Reserve Bank of New Zealand
Te Pūtea Matua

Board Paper for Decision #3.1

From	Review of key capital settings team (Katy Simpson - Manager, Prudential Policy)
Approved by	Angus McGregor, Acting Assistant Governor Financial Stability
Date	11 December 2025
Subject	2025 Review of Key Capital Settings: Finalised capital settings
For	Decision
Value(s)	Innovation/Wānanga | Inclusion/Taura
Strategic Theme(s)	Strengthening efficiency and competition; Promoting understanding and trust

1. Purpose

As part of the final stage of the Review on Key Capital Settings (the **Review**), this paper recommends policy positions for the finalised capital settings. A glossary is at Appendix 17.

To address specific issues raised by the Board, the paper also: provides a draft risk appetite statement and key messages (at Appendix 5) and an overall assessment of proportionality across the range of prudential standards (at paragraphs 4.71 to 4.76).

2. Recommendations

We recommend that, subject to discussion by the Financial Stability Oversight Committee (**FSOC**), the Board:

1. **Note** the Review began on 27 March 2025 and in accordance with the Terms of Reference set by FSOC.
2. **Note** that on 28 July 2025, following its meeting on 24 July 2025, we consulted the public on:
    a. More granular risk weights.
    b. Removing Additional Tier 1 (**AT1**) capital as a recognised form of regulatory capital and partially replacing it with a combination of Common Equity Tier 1 (**CET1**) and Tier 2 capital.
    c. Two options for the amount and form of capital, one option without Loss-Absorbing Capacity (**LAC**) (Option 1) and one option with LAC (Option 2).
3. **Approve** for the policy positions outlined in Appendix 1 to be implemented (under delegation for a. and b.) by:
    a. Changes to the conditions of registration applying to registered banks made under section 74 of the Banking (Prudential Supervision) Act 1989.
    b. Either (subject to further legal advice):

i. A recommendation to the Minister of Finance under section 33 of the Non-Bank Deposit Takers Act 2013 (**NBDT Act**) to amend the Deposit Takers (Credit Ratings, Capital Ratio and Related Party Exposures) Regulations 2010; or
ii. Conditions of licence imposed by the Bank under section 18 of the NBDT Act.

c. A Capital Standard issued under section 72 of the Deposit Takers Act 2023 (**DTA**).

4. **Note** that before the powers referred to in recommendation 3 are exercised by the Bank, it must consider the legal prerequisites outlined in each of the Acts (see Appendix 2).

3. Background

The Review began in late March 2025 with a targeted Terms of Reference to enable decisions by the end of the year

3.1. We consulted on the Capital Standard, as part of consultation on the 4 core standards of the DTA, from May to August 2024. On 27 March 2025, the Board approved a reassessment of regulatory capital settings for deposit takers. On 14 April 2025, FSOC (under the Board's delegation) approved the Terms of Reference that set out scope, methodology, timing, and the use of external international experts.[1]

3.2. The Review's Terms of Reference set out the purpose of the Review, which is to assess whether the Reserve Bank's prudential capital requirements for deposit takers are set at the appropriate 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.

3.3. In order to complete the Review by the end of the year, the scope of the Review is targeted to some specific issues. While we have attempted to address out-of-scope issues where practicable as part of the Review. However, in line with the Board's previous decision when setting the Terms of Reference, we have not undertaken any work that would impact the delivery deadline of the Review.

This paper seeks your approval to make changes to our capital settings

3.4. This paper sets out our recommended capital settings – and the analysis behind it – to align with the Board's risk appetite. As part of this Review, we have analysed the following sources of information and analysis to support the Board's decision-making process:

i. Submissions from stakeholders on our Consultation Paper where we sought feedback on options (discussed at the Board meeting of 30 October 2025).

ii. Independent reports from the three international experts to the Review (high-level points summarised and discussed in this paper at Table 1 below and discussed at the meeting between the experts and FSOC on 7 November 2025).

[1] Reserve Bank of New Zealand. (2025). *2025 Review of key capital settings: Terms of Reference*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/2025/2025-review-of-key-capital-settings-terms-of-reference.pdf

iii. Updated analysis including criteria analysis and cost benefit analysis (**CBA**), having considered feedback from stakeholders (discussed in this paper).

3.5. A summary of our recommended final policy positions and key feedback received is at Appendix 1. We recommend that the Board approve these policy positions. While our focus is on the content of the Capital Standard to be issued by the Board in 2027, we are also seeking to bring forward the benefits of the updated policy where possible by changing banks' conditions of registration and the regulations made under the NBDT Act 2013 (as per advice to the Minister of Finance and our external commitments). Each Act has its own statutory purpose and other legal prerequisites which the Board is being advised to consider at this time.

3.6. Appendix 2 outlines the legal process from here and includes a general legal risk assessment.

We received 43 submissions in response to our Consultation Paper

3.7. During June and July, we developed several policy positions for the Reserve Bank to consult on in August. On 28 July 2025, the Board approved our consulting on the following policy positions:

i. Introducing more granular risk weights.

ii. Removing AT1 capital and partially replacing it with a mixture of CET1 and Tier 2 capital.

iii. Two options – one without LAC (Option 1) and one with LAC (Option 2), with both options expected to result in lower average funding costs for deposit takers than under the outcomes that resulted from the 2017-2019 review of capital settings (**2019 Capital Review**).

3.8. Public consultation on these positions and our initial analysis took place from 25 August to 3 October 2025. We received 43 submissions as part of this consultation.

3.9. We have also been engaging with stakeholders during the consultation period and as we analysed submissions. This has included a public webinar, facilitating deposit takers' meetings with the independent international experts, and bilateral meetings with deposit takers and other stakeholders. Feedback on our engagement approach has been positive.

The Review includes two avenues of challenge to our advice

3.10. The Terms of Reference set out the role of the Treasury and independent international experts and the in the Review. In particular:

i. The Treasury played a role in challenging the Reserve Bank's analysis. We have worked closely with the Treasury to update them on our thinking as part of the Review, and to consider their feedback on our analysis. The Board was provided the Treasury's initial view to the Minister of Finance on our approach and direction of travel on 5 November (T2025/2719 refers). The Treasury was broadly supportive of our approach and process, and of our general direction of travel.

ii. Three international experts reviewed our options and recommendations to provide rigorous and independent perspective as part of the decision-making process. This is discussed in the next section below.

Three independent international experts have completed reports with their views on our capital settings

3.11. As agreed in the Terms of Reference, three independent international experts have reviewed the Reserve Bank's analysis, options and recommendations to support the Financial Stability Oversight Committee in reaching decisions.

3.12. Their near-final report will be provided to you on 24 November 2025, and the finalised versions will be published alongside the final decisions the Board makes. This paper includes summaries of and responses to the experts' findings based on a draft report we received on 17 November 2025. The table below summarises the of the experts' high-level findings.

Table 1: Summary of independent international experts' reports

International expert	Summary of report
Thorsten Beck Thorsten Beck is Director of the Florence School of Banking and Finance and Professor of Financial Stability at the European University Institute. He is also the co-chair of the Advisory Scientific Committee of the European Systemic Risk Board. He is an expert in the relationship between finance and economic development.	• Notes that, while the 2019 Capital Review went beyond Basel II and other advanced countries, this can be justified given NZ's higher reliance on its banks, limited diversification benefits and risks that come with a small open economy. The 2019 model assumed risk neutrality, and one cannot say that the approach was too risk-averse. • Notes RBNZ should focus on long-term financial stability and not be influenced by short-term political cycles. • Notes global macro financial landscape is worse than in 2019. • Notes there is no clear relationship between capital levels and lending or economic growth. Notes negative effects in transition phase to new capital requirements, not in the steady state. • Notes there is an unclear relationship between capital requirements and competition. • Notes absence of Pillar 2 calls for higher Pillar 1 requirements. • Supportive of proportionality given stronger negative repercussions to economy from a large bank failure. Notes LAC would be problematic for Group 2 moving to Group 1 as they would be unable to issue internal LAC. • Supportive of replacement of AT1 but prefer for it to be wholly replaced with CET1 capital. • Supportive of aligning risk weights with historical loss data but notes it's important to calculate loss rates across the cycle and use longer time-series to take tail risks into account particularly given NZ hasn't used the Counter-Cyclical Capital Buffer (**CCyB**) actively. • Thinks New Zealand should consider introducing a leverage ratio. • Feels it is premature to transition to a system that relies heavily on LAC while the overall resolution framework is not yet in place.

International expert	Summary of report
	• Notes that the theme of the Review is simple, strong and proportionate. Agrees with the theme but notes: ◦ simple would certainly imply option 1 rather than option 2, ◦ strong would certainly imply option 1, but with higher CET 1 (more comparable to 2019 requirement) and ◦ proportionate is important but should include a CCyB for banks of all groups, so that proportionality does not change across the cycle. • Very critical of lowering capital requirements and notes both options do this. Notes significant gross domestic product (**GDP**) impact from a banking crisis.
Elena Carletti Elena Carletti is a Professor of Finance at Bocconi University. She is also the Vice-Chair of the Board of Directors of UniCredit, a former member of the Advisory Scientific Committee of the European Systemic Risk Board and past-President of the European Finance Association. She is an expert in banking, finance and regulation. Elena was supported by Brunella Bruno, a researcher with tenure in Financial Markets and Institutions at Bocconi University Finance Department.	• Thinks benefits of changing the current framework are unclear. Notes NZ is high-risk relative to other jurisdictions. • Notes revised risk appetite of this Review is unclear. Notes that short-term politically driven setting of risk appetite can have unintended consequences and may not align with the long-term interests of the public and increases likelihood of individual and systemic crises. Greater probability of intervention and fiscal costs should be made clear to RBNZ and government. • Notes the global environment remains fragile and subject to a variety of significant risks, including geopolitical tensions and the potential formation of asset price bubbles. • Notes empirical evidence overall supports the positive link between bank capital and growth. Better-capitalized banks tend to lend more, particularly during downturns, helping to smooth economic cycles. • Notes no clear and well-established long-term relationship between tighter capital requirements and lending costs. Higher costs only during transition phase, particularly if the transition is short. • Notes the relationship between higher capital requirements and bank competition is complex and difficult to establish. • Cautious about international comparison exercise given the high presence of foreign-owned banks, absence of Pillar 2 requirements in NZ (which are often bank-specific and not disclosed publicly in other jurisdictions) and bank sizes relative to peers. • Raises significant risks regarding LAC, including internally issued LAC. Advises against introducing LAC, citing substantial resource and time investment, lack of sufficient control over trigger and significant risks given the banking system's structure. • Thinks Option 2 involving introduction of LAC is problematic with concerns stemming from complexity of these instruments and uncertainty about their effectiveness. Risks and limitations must be clearly communicated.

International expert	Summary of report
	• Supports more proportionality but thinks it should be applied within groups, not only across groups. Differentiated oversight within groups could ensure a more balanced regulatory approach. • Supports adjustment of risk weights particularly where justified by empirical loss data and cyclical patterns. Also enhances proportionality and efficiency. • Notes advancing crisis management and resolution frameworks is important. Continued progress in this area will enhance confidence and might, over time, justify a less conservative capital framework once these mechanisms are fully operational.
Sir John Vickers Sir John Vickers is a Professor of Economics at Oxford University. He is a former Chief Economist at the Bank of England and was Chair of the 2010-11 UK Independent Commission on Banking. He is an expert in competition and regulation.	• Notes 2019 Review was robust and risk-neutral. • Notes global macroeconomic and fiscal risks have risen and would not say the 2019 framework overstates the risks today. • Notes there is no strong foundation that higher capital requirements are negative for economic growth. Notes the large negative effects on economic growth of banking crises. • Thinks Option 2 carries high risk and advises against it. Concerns include limited international experience on bail-in and the fact that our design and regulatory infrastructure is not yet finalised. Does not have confidence that LAC would absorb loss with high probability, even when internal to the banking group. • Thinks Option 1 is safer than Option 2 but not superior to current policy given the significant reduction in equity capital is estimated to have greater expected cost than benefit. • Recommends against a long-term reduction of planned CCyB. • Supports removal of AT1 but favours replacement with more CET1 instead of lower-tier instruments. • Supports proposal to introduce more granular risk weights in line with historical loss data but uncomfortable with magnitude of overall reduction. • Notes lack of Pillar 2 and leverage ratios in NZ (which most comparator countries have) so differences to international peers should not be exaggerated. • Notes that while competition from smaller deposit-takers is clearly important, in a concentrated banking market such as NZ's, the intensity of competition between the large banks is a key issue for how well the market serves its customers. Bank capital regulation does not strongly influence that dimension of competition. Much more on point are policy measures to improve the ability of customers to compare rival offerings and to switch between providers, such as open banking. • Does not recommend significant reduction in overall equity capital requirements relative to 2019 Review.

We followed a process to quality assure the final policy positions

3.13. Our recommended final policy positions have been subject to the Reserve Bank's internal policy-making process, including seeking input from relevant areas across the Reserve Bank.

3.14. They were approved for submission to the Board following consideration by FSC on 12 November. FSC was supportive of a LAC option, and ultimately the majority of FSC endorsed recommending a variant of Option 2. This is discussed at paragraphs 4.34 to 4.47 below.

4. Discussion

We received some suggestions on our assessment criteria for the Review, but do not think any changes are needed

4.1. We developed and consulted on assessment criteria for the Review, based on our statutory parameters including the DTA purposes and principles:

1. Financial stability criteria

   - **Going concern loss absorbency:** Maintain a sufficient prudential capital buffer above the regulatory minimum to absorb losses, protect and promote the stability of the financial system, and promote the safety and soundness of each deposit taker (links to DTA section 3(1) and 3(2)(a) purposes).
   - **Crisis management:** Enable a distressed deposit taker to be dealt with in an orderly manner, recognising the need for a credible resolution strategy for deposit takers to promote financial stability and avoid the use of public money (links to DTA section 259 purposes).

2. Other criteria

   - **Proportionality:** Take a proportionate approach to regulation and supervision (links to DTA section 4(a)(i) and (ii) principles).
   - **Competition:** Maintain competition within the deposit-taking sector, recognising the desirability of a diverse deposit-taking sector that provides financial products and services to a diverse range of New Zealanders (links to DTA section 3(2)(c) purpose, and section 4(a) and (b) principles).
   - **Funding costs:** Consider the impact on deposit takers' weighted average funding costs, which in turn affect lending rates, recognising their importance for supporting the prosperity and well-being of New Zealanders (links to DTA section 3(1) and 3(2)(d) purposes).
   - **Simplicity/achievability:** Be practical to administer, easy to implement and avoid unnecessary compliance costs (links to DTA section 4(c) principle).
   - **International alignment:** Align with international standards where appropriate (links to DTA section 4(d) principle).

4.2. Submitters were generally supportive of the assessment criteria. One submitter also suggested that we include criteria assessing against the recommendations in the Finance and Expenditure Committee's inquiry into banking competition (**FEC Inquiry**).

4.3. We do not propose amending our assessment criteria. As our assessment criteria are based on our legislative mandate under the DTA, we do not think it is appropriate to explicitly weight specific criteria. Our current approach allows us to appropriately balance competing criteria.

4.4. We also do not propose including additional criteria to address recommendations made by the FEC Inquiry. In developing the Consultation Paper and our final advice, we considered submissions to the FEC Inquiry, and the recommendations made by FEC.

Our assessment of the risk environment and international context is broadly as consulted (Appendix 4)

4.5. New Zealand's banking sector is riskier than many of our peers.[2] We are a small, open economy with a highly concentrated banking sector dominated by four major banks that are owned overseas (we are a 'host' regulator). By international standards, our supervisory function is relatively lightly resourced and less intensive.

4.6. We are in the process of moving to a new suite of prudential standards under the DTA and are building our resolution function. In the Consultation Paper, we argued that cumulative policy changes in recent years should support lower risks in the New Zealand financial system and could suggest it would be appropriate to have lower capital requirements.

4.7. Submitters largely agreed with our assessment of changes to the risk environment since 2019, however some feedback suggested that policy changes have reduced risks by more than we stated in the Consultation Paper. We do not think that this materially changes the assessment of the risk environment.

4.8. However, the independent experts all assess the economic environment as fragile and higher risk since the 2019 Capital Review. They note, in particular, that macroeconomic and fiscal risks have risen. The pandemic has reduced fiscal capacity there are greater geopolitical tensions, and the potential formation of new asset bubbles. They note that, as a small open economy, New Zealand is especially vulnerable to these risks.

