

Review of capital settings

FSOC

14 April

Purpose statement – alternative

Drawing on our published definition of financial stability:

- The purpose of the review of key capital settings is to assess whether the Reserve Bank's prudential capital requirements for deposit takers are set at the optimal level to support a stable financial system – one where resilient financial markets, institutions and infrastructures enable a productive and sustainable economy, and ultimately promote the prosperity and wellbeing of all New Zealanders.



Status quo

Minimum capital

Condition of registration for banks to meet at all times

- 9% for all deposit takers

Prudential capital buffer

Supervisory response if banks dip into the buffer.

- 9% for Group 1 (big 4)
- 7% for Group 2 (mid-sized banks)
- 4% for Group 3 (mostly non-bank deposit takers).

Tier 1

Common Equity Tier 1 (CET1) – ordinary share capital and retained earnings

- 13.5% for Group 1
- 11.5% for Group 2
- 8.5 for Group 3

Tier 1

Additional Tier 1 (AT1) – redeemable perpetual preference shares

- up to 2.5%

Tier 2

Long term subordinated debt

- up to 2%

$$\text{Capital Ratio} = \frac{\text{Capital}}{\text{Risk Weighted Assets}}$$

Credit risk

~85% of RWAs

Calculated via either:

- **IRB approach** (big 4): more accurate, but costly. Subject to a floor to limit the benefit.
- **Standardised approach**: simpler but less granular.

Operational and Market Risk

~10% operational risk
~5% market risk

Calculated consistently across deposit takers

Review

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Credit risk

~85% of RWAs

Calculated via either:

- **IRB approach** (big 4): more accurate, but costly. Subject to a floor to limit the benefit.
 - **Standardised approach**: (all other banks) simpler, but less granular.

Operational and Market Risk

~10% operational risk
 ~5% market risk
 Calculated consistently across deposit takers

In scope of the review

Already being updated under DTA work programme.



Analytical framework – 2017-19 review

Develop options

- Estimates to meet soundness and efficiency objectives
- Consideration of society's risk tolerance (focus groups)
- International approaches to risk tolerance
- Iterate based on cost benefit analysis results

Appropriate risk appetite for New Zealand.

Analyse costs and benefits of options

Probability of crisis

- Relationship between capital and likelihood of banking crisis estimated using value-at-risk portfolio risk modelling (including using stress test results) and international literature.

Cost of crisis

- Estimates of costs of banking crises using international empirical estimates (given NZ's limited experience of crises).

Bank funding costs

- Estimates of costs of capital for different instruments

Interest rates and economic growth

- Estimates of feed through from capital to interest rates
- Assumptions about the offset from lower risk
- Multiplier of impact of interest rate on economic growth

Tax and wealth transfer effects

- Higher capital levels raise net tax revenues in NZ, offsetting the wealth transfer to foreign shareholders

Unquantified costs and benefits

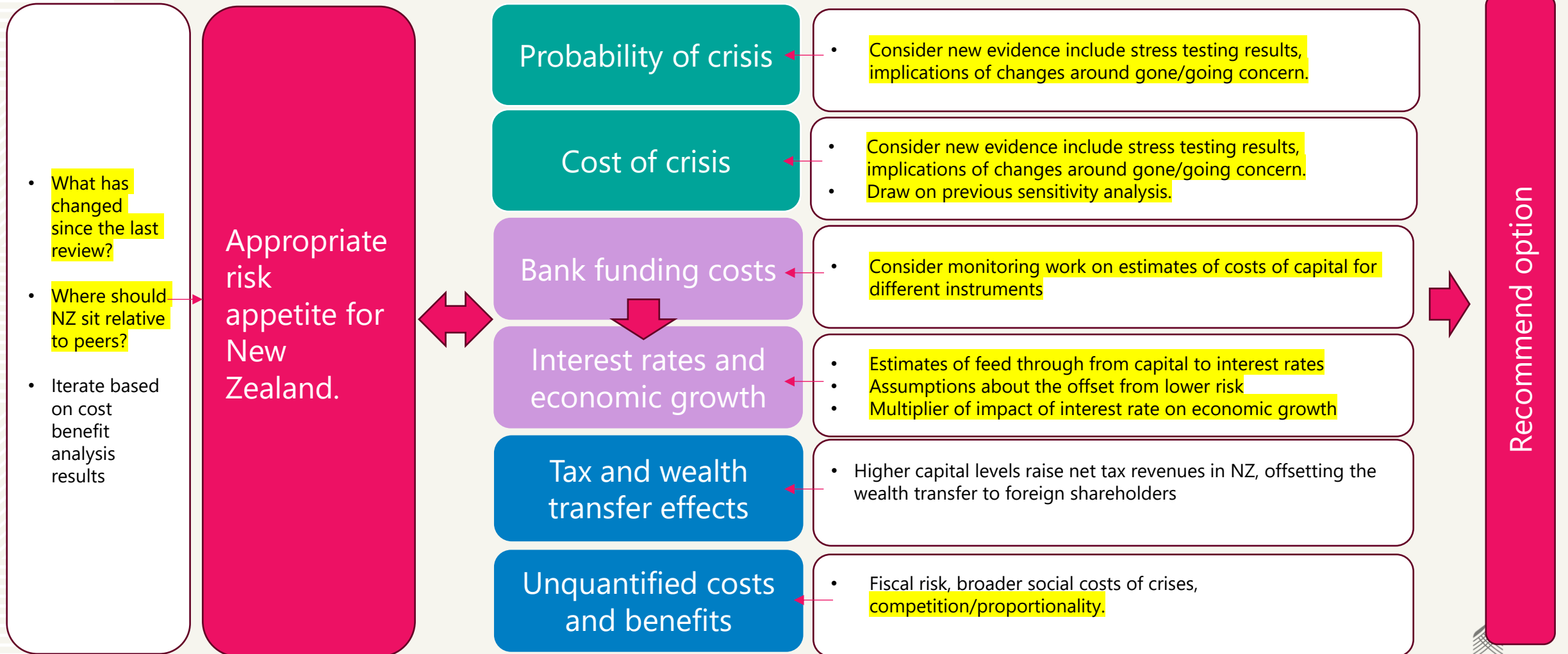
- Fiscal risk, broader social costs of crises, competition.

Recommend option

Analytical framework – 2025 review

Analyse costs and benefits of options – what new evidence is there?

Develop options



Annex

Purpose statement – more alternatives

- Assess whether the Reserve Bank's prudential capital requirements for deposit takers **balance the costs and benefits for the New Zealand economy.**
- Assess whether the Reserve Bank's prudential capital requirements for deposit takers **are set at the optimal level to effectively meet the Reserve Bank's financial stability objective while not unduly inhibiting economic efficiency.**
- Assess whether the Reserve Bank's prudential capital requirements for deposit takers **are set at the optimal level.**

