Reserve Bank of New Zealand
Te Pūtea Matua

Liquidity Policy Review.

Summary of Submissions and Key Decisions: Consultation Paper #1 (Issues and Scoping)

14 June 2022

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Background

At the Reserve Bank of New Zealand – Te Pūtea Matua, we are undertaking a fundamental review of our liquidity policy (BS13), known as the 'Liquidity Policy Review' (LPR). This is the first comprehensive review of our liquidity policy since it was implemented in 2010.

We published our first consultation paper (C1) for the LPR in February 2022. C1 set out the proposed issues and scope for the review. It also contained the principles we proposed be used to guide the review and our decision-making.

This document summarises, and responds to, submissions received on C1. It also sets out our key decisions and the next steps for the review, including an updated (and extended) timeline for the review. We thank submitters for providing their views, and note that these will be considered as we progress through the review.

We intend to issue at least three more consultation papers as part of the LPR. The second and third consultation papers will seek feedback on a number of fundamental issues related to our liquidity policy, with the fourth consultation paper expected to contain the proposed final liquidity policy text.

Consultation Process

We released C1 on 28 February 2022, with the comment deadline closing on 14 April 2022.[1] We received seven official submissions on the consultation paper, most of which were from the deposit taking sector, comprising:

- Three submissions from locally-incorporated banks;
- One submission from a bank branch;
- One submission from the New Zealand Bankers Association (NZBA);
- A joint submission from entities in the Non-Bank Deposit Takers (NBDT) sector; and
- A submission from an individual.

This document provides a summary of these submissions, as well as our responses to these submissions. Our responses focus on the common themes and views raised in the submissions. This document is not intended to be an exhaustive summary and response to all points raised. We direct readers to C1 and the published submissions in response to C1 for a full understanding of the feedback received. The feedback received through this consultation will inform the next stages of the review.

[1] LPR C1 can be found here: Liquidity Policy Review - C1.

Our Responses to Feedback Received

General Feedback

Submitters supported reviewing our liquidity policy now, agreeing that it needed a review and update. Submitters also agreed that given the developments in international practice since our liquidity policy was introduced in 2010, and our recent Liquidity Thematic Review, now is a good time to review the policy and ensure that it remains fit for purpose.

Submitters requested that we run industry workshops and 'question and answer' (Q&A) sessions with stakeholders throughout the review.

Members of the NBDT sector, in a joint submission, highlighted and provided an overview of the uncertainty facing the sector, mainly related to implementation of the forthcoming Deposit Takers Act (DTA) and the standards they may be subject to in the future. The submission highlighted the need for proportionality in designing requirements for the sector. They noted that liquidity requirements for banks, particularly quantitative requirements, would not work for NBDTs and it would be difficult for them to comply if we expected them to meet the requirements under BS13 or the BCBS' liquidity framework. The NBDT sector requested we create a separate workstream to consider what reasonable requirements might be for them. As part of this, they asked us to also consider whether we could provide cost effective liquidity to NBDTs, and whether we could provide liquidity support to NBDTs in a crisis situation, given that they are currently reliant on registered banks for this.

One submitter stated the focus on liquidity risks generated in the payments function is an area that could be expanded, as distinct from more established monitoring of assets, liabilities and maturity transformation.

Our response

As outlined in C1, we agree that the policy needs a review and update. We intend to work with industry and other stakeholders to find opportunities to effectively engage with industry throughout the review. We are also happy to meet bilaterally with stakeholders at any time during the review.

We will consider and incorporate all feedback provided in the NBDT submission throughout the review. We note that the concept of proportionality is contained in one of the guiding principles of the review, and we will be mindful of this as the review progresses. As we intend to devote significant analysis and attention to NBDT liquidity requirements, we do not believe establishing a separate work stream for this purpose is necessary. We note that while the provision of liquidity to the NBDT sector directly via the Reserve Bank's facilities is outside the scope of this review, we have initiated a separate review of our access policy and criteria for deciding applications to open ESAS (settlement) accounts, and we welcome the NBDT sector's participation in this consultation.[2]

We will further explore the concept of liquidity risks in the payments function as part of the review.

[2] Further information is available here: ESAS Application Policy - Reserve Bank of New Zealand (rbnz.govt.nz)

The Case for Review

Q1: Are there other drivers that are relevant to the case for review?

Submitters agreed with the list of drivers provided in the consultation paper. Submitters also highlighted that BS13 is unclear in places and should be reviewed to ensure clarity, with some suggesting that we provide guidance where appropriate.