We have based this paper on our understanding of the Board's risk appetite used ahead of consultation, though we recommend that we refine our articulation of it (Appendix 5)

4.9. When considering a risk appetite for prudential policy settings, we look to balance:

i. Benefits to society of preventing or managing the failure of regulated entities; and

ii. Costs to society of regulation – for example, compliance and administrative costs, and efficiency losses.

[2] S&P Banking Industry Country Risk Assessment reports score the New Zealand baking sector a 4 out of 10 (where lower numbers represent lower risk), compared to Australia, Canada and Singapore at 2 out of 10 and the UK, Norway, Sweden, the US at 3 out of 10.

4.10. Our risk appetite for prudential policy generally is set out in the Statement of Prudential Policy[3], which is a statutory document produced under the Reserve Bank of New Zealand Act 2021 and published on our website. In this document, we state that we have a low appetite for events that could materially damage financial stability. We seek to limit uncertainty and ensure risks are identified and mitigated before they crystallise. However, we do not operate a zero-failure regime – we have a medium tolerance for risks that may lead to the failure of regulated entities where the impact is understood, manageable, and will not materially damage the financial system.

4.11. Historically, this translated into a risk appetite for capital settings for the largest deposit takers that focused on building headline levels of the highest quality capital (CET1) that were high by international standards - given our high-risk environment and light-touch supervision regime. This resulted in an extremely low likelihood of failure (we focused on one in every 200 years) but with moderate-to-high cost of failure, prioritising prevention over crisis management.

4.12. Ahead of the consultation, the Board indicated that its risk appetite for capital settings was higher than in the 2019 Capital Review, given the introduction of the DTA and the step up in our broader prudential regime. Therefore, the Consultation Paper proposed options that moved to capital settings that would deliver a low (but not extremely low) likelihood of failure, with Option 2 (which introduces LAC) focusing on reducing the cost of failure through credible recovery and resolution tools. Option 1 maintained more of a focus on reducing the likelihood of a failure.

4.13. While there was support from stakeholders for the proposal in the Consultation Paper to move away from the 1-in-X year approach, some noted the need to clearly articulate our risk appetite.

4.14. In Appendix 5 we set out a proposed framework and communications narrative to help articulate the Board's risk appetite. We have provided an articulation of the risk appetite that would be consistent with the main capital ratio options considered in this paper in paragraphs 4.34 to 4.75.

We recommend further refinement and granularity on standardised risk weights (Appendix 6), and agreeing to do further work in some areas

4.15. In the Consultation Paper we recommend a range of changes to make risk weights more granular. Submitters were supportive of the overall risk weight approach, but suggested a range of further changes.

4.16. We recommend making the following further changes to what we consulted on in response to feedback:

i. Lower residential mortgage lending (**RML**) risk weights at low loan-to-value ratios (**LVRs**) because we received strong evidence in the feedback pointing to lower risk at low LVR lending.

[3] Reserve Bank of New Zealand. (2022). *Statement of Prudential Policy*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/statements-of-approaches/sopp-2022.pdf

ii. Do not increase personal consumer risk weight as we do not think a higher risk weight is warranted for most borrowers.

iii. Set the qualification for the small and medium-sized enterprise (**SME**) at $2 million, such that the lender's exposure to the borrowing enterprise qualifies as SME if their total exposure is less than $2 million. We are also recommending an increase the equivalent measure in the internal ratings-based (**IRB**) approach from $1 million to $2 million to match the threshold for IRB SME lending categories.

iv. Refine our proposals for Community Housing Providers (**CHPs**), including separating housing co-operatives from CHPs and providing more granularity to apply lower risk weights than proposed previously for registered CHPs with long term Crown contracts, due to the substantially lower risk associated with these borrowers.

4.17. We recommend committing to do further work on the following areas where valid concerns were raised, but we do not have the time and/or data to reach firm recommendations at this stage:

i. Agree in principle to a lower risk weight for infrastructure lending, subject to completing further detailed design work. The nature of the regulatory parameters as well as private/public contracting arrangements means that risks are lower than currently allowed for. This will affect IRB and standardised approaches.

ii. Commit to doing additional work and consultation on securitisation risk weighting, focused on allowing deposit takers to 'look through' to the underlying assets when funding warehousing facilities for other lenders.[4]

iii. Consider reverse mortgages risk weights further, as proposals from respondents have some merit given reductions that will apply in other residential lending, but we need longer to adequately assess them.

iv. Agree to do further work on commercial property risk weights. We agree with submitters that more granularity is justified, but there is a lack of robust, reliable data makes any changes here more risky than other proposals.

4.18. In other areas, we recommend we proceeds as consulted:

i. No change to RML risk weights at high LVRs as stress test results indicate losses are substantially higher at high LVRs than at low LVRs, and our assessment is that this is in line with our previously proposed calibrations.

ii. No change to new SME corporate exposure categories – this received strong support.

iii. No change to new agriculture risk weight categories. There was general support for proposals and limited evidence to support further reductions in risk weight proposed by some respondents.

[4] In order to make this tractable and to manage expectations, if further work is agreed, we would communicate that the scope is limited to only the narrow issue of considering ways to allow deposit takers to 'look through' to the underlying assets when funding warehousing facilities for other lenders. This is much more limited in scope than issues canvassed in the EY Report titled "External Perceptions of the New Zealand Banking System" discussed at the Board in October. This report suggested considering wide ranging reforms, including encouraging risk transfer from deposit takers to investors and/or creating a New Zealand Freddie Mac/Fannie Mae.

iv. No changes to other corporate lending – we considered a range of alternatives, but none would sufficiently address risk differentiation without adding significant complexity.

4.19. We estimate that implementing our revised recommended risk weights could result in a 7.0% reduction in capital in the system (risk-weighted assets (**RWA**)) compared with the status quo of the risk weights prior to the 2025 Review. Group 1 deposit takers are expected to experience a 5.8% reduction on average, whereas the estimate for Group 2 is a 15.3% reduction.

4.20. We estimate that the risk weight changes we proposed in the Consultation Paper in August would lead to a 6.5% reduction in RWA. The revised proposals in this paper would increase that reduction in RWA to 7%.[5] The impacts are not spread evenly across deposit takers. In particular, we estimate that Group 1 RWA would only fall by a further 0.2 percentage points, whereas Group 2 would fall by a further 2.7 percentage points (with a similar change for Group 3). This is because for some Group 1 deposit takers the output floor is likely to no longer be binding, making changes in standardised risk weights less relevant. This provides additional proportionality in the overall proposals.

4.21. These numbers do not factor in any further reductions in risk weights following the further work we recommend committing to. While we have limited data, we estimate moving to commercial property risk weights in line with the Australian Prudential Regulation Authority (**APRA**) could lead to up to a further 2 percentage point reduction in total RWA calculated under the Standardised approach.

We recommend proceeding with removing AT1 (Appendix 7)

4.22. AT1 was designed as a cheaper form of Tier 1 capital whilst still providing going concern loss absorbency. However, in reality, the NZ form of AT1 is difficult to issue for deposit takers due to its equity characteristics. In addition, international experience has shown it may not act to stabilise a crisis situation but, instead, could have the opposite effect.[6] Finally, removing AT1 will both simplify the capital stack and enable easier crisis resolution planning.

4.23. The proposal to remove AT1 from the capital stack was overwhelmingly supported by respondents with feedback focusing on the need for carefully managed transitional arrangements.

4.24. We recommend proceeding with removing AT1 – for more detail, see Appendix 7. To manage the transition, we are proposing that current AT1 instruments (including perpetual preference shares (**PPS**) issued by non-bank deposit takers (**NBDTs**)) will be recognised as Tier 1 capital on a reducing basis until 1 December 2031 before being phased out completely for Groups 1 and 2 deposit takers.

4.25. For Group 3 deposit takers, we recommend PPS continue to be recognised as Tier 2 capital. This was as a result of feedback and is a proportionate response that allows the smaller deposit takers options for raising Tier 2 capital.[7] We intend to seek feedback from Group 2 deposit takers during the Capital Standard exposure draft process to see if there is

[5] As part of the consultation, we asked deposit takers for more detailed information to help assess the impact of risk weight changes. We have used this information to refine our estimates and have included these updated numbers, including revising the expected impact of the original proposals from the Consultation Paper.
[6] For example, Credit Suisse did not defer a coupon and continued in its practice of redeeming instruments to avoid negative signalling. This meant its AT1 increased the financial pressure on the bank. *See* Federal Department of Finance (2024). *Federal Council report on banking stability*. https://www.efd.admin.ch/en/report-tbtf
[7] The characteristics of AT1 instruments that caused us concern and led us to propose removing AT1 (e.g. challenges with issuing and signalling effects) do not have the same impact as Tier 2 capital or for smaller deposit takers (and would have no impact on our resolution strategy).

demand for this approach to be extended to Group 2. This provides additional proportionality in the overall proposals.

We have developed a viable high-level design for a LAC instrument (Appendix 8)

4.26. Feedback from stakeholders stressed the importance of any LAC instruments being eligible for APRA's corresponding deduction rules, which require the instrument to be Basel/Financial Stability Board (**FSB**) compliant. s6(a) s6(a)

4.27. We have undertaken further analysis on a high-level design for a LAC instrument for New Zealand based on the FSB guidance. We propose that a LAC instrument under Option 2 would be a subordinated debt instrument like existing Tier 2, but with the addition of new conversion and write-off provisions with contractual triggers to enable the instrument to be converted to equity when triggered by the Reserve Bank.

4.28. We have worked closely with APRA in developing what the proposed LAC instrument would look like. s6(a) However, we note that consultation would be needed prior to finalising the terms of the instrument. If an option including internal LAC is agreed to by the Board, we will continue to develop detailed LAC requirements during 2026 and 2027, and engage with APRA and deposit takers on this issue.

4.29. We are not currently proposing a contractual LAC requirement for Group 2 or Group 3 deposit takers given the nature of their business. However, we may revisit this issue at a later point for Group 2 deposit takers as part of our implementation of the crisis management framework in the DTA. We expect to seek the Board's decisions on our recommendation to the Minister of Finance on the need for a statutory bail-in power in February 2026 with a view to report back to the Minister for her approval as decisionmaker in March 2026. Further public consultation would be required if any changes were considered to either LAC requirements for Group 2 or statutory bail-in powers.

4.30. The international experts raised concerns about the design of LAC instruments not being fully developed and expressed uncertainty about whether the internal LAC would work effectively during a crisis – noting that internal LAC has not been used in other jurisdictions to date and there have been challenges in the use of external LAC.

4.31. We acknowledge the concerns raised by the experts and agree that the use of LAC involves significant complexity, particularly in relation to the political economy of trans-Tasman negotiations that would accompany any decision to trigger internal LAC. However, as set out in paragraphs 4.34 to 4.47 below, we are recommending an option that includes internal LAC on the basis that it meets the Board's risk appetite, has positive net benefits in our CBA modelling, and supports our preferred Single Point of Entry (**SPE**) resolution approach for Group 1 deposit takers. We note that SPE would remain our preferred approach even if we do not introduce LAC, and that in either case a group SPE resolution will require complex trans-Tasman negotiations involving the Reserve Bank, APRA, and other agencies in both countries. Further analysis of issues related to the design and use of LAC can be found in Appendix 8.

We do not recommend any changes to the output floor and scalar (Appendix 10)

4.32. There was a strong divergence in views about the output floor and scalar for IRB credit risk weights in stakeholder feedback. Group 1 generally want a lower output floor and/or IRB scalar to align with APRA, whereas Group 2 generally want the output floor to be increased to support proportionality.

4.33. We recommend retaining the current 85% output floor and 1.2 scalar, as these settings have been calibrated to a level that we consider is appropriate for New Zealand. We have analysed the impact of moving to the same output floor and scalar as APRA. That is presented in Appendix 10 – it would reduce the amount of capital in the system by around 6% and would reduce the gap between Group 1 and Group 2 deposit takers – as this change would only benefit Group 1.

We have analysed a range of options and recommend a variant of Option 2

4.34. In the consultation, we sought feedback on two options for capital ratio requirements – and noted we were open to feedback on a wider range of options:

i. **Option 1** proposed a similar approach to current settings but did not require an increase in capital from current levels, whereas additional step ups would be required to 2028 under the existing rules.

ii. **Option 2** proposed a shift in approach – with lower capital ratios than those proposed in 2019 or under Option 1, but introducing LAC requirements for the largest banks.

4.35. Table 2 below shows these options, as well as alternative calibrations of these options that are discussed later in this section. Further alternative options are considered in Appendix 11 and Appendix 13.

Table 2: Summary of proposed capital ratios (% of RWA)

		Proposed option for: Group 2 and 3 (%)		Proposed options for: Group 1 (%)		
		Group 2	Group 3	Option 1 No LAC	Option 2 LAC	Option 2a CET1 +1%
Minimum Tier 1* (CET1)		6	6	6	6	6
Minimum Total		9	9	9	9	9
Of which max Tier 2		*3*	*3*	*3*	*3*	*3*
LAC		-	-	-	6	6
Prudential Capital Buffer (all CET1)		5	4**	8	6	7
Of which CCyB		*1*	*0*	*1*	*1*	*1*
*Of which Domestical Systemically Important Bank (**D-SIB**) buffer*		*n/a*	*n/a*	*3*	*1*	*1*
Totals	**Tier 1/CET1**	**11**	**10****	**14**	**12**	**13**
	Total + LAC	**14**	**13**	**17**	**21**	**22**

***Note:** We propose under all options the removal of AT1 capital as a recognised form of regulatory capital. This means all Tier 1 capital will be made up of CET1 capital.

****Note:** We propose Group 3 deposit takers without a credit rating are subject to a 5 percent Prudential Capital Buffer.

4.36. Respondents to the consultation generally supported the options consulted on over the status quo of the 2019 Capital Review decisions, and in many places pushed for changes to go further. However, the international experts are very sceptical about the benefits of the options over the 2019 Capital Review decisions. The experts reiterated in their reports that the 2019 Capital Review was robust and risk-neutral and none agreed that there is a clear case to support any significant relaxation of capital requirements. One expert noted that higher capital requirements for New Zealand can be justified given New Zealand's higher reliance on its banks, limited diversification benefits and risks that come with a small open economy. All three of the experts also do not support either of the options proposed over the status-quo and are not confident that LAC will work as intended.

4.37. Throughout this Review, we have focused on the three key aspects of capital settings: *form*, *amount* and *distribution*.

4.38. Capital settings are made up of a range of elements that interact to deliver an overall outcome. This analysis in this section assumes the recommendations made elsewhere in this paper are agreed to, including:

i. Removing AT1 from the capital stack.

ii. Making further changes to risk weights to improve granularity and better align them with the actual risk.[8]

iii. Retaining the output floor and scalar at their current settings.

Form of capital: We support introducing LAC, but there are risks to this

4.39. On the *form* of capital, we have considered the role different capital instruments play in mitigating the probability, and managing the impacts, of distress. This includes consideration of the balance between 'going concern' and 'gone concern' capital, and the appropriateness of any LAC requirements. This section focuses on Group 1 as we do not currently propose any changes to the form of capital for Group 2 or 3 deposit takers (aside from removing AT1 as mentioned above).

4.40. Stakeholder feedback was broadly divided by size of deposit taker. Group 1 deposit takers supported the LAC option over the non-LAC option, though many noted that their support was conditional on LAC instruments and revised Tier 2 satisfying APRA rules. However, some Group 2 deposit takers preferred the option without LAC, mostly due to concerns about proportionality. They raised concerns about the use of internal LAC acting a barrier to domestic banks moving to Group 1, and reducing the depth of the market for Group 2 Tier 2 instruments.

4.41. The independent experts noted some caution around moving to a model with LAC – noting the need to confirm the design of LAC instruments, the risks that bail-in may not work as expected, the reduction in the depth and liquidity of markets for banks' Tier 2 capital instruments and the fact that our resolution framework is still under development. These are risks that the Board needs to accept if we decide to implement Option 2. The following

[8] This analysis does not includes the effects of further reductions in risk weights that may come about due to the further work we recommend we committing to, or IRB results moving lower over time following changes in the standardised approach. These changes would further reduce capital levels, possibly up to around 2% for the standardised approach.

paragraphs articulate risk factors for the Board to make a balanced decision. Appendix 8 contains additional analysis on the suitability of internal LAC for New Zealand conditions, including range of outcomes that could occur following a decision (or declared intention) to trigger LAC.

4.42. The table below sets out the key arguments for each of the models, and how these align with the Review's assessment criteria.

