RESERVE BANK

OF NEW ZEALAND

TE PŪTEA MATUA

A framework for identifying domestic systemically important banks

Summary of submissions

August 2019

1. On 8 April 2019, the Reserve Bank published a consultation paper "A framework for identifying domestic systemically important banks" with a feedback deadline of 31 May 2019. The main purpose of the framework is to provide the methodology of identifying domestic systemically important banks (D-SIBs), as a complement to the review on new bank capital adequacy requirements.
2. The proposed framework uses an indicator-based methodology that is aligned with international practice. The significance of banks to the financial system is evaluated according to four categories of bank characteristics and activities: size, interconnectedness, substitutability and complexity.
3. Using the proposed framework, ANZ NZ, BNZ, ASB and Westpac NZ are identified as D-SIBs in New Zealand.
4. We received four responses to the consultation from ASB, Kiwibank, ANZ, and BNZ. All submissions are being published, with the consent of the submitters, on the Reserve Bank's website at the same time as this summary.
5. In general, submitters support the proposed framework for identifying D-SIBs. The following are the main aspects considered by the submitters and the response by the Reserve Bank.

Aligning with International Practice

6. ASB, Kiwibank and ANZ agree with the proposed indicator-based methodology that is aligned with international practice.
7. BNZ suggests that a bank should be identified as a D-SIB as long as it meets any threshold of BS1 (Local Incorporation, 15 billion NZD external liabilities), BS11 (Outsourcing Policy, 10 billion NZD net liabilities) or BS17 (Open Bank Resolution, 1 billion NZD retail deposits). BNZ suggests that banks being captured by the aforementioned policies indicate they are of domestic systemic importance in the local context.
8. **Response**: All prudential regulatory requirements share the common fundamental purpose of maintaining financial stability. However, the D-SIB framework differs from the above policies. The framework for identifying D-SIBs is an integral part of the new capital adequacy framework, especially for facilitating the implementation of a D-SIB capital buffer. The additional capital requirement for D-SIBs focuses on strengthening the resilience of D-SIBs by decreasing the possibility of banks being insolvent from the ongoing perspective. By contrast, the purpose of having Open Bank Resolution and Outsourcing Policy is to manage bank failures and strengthen the continuity of operation in case of bank failures.
9. Another difference between the D-SIB framework and the other three policies is the methodology. The indicator-based approach adopted in the D-SIB framework takes into consideration a comprehensive picture across four different aspects, which are aligned with international practices. By contrast, BS1, BS11 and BS17 adopt a size-only approach. We have compared the pros and cons of having a size-only method vs. an indicator-based approach — Table 8 in the consultation paper summarises the comparison. Using a size-only method in the D-SIB identification is not necessarily simple; it may also impose additional disclosure costs on banks, as currently the data for retail deposits (the threshold for BS17) are not publically available.

10. Considering the differences in the purpose and the methodology between the D-SIB framework and the other three policies, we think the indicator-based approach proposed in the consultation paper is robust and can sufficiently reflect the characteristics of the banking system in New Zealand.

Indicators selection

11. Submitters agree with the main four categories for evaluating systemic significance: size, interconnectedness, substitutability and complexity. These categories also align with those recommended by the Basel Committee.

12. Kiwibank agrees with the selection of the specific metrics underpinning each category in the proposed framework, arguing that the benefit of adding any further metrics would be marginal. Adding more metrics could undermine the simplicity of the proposed framework while bringing no significant change to the rankings of banks. Any New Zealand-specific metrics not recommended by the Basel Committee would also affect international comparability.

13. ANZ also points out that adding more measures would create unnecessary complexity, while suggesting that the Reserve Bank could consider using *Risk Weighted Assets (RWA)* as well as *Total Assets* to measure the size of banks.

14. **Response**: The Reserve Bank considers that *Total Assets* is a simpler and more transparent metric that allows for comparability across all locally incorporated banks. Using RWA as the measure of size introduces challenges when comparing IRB banks with other banks. Moreover, a robustness check based on unpublished RWA data produced similar results to those using *Total Assets*. Therefore, we believe it is robust to use *Total Assets* as the only measure of *Size*.

15. ANZ raises concerns about the selection of measures for Interconnectedness (Top 5 Exposures) and Complexity (Derivatives), arguing these measures may produce inconsistent results since banks differ in their operating models.

16. **Response**: The Reserve Bank acknowledges that different banks have different operating models. Banks may vary in their reliance on parent banks or branches of their parent banks to carry out certain banking activities (e.g. wholesale funding or derivatives). However, this does not affect the overall picture in terms of the gap between the big four Australian banks and other banks. Removing these two measures from the evaluation process does not change the relative ranking and gaps among banks, as shown in Table 1.

Table 1 Total scores of banks when including and excluding the measures of Top 5 Exposures and Derivatives

Banks (in order of total assets)	Including the two metrics	Excluding the two metrics
ANZ	35.50	32.27
BNZ	21.00	20.89
ASB	18.98	19.43
Westpac	14.45	16.96
Kiwibank	3.40	3.52
Rabobank	1.49	1.61
TSB	1.72	2.03
SBS	0.99	0.91

Heartland	0.66	0.70
Co-op	0.47	0.47
BOC	0.42	0.40
ICBC	0.47	0.44
CCB	0.38	0.37
BOB	0.03	0.01
BOI	0.02	0.01

17. The Reserve Bank acknowledges the points raised by ANZ but has decided to include the metrics in the analysis as proposed with an explanation stating that the scores have the limitation of not being able to fully reflect the differences in banks' operating models.