One submitter noted that payment systems present risks to banks, including offshore payment systems. They also noted the move in recent years to centralised clearing of derivatives.

Our response

As noted in C1, there are a number of drivers for this review. We will consider our existing liquidity policy and the BCBS liquidity framework and will endeavour to ensure that any new or revised policy is as clear as possible and that guidance is provided where appropriate, in line with our LPR principles (listed at the end of this document).

As noted in our response to general feedback above, we will further consider the risks that exist in the payments system/function. We will also further consider any potential impacts that centralised clearing of derivatives might have.

The Reserve Bank's Liquidity Policy

Q2. Are there any areas of the current liquidity policy that you believe are not fit for purpose and should be an area of focus for the review?

Bank submitters provided a list of areas of BS13 that they thought we should focus on. We provide a non-exhaustive list below, noting that we will consider all points raised as we progress through the review.

- Submitters asked us to consider including a materiality threshold for breaches of liquidity conditions of registration related to errors or miscalculation.
- A submitter suggested removing the one week mismatch ratio and to change the one month mismatch ratio to 30 days. Another submitter noted that the one week mismatch ratio would become irrelevant if we decided to adopt the LCR.
- Submitters commented on the need for us to consider customer and deposit bucketing, customer and deposit groupings, and customer type definitions as part of the review, noting that this has been an ongoing issue with the current policy.
- Submitters also asked for clarity on particular definitions, e.g. business day, calendar month.
- A submitter asked us to consider whether policy clarification, or the policy intent, should be part of the policy itself or part of guidance accompanying the policy.

Our response

As noted above, there were many points raised in relation to areas of our current liquidity policy that submitters thought should be an area of focus for the review. We will consider all of these points as we progress through the review, noting that our response to these points will depend partially on whether or not we propose to adopt the BCBS liquidity framework, where some of these points would be addressed automatically. If we decide to retain much of our existing liquidity policy and metrics, we will ensure that all of these points are considered.

In relation to the last bullet point above, around the question of where policy clarification and intent should be reflected, we will consider the best place for this information. We are exploring the best way to communicate policy guidance more transparently and aim to provide a consistent approach for how clarifications/FAQs are communicated across our prudential policies, as part of implementing standards under the DTA.

International Liquidity Framework

Q3. Do you have any initial views on whether we should consider the BCBS liquidity framework as part of the review (noting that views on this question will be sought again in the next consultation paper)?

Submitters were supportive of us considering the BCBS framework as part of the review, but noted that it should not be adopted unless we are able to determine that it is better than our current policy. One submitter noted that the costs of moving to the BCBS framework might be higher for smaller banks, and requested that we undertake a cost/benefit analysis if we consider this shift.

Submitters noted the potential benefits of international alignment if we adopted the BCBS liquidity framework. One submitter noted that harmonising frameworks with Australia and other OECD countries would strengthen New Zealand banks' liquidity and balance sheets, and will allow ratings agencies and investors of debt and capital to be able to rely on liquidity reporting and dashboards on a level playing field. This submitter also noted that the Australian-owned New Zealand banks currently have to manage two slightly different liquidity metrics, and that we needed to align any run off rules with the Australian Prudential Regulation Authority's (APRA's) liquidity standard (APS210) or ensure that our rules would be accepted by APRA. Another submitter noted that international branches of large global banks in New Zealand are also subject to the BCBS liquidity standard (or variants of this standard), as well as the four Australian-owned banks.

One submitter stated that the BCBS' LCR sets a higher bar for liquidity during business-as-usual and in stress. This submitter also stated that BCBS' NSFR is better than the CFR because it considers the liquidity draw of assets, and that a move to the BCBS framework may allow New Zealand covered bonds to be repo eligible with the European Central Bank.

Another submitter noted that current mismatch ratios do not calculate mismatches by currency to ensure there are not significant mismatches at the currency level, whereas this is a requirement in the BCBS framework.

Our response

We are mindful that we will need to consider the benefits and costs of the BCBS framework relative to our current settings, and will ensure that we articulate our rationale behind any proposals that we make as part of the review. We will consider all points made in relation to this question as part of our second consultation (C2).

We agree that a cost/benefit analysis should be undertaken as part of the review. Our proposed framework to assess the potential move to the Basel framework, including the cost/benefit considerations, will be provided as part of C2, and we will be seeking views on the underlying assumptions from stakeholders to inform our final decisions. We expect to provide a more fulsome cost/benefit assessment articulating the rationale for our decision on this matter in the C2

Summary of Submissions and Key Decisions document. We also note that we will produce a full Regulatory Impact Analysis of the changes towards the end of the review.

