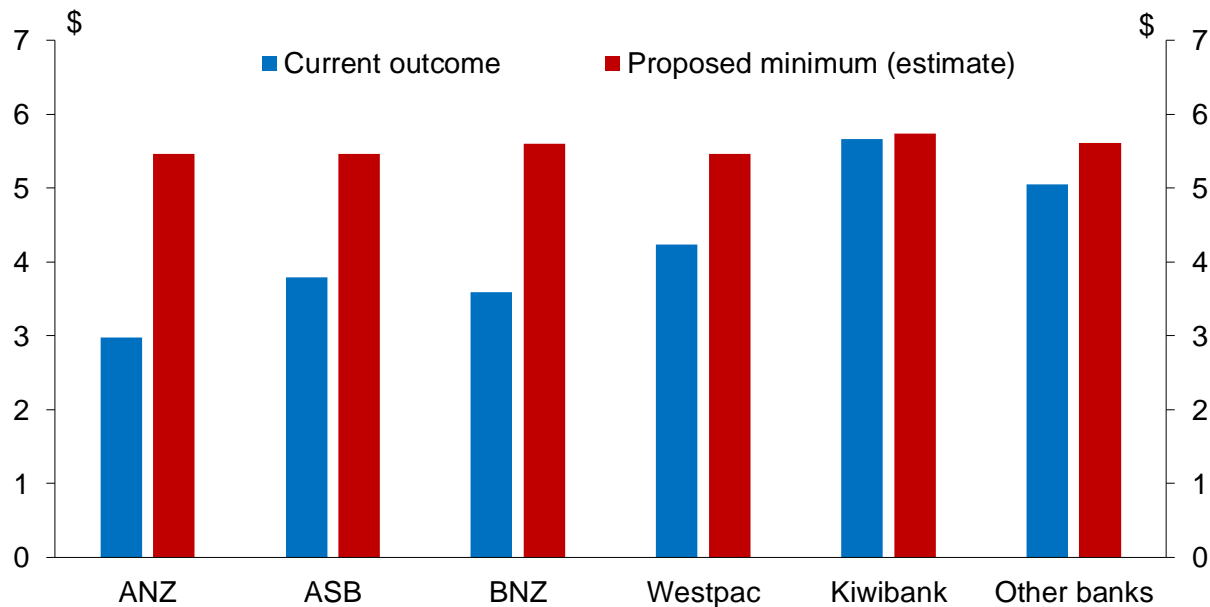
What will banks do?

- Banks will keep making their own commercial decisions about how they respond in terms of their funding, lending, pricing and margins
- They have a number of options to raise the capital they need
- They may also:
 - increase their margins between lending rates and deposit rates
 - accept lower return on equity, since their investors carry less risk
 - receive lower debt funding costs since they are lower risk
 - re-price and in some cases even reduce some unprofitable lending
- Competition amongst the banks and from other sectors will influence the outcomes