Table 3: Key arguments for models with and without LAC

Key arguments for a model with higher buffers and no LAC (e.g. the Option 1 approach)	Key arguments for a model with lower buffers but with LAC (e.g. the Option 2 approach)
Simpler framework based on existing capital instruments *(Simplicity/achievability criteria)*	Likely to be more efficient at a system level – provides more stability for a given cost of capital than models without LAC. *(Funding cost criteria)*
Makes any trans-Tasman resolution negotiation less likely (as larger buffer means less likely to reach resolution) *(Going concern loss absorbency criteria)*	Could make it easier or faster to achieve a trans-Tasman SPE resolution that is acceptable to both New Zealand and Australia, as the LAC instruments are explicitly pre-positioned to deliver capital down-streaming as part of a group recapitalisation. However, there will always be significant uncertainty over how political economy dynamics will evolve in a crisis. *(Crisis management criteria)*
Works for any market structure *(Competition criteria)*	Aligned with international practice and s6(a) Could be made to work for other market structures. *(International alignment criteria)*
Models with higher buffers make it easier to have a larger CET1 gap between Group 1 and Group 2 & 3 requirements *(Proportionality criteria)*	

4.43. Our view is that is a balanced judgement between the two models – with each best meeting different criteria. However, we support a LAC option for the following main reasons:

i. Our quantitative CBA suggests a LAC option would provide a larger net benefit to New Zealand (see Appendix 13). This is because we expect LAC would provide a lower-cost capital stack, while also providing a tool which helps us manage crises and potentially reduce their cost.

ii. Lessons from previous crisis simulations suggest that any future negotiations with Australia in a trans-Tasman crisis event are likely to be improved by having pre-positioned, bail-in-able instruments. However, there will always be significant uncertainty over how these negotiations will unfold. Further discussion of the potential political economy dynamics that could result from a decision to trigger LAC can be found in Appendix 8.

4.44. However, this option does come with some risks and downsides that the Board would need to accept within its risk appetite if a LAC option is chosen:

i. The CBA is uncertain and dependent on assumptions, particularly about how much difference LAC makes to the cost of crisis. However, we have conducted a range of sensitivity analysis which suggest the overall result is relatively robust to a range of assumptions. Nevertheless, if subsequent evidence showed LAC was ineffective in a crisis, then the CBA would favour higher going concern capital without LAC.

ii. Further work and consultation on the detailed design of LAC will be needed next year. However, s6(a) , we are confident that LAC instruments can be designed in a way that is recognised under APRA rules, thus allowing the instrument to qualify for corresponding deductions under Tier 2 (rather than CET1) (see Appendix 8).

iii. A LAC approach would become more complex if a bank without a parent entity entered Group 1. However, this is not expected in the short-medium term and there are possible solutions – such as allowing existing Tier 2 instruments to be used to meet LAC requirements. This is discussed in more detail in Appendix 8. Accordingly, we do not consider this an insurmountable hurdle.

iv. A LAC approach will reduce the depth and liquidity of the New Zealand Tier 2 market for Group 2 and 3 deposit takers (as Group 1's LAC will be issued internally, and then lead to external parent issuance in the Australian market). However, it is already a small market – in part because some Group 1 deposit takers were issuing their Tier 2 internally or in global markets. This is also not connected to prudential criteria – i.e. in an efficient economy, market for specific instruments should not be dependent on regulatory requirements.

4.45. It is important to remember that regardless of which instruments or settings we have, a recapitalisation of a Group 1 deposit taker will be a difficult and complex process. It will also potentially require years of recovery and rebuilding of capital buffers, or further restructuring. In addition, the lower CET1 buffer under options with LAC further cements the need for continued investment by the Reserve Bank in the tools, capabilities and plans required to support our resolution and recovery framework. This includes pre-positioning of a Multiple Point of Entry resolution strategy in case SPE resolution cannot be achieved successfully in a crisis (i.e. we cannot simply rely on SPE with internal LAC as our sole strategy for Group 1).

4.46. Overall, it makes sense to choose a LAC option if your view is that LAC provides sufficient increased confidence that capital will be down-streamed in a crisis to offset the slightly increased chance of a resolution event resulting from lower CET1 capital buffers. However, if the Board wanted to put more weight on simplicity and significantly reducing the likelihood that a deposit taker faces a resolution event, we consider a model without LAC (e.g. Option 1) to be a viable alternative, which reduces buffer requirements, removes AT1 and increases the granularity of risk weights.

4.47. While we recommend a LAC model, the precise calibration is important – both the *amount* and *distribution*. This is discussed in the next two sections.

Amount of capital: We have considered a range of calibrations of Option 2, and do not recommend reducing requirements compared to the consultation proposal

4.48. For the *amount* of capital, we have focused on establishing the appropriate level of capital in the system to support financial stability. This section focuses on Option 2 for Group 1, given our recommendation to proceed with a LAC model above and that Group 1 make up the majority of the system. The amounts for Groups 2 and 3 are covered in the next section on the *distribution* of capital.

4.49. Respondents to the consultation, particularly Group 1 deposit takers, argued the levels of capital in our proposals were too high – with many arguing for alignment with the risk weights and capital ratios used in Australia. On the other hand, our independent experts – and some other respondents - questioned whether the reduction in the amount of capital compared to the 2019 Capital Review decision is warranted at all.

4.50. As discussed at the October FSOC and Board meeting, we have analysed an option with **full alignment with APRA's capital ratios** (Option 3) and do not consider it appropriate for s6(a)

more detail in Appendix 12 and is also covered by the CBA presented in Appendix 13 and in communications narrative in Appendix 5.

4.51. However, we have also analysed two other options that would lead to an amount **of capital between Option 2 and full alignment with APRA**. These options are:

i. **Option 2b** – Option 2 with a 1% lower CET1 buffer

ii. **Option 2c** – Option 2 with the same amount of LAC as APRA (2.5% less LAC)

4.52. We do not recommend either of these options:

i. Option 2b reduces the amount of CET1 held by Group 1 deposit takers significantly below where they are now, reducing going concern loss absorbency (Figure 1). This would likely result in a significant outflow of equity capital from New Zealand back to Australia in the form of dividends, share redemptions or other financial transactions.

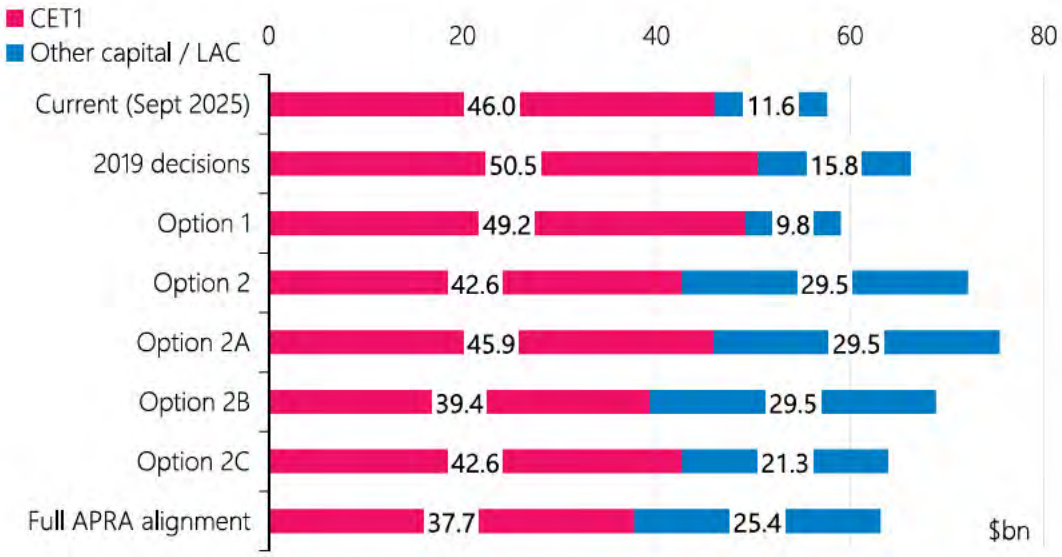
ii. Option 2c reduces the amount of LAC below what we consider would be sufficient to recapitalise an entity to the extent that markets consider stable. We are likely to trigger LAC when an entity is close to its minimum capital requirement, so we would need at least 6% LAC to bring the entity back to its full quota of CET1 capital. Standard international practice when setting LAC requirements is to require at least enough to restore buffers - from that perspective, 6% is an absolute minimum.[9]

4.53. Further, both options reduce the gap between Group 1 and Group 2 and 3 deposit takers, undermining competition and proportionality (see Figure 8 in Appendix 11 – which shows these options would lead to larger falls in capital for Group 1 than Group 2). In addition, they leave New Zealand lower relative to peer countries in the Oliver Wyman report than our risk

[9] While the 3% Tier 2 will be the same instrument as the 6% LAC, they should not be thought of together as 9% LAC. This is because the 3% Tier 2 plays a different role – it is gone concern capital that is in the framework to provide protection for creditors in the event of a failure. Using it as LAC would undermine market confidence in the stability of the post-resolution entity.

level suggests is appropriate (see Figure 11 and Figure 12 in Appendix 11) and perform worse in our CBA (see Table 35 in Appendix 13).

Figure 1: Nominal capital amounts for Group 1 under Consultation Paper and alternative options ($bn)



Note: These options all include our further refinement to risk weights, our current output floor and scalar, and a 1% management buffer assumption. However, it does not include any further reductions in capital that could occur following further work on risk weights, particularly commercial property – which we estimate could reduce capital levels by a further 2%.

Amount of capital: We recommend Option 2, with the exact ratios determined by your risk appetite

4.54. The s9(2)(g)(i) the Financial Stability Committee (**FSC**) favoured an adapted version of Option 2 which **increases the amount of CET1 by 1% for Group 1 relative to Option 2 as consulted on (Option 2a)**. This option reflects feedback from the international experts that suggests a higher level of CET 1 is optimal for a country like New Zealand, as well as increasing proportionality to reflect feedback from Groups 2 and 3 (who preferred Option 1). This option would reduce some of the risks associated with introducing a LAC model: by increasing the buffer, we reduce the chances of needing to call on LAC. The effect of this is similar to keeping the D-SIB buffer at the current requirement of 2%, versus the 1% consulted on. The D-SIB buffer recognises the systemic importance of the Group 1 banks, and that they need to be commensurately safer.

4.55. Option 2a would leave Group 1 requiring about the same amount of CET1 as now, but less than they would be required to hold under the 2019 decisions. This option scores well on the BAU loss absorbency criteria and the crisis management criteria and, by increasing the gap between Group 1 and 2 deposit takers, would support the competition and proportionality criteria. However, it would see less of a reduction in the lending rates and therefore be worse than Option 2 in terms of the funding cost criteria.

4.56. While, on balance, we favour Option 2a, Option 2 is a valid option and may better meet your risk appetite. The margin between the two options is small, and so the objectives you put the most weight on become the deciding factors.

4.57. Table 4 below presents criterial analysis for Option 1, 2 and 2a for the Review's criteria (discussed at paragraphs 4.1 to 4.4 above), assessed against the status quo of the fully phased in 2019 Capital Review decisions. Table 5 below presents risk appetite strategies that would correspond with different options.

Table 4: Criteria analysis of Option 1, 2 and 2a against the status quo of the 2019 Capital Review decisions, once fully phased in by 2028

		Financial stability criteria		Other criteria				
		Going concern loss absorbency	Crisis management	Proportionality	Competition	Simplicity/ achievability	Funding costs (green means lower)	International alignment
No LAC	Option 1	↓	↔	↑	↔	↑	↔	↑
LAC	Option 2	↓↓	↑	↔	↔	↓	↑↑	↑↑
LAC	Option 2a	↓	↑	↑	↔	↓	↑	↑↑

Table 5: Risk appetite strategies under alternative options

Option	**Risk appetite for capital settings** (choose this if you have...)
Status quo	Extremely low appetite for failure; **high weight on crisis prevention**; low confidence in effectiveness of LAC instruments for NZ conditions; low-medium proportionality
1	Very low appetite for failure; high weight on crisis prevention; low confidence in effectiveness of LAC instruments for NZ conditions; **high weight on proportionality and simplicity**
2	Low appetite for failure; **medium-high confidence in effectiveness of LAC instruments for NZ conditions**; **moderate weight on proportionality**
2a	Low appetite for failure; **moderate confidence in effectiveness of LAC instruments for NZ conditions**; **high weight on proportionality**

4.58. We have used our most recent stress test results to test impact of the two main options in the 2025 Consultation Paper (see Appendix 11). The results from this stress test indicates that the four largest deposit takers could withstand a severe but plausible stress scenario under all options with capital remaining above regulatory minimum levels. Nevertheless, in all scenarios, buffers would be depleted to varying degrees, trigger a range of regulatory responses, and in some scenarios the deposit takers would be close to hitting minimum ratio requirements.

4.59. Figure 13 in Appendix 11 shows how capital levels would drop following the scenario used in the 2025 stress test as another illustration of the risk appetite each option encompasses.

Distribution of capital: We do not recommend further lowering requirements for Group 2 and 3 deposit takers

4.60. The previous sections focus on getting the form and amount right for Group 1 deposit takers. Now we focus on the distribution of capital, particularly capital ratios for Group 2 and 3.

4.61. In the Consultation Paper, we proposed capital ratios for Group 2 and Group 3 as set out in Table 2 above. We do not recommend further reductions in capital ratios. Group 2 and Group 3 deposit takers already have a smaller buffer, so a shorter runway for recovery, than Group 1. Further, the proposals in the Consultation Paper and the additional risk weight changes proposed in this paper mean Group 2 and Group 3 are expected to see substantial drops in capital requirements relative to the 2019 status quo.

4.62. In addition, our analysis suggests further reductions in capital ratios would be unlikely to change outcomes for Group 2 and 3 significantly as a whole (see Figure 9 and 10 in Appendix 11). This is because lower ratios would allow capital to drop to levels observed before the 2019 Capital Review, so regulatory settings would be less binding - instead, factors like desired credit ratings and ICAAPs would be the main determinant of capital levels, as they were prior to the 2019 Capital Review. However, individual deposit takers could still choose to take on more risk and operate with smaller buffers, increasing their risk of failure.

4.63. While we have criteria around competition and proportionality, which are influenced by the distribution of capital, it is important to note that competition and proportionality are matters we have had regard to but are not objectives in the legislation in their own right. Generally, we do not think capital settings are a significant driver of competition – though the relativities between groups do have some effect – and proportionality can include simpler, but more conservative, rules. For example, in Australia some of the smallest deposit takers have the highest capital ratios – s6(a)

Figure 2: CET1 ratios vs. balance sheet size for Australia and New Zealand deposit takers

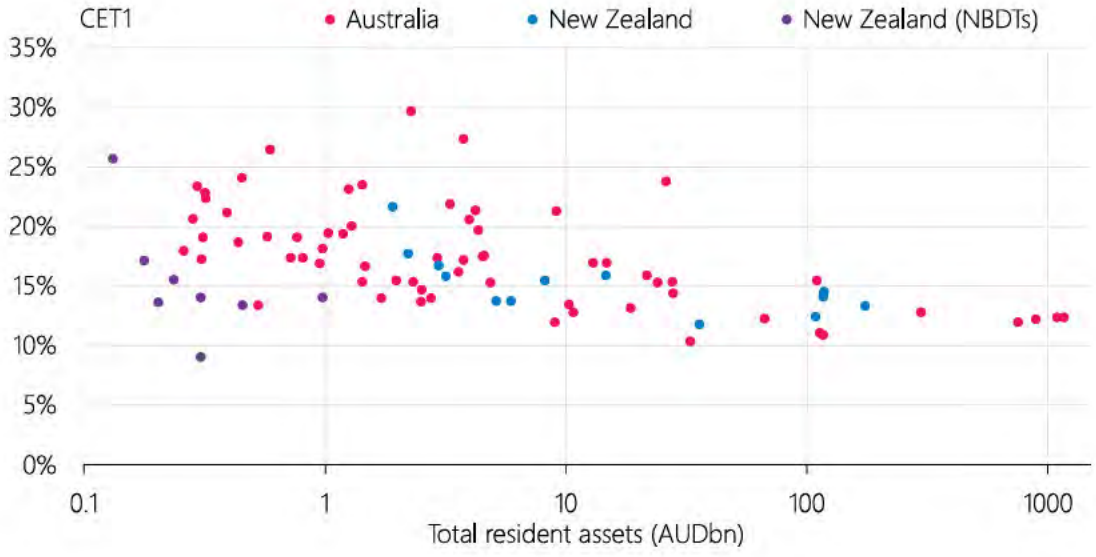


Table 6: Median CET1 ratio of Australian and NZ deposit-takers (including NBDTs) by size, June 2025

	Total resident assets (AUDbn)			
	0.1-1	1-10	10-100	100+
Australia	19.0%	17.4%	14.8%	12.2%
New Zealand	14.0%	15.8%	13.8%	13.6%

Note: CET1 ratios not adjusted for differences in risk-weighting between countries.