Key Issues for the Review

Q4. Is the proposed scoping of this review sufficiently comprehensive? Are there any issues that should be examined that are not mentioned in this consultation paper?

Submitters generally agreed with the proposed scoping of the review. Submitters asked that we consider the broader prudential landscape, including implementation of the forthcoming DTA, and the potential implications that this may have for our liquidity policy. A submitter also requested that we consider adding materiality thresholds for liquidity metric calculation errors, and consider including minimum requirements for stress testing, in the review's scope.

A submitter also highlighted that we need to consider of the role of self-securitised assets, particularly internal RMBS (I-RMBS). One submitter noted that removing I-RMBS as a liquid asset, or making them more costly for banks to hold, could have implications for monetary policy and financial stability.

One submitter suggested that we should consider using foreign currency liquid assets given the limited amount of securities in New Zealand dollars, and noted that if we consider this we should confirm with APRA whether they would consider foreign currency assets as eligible under their own liquidity requirements. Another also noted that we should consider a home jurisdiction's liquidity requirements when considering liquidity requirements in New Zealand.

Two submitters noted that there are clear linkages between the review of our branch policy and this review, in terms of whether liquidity requirements will be applied to branches. One of these submitters noted this is also related to management of the risks of offshore derivatives, and whether these are traded through branches.

Our response

The LPR will consider the broader prudential landscape and the implications this may have for our liquidity policy as part of the review. We will consider whether materiality thresholds are appropriate, particularly as we move to the new 'standards' framework as part of the DTA.

We are considering the role of RMBS (including I-RMBS) and the role of foreign currency liquid assets, and will put forward our proposal on these in C2.

Home jurisdiction liquidity requirements will be considered in the analysis of liquidity requirements for branches. We will consider this as part of our third consultation paper (C3). We will also further explore the risks of offshore derivatives.

Proposed Liquidity Policy Review Principles

Q5. Are the proposed principles for the Liquidity Policy Review appropriate? Should any principles be added, removed, or amended? If so, please provide specific feedback on how this should be done.

Submitters supported the proposed principles for the review, but asked that we consider amending or adding in certain principles.

A couple of submitters suggested adding an additional principle that captures the idea that the Reserve Bank will have regard to its other stability mechanisms when designing its liquidity policy (either implemented or proposed). They stated that these other mechanisms reduce the probability of bank-specific liquidity risk.

Two submitters mentioned that a goal of the review should be to ensure a level playing field between deposit takers, and that liquidity requirements should not adversely impact competition. As part of this, one submitter emphasised that proportionality should be a guiding principle of the review, noting that the financial system benefits from increased competition, innovation and diversity of products and services. This submitter noted that if the benefits of proportionality form a principle for the review, this would encourage decision makers at the Reserve Bank to take a cost/benefit approach when designing standards for different types of deposit takers.

A few suggestions were made in relation to principle 5, which states that "liquidity requirements should be sufficiently prescriptive to promote and facilitate consistent implementation and enhance market discipline". One submitter noted that if we adopt this principle, we need to also be prepared to appropriately categorise institutions and create fit for purpose standards for each category. Another submitter suggested that this principle also include a statement that requirements are sufficiently clear to promote and facilitate consistent interpretation.

Similar to the suggestion around clarity and facilitating consistent interpretation above, another submitter suggested that an additional principle of transparency be included in areas that require interpretation by banks. They noted that in practice, this could be achieved via such mechanisms as a Prudential Practice Guide (which APRA publishes that provide guidance on their view of sound practice in particular areas), frequently asked questions (FAQs), or clear assumption registers that are disclosed to the industry where applicable.

Our response

While we agree that we should have regard to other regulatory measures in the prudential framework (both existing and future), we have chosen not to adopt this suggestion as an additional LPR principle. We note that this is generally captured within principles 1 and 3 for the review, given that these measures will feed these in to our calibration of liquidity requirements through considering stress scenarios and impact on financial stability (principle 1), and given that we will have regard to the New Zealand context in setting liquidity requirements (principle 3). We note that the primary focus of this review is on developing a policy that best addresses liquidity risks in New Zealand, noting that our other policies and regulatory measures are in place to address different risks and support financial stability, which are complementary to (but not substitutes for) our liquidity policy.