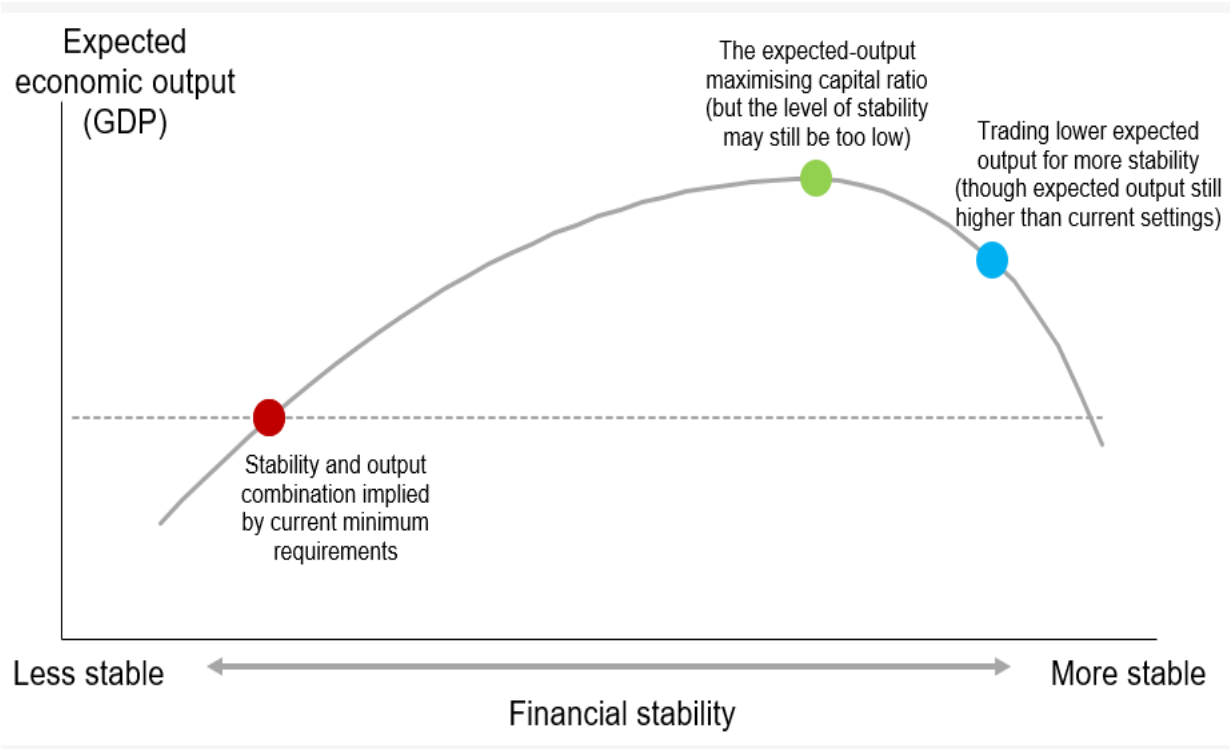
A more level playing field

- Current Tier 1 capital per \$100 of mortgage lending, Tier 1 capital at proposed minimum ratios (estimate using publicly available data)





Higher soundness and expected output





Costs assessment

- Estimated impact of policy on lending margins 20 bps to 40 bps
- Net benefit of policy proposal =

*Expected Costs of Crisis × Reduction in probability of crisis –
Lower steady state output due to higher lending margins*

- Overseas research suggests the present value (PV) impact of this change in lending rates on long run GDP is expected to be < -0.3% of GDP
- Final cost-benefit analysis will be included in a Regulatory Impact Statement (RIS)



International comparison – Basel Committee

Fully phased-in CET1, Tier 1 and total capital ratios under the final Basel III standards