Distribution of capital: We have considered options that lower Group 2's requirements further but think the risks outweigh the benefits

4.64. Some Group 2 stakeholders argued that Option 2 would reduce the degree of proportionality in the framework relative to the status quo, limiting their ability to compete. The D-SIB buffer – designed to reflect the great systematic risk associated with the largest deposit takers – was 2% under the status quo of the 2019 decisions, but is only 1% under Option 2. In addition, the largest banks use of IRB models means they have lower risk weight outcomes, which in the past has tended to offset this D-SIB buffer.

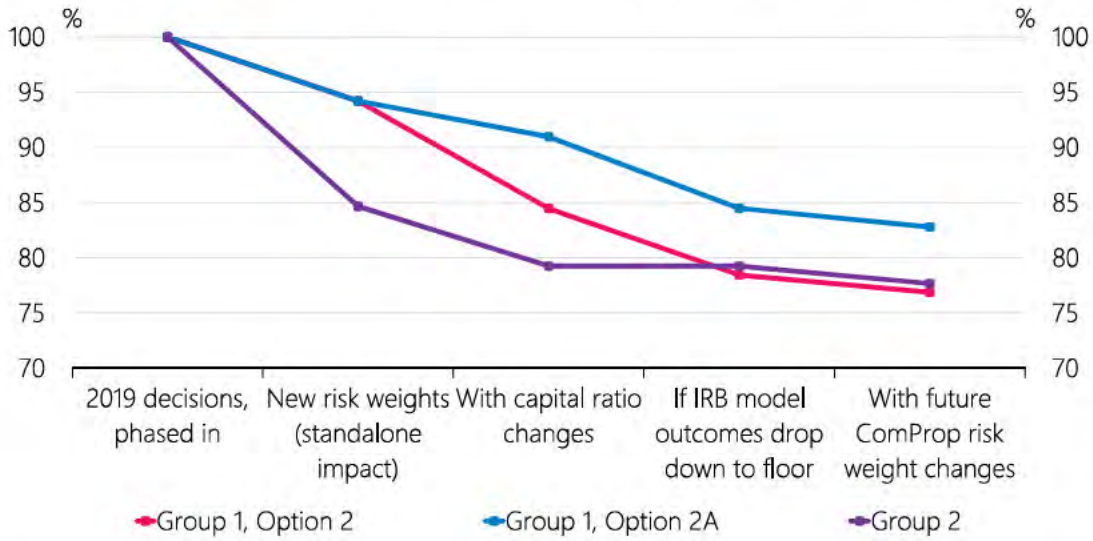
4.65. Our analysis suggests Option 2 would not decrease the degree of proportionality and competition relative to the status quo of the 2019 Capital Review decisions, but it would not go a long way to enhance either relative to the status quo. **Figure 3** steps through the estimated reduction in nominal CET1 for Groups 1 and 2. After the risk weight changes to the Standardised approach (shown in Panel 2), Panel 3 shows that under Option 2 we expect Group 2 to see a bigger fall (21%) in the amount of CET1 relative to what they would be required under the 2019 decisions, than Group 1 (15%).[10] In addition, because Group 1 would be required to hold additional LAC under Option 2, they would hold more total capital than in 2019 – whereas Group 2 see a fall).

4.66. However, over time this gap could shrink if, for example IRB models outcomes drop and the output floor becomes the binding constraint. This is not expected in the short-term, but as Panel 4 of **Figure 3** shows, this could lead to Group 1 seeing a bigger fall in capital and reduce (or even reverse) the gap between Group 1 and 2, relative to the 2019 decisions – going against proportionality and competition.

4.67. Option 2a increases the gap significantly, better meeting the proportionality and competition criteria. Panels 3 and 4 of **Figure 3** illustrate how Option 2a would ensure that Group 2 would still see a larger reduction in required CET1 compared to the 2019 decisions, even if IRB outcomes drift down towards the output floor over time. At this stage, we think future potential changes to commercial property risk weights would have neutral effects on proportionality (shown in Panel 5).

[10] This analysis includes the further changes we are recommending for risk weights based on consultation feedback, which increase the gap between Group 1 and Group 2&3 deposit takers compared to the consultation proposals – in part because the output floor is not expected to be binding on most Group 1 deposit takers so the risk weight changes only lower capital by a further 0.2ppt for Group 1, whereas Group 2 and Group 3 will see around a further 2.7ppt decrease.

Figure 3: Nominal amount of CET1 capital, as a percent of fully phased-in 2019 decisions, by group



Note: Options include our current output floor and scalar, and a 1% management buffer assumption. Assumes that changes to Standardised commercial property risk weights reduce total RWA by an average of 2% compared to current levels.

Distribution of capital: We proposed setting Group 3 requirements at a minimum viable capital ratio to ensure soundness

4.68. Group 3 deposit takers were also concerned about a loss of proportionality compared with 2024 Capital Standard proposals and argued for lower ratio requirement. They noted we proposed reductions in requirements for Group 1 and 2 based on a higher risk appetite in the Consultation Paper, but did not propose ratio reductions for Group 3.

4.69. However, given one of the purposes under the DTA is to promote the safety and soundness of individual deposit takers, and that the smaller deposit takers are inherently more likely to fail, there is a minimum amount of capital the smallest deposit takers must maintain to ensure soundness. Further, the risk weight changes proposed as part of this Review would reduce capital for Group 3s by around 16% – though this will vary by deposit taker, and is more uncertain than our other estimates as we have much less data.

4.70. Other recommendations also support Group 3 entities, such as allowing a slower transition to higher capital ratios while bringing forward new risk weight changes, and allowing PPS to count as Tier 2 capital for Group 3 (which gives smaller deposit takers more options for raising Tier 2 capital if desired).

Overall proportionality: We consider the options represent a reasonable balance between groups

4.71. Many submitters were concerned that Option 2 lacked sufficient proportionality or differentiation in capital ratios, especially given the Group 1 entities are systemically important. We carefully considered whether there were options that could increase proportionality, without increasing Group 1 capital levels.

4.72. This included considering whether any of the other prudential standards could be eased for those groups. However, the prudential standards have already been set at the minimum level required to meet our statutory purposes, and so there is no ability to recalibrate settings

to change the relativities (other than by implicitly or explicitly increasing requirements for Group 1).

4.73. The proposals in the paper do however benefit Groups 2 and 3 more than Group 1, as compared to the options consulted on (discussed at paragraphs 4.64 to 4.80). This is because the Group 2 and 3 deposit takers benefit more from the increased granularity in risk weights, and we have also recommended allowing these groups to issue perpetual preference shares to contribute towards their capital requirements. We have also recommended against lowering the output floor and scalar to be closer to the Basel recommendation, on the basis that this would decrease proportionality.

4.74. Accordingly, we consider the options represent a reasonable balance between the different groups of deposit takers.

4.75. We also note that capital requirements are just one component of our prudential regulatory regime and need to be considered as part of the wider package of measures. In particular, there are a range of prudential standards that will only apply to Group 1 entities (see Table 7 below).

Table 7: How DTA standards apply across deposit takers

Standard	Group 1 applicable?	Group 2 applicable?	Group 3 applicable?	Branches applicable?
Capital	✓	✓	✓	✗
Liquidity	✓	✓	✓	✓
Disclosure	✓	✓	✗	✓
Reporting	✓	✓	✓[11]	✓
DCS	✓	✓	✓	✗
Governance	✓	✓	✓	✓
Risk Management	✓	✓	✓	✓
Operational Resilience	✓	✓	✓	✓
Lending	✓	✓	✗	✗
Related Party Exposures	✓	✓	✓	✗
Restricted Activities	✓	✓	✓	✓
Open Bank Resolution (**OBR**) Pre-positioning	✓	✓[12]	✗	✗
Outsourcing	✓	✗[13]	✗	✗
Incorporation outside New Zealand	✗	✗	✗	✓

4.76. We also apply a proportionate and risk-based approach to our supervisory and enforcement activities, which means that the larger entities are generally subject to greater

[11] Group 3 will be subject to simplified reporting requirements.
[12] The OBR Pre-positioning Standard will only apply to Group 2 deposit takers that are already subject to Open Bank Resolution Pre-positioning Requirements Policy.
[13] The Outsourcing Standard will only apply to the small number of Group 2 deposit takers that are already subject to BS 11 Outsourcing Policy.

scrutiny and more regular interactions (as detailed in our Statement of Prudential Policy).[14] One example is that regulatory reporting for Group 3 deposit takers will cover under 3000 data points compared to approximately 17,000 data points for Group 1 deposit takers.

We have updated our CBA following feedback, including sensitivity analysis (Appendix 13)

4.77. Appendix 13 covers the feedback received and changes we have made to our CBA following consultation.

4.78. The CBA evaluates the economic impacts of different capital stack options, focusing on indirect effects from changes in lending rates, deposit taker failures, and wealth transfer costs under various sensitivities. Our CBA results are provided below in Table 8 and in more detail in Appendix 13. Overall, the analysis suggests:

i. Option 2 and Option 2a having the highest expected net benefit. Option 1 and the APRA-alignment option are expected to have a net cost on New Zealand as compared to the 2028 settings.

ii. Lending rates are expected to be lower under all options analysed as compared to the 2028, though only by relatively small amounts.

iii. Financial stability (loss in GDP from crisis effects) is expected to worsen under all options analysed as compared to the 2028 settings.

Table 8: CBA results

Status quo: 2028 settings	Option 1 No LAC	Option 2 LAC	Option 2a + 1% CET1	Option 2b - 1% CET1	Option 2c - 1.5% LAC	Option 3 APRA
Sensitivity range of total net benefit	-0.18 to -0.06	-0.02 to 0.19	0.02 to 0.17	-0.07 to 0.19	-0.05 to 0.17	-0.22 to 0.08

4.79. The modelling depends on assumptions and the differences between viable options (Option 1, Option 2 and its variants) are small relative to the range of outcomes under different sensitivities – therefore the CBA should be read as one input into the decision-making process.

4.80. For example, the magnitude of the results are highly sensitive to the assumed benefit on lending rates. Our estimates of the impact on lending rates assumes that changes in funding costs are fully passed through to borrowers via lower lending rates.[15] Sir John Vickers has pointed out that this may not hold, and we have therefore modelled a scenario with a 50% pass through assumption (Appendix 13 – Sensitivity 1a of Table 36 and Table 37). A lower pass-through rate would improve the relative benefit of options that have a lower estimated cost of crisis. Sir John has also questioned the Net Wealth Transfer impact and if it is ignored entirely, only Option 2a (CET1 +1%) is expected to be net positive compared to the 2028 settings.

[14] Reserve Bank of New Zealand. (2022). *Statement of Prudential Policy*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/statements-of-approaches/sopp-2022.pdf

[15] This WAFC includes an estimate of required rates of return on equity. Sir John Vickers has pointed out that if banks earn profits in excess of those required rates of return, some of the increase in WAFC could be absorbed by the banks rather than passed into lending rates.

We also received feedback on additional matters

We recommend setting the long-run CCyB at 1% (Appendix 14)

4.81. There was mixed feedback on our proposals to set the long-run CCyB at 1% and to not apply the CCyB to Group 3 deposit takers. Some submitters agreed with the proposal, while others (including two of our international experts) suggested that the long-run CCyB should be higher than 1% to give additional flexibility.

4.82. As discussed in Appendix 14, we recommend proceeding with our proposal to set the long-run CCyB at 1%. This means that the CCyB could be reduced to 0% when needed without being inconsistent with proportionality.[16] If we felt that cutting the CCyB to 0% did not go far enough in a particularly severe systemic stress, we could encourage deposit takers to use their remaining buffers, and will design the Capital Standard to permit this.

4.83. We also recommend proceeding with the proposal to not apply the CCyB to Group 3, consistent with our approach to other macroprudential tools.

We do not recommend introducing a leverage ratio at this stage (Appendix 15)

4.84. As discussed in Appendix 15, Thorsten Beck recommends that we consider introducing a leverage ratio, given the reduction in capital ratios and risk weights. This is a part of the Basel capital framework and is a measure of capital as a percentage of assets, but unlike in the normal capital ratios, there is no risk weighting of the assets. This was considered in 2013 and as part of the 2019 Capital Review, but ultimately we did not recommend imposing a leverage ratio – in part because it was unlikely to be binding.

4.85. We do not recommend introducing a leverage ratio through this Review given the Terms of Reference, and given it was considered in the 2019 Capital Review. However, we recommend announcing we will consider whether a leverage ratio should be introduced in the future. However, to ensure that we are able to prioritise the implementation of the Review's decisions in 2026, this would not be until 2027 at earliest.

5. Next Steps

5.1. As noted in the Te Kete of 1 October 2025, *Review of Key Capital Settings: Update on process for reaching final decisions*, we have prepared for the Review's decisions be announced shortly after the Board intend to make decisions in December 2025. The announcement is planned for 18 December in order not to clash with the publication of the next Half Year Economic and Fiscal Update by the Treasury on 16 December.

5.2. Given the short turnaround between the Board's considerations in December and the expected announcement date of 18 December, the December announcement will focus on the policy decisions. The communications package will be drafted in line with the communications narrative at Appendix 5 and in line with the proposed plan following discussions with the Board on 30 October 2025, with more detail being provide in a second release in February 2026:

[16] Retaining a 1.5% CCyB would mean Group 3 deposit takers would have higher capital ratio requirements than Group 2 if the CCyB was dropped to 0%.

Table 9: Decision announcement approach

Announcement date	Documents released
18 December 2025	A media release and Q&As outlining the key decisions and a broad implementation timeline (similar to Table 40 in Appendix 16).
	Key documents that supported the Board's decision making, including the stakeholder submissions to the Consultation Paper and the independent international experts' finalised reports.
	A summary of key decisions with an explanation of why key decisions were made and how they fit with broad stakeholder feedback based on the content of this Board paper (where Board decisions are consistent with our recommendations).
	High-level CBA results based on the content of this Board paper.
	Ernst & Young's report, External perceptions on the New Zealand banking market, will be included in this release. This report was discussed by the Board on 30 October 2025.
February 2026	A detailed summary of submissions with our full responses in line with the policy decisions made by the Board.
	A full updated write up of the CBA for the Review.
	A detailed implementation timeline to support deposit takers.
	Proactive release of all decision documents.

5.3. To support public understanding of the decisions, we endeavour to release as much information in the December announcement as possible. As the Review decisions are market sensitive, no embargoes will be sent prior to publication on 18 December. A media briefing and interviews will happen 1 - 2 hours post-release, done in a similar manner to Monetary Policy Statement releases.

Process for implementing the recommended policy positions

5.4. The policy decisions made by this Board paper are intended to apply to current regulated entities (banks and NBDTs) and future licenced entities (deposit takers).

5.5. For the decisions to apply before the DTA comes into effect:

i. We will revise the Banking Prudential Requirements (BPRs) to reflect revised risk weights and update the Conditions of Registration for Banks to implement all changes in requirements. The BPRS would need a 'one-off' change for new risk weights, while other changes to Conditions of Registration would be relatively minor annual adjustments that start the chosen transition path to the option we have decided on (see Appendix 16 for more detail).

ii. We will recommend the Minister of Finance to amend the NBDT regulations. Currently, risk weights for NBDTs are set out in NBDT regulations (a legislative instrument). As consulted on, we recommend advising the Minister that the standardised risk weights (including those amended as part of this Review) should apply to NBDTs from October 2026. The standardised risk weights are expected to significantly reduce the amount of capital certain NBDTs would be required to hold. To promote a sound financial system, we also recommend amending the regulations to offset some of this reduction by increasing NBDTs total capital ratio from 8% to 9% (an extra 1% would continue to apply to credit rating exempt NBDTs), this aligns with the proposed minimum set out in the options section. Industry agreed with these approaches.

5.6. For the decisions to apply to deposit takers, we intend to action this through changes through the Capital Standard and the Bail-in Standard. This will be done as part as part of tranche 3 of the broader DTA implementation timeline (i.e. exposure draft consultation intended in June to September 2026).

5.7. If the Board decides to implement an option with LAC, it would need to issue a "Bail-in Standard" under section 80 of the DTA, setting out new requirements for LAC instruments. A policy consultation would occur in June to September 2026, and an exposure draft consultation in February to April 2027. We aim to include the LAC requirements in the Capital Standard when the standard is issued on 31 May 2027. The Capital Standard is planned to commence on 1 December 2028 where phased transition to new LAC requirements will begin.