In respect of the point made around including the benefits of proportionality as a principle for the review, we explored various options for amending principle 3 to better draw out this concept, while also reflecting the costs of proportionality. On balance, we have decided not to amend the principle. We would like to reassure industry, particularly the NBDT sector, that proportionality is a guiding principle for the review.[3] We will take a cost/benefit approach to proportionality, and all other aspects of the LPR.

Regarding principle 5, we agree that drawing out the point raised around clarity and facilitating consistent interpretation would further commit us to making our liquidity framework able to be consistently implemented. As such, we have amended this principle to read "Liquidity requirements

[3] Further, under the proposed DTA, we would be required to take into account the desirability of taking a proportionate approach to regulation and supervision.

should be sufficiently clear and prescriptive to promote and facilitate consistent interpretation and implementation by deposit takers to enhance comparability and market discipline".

In relation to the point around adding an additional principle relating to transparency in areas that require interpretation by banks, we note that this is similar to the points raised around principle 5. As noted above, we have amended principle 5 to draw out the point around clarity and consistent interpretation. We also recognise the importance of being transparent with issues around interpretation. However, we do not see that this should be included as a standalone guiding principle for the review. We note that we are exploring the best way to communicate any policy guidance more transparently, whether it be through embedding such guidance within policies, providing separate guidance documents, FAQs, or a combination of such methods.

Our final set of principles is provided in the last section of this document.

Proposed Consultation Process and Approximate Timeline for the Review

Q6. Is the proposed process and approximate timeline for the review appropriate?

Two submitters requested that the minimum 60 day consultation periods be extended to between three and four months (i.e. have a minimum consultation period of at least 90 days). This request came in light of the other regulatory initiatives underway, and given the potential scope of the review. These submitters also asked that the timeline include an estimated transition period, and that deposit takers be given sufficient implementation time.

Submitters also noted that depending on the extent of the changes that occur as part of the review, deposit takers will need time to rework their systems. This will likely be different across the spectrum of deposit takers, and consideration needs to be given to this factor when deciding on an appropriate implementation period.

Our response

We recognise the large number (and magnitude) of existing and planned regulatory initiatives impacting stakeholders of this review. We will endeavour to have a minimum consultation period of 12 weeks for our next three consultation papers. We provide an amended (and extended) consultation timeline that reflects these longer consultation periods at the end of this document.

In terms of implementation, we are committed to providing appropriate transition periods for all material policy implementations. In this case, the appropriate approach will be influenced by the key decisions taken in the review, specifically whether we adopt the Basel framework (which would likely imply a longer transitional period), or retain a modernised version of BS13. We will consult on a proposed transition period once we have more certainty around our final policy settings.

Additional Feedback

Q7. Do you have any additional feedback on the proposed issues and scoping of the Liquidity Policy Review?

A submitter asked us to incorporate stress testing as part of our liquidity policy, noting that it would be good for this to be standardised where applicable.

Submitters asked for us to consider publishing FAQs on the policy (like APRA does in Australia), or to provide guidance notes on the policy where needed.

One submitter from the banking sector highlighted that it would be good for the Reserve Bank to, in collaboration with APRA, arrange a workshop with industry to understand APRA's experience under their liquidity standard (APS210), and to understand areas where APS210 works well and areas that may need review, which we could take into account when designing our revised liquidity policy.

Two submitters noted that C1 was silent on a review of outflow assumptions, including how term deposit breaks and undrawn lending commitments should be treated. Submitters also highlighted that the forthcoming Deposit Compensation Scheme (DCS) will have a bearing on the liquidity policy, and asked us to consider how the implementation of the DCS may affect run-off rates.

One submitter also asked us to review our covered bond limit (of 10 percent), stating that rating agencies have no hard secured funding limit. They stated that expanding this limit and allowing offshore denominated covered bonds issued by New Zealand banks to be held in the liquidity portfolio will increase the overall pool of liquid assets available to support moving to a LCR framework.

This submitter also welcomed the Reserve Bank's proposition to assess the need for a Committed Liquidity Facility (CLF) type mechanism with a committed line fee and CLF caps based on banks' balance sheet profiles. The submitter preferred this proposition to the Residential Mortgage Obligations (RMO) type framework. This submitter additionally suggested that we consider how banks can use Open Market Operations (OMO) to liquefy I-RMBS more easily in managing liquidity and ESAS balances under business as usual or stressed liquidity conditions without setting up bespoke lending facilities.