Weighting of the four aspects

18. Kiwibank agrees with the equal weighting method across all four categories.

19. ANZ raises the concern that the equal weighting method is arbitrary and suggests that a larger weighting is put on *Size* (e.g. 50%), while *Complexity* should have a smaller weighting. ANZ's main argument is that derivatives (one measure of *Complexity*) are overly weighted compared to capital calculation.

20. **Response**: Using an equal weighting system is a common practice for D-SIB frameworks in jurisdictions around the world. The equal weighting approach reflects the similar importance of different aspects of systemic risks banks can bring to the financial system.

21. The consultation paper (page 12) already discussed the importance of derivatives for the financial system of New Zealand. When adjusted for total assets of the banking system, the turnover of OTC interest rate and foreign exchange derivatives in New Zealand is comparable to other countries.

22. Moreover, using different weighting methods do not significantly alter the rankings or the gap between the big four Australian banks and other smaller banks. Table 2 shows the results. Again, it is unlikely that any bank, which should be identified as a D-SIB, will fail to be designated as systemically important under the equal-weighting method. We believe the equal weighting method will yield robust results when identifying D-SIBs, bearing in mind that there will always be a need to exercise supervisory judgment, as proposed.

Table 2 Total score for banks using different weighting methods

Banks (in order of total assets)	**Equal Weighting**	**50% for Size and equal weighting for the other three categories**
ANZ	35.50	34.21
BNZ	21.00	20.63
ASB	18.98	19.01
Westpac	14.45	15.59
Kiwibank	3.40	3.66
Rabobank	1.49	1.77
TSB	1.72	1.65
SBS	0.99	0.97

Heartland	0.66	0.74
Co-op	0.47	0.49
BOC	0.42	0.43
ICBC	0.47	0.46
CCB	0.38	0.35
BOB	0.03	0.03
BOI	0.02	0.02

23. ANZ queries the methodology of determining the weightings for *Loans to Household and Non-financial Businesses* (40%) versus *Agriculture Loans* (10%) in the category of *Sustainability*.

24. **Response**: Within the category of *Substitutability*, deposits and loans take 50%:50% weighting each. Within the subcategory of loans, there are roughly four times as many *Loans to Household and Non-financial Businesses* as *Agriculture Loans* in all locally incorporated banks. Therefore, the weighting system within the category of *Substitutability* is 40% for *Loans to Household and Non-financial Businesses*, 10% for *Agriculture Loans*, and 50% for *Deposits*.

Threshold and transition period

25. Kiwibank and ANZ agree that no numerical threshold should be included in the framework. Although this might reduce transparency, submitters acknowledge the appropriateness and necessity of using supervisory judgement in D-SIB decisions, especially considering the changing environment of the banking system in New Zealand.

26. Kiwibank proposes that the Reserve Bank should advise a bank that is approaching D-SIB status years in advance and provide it with an appropriate transition time to meet the additional capital requirements.

27. **Response**: The Reserve Bank agrees that banks moving into the group of D-SIBs will need time to meet any additional regulatory requirements. An appropriate transition period for meeting the D-SIB capital buffer will be decided as part of the final decision of the Capital Review, which is scheduled to be announced in November 2019. However, the Reserve Bank cannot commit to giving future D-SIB banks notice years in advance. Part of the methodology of determining whether a bank is a D-SIB is the relative significance of that bank vis-à-vis other banks. Predicting the relative position of banks within a banking system years in advance is too unreliable to be useful in this context. In reality, a bank will be well aware of its relative importance and have a good sense of the trajectory it is on, not least through its interactions with Reserve Bank supervisors. Any decision to include a bank in the group of D-SIBs is unlikely to be a surprise for the bank concerned.

Scope of application

28. ASB and ANZ agree that the D-SIB framework should not be applied to the current branch registration requirement as per BS1, arguing that the two policies address different kinds of risk. Kiwibank agrees with the suggestion of developing a different terminology for the local incorporation threshold to avoid confusion with the D-SIB framework.

29. ANZ agrees that the framework for identifying D-SIBs should only apply to locally incorporated banks rather than branches of overseas banks but queries whether the D-

SIBs may be required to calculate and publicly disclose all/any of the quantitative metrics making up the D-SIB methodology.

30. **Response**: The Reserve Bank notes that the metrics used in its framework are all based on publicly available information, a lot of which is included in the Bank Financial Strength Dashboard. The Reserve Bank may consider enhancing the transparency around the D-SIB scores in future but there are no plans to require banks to calculate or disclose the information at this stage.

31. The main purpose of the D-SIB framework is to provide analytical clarity for the identification of banks that may be subject to the proposed D-SIB capital buffer. At this stage, the Reserve Bank does not intend to impose any additional requirements on D-SIBs except for the proposed D-SIB buffer in the Capital Review.

Calibration of the D-SIB buffer

32. A number of submitters include their feedback on the calibration of the proposed D-SIB buffer in their submission.

33. **Response**: This consultation focused on the framework for 'identifying' D-SIBs. The Reserve Bank notes the feedback on the calibration of the D-SIB buffer and has already incorporated the feedback in the summary of submission "Capital Review Paper 4: How much capital is enough? The Reserve Bank will consider all the feedback when making decisions on the final outcome of the Capital Review, including the D-SIB buffer. Those decisions are scheduled to be released in November 2019.

Next step

34. The Reserve Bank would like to thank all submitters for their constructive input into the development of a D-SIB methodology. The final framework for identifying D-SIBs and the list of D-SIBs will be published in November 2019, alongside all other capital review-related decisions.