5.8. Appendix 16 shows an indicative transition path. We intend to publicly consult on these three implementation path options as part of the policy consultation in 2026:

i. December 2033 (Slow implementation)

ii. December 2031 (Moderate implementation)

iii. December 2030 (Fast implementation) s9(2)(f)(iv)

Monitoring the effects of the Review decisions

5.9. Ensuring we understand the impacts of the capital requirements is important to ensuring we have the calibrated the settings correctly for New Zealand and is core to our role as regulatory stewards. We expect to monitor the impacts and publish our findings every two years as we have been doing under the 2019 Capital Review.

5.10. We would expect to monitor:

i. Trends in amounts and prices of different capital instruments issued, and whether costs of capital are tracking in line with our expectations.

ii. Trends in lending rates (by sector), banks' profits and return on equity.

iii. We note that the changes will be implemented over several years to give deposit takers time to adjust and need to be in place for a period before we can assess the impacts of the decisions. Therefore, our first monitoring report would likely be in 2027 or 2028 in order to allow deposit takers to transition.

5.11. We also intend to monitor changes in observed risk weights and comparisons between modelling and standardised outcomes, and look for opportunities to continuously improve our settings.

5.12. Finally, we will monitor the conformity of our settings to the Board's risk appetite through our regular stress tests and our twice-yearly Financial Stability Reports.

6. Guide to the Appendices

The appendices are categorised as below.

Information required to make a decision

- **Appendix 1:** Summary of recommended final policy positions and summary of key feedback received
- **Appendix 2:** Legal requirements (Legally privileged)
- **Appendix 3:** Consultation and notification requirements for issuing standards (as per s75 of the Deposit Takers Act 2023

Detailed appendices that provide additional information to explain recommendations

- **Appendix 4:** Risk environment
- **Appendix 5:** Risk Appetite Framework and communications narrative
- **Appendix 6:** More granular standardised risk weights
- **Appendix 7:** Additional Tier 1 (AT1)
- **Appendix 8:** Design and use of Loss-Absorbing Capacity (LAC)
- **Appendix 9:** s6(a)
- **Appendix 10:** Output floor and scalar
- **Appendix 11:** Capital ratio option appraisal
- **Appendix 12:** Alignment with Australia
- **Appendix 13:** Updated cost benefit analysis (CBA)
- **Appendix 14:** Counter-Cyclical Capital Buffer (CCyB)
- **Appendix 15:** Leverage ratio
- **Appendix 16:** Implementation plan
- **Appendix 17:** Glossary.

Appendix 1: Summary of recommended final policy positions and summary of key feedback received

#	Consultation paper position	Feedback received	Recommended policy proposal	Comment
Standardised risk weights				
1	**Residential mortgage lending (RML)** We proposed adding more granular lower risk weights for lower risk low-loan-to-value ratio (**LVR**) lending – specifically for owner-occupier and property investor RML with LVR ≤ 60. Currently, all RML within the same lending category (owner-occupier or investor) with an LVR ≤ 80 has the same risk weight under the standardised approach.	Almost all submitters supported more granular risk weights, but wanted further reductions than what was proposed to match the risk weights used by the Australian Prudential Regulation Authority (**APRA**) and Basel. Submitters provided robust evidence and analysis for lowering low-risk, low-LVR lending to be more in line with APRA and closer to internal ratings-based (**IRB**) model outputs, including the introduction of further granularity by adding an extra LVR band with a lower risk weight for RML with LVR 60 – 70.	**Policy changed in response** Based on the evidence in feedback, we have revised our RML risk weight proposals as per Table 13 in Appendix 6. We recommend amending the Consultation Paper RML risk weight proposals to match APRA risk weights at lower LVRs (≤70). However, at higher LVRs the existing RML risk weight proposals appear better aligned with IRB model outputs and stress test results, so we propose leaving them unchanged.	This change results in lower risk-weighted assets (**RWA**) and overall capital in the system. Compared to the status quo, this could result in an overall 7% reduction of RWA, which is an extra 0.5 percentage point fall on top of the proposals in the Consultation Paper. This is made up of a fall for Group 1 of approximately 5.8% fall, and for Group 2 it is around 15.3%.
2	**Corporate lending** We proposed introducing more granularity for unrated corporate lending through separate risk weight categories for small and medium-sized enterprise (**SME**) retail and SME corporate lending, with proposed risk weights of 75% and 85% respectively. Currently, the standardised approach sets a 100% risk weight for all unrated corporate lending.	The proposed change for SME lending was widely supported. Most feedback focused on the definitions and thresholds for SME loan eligibility. The current $1 million threshold was put in place in 2008 and many respondents asked for this to be revised to something closer to Australia's $1.5 million (AUD) which was updated in 2024.	**No policy change** No amendments are recommended to the Consultation Paper proposal to introduce additional SME risk weight categories. However, we do recommend that the threshold for standardised and IRB SME lending categories be increased – this can be confirmed through the Exposure Draft process.	The omission of other changes for sub-components of corporate lending, such as no new more granular risk weights for other unrated corporate lending types, could be opposed by some deposit takers that were seeking more granular risk weights in a range of other corporate areas.
3	**Agriculture** We proposed introducing more granularity by introducing three new risk weight categories for agricultural lending, with risk weights assigned according to LVR. Currently, agricultural lending is treated as an unrated corporate with a 100% risk weight under the standardised approach as it is unlikely to have a credit rating.	Most submissions were supportive of the additional granularity and of the risk weights proposed. There was one submission that didn't agree with introducing new categories for agricultural lending, one that suggested that the risk weights should be higher and more aligned with SME risk weights, and two that proposed alternative, lower risk weights for agricultural lending. However, there was no strong evidence presented to support a change to our initial proposal.	**No policy change** We recommend proceeding with the new agricultural lending categories as proposed in the Consultation Paper.	
4	**Commercial property** We floated the possibility of introducing more granularity through a new risk weight category specifically for unrated commercial property lending. We suggested it could have a flat 100% risk weight, as we did not have the data available to be able assess a more granular option. We asked deposit takers for more information to help us assess the impact of introducing this new category.	The 100% flat risk weight was strongly opposed by most respondents. They considered it to be too blunt and that it would not sufficiently capture the vastly different risk profiles that unrated commercial property can have. Some also noted that the default risk weight for this lending is already 100% (with the exception of those to be captured under the new SME risk weights), so this change would do very little deposit taker outcomes.	**Policy changed in response** We recommend removing this Consultation Paper proposal. Commercial property lending can be very high risk, and we do not have the data to be able to fully assess the impacts of any alternative risk weight calibrations, so we are cautious of making changes in the absence of this detailed information. Instead, we recommend signalling that we are open to considering change in this area in 2026, based on the	Deposit takers will be satisfied that we have chosen not to proceed with the flat 100% risk weight, but may be unsatisfied that we have chosen not to take on their suggestions for alternate risk weights for commercial property at this stage. However, on balance we think that they shouldn't object to this approach as we intend to signal an openness to considering change in 2026, dependent on the evidence we receive.

#	Consultation paper position	Feedback received	Recommended policy proposal	Comment
		Most respondents supported a separate category but wanted additional granularity and proposed a range of alternative risk weight calibrations for this.	results of obtaining more detailed data from deposit takers, an assessment of IRB model outcomes, and potentially further stress tests to help us assess the impacts.	
5	**Personal lending** We floated the possibility of introducing more granularity by splitting personal lending into unsecured and secured personal lending and assigning a 150% and 100% risk weight to those categories respectively. We felt this would more accurately reflect the inherent riskiness of this type of lending. We asked respondents for feedback and more data to be able to assess the impact of taking this action.	The idea of raising the unsecured personal lending risk weight to 150% was unanimously opposed by respondents. Some also opposed keeping the 100% risk weight for secured personal lending. However, respondents were supportive of more granularity in personal lending and suggested alternative (lower) risk weight calibrations for consideration. Several recommended adopting APRA's approach of 75% risk weight for credit cards and 100% for other.	**No policy change** We recommend removing this Consultation Paper proposal and continuing with the status quo. Although respondents supported more granularity, our assessment is that lower risk weights cannot be justified, based on our stress test results which show that personal lending is consistently significantly risker than other types of lending. We also have limited data available on personal lending and its subcategories to enable us to estimate the impact of any potential changes.	Respondents opposed our proposal for a category that featured higher risk weights. They will likely be satisfied that this has been removed, but may object to us not accepting their alternative proposal to reduce risk weights.
6	**Community housing providers (CHPs) and housing co-operatives** We proposed introducing a new risk weight category for these types of lending which would treat both CHPs and housing co-operatives as investor RML with risk weights assigned according to LVR.	More granularity was welcomed by most respondents, with many grateful to see community housing included in this workstream. However, while many respondents supported the approach of creating a separate category for these types of lending, they also provided robust evidence that the risk of these types of lending is more like that of owner-occupiers than investors (or could be even lower risk than owner-occupiers). Some also argued that CHPs and co-ops have quite different risk profiles and should be considered separately.	**Policy changed in response** We recommend amending the Consultation Paper proposal to introduce different treatments of CHPs and co-operatives. We propose that co-ops are treated as owner-occupier RML within the existing standardised approach, and that a new category is created for CHPs, which aligns their risk weights with that of owner-occupier RML according to their LVR. We also propose an upper risk weight limit of 30% for any CHPs with long-term Crown service provision contracts due to their materially lower risk profile. While this approach is likely to be supported by most CHPs, two of the Group 1 deposit takers wanted us to use IRB modelling for CHP lending. We have rejected this due to complexity.	
7	**Other risk weights feedback** • **Infrastructure** • **Securitisation** No original proposals made.	There were a range of additional topics we received feedback on in response to our standardised risk weight proposals, including on different approaches to infrastructure lending and securitisation.	**Policy work to be done in the future** We recommend looking further into these topics as part of our future work programme for 2026 Some deposit takers may be disappointed that these topics have not been considered in more depth during the available time. We have proposed addressing these topics in more depth in 2026.	The topics will require varying amounts of analysis and consultation. In the case of securitisation, we propose defining the scope very narrowly to cover only issues relating to warehousing facilities provided by deposit takers to other lenders. We propose looking at options to allow deposit takers to assign risk weights based on 'looking through' to the underlying lending activity of the lender.

#	Consultation paper position	Feedback received	Recommended policy proposal	Comment
Capital stack				
8	**Additional Tier 1 (AT1) capital** We proposed to remove AT1 from the capital stack and to replace it with a mix of Common Equity Tier 1 and Tier 2 capital.	Respondents overwhelmingly supported the proposal. Feedback focused on ensuring transitional arrangements were carefully managed and sensible. Respondents were keen that arrangements avoided market disruption, did not lead to unintended consequences, reduced or removed complexity and ambiguity, and also mitigated any impacts on the small deposit takers. Mixed views were received on whether to incentivise early redemption of existing instruments or whether that would lead to unnecessary market disruption. One Group 3 respondent highlighted that half of its regulatory capital requirements were met with perpetual preference shares (**PPS**).	**No policy change** We are proceeding to remove AT1 from the capital stack. We have developed proportionate transitional arrangements which treat PPS issued by Group 3 deposit takers differently to AT1 instruments issued by Group 1 and 2 deposit takers. Group 1 and 2 deposit takers will be subject to a phase out schedule for recognition of AT1 as Tier 1 capital. Group 3 deposit takers will be able to recognise a portion of existing issued PPS as Tier 1 and a portion as Tier 2 capital during the transitional period. This balance will gradually shift until no PPS will be recognised as Tier 1 capital. However, Group 3 deposit takers will be able to continue to issue PPS (as an alternative option to subordinated debt) to meet Tier 2 requirements on an ongoing basis.	The phase out schedule together with the potential to redeem instruments early due to a regulatory event, mean there is ample scope for existing AT1 instruments to be redeemed in an orderly manner. We believe this enables – but does not incentivise – early redemption which will minimise the risk of unnecessary market disruption. We recognise there will be a degree of complexity while current instruments are phased out whilst introducing new requirements. However, we expect that clear and early communication about how the transition will operate will mitigate any concerns. In addition, by not changing the regulatory value of AT1 and phasing it out in a well communicated, clearly defined way, we expect that the risk of unintended consequences is low. Finally, the different approach for Group 3 recognises the limited market access and issuance capacity smaller institutions face. Whilst adding complexity, we consider retaining PPS as Tier 2 capital for Group 3 only is proportional and mitigates impacts for smaller entities.
9	**Introducing Loss-Absorbing Capacity (LAC) for Group 1 deposit takers** Option 2 proposed introducing LAC for Group 1 deposit takers	Group 1 deposit takers preferred Option 2 (LAC) over Option 1 provided it would qualify for corresponding deductions against Tier 2 for the parent authorised deposit-taking institution. Some Group 2 and 3 deposit takers were concerned about proportionality. Some indicated a preference for Option 1 (No LAC) over Option 2 as they would not be able to issue internal LAC to their parent if they became Group 1.	**No policy change** We continue to propose introducing internal LAC for Group 1 deposit takers only under Option 2. Larger Group 2 deposit takers may object to this if Option 2 (or another LAC option) is chosen.	If a future Group 1 emerges that is not part of an overseas parent, there are options for addressing this when it occurs, such as imposing requirements to hold Tier 2 instruments without contractual clauses (held either internally or externally), or to issue internal LAC with conversion clauses to a NZ holding company. Once adjusting for deposit taker specific factors, Tier 2 instruments without a conversion feature or issued externally are not expected to have a higher price than internal LAC. The removal of current Group 1 Tier 2 instruments from the debt markets in New Zealand would likely make the market smaller, but future Group 1 external instruments could still be issued alongside existing Group 2 and Group 3 Tier 2 and senior debt.
10	**Design of LAC instrument** LAC instruments would be designed in a manner consistent with Financial Stability Board (**FSB**) and Basel Committee on Banking Supervision guidance, subject to	Feedback from stakeholders stressed the importance of any LAC instruments satisfying APRA rules (i.e. being Basel/FSB compliant).	**Policy to be further developed** LAC would be designed in a manner consistent with the international guidance and be similar to existing Tier 2 with the following changes:	These recommendations balance the requirements to effectively recapitalise a distressed deposit taker under a range of crisis scenarios while still qualifying for Tier 2 corresponding deductions under the APRA rules which has an implication for the cost of funding.

#	Consultation paper position	Feedback received	Recommended policy proposal	Comment
	any necessary tailoring to reflect New Zealand circumstances. LAC would be issued by Group 1 deposit takers internally to their parent entities and used to recapitalise when they are distressed.		1. Removal of the current prohibition of on conversion or write-off. **2.** Include qualitative contractual triggers 3. Discretion whether to exercise trigger remains with Reserve Bank. If a LAC option is chosen we will hold a public consultation on LAC design in June 2026 and keep working closely with APRA in developing LAC instruments.	If a LAC option is chosen, detailed design and implementation will be required beginning in 2026.
11	**Group 1 capital requirements** We consulted on two options as set out in Table 2, noting we were open to alternative options.	Respondents to the consultation argued the levels of capital in our proposals were too high – with many arguing for alignment with the risk weights and capital ratios used in Australia. On the other hand, our independent experts – and some other respondents - questioned whether the reduction in the amount of capital compared to the 2019 Capital Review decision is warranted at all.	**No policy change** We have analysed a range of alternative options and recommend Option 2a, or alternatively Option 2 or 1 if they better align with your risk appetite.	
12	**Group 2 capital requirements** We consulted on settings as set out in Table 2.	Some Group 2 stakeholders argued that Option 2 for Group 1 would reduce the degree of proportionality in the framework relative to the status quo, limiting their ability to compete.	**No policy change** Risk weight changes will reduce capital requirements, but we do not recommend further reducing capital ratios.	
13	**Group 3 capital requirements** We consulted on settings as set out in Table 2.	Group 3 deposit takers were concerned about a loss of proportionality compared with 2024 Capital Standard proposals (given the reduction for Group 2) and argued for lower ratio requirement. They noted we proposed reductions in requirements for Group 1 and 2 based on a higher risk appetite in the Consultation Paper, but did not propose ratio reductions for Group 3.	**No policy change** Risk weight changes will reduce capital requirements, but we do not recommend further reducing capital ratios.	
Additional matters				
14	**Long-run Counter-Cyclical Capital Buffer (CCyB)** We proposed to set the long-run CCyB at 1% (of RWA).	Respondents had mixed views on whether the long-run CCyB should be set at 1%. Some respondents suggested that the long-run CCyB should be higher. A 1% CCyB (reduced in a downturn) would not likely give deposit takers enough incentive to extend more credit during a downturn (and hence support economic recovery) - a higher long-run CCyB gives additional flexibility in responding to a range of shocks.	**No policy change** We will proceed with our proposal to set the long-run CCyB at 1% (of RWA).	If the long-run CCyB was greater than 1%, then reduced to 0%, Group 2 deposit takers could end up with lower capital than Group 3 deposit takers (in percentage terms), which may be inconsistent with proportionality. This was a key consideration for proposing to set the long-run CCyB at 1%. If we felt that cutting the CCyB to 0% did not go far enough in a particularly severe systemic stress, we could encourage deposit takers to use their remaining buffers, and will design the Capital Standard to permit this.