Our response

We will consider the best way to incorporate stress testing as part of our liquidity policy in the review. We will also work towards communicating any policy guidance more transparently, whether it be through embedding such guidance within policies, providing separate guidance documents, FAQs, or a combination of such methods.

In relation to the request for a workshop with industry in relation to APS210, we agree that experiences of operating under APS210 offer a useful input into the LPR, and will explore options to identify and disseminate any key lessons learnt from that framework.

We have always intended to review outflow assumptions as part of the LPR. However, we note that final outflow assumptions may depend on the direction of travel we propose for the policy, that is, whether we propose to move to the BCBS liquidity framework or retain the existing metrics used in BS13. We will also consider the impact of the DCS on outflow assumptions. This will be explored as part of C3.

In regards to the points raised around the covered bond limit, while this will not be considered as part of the review, this issue will be considered outside of the LPR. In relation to the point around the Reserve Bank considering how banks can use OMO to liquefy I-RMBS more easily without setting up bespoke lending facilities, we will revisit this point once we have made a decision around whether a CLF is appropriate.

Final Liquidity Policy Review Principles and Updated Timeline

Liquidity Policy Review Principles

The final LPR principles are listed below, with an amendment to principle 5 to incorporate C1 feedback. That is, throughout the review, we will have regard to the following high-level principles:

1. Liquidity requirements should be calibrated using assumptions that reflect stress scenarios to help ensure financial stability.
2. The liquidity policy should encourage banks to make reasonable efforts to maximise reliance on private sector liquidity.
3. Liquidity requirements should have regard to international practice, while reflecting the New Zealand context, and be proportional by taking into account the differing size, nature, and complexity of all deposit takers.
4. The liquidity policy should contain both qualitative and quantitative requirements and encourage banks to take a holistic approach to their management of liquidity risk.
5. Liquidity requirements should be sufficiently clear and prescriptive to promote and facilitate consistent interpretation and implementation by deposit takers to enhance comparability and market discipline.
6. Liquidity requirements should be practical to administer and seek to avoid any unnecessary complexity and compliance costs.

As outlined in C1, while we do not believe that any of these principles are in direct conflict with one another, we recognise that it may be necessary for us to strike a balance between these principles at times.

In response to feedback received in C1, we note that we are exploring the best way to communicate policy guidance more transparently and aim to provide a consistent approach for how clarifications/FAQs are communicated across our prudential policies, as part of implementing standards under the DTA.

It should also be noted, that while not a principle for the review, we do not wish to see an overall material weakening in liquidity requirements relative to what currently exists, which applies to both qualitative and quantitative requirements.

Updated Approximate Timeline

In response to concerns expressed by stakeholders over the amount of regulatory initiatives currently underway, as well as those expected in the coming years, and to ensure workloads are sustainable for all those involved, we are extending the overall LPR timeline by several months. This includes a commitment to endeavour to provide stakeholders with a minimum 12 week comment period for the next three consultation papers (C2, C3, and C4). The updated approximate timeline is below; the previous approximate timeline can be found in C1.

Updated Approximate Liquidity Policy Review Timeline	
Q1 2022	• Release of C1, with submissions due by 14 April 2022
Q2 2022	• Reserve Bank publishes summary of submissions and key decisions for C1
Q3/Q4 2022	• Release of C2[4]
Q1 2023	• Reserve Bank to publish a summary of submissions and key decisions for C2
Q2/Q3 2023	• Release of C3
Q4 2023	• Reserve Bank to publish a summary of submissions and key decisions for C3
Q1 2024	• Release of C4
Q3 2024	• Reserve Bank to publish a summary of submissions and key decisions for C4
Q4 2024	• Reserve Bank to launch a quantitative impact study (QIS) on the near-final liquidity policy, to take place over several months
Q1 2025	• QIS results received and analysed by the Reserve Bank • Reserve Bank to amend near-final liquidity policy based on QIS results
Q2 2025 to Q4 2025	• Reserve Bank to undertake further consultations (in addition to the four consultation papers and QIS), either public or targeted, if required • Reserve Bank to publish final liquidity policy

Next Steps

As noted throughout this document, we will consider all feedback received on this consultation and this will be incorporated into subsequent consultations. We again would like to thank submitters for taking the time to provide their views.

We intend to release C2 in the third quarter of this year, as outlined in the timeline above. We welcome engagement with stakeholders throughout the review, and invite any questions or comments on the LPR to LiquidityPolicyReview@rbnz.govt.nz

[4] For C2, C3, and C4, we will endeavour to provide a minimum 12 week consultation period.