In per cent

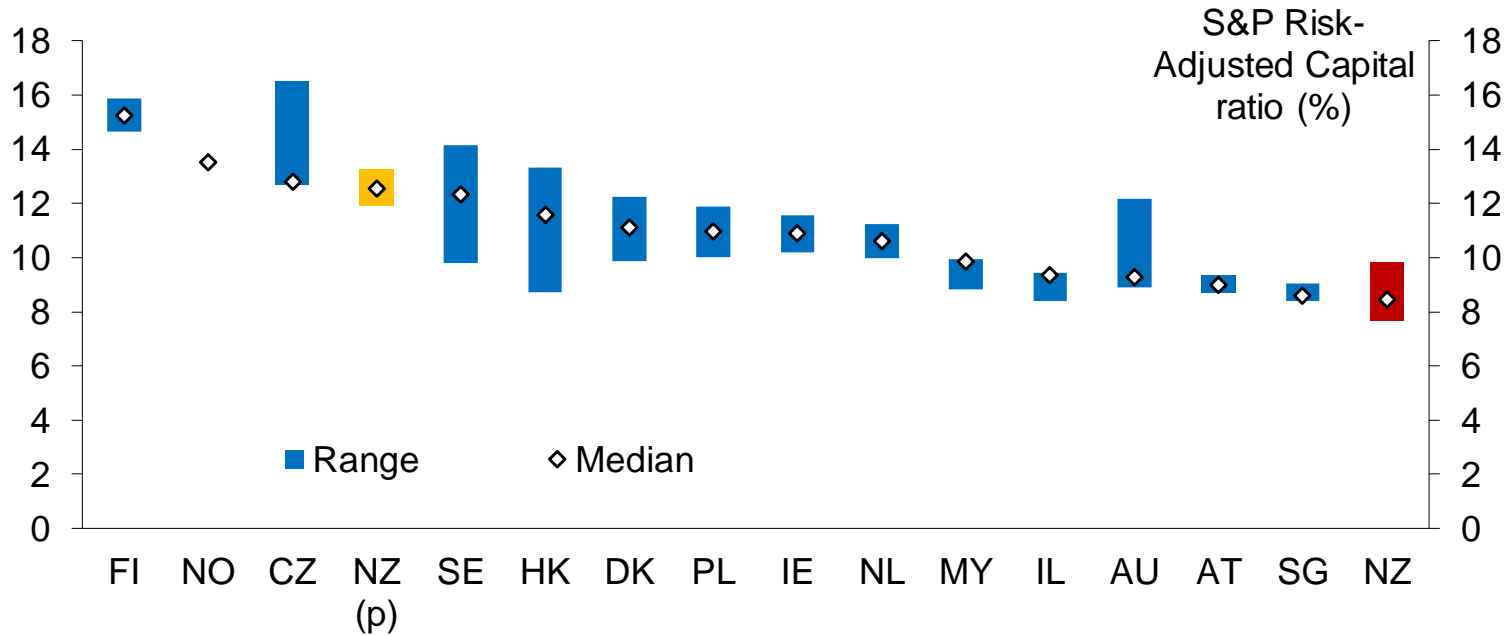
Table C.10

	Group 1 banks			Of which: G-SIBs			Group 2 banks		
	CET1	Tier 1	Total	CET1	Tier 1	Total	CET1	Tier 1	Total
Max	54.0	56.8	58.3	15.6	18.6	20.1	70.9	70.9	70.9
95th percentile	21.8	22.4	24.0	15.4	17.8	19.9	27.1	30.1	33.1
75th percentile	13.9	15.1	17.2	13.4	15.6	17.8	15.9	16.5	19.7
Median	12.3	13.4	15.1	12.0	13.6	15.5	13.4	13.6	15.4
25th percentile	10.8	11.7	13.3	10.2	11.4	12.7	11.0	11.1	12.3
5th percentile	8.7	9.8	11.0	8.3	9.6	10.9	9.4	9.4	11.0
Min	7.1	7.2	10.0	8.1	8.9	10.6	3.9	4.0	4.0
Weighted average	12.2	13.3	15.2	12.0	13.3	15.1	12.6	13.1	15.1

Source: Basel Committee on Banking Supervision.



International comparisons – S&P





Conclusion

The benefits...

- Safer banks and more resilient banking system
- Greater protection from banking crisis and recessions
- Greater wellbeing for New Zealanders

The costs...

- Lower investment returns for bank shareholders
- Modestly higher lending rates from banks are possible

Next steps...