#	Consultation paper position	Feedback received	Recommended policy proposal	Comment
		Other respondents agreed with a long-run CCyB of 1% (which aligns with Australia) but stated that more guidance is needed under which conditions the settings of the CCyB would be changed (particularly during a period of stress) and interact with the broader capital framework (including the Capital Buffer Response Framework).		
15	**CCyB and Group 3 deposit takers** We proposed to not apply the CCyB to Group 3 deposit takers.	Respondents had mixed views on whether CCyB should apply to Group 3 deposit takers. Some respondents supported the proposal, agreeing that it would not have a big impact on the financial system overall and would be consistent with our approach to using other macroprudential policy tools. Other respondents disagreed as applying a CCyB to Group 3 deposit takers would provide these deposit takers with some relief to capital requirements during a downturn and may lead to a competitive imbalance between Group 3 deposit takers and Group 1 and 2 deposit takers.	**No policy change** We will proceed with not applying the CCyB to Group 3 deposit takers.	This is consistent with our approach under the Lending Standard, where we do not intend to apply other macroprudential tools such as LVR and debt-to-income restrictions to Group 3 deposit takers. Given the small size of the Group 3 sector, the impact on aggregate lending (and overall financial conditions) would be small if we applied the CCyB to Group 3 deposit takers.
16	**Output floor and scalar** No original proposal made.	Some feedback from respondents included views about the output floor for IRB credit risk weights. Group 1 deposit takers generally wanted a reduction of the output floor and/or IRB scalar to align with APRA (72.5% output floor and 1.1 scalar). Group 2 generally wanted the output floor increased to 100% to support proportionality and competition.	**No policy change** We propose retaining the 85% output floor and 1.2 scalar. These settings have been calibrated to a level that we consider is appropriate for New Zealand circumstances. While industry may object, some will argue it should be higher and some that it should be lower.	This is consistent with our approach to maintain incentives for good credit risk management and create a role for improved risk modelling. At the same time, we want to limit the divergence in capital requirements for similar lending, purely based on how risks are measured. This is particularly relevant in New Zealand, given the relatively simple balance sheets and business models of New Zealand banks.
17	**Leverage ratio** No original proposal made.	The leverage ratio is part of the Basel capital framework. It compares capital to a non-risk-weighted measure of a bank's balance sheet. Thorsten Beck has questioned the absence of this measure from the NZ framework.	**Policy work to be done in the future** Given the Terms of Reference, and that the issue was considered in the 2019 Capital Review, we do not recommend introducing a leverage ratio requirement through this Review. We are open to considering whether a leverage ratio should be introduced in the future.	Any work on considering if we should introduce a leverage ratio would not begin until 2027 at the earliest, to prioritise the implementation of the Review decisions.

Appendix 2: Legal requirements (Legally privileged)

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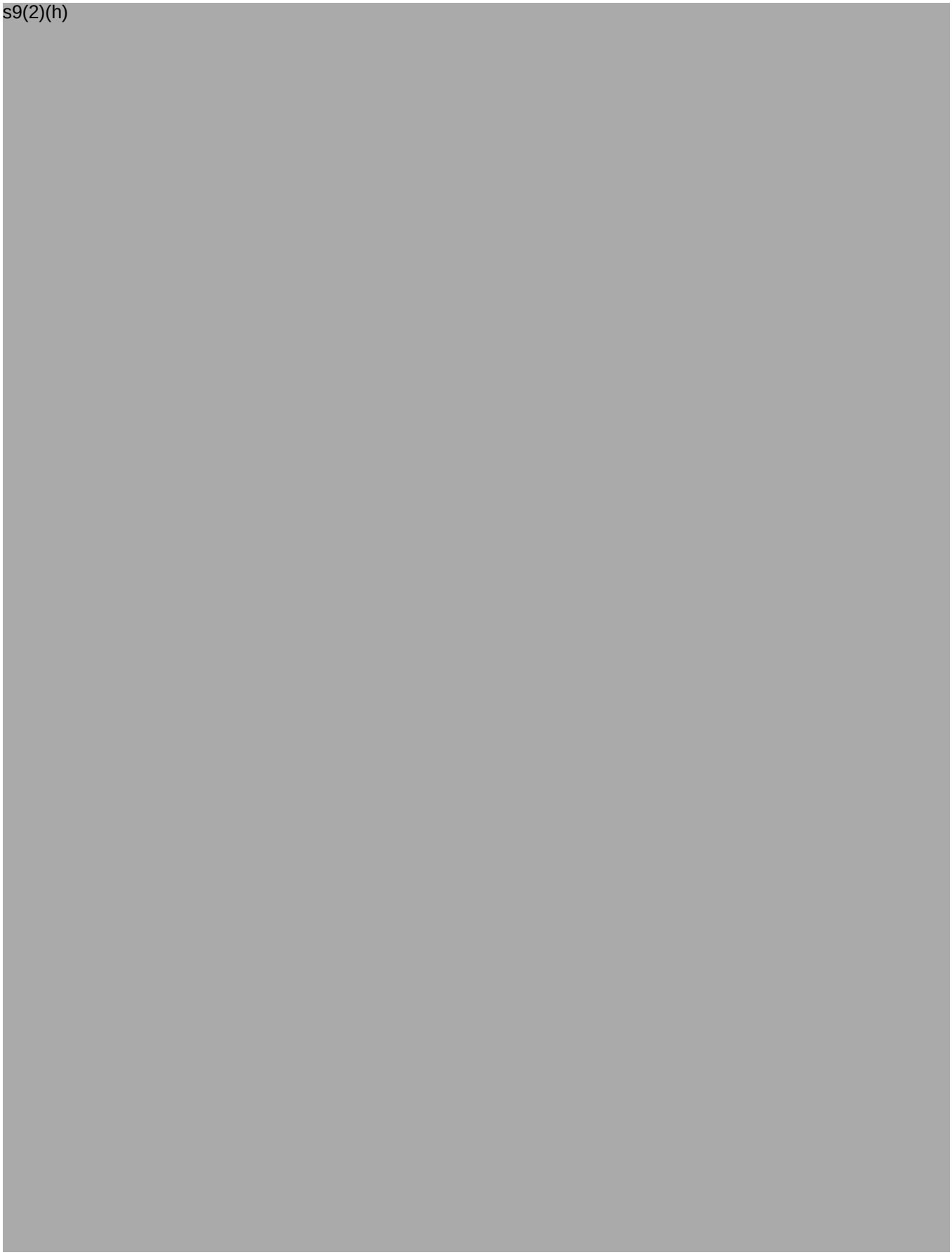

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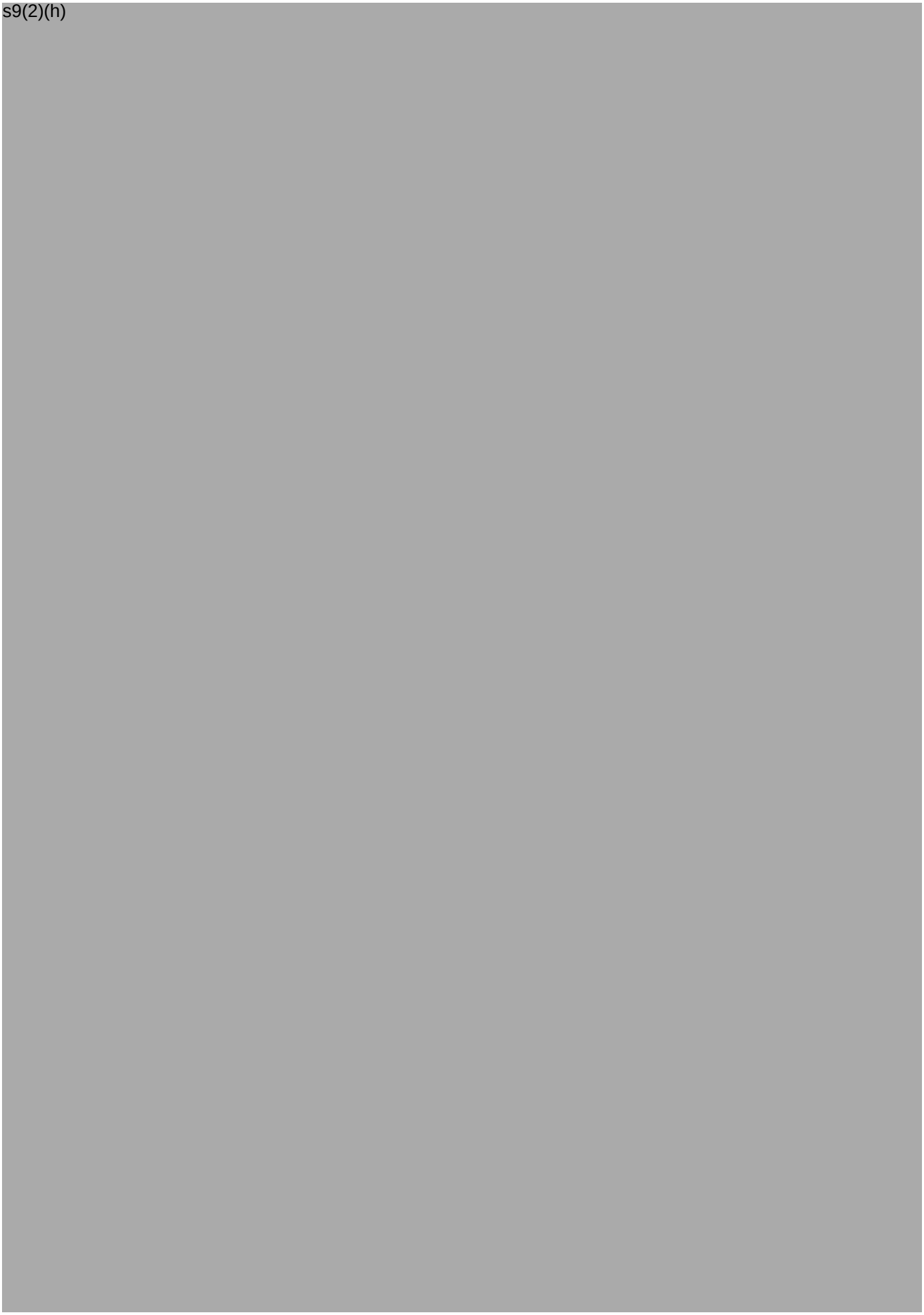

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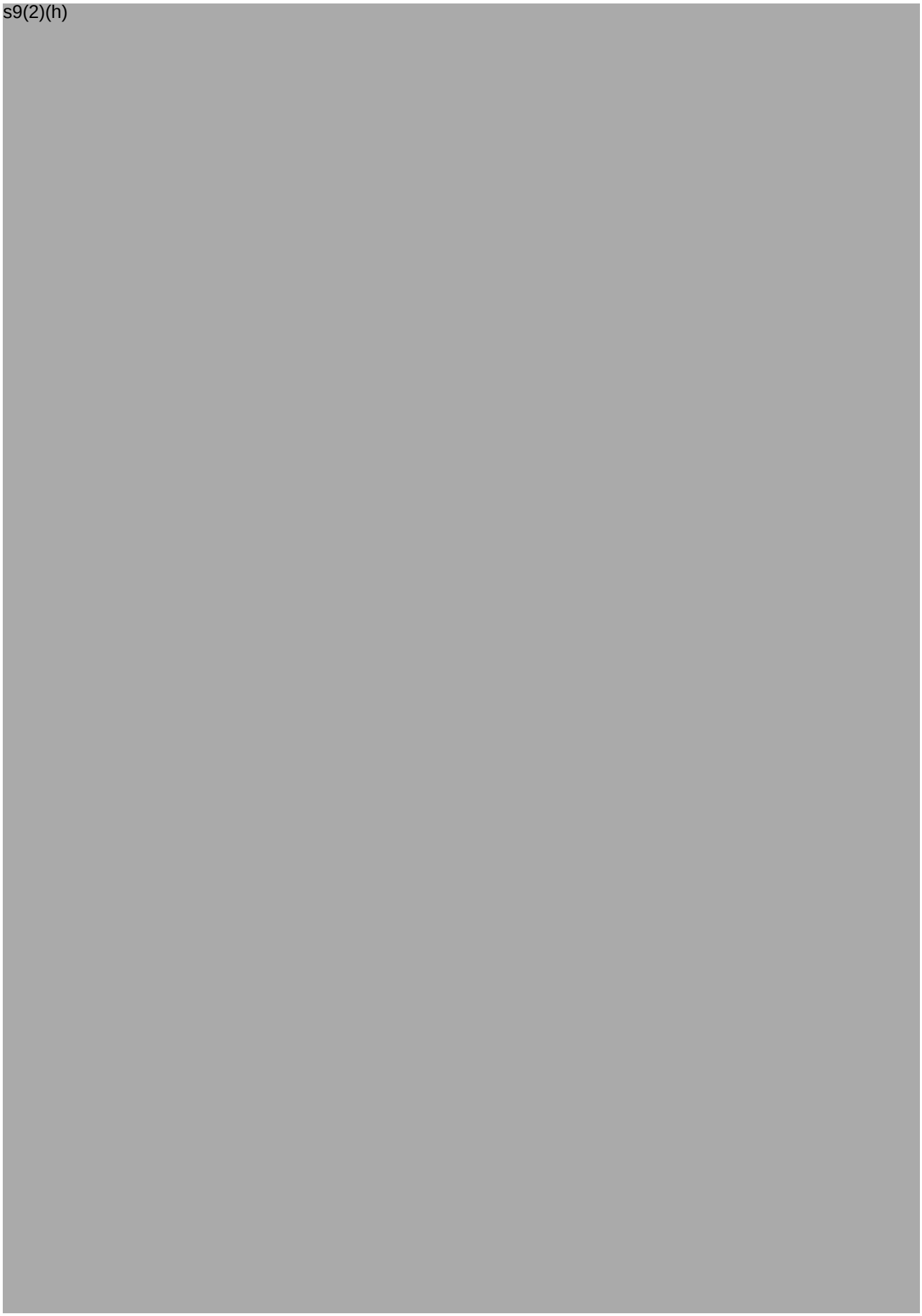

