Housekeeping

• Briefing material embargoed until 4pm today – at media’s request.

• Draft speech provided under embargo. Final text released at 12.30pm on Tuesday 26th.

• Time for questions at the end.

• Media and Reserve Bank people on videoconference from Auckland.
Opening remarks: Geoff Bascand
What we’re trying to achieve

• Stronger banks and stronger banking system - better able to survive large shocks.

• Protect New Zealand from the significant harm that accompanies a banking crisis.

• Protect depositors and potentially taxpayers from failing banks.

• Maintain investor confidence in New Zealand’s banking system.
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)
Why we care

• The Reserve Bank’s job is to promote a sound and efficient financial system.

• If a bank fails, then all of society suffers – not just the bank’s customers.

• Our tolerance of bank crises has reduced given evidence of enduring, wide-ranging crisis impacts.

• We want banks to have enough capital, and the right quality capital, to withstand significant shocks.

• More capital reduces the likelihood of a bank failure.
What will it mean for society?

- Banks will be safer – the costs and risks of a bank failure are reduced.
- Interest rates (borrowing and lending) could change – but we don’t expect by much. Lending margins above borrowing cost may expand by 20-40 basis points.
- Banks make profits from lending. The competitive market will continue and if one bank pulls back in a particular segment of lending, we expect another will step up.
- 20 banks operate in NZ, with 16 in the retail market.
What does it mean for banks?

• More and better-quality capital. So that means banks will be safer – so will likely get cheaper credit.

• The big four banks would have five years to increase their capital ratio from the current 12% to 16%. We expect a combined increase in capital of around $20bn for the big four.

• Other banks have to increase their capital ratio from the current average of 14% to 15%. We expect a combined increase of around $0.9bn in capital for these banks.
Clarity on regulator-regulated relationship

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

<table>
<thead>
<tr>
<th>Tier 1 capital ratio of a bank</th>
<th>Potential supervisory actions</th>
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</thead>
<tbody>
<tr>
<td>16%</td>
<td>Subject to increased monitoring</td>
</tr>
<tr>
<td>Capital below RBNZ buffer requirements</td>
<td></td>
</tr>
<tr>
<td>6%</td>
<td>Capital plan must be submitted</td>
</tr>
<tr>
<td>Prudential response is increasingly restrictive on the bank</td>
<td></td>
</tr>
<tr>
<td>Bank likely to be in resolution</td>
<td></td>
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<tr>
<td>Additional capital must be raised</td>
<td></td>
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</tbody>
</table>
What will banks do?

• Banks will keep making their own decisions about how they manage their balance sheets. They have a number of options to raise the capital they need.

• They could retain more profits over several years (rather than paying out dividends to their owners) or they could raise more capital from shareholders.

• We estimate the big four banks could get there by retaining 70% of their net earnings over 5 years.

• The small bank sector might take a bit longer, around 7 years.
### International comparison – Basel Committee

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

<table>
<thead>
<tr>
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<th>Group 1 banks</th>
<th>Of which: G-SIBs</th>
<th>Group 2 banks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CET1</td>
<td>Tier 1</td>
<td>Total</td>
</tr>
<tr>
<td>Max</td>
<td>54.0</td>
<td>56.8</td>
<td>58.3</td>
</tr>
<tr>
<td>95th percentile</td>
<td>21.8</td>
<td>22.4</td>
<td>24.0</td>
</tr>
<tr>
<td>75th percentile</td>
<td>13.9</td>
<td>15.1</td>
<td>17.2</td>
</tr>
<tr>
<td>Median</td>
<td>12.3</td>
<td>13.4</td>
<td>15.1</td>
</tr>
<tr>
<td>25th percentile</td>
<td>10.8</td>
<td>11.7</td>
<td>13.3</td>
</tr>
<tr>
<td>5th percentile</td>
<td>8.7</td>
<td>9.8</td>
<td>11.0</td>
</tr>
<tr>
<td>Min</td>
<td>7.1</td>
<td>7.2</td>
<td>10.0</td>
</tr>
<tr>
<td>Weighted average</td>
<td>12.2</td>
<td>13.3</td>
<td>15.2</td>
</tr>
</tbody>
</table>

Source: Basel Committee on Banking Supervision.

- Limitations: NZ application of Basel framework on average is more conservative than other jurisdictions. Peer group includes banks with less comparable business models to NZ banks.
International comparisons – S&P

- Limitation: Standard and Poor’s Risk-Adjusted Capital methodology relies on S&P’s economic risk assumptions

(Peer group: 4 largest NZ banks, large retail and commercial banks in each country; NZ (p) = pro forma)
## Proposed transition

<table>
<thead>
<tr>
<th>Quarter / year</th>
<th>Proposal</th>
</tr>
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</table>
| Q3 2019        | • Confirm final Capital Ratio decisions  
                • New AT1 instruments need to meet revised standards |
| Q4 2019        | • Start of transition to higher ratios  
                • Implement changes to IRB framework (floor / scalar) |
| 2020           | • Dual reporting  
                • Revised Standardised Measurement Approach (Op Risk)  
                • Leverage ratio requirements  
                • Transition to higher capital ratios |
| 2021           |          |
| 2022           |          |
| 2023           | • Transition to higher capital ratios |
| 2024           |          |
Timeline – near term

- Speech from Deputy Governor Geoff Bascand (26 Feb).
- Another industry forum penciled in, Auckland (March).
- Analytical note on Risk Appetite Framework (March).
- Open to further discussions with industry during the consultation period, including bilateral meetings if desired.
- Consultation closes (3 May).
- Reserve Bank publishes submissions (June).
- Release of final decisions, accompanied by Regulatory Impact Statement (Q3).
Further work

• Consultation on further elements of the framework:
  ➢ Near term:
    – Identification framework for systemically important banks (March).
    – Internal model change process (workshop with affected banks).
  ➢ Later in 2019 and beyond:
    – Mutual capital instrument.
    – Leverage ratio design (if decision made to proceed).
    – Escalating Supervisory Response framework and trigger points.
    – Strategy for setting the countercyclical capital buffer.
    – Operational risk framework (pending APRA finalisation).
    – Tier 2 (subject to current consultation).

• Dovetail with changes to Banking Supervision Handbook as Capital Review decisions are implemented.
Questions ?