- Submissions open until 3 May 2019
- Decisions expected in 3rd Quarter 2019

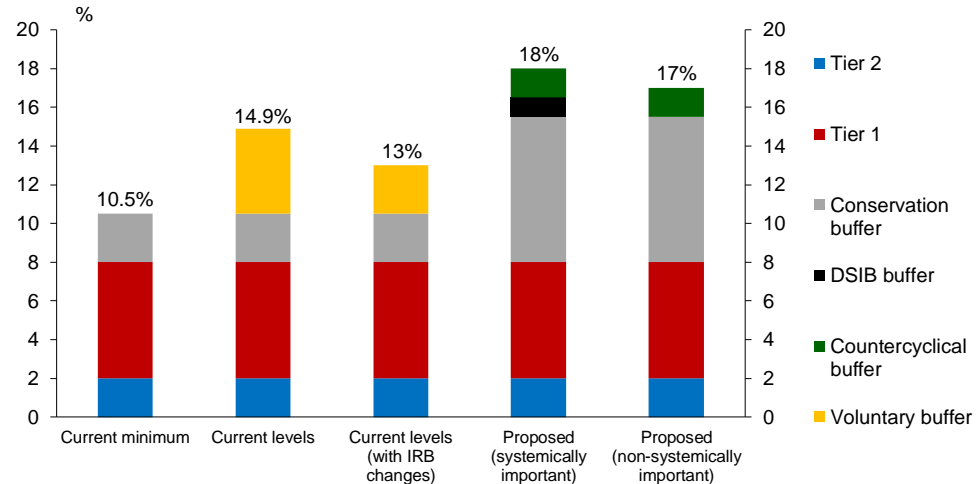


Questions?

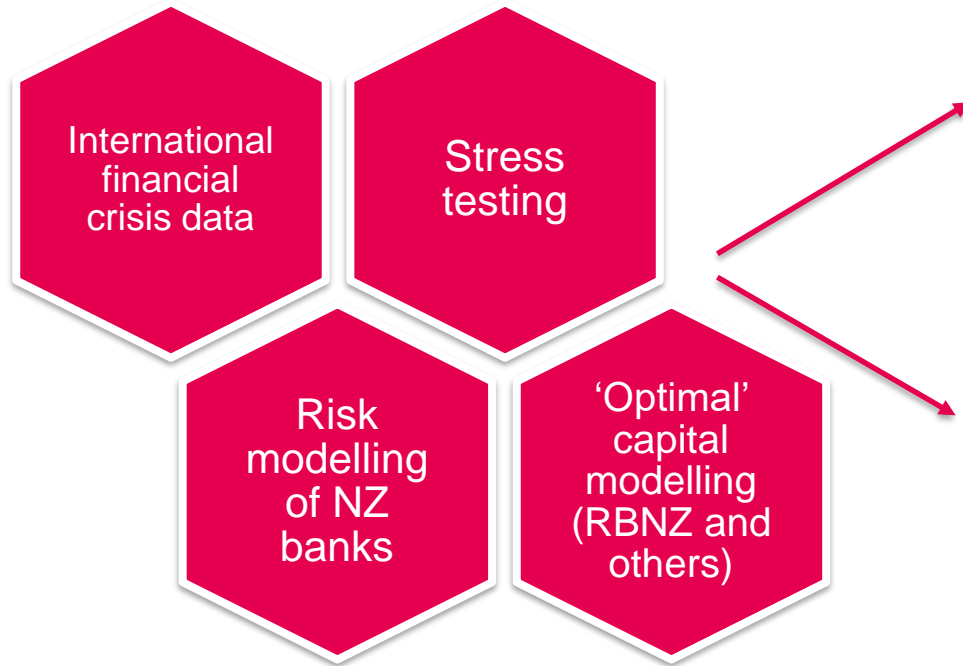


Our proposals

- ✓ Total capital ratio of 18/17 percent of RWA
- ✓ Tier 1 capital of 16/15 percent of RWA
- ✓ Recalibrate internal models to around 90 percent of standardised
- Enhanced role for capital buffers (including countercyclical, DSIB)
- Leverage ratio – disclosure and minimum (4/3 percent of exposures)
- 5 year transitional period



Four lenses on capital adequacy



Risk Appetite Framework:

- Soundness objective
 - Capital sufficient to retain the confidence of creditors when subject to an extreme (notional 1 in X) shock
- Efficiency objective
 - Subject to meeting soundness objective, does the capital requirement maximise expected economic output?