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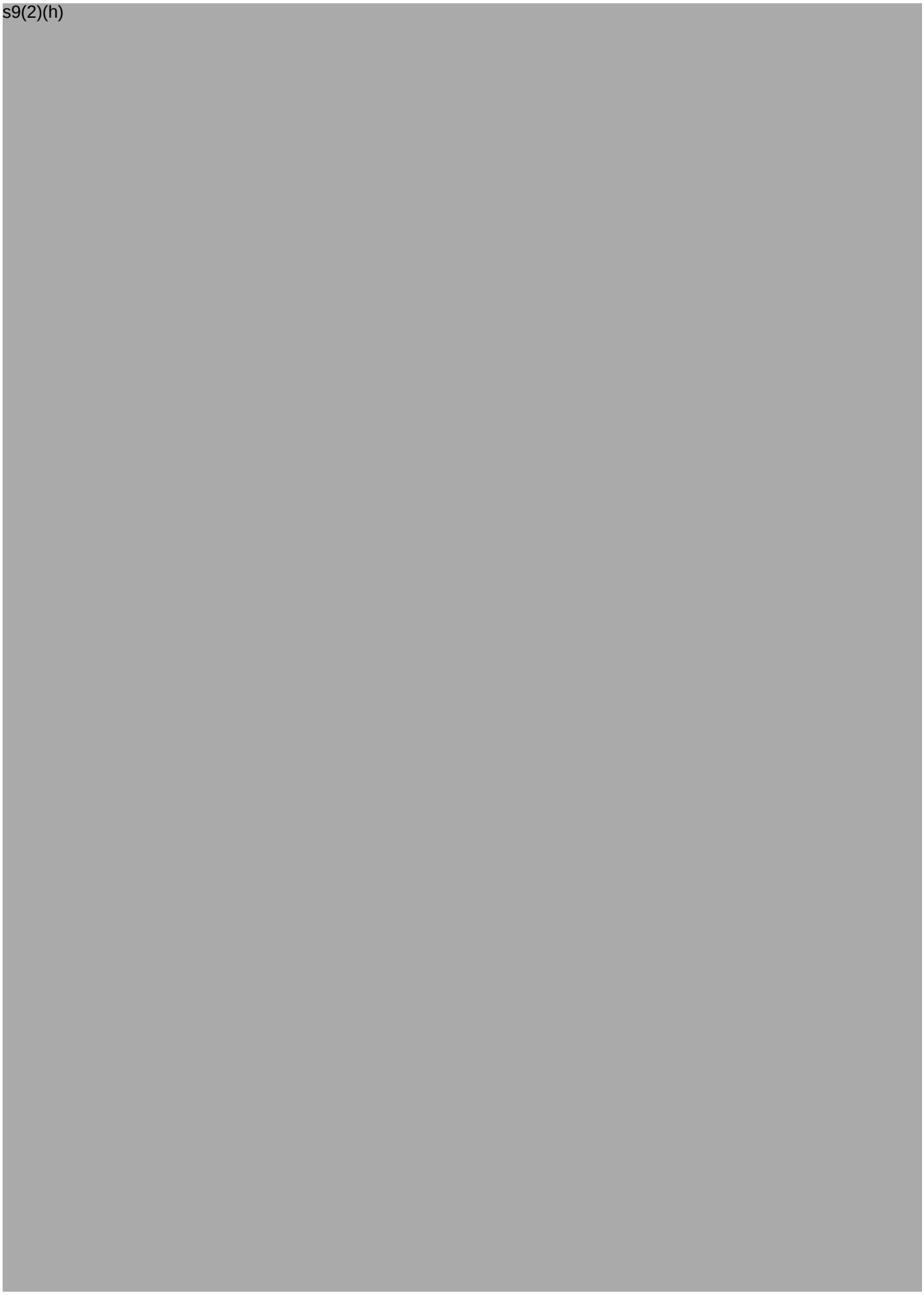

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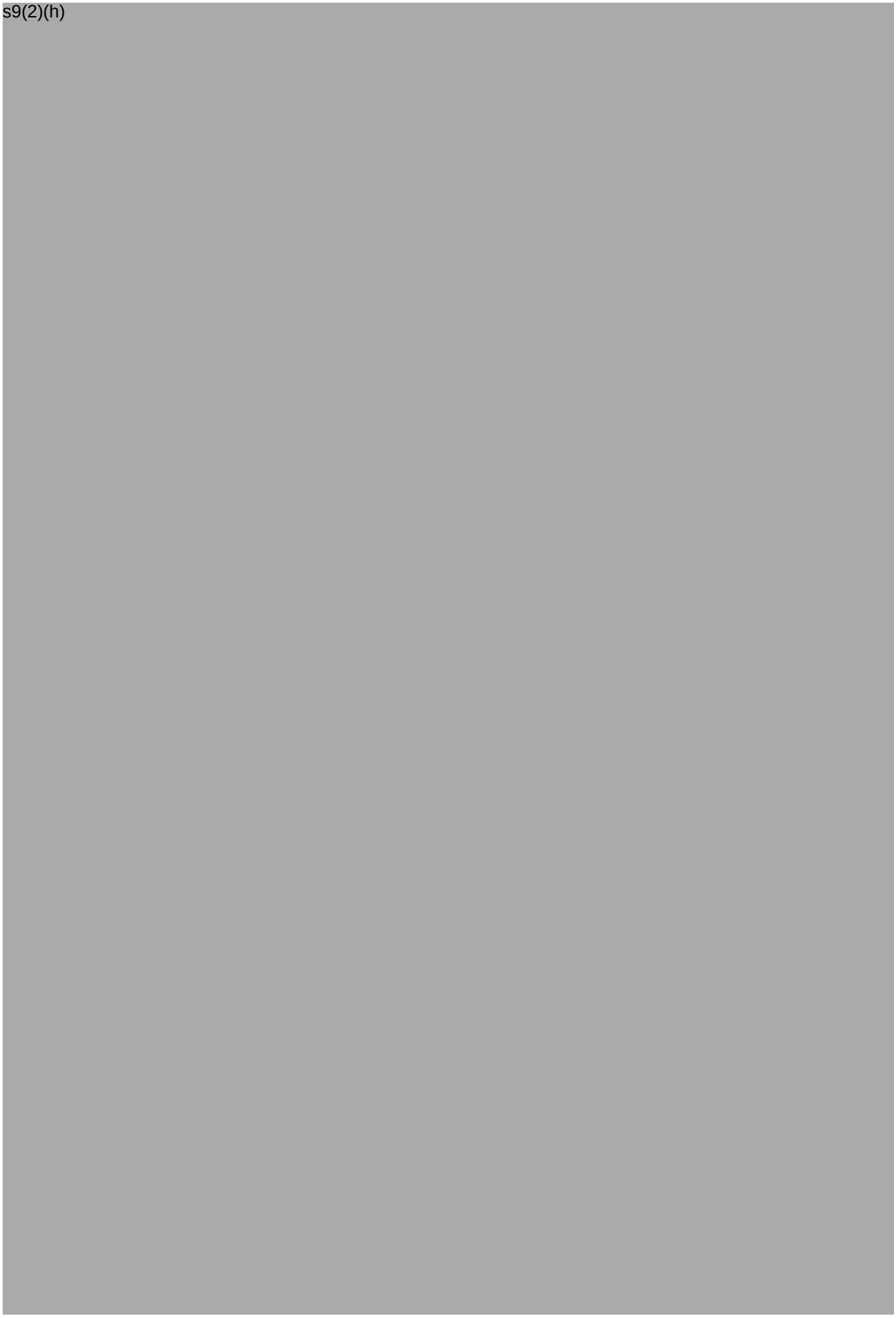

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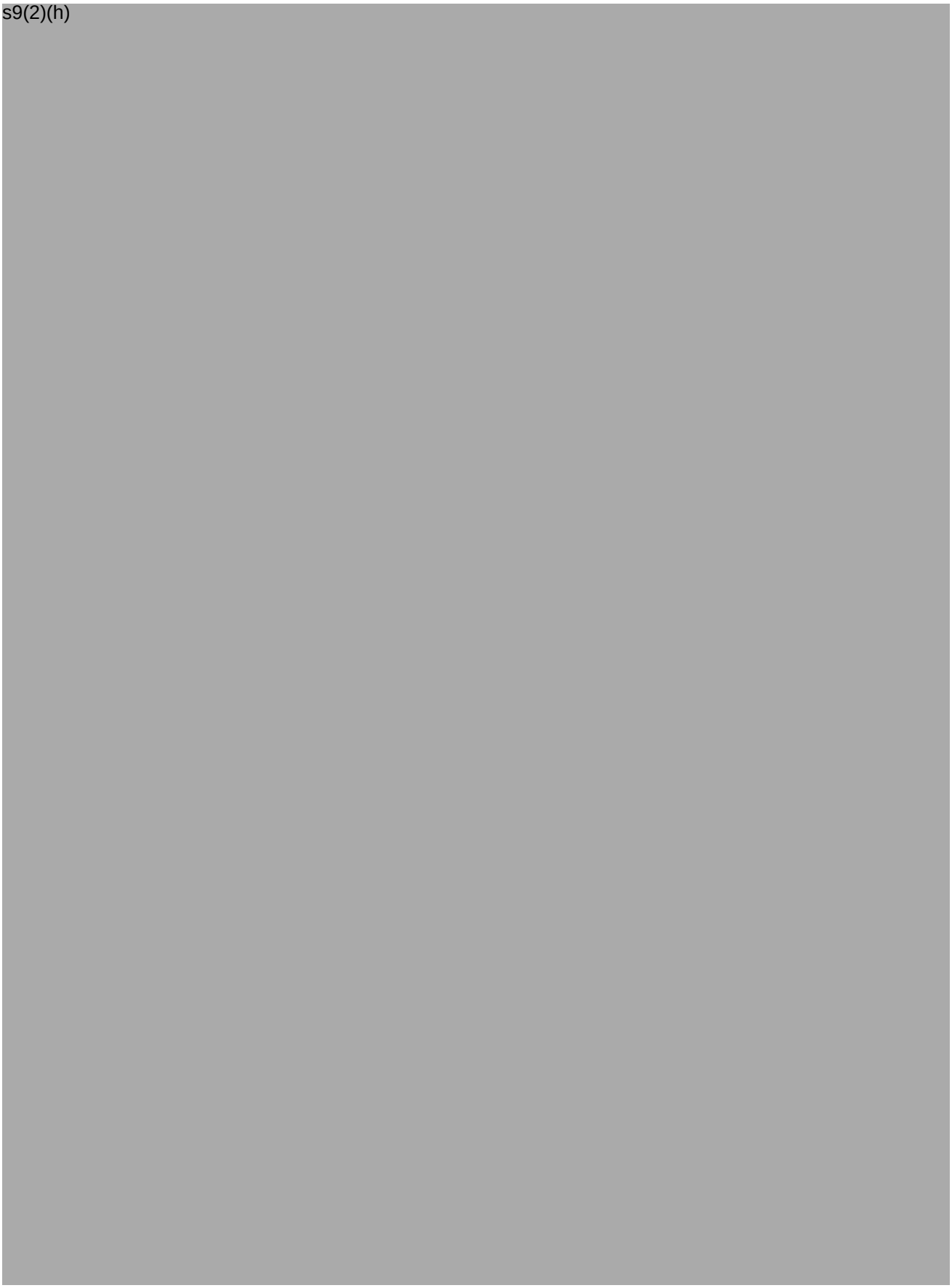

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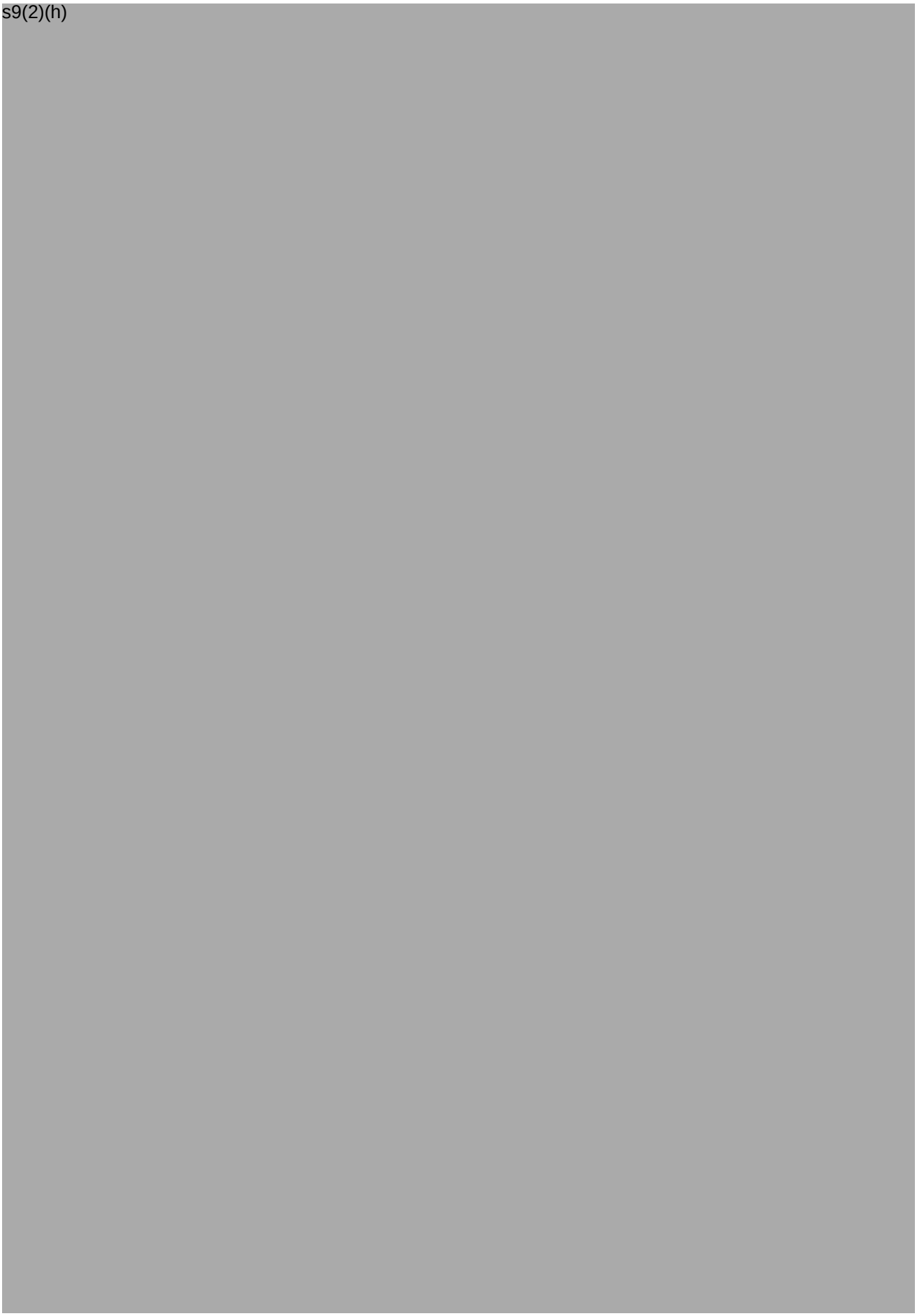

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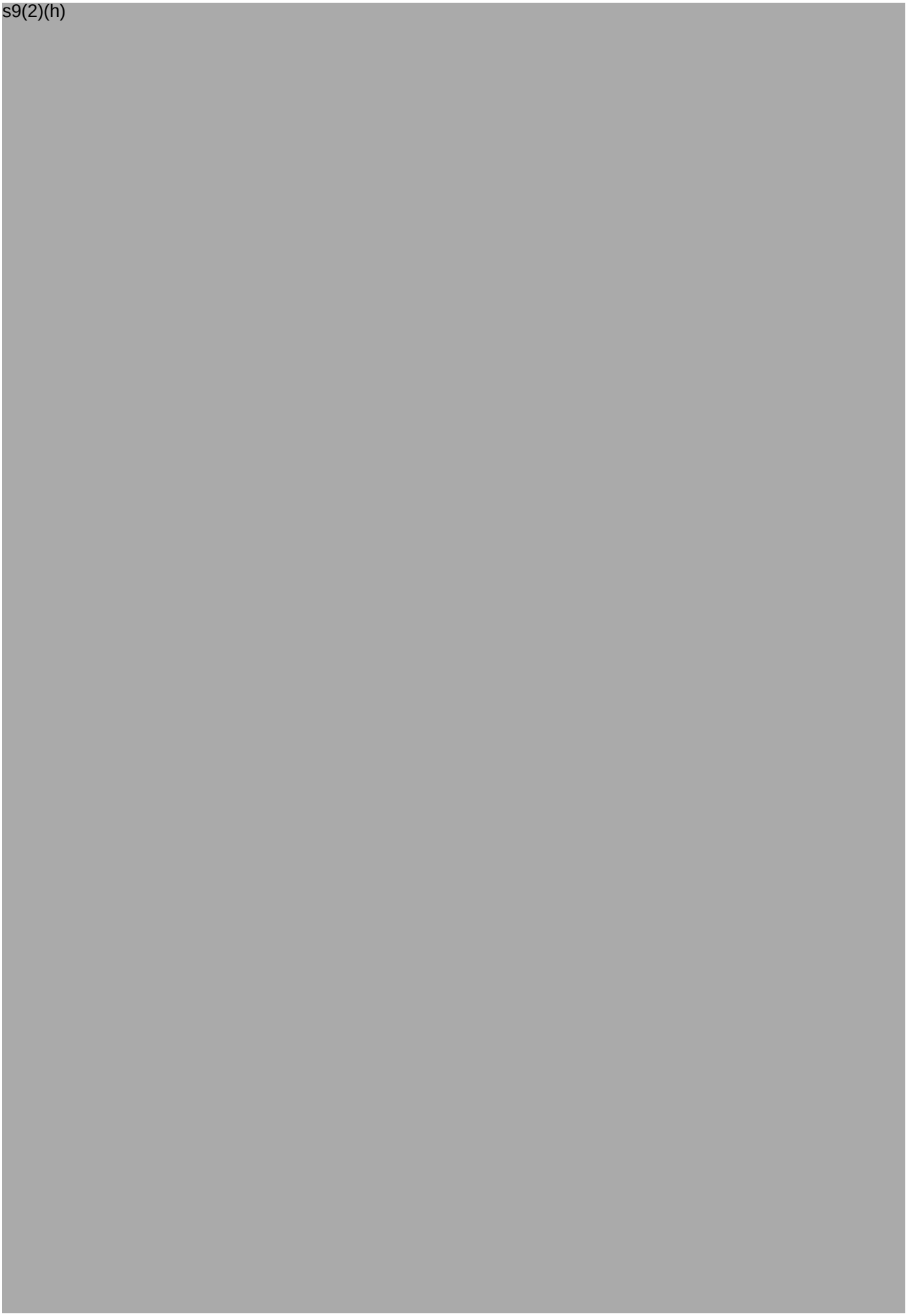

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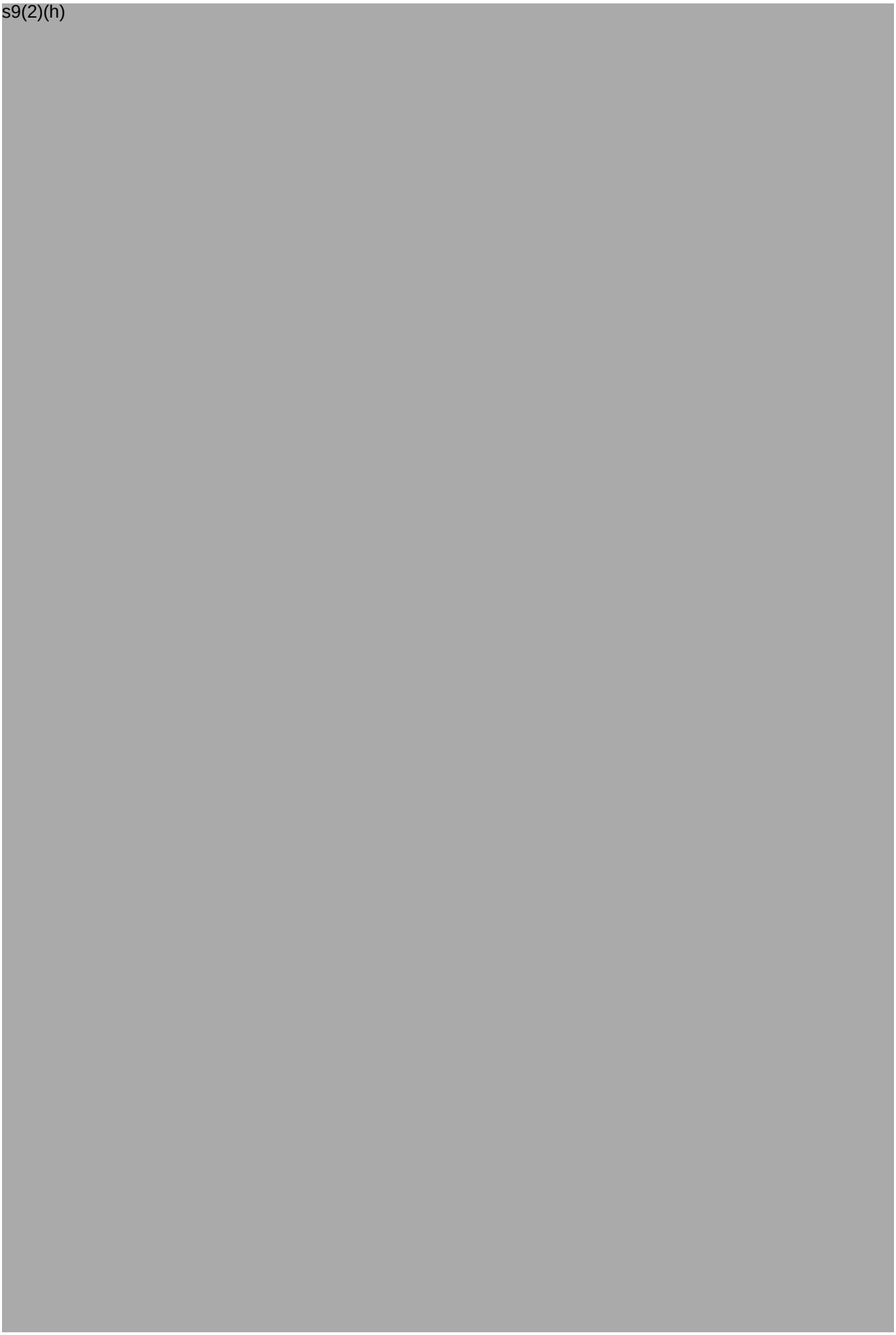

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Appendix 4: Risk environment

Consultation feedback

In the Consultation Paper we considered that cumulative policy changes since 2019 should lower risks in the New Zealand financial system and may support lower capital requirements. However, New Zealand-specific risk factors are largely unchanged and risks in the broader macroeconomic environment have increased since 2019. We sought feedback on our assessment of these changes and whether there was other new evidence that we should be considering.

One-third of submissions commented on this analysis. Most of these submissions largely agreed with our assessment or expanded on the analysis with details that we agree with but did not include in the Consultation Paper.

There were two specific policy changes that submitters suggested would have larger impacts on reducing risk and the appropriate level of capital than we stated in the Consultation Paper. Two submitters argued that the strengthening of the Credit Contracts and Consumer Finance Act (**CCCFA**) in 2021 would have a more-than-minimal impact as affordability assessments are still more comprehensive than in 2019 and it has strengthened bank portfolio quality. Three submitters argued that enhanced stress testing would also have a more-than-minimal impact as the results show that banks are sufficiently capitalised to withstand extreme scenarios, and suggested we could use enforcement powers or capital overlays in response to bad stress test results.

Two submitters raised the potential for a stagflation scenario and mounting worldwide government indebtedness as additional macroeconomic concerns that we did not discuss in the Consultation Paper. It was suggested that these could increase the risk of an economic downturn and pose significant risks to banks.

The international experts to the Review broadly agreed that the macroeconomic environment has deteriorated in recent years, and that policy and legislative changes since 2019 would have unclear or minimal impacts on capital requirements. One expert thought we had underestimated the extent to which macroeconomic risks have increased and suggested changes could have severe impacts on the New Zealand economy that more than offset policy changes.

We also sought feedback on the analysis undertaken by Oliver Wyman of how New Zealand bank capital ratios compare internationally. Most submitters noted that the report highlights the conservatism in our rules compared to international standards. Respondents generally agreed with the analysis, with some targeted critiques.

One submitter was critical of the choice of comparator countries and the methodology used to make cross-country comparisons. The submitter emphasised that the banks being compared to the largest NZ banks were on average much larger. Further analysis provided by the submitter suggested that New Zealand banks have similar capital ratios to a broader group of similarly sized global banks.

Our assessment of the feedback and other context/analysis

We think that the impacts of policy changes may be slightly larger than what we consulted on, but not to the extent that submitters have suggested. The additional macroeconomic issues raised support our view that risks in the broader environment have increased since 2019.

Subsequent changes to the CCCFA in 2024 included a significant easing of requirements and allowed a return to 'principles-based' affordability checks. In our view, as a result, requirements for residential mortgage lending are not dramatically tighter than in 2019. CCCFA rules for personal lending are notably stricter than in 2019 and would improve loan quality in this area.

In the Consultation Paper we noted that stress test results are limited to the specific scenario being tested, sensitive to underlying assumptions, and that it is difficult to capture the real-world complexities of a financial crisis. Our enhanced stress testing regime allows us to assess a wider range of specific risks, but the scenarios do not capture all possible risks facing the financial system. We therefore view stress test results and capital requirements as complements in our prudential framework, rather than substitutes.

Many of the concerns about the Oliver Wyman report raised by the submitter were addressed either in the report itself or in our analysis in the Consultation Paper. Oliver Wyman also included several alternative comparisons to support the main results, including comparing New Zealand to wider group of similarly sized international banks. This showed similar results to the submitters' analysis, which we identified as a caveat in our discussion.

Proposed response

On balance, we do not think the broader context is materially different to our assessment in the Consultation Paper and our view on the appropriate capital stack has not changed. The impacts of some policy changes since 2019 might be slightly larger than what we consulted on, but we do not think these impacts are as significant as submitters suggested.

Our interpretation of the results in the Oliver Wyman report has not changed and we generally agree with the caveats expressed in submissions - and have considered these caveats when interpreting the Oliver Wyman report when reaching final recommendations.

Appendix 5: Risk Appetite Framework and communications narrative

This appendix sets out a risk appetite framework and communication narrative – based on the recommendations in this paper – that could be used publicly to communicate the Board's decisions.

Risk Appetite Framework

This Risk Appetite Framework sets out the Reserve Bank of New Zealand's approach to prudential risk management. It reflects our context as a small, open economy with a concentrated banking sector and evolving resolution capability. Our framework prioritises financial stability, emphasises going-concern capital as the cornerstone of resilience, and outlines options for capital calibration to balance prevention and crisis management.

Our context

New Zealand is a small, open economy with a highly concentrated banking sector dominated by the four major Australian-owned banks. By international standards, our supervisory function is relatively lightly resourced, with less exhaustive scrutiny and bespoke interventions. We are currently building a resolution function, which will be fully operational by 2028.

How we calibrate our Risk Appetite

We balance:

- Benefits to society of preventing or managing the failure of regulated entities.
- Costs to society of regulation, for example compliance and administrative costs, and efficiency loss.

Our Risk Appetite for Prudential Policy

As set out in our Statement of Prudential Policy, we have a low appetite for events that could materially damage financial stability. We seek to limit uncertainty and ensure risks are identified and mitigated before they crystallise. However, we do not operate a zero-failure regime – we have a medium tolerance for risks that may lead to the failure of regulated entities where the impact is understood, manageable, and will not materially damage the financial system.

How this translates to capital strategy and our transition

Our prudential approach places heavy reliance on going-concern capital as the first line of defence against systemic instability. High-quality Common Equity Tier 1 (**CET1**) capital ensures institutions can absorb losses while continuing operations, reducing contagion risk and maintaining confidence without triggering resolution or taxpayer support.

We use two dimensions to calibrate capital requirements:

- Likelihood of failure
- Cost of failure

Historically, we maintained high headline CET1 levels, imposed no bespoke Pillar 2 add-ons, and operated a light-touch supervision regime with limited resolution capacity. This resulted in an extremely low likelihood of failure but moderate-to-high cost of failure, prioritising prevention over crisis management.

With the introduction of the Deposit Takers Act 2023 (**DTA**) and the step up in our broader prudential regime, we are transitioning to a model that maintains a low (but not extremely low) likelihood of failure while reducing the cost of failure through credible recovery and resolution tools. Systemically important entities will hold the highest levels of CET1 plus sufficient Loss-Absorbing Capacity (LAC), while non-systemic entities will maintain sound capital without additional buffers.

We monitor the conformity of our settings to our desired risk appetite through our ongoing supervisory monitoring, our stress testing programme, and our twice-yearly Financial Stability Reports.

Key messages on communication of our approach

- We have adopted an approach that is **simple**, **strong** and **proportionate**.
- We have **benchmarked to international settings** and intend to monitor our position over time.
- We have carefully considered where to calibrate our rules to align with international norms and standards where possible, while acknowledging our unique features:
    - We are a small, open economy with a relatively high-risk profile.
    - We have a highly concentrated banking sector, with significant exposure to Australia at the Domestic Systemically Important Bank level, but many smaller entities that benefit from simple but strong rules.
    - While the introduction of the DTA means we've been building our supervisory and regulatory toolkit over recent years, our supervision approach is still fairly light touch internationally.
    - This means our explicit statutory rules are set to be slightly more conservative, but simpler – without additional capital add-ons seen overseas.
    - This means the market can clearly observe the requirements of our banks without needing dig into capital overlays, and this should allow for a more efficient market.
- This approach is **tailored for New Zealand circumstances** – it allows both the sector and the regulator to operate simply and efficiently, and with a level playing field for the big and small players.
- We thought very carefully about ensuring our capital rules, and the overall prudential framework, is proportionate.
- This includes:

- Setting graduated capital levels with Group 1 entities holding the highest amount of CET 1 and LAC capital.
- Retaining our relatively conservative output floor and scalar, to ensure there isn't a disproportionate benefit to Group 1 of using IRB models.
- Introducing additional granularity into the standardised risk weights, which benefit Groups 2 and 3 relatively more than Group 1.
- Allowing Groups 2 and 3 entities the flexibility to continue to count perpetual preference shares as Tier 2 capital.
- Setting a lower minimum capital level ($5m versus $30m) and consulting on a more permissive approach to the use of the term "bank".
- Carefully calibrating the other prudential standards, so that they only apply as necessary. For example, Group 3 entities do not need to comply with the disclosure, lending, OBR and outsourcing standards. Only a small number of Group 2 entities need to comply with the outsourcing standard, and only those Group 2 entities already subject to OBR will need to comply in future. There are also simplified requirements for Group 3 entities e.g. in relation to liquidity, governance and reporting.
- We also apply a proportionate and risk-based approach to our supervisory activities, which means the larger entities are generally subject to greater scrutiny and more regular interactions (as detailed in our Statement of Prudential Policy[18]).
- We have updated our CBA following feedback, including sensitivity analysis.

Key public messages on alignment with Australia

- Aligning with Australian settings has an intuitive appeal and some aspects – such as aligning capital instruments – could bring efficiencies.
- The proposed settings – especially under Option 2 – would go a long way to aligning our overall framework. For example, we would be applying the same simple categories of instruments as Australia (Tier 1 and Tier 2/LAC)), supporting trans-Tasman resolution.
- However, we do not recommend fully aligning with all the Australian levels and settings.
- This is because there are important differences in our **regulatory frameworks** and **economies/banking market** meaning full alignment would not meet our financial stability objectives and would be outside the Board's risk appetite.
- The first and most important reason we should not adopt the statutory Australian capital ratios is that these only partially reflect the requirements for Australian firms.
  - Confidential supervisory buffers take the actual required capital levels closer to our proposed levels under Option 2, and even above that for riskier firms.

[18] Reserve Bank of New Zealand. (2022). *Statement of Prudential Policy*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/statements-of-approaches/sopp-2022.pdf

- This holds true even after adjusting for Australia's less conservative risk weights and output floor – partly as our proposals already reduce much of the difference between Australia and New Zealand's risk weights.
- We do not have the supervisory resource to apply these firm specific buffers and so rely on clear and transparent published requirements.

- Other features of our system, set out below, support the view that we should have somewhat more conservative rules than Australia even with this adjustment to the observed capital levels. There is not an easy way to identify how much each of these contributes to the overall level we set above Australia, nevertheless they are important considerations.
  - We are a host jurisdiction, so we are more reliant on Australian supervision. Host jurisdictions tend to have higher requirements as they are not able to fully observe and supervise all group risk.
  - The New Zealand economy and banking industry is acknowledged as riskier than Australia. This justifies higher capital levels to mitigate the risk to remain within the statutory and Board risk appetite.
  - Unlike Australia, our legislation requires us to minimise the risk that government support is required when formulating our crisis management framework. This is a reason for our risk appetite to be higher than Australia's when setting capital requirements.
  - Our market participants and regulators are smaller and less well-resourced than Australia. This means we do not have the data, expertise and resource to model risk to the same extent as in Australia. The trade-off is that our risk weights are likely to be more conservative/less accurate and our output floor must be set higher.

Appendix 6: More granular standardised risk weights

Summary

Evidence provided in the submission suggests that our standardised risk weight proposals were a little conservative in some areas. We have reviewed the evidence presented in the submissions and agree that more can be done to align the standardised risk weights with the actual risk of lending – a key driving factor for our framework. To achieve this result, we are proposing the following changes to align with that evidence:

- Lower risk weights for low-loan-to-value ratio (**LVR**) residential mortgage lending (**RML**) – matching the Australian Prudential Regulation Authority (**APRA**) and Basel at LVRs ≤ 70.
- Not proceeding with suggested new, higher risk weight for unsecured personal lending.
- Not proceeding with new flat 100% risk weight suggested for unrated commercial property lending.
- Lower risk weights for lending to Community Housing Providers (**CHPs**), particularly for those borrowers with long-term funding contracts with the Crown.

There has been a lot of feedback comparing New Zealand risk weights with Australian risk weights. Our assessment is that the final proposals are a closer match with actual risk, after considering the feedback and additional evidence that we received. The points below summarise the revised proposals compared with Australia:

- RML: New Zealand would be the same as Australia, except at some high LVRs (over 90%) where New Zealand risk weights would be around 5% higher than Australia's.
- Corporate lending, including small and medium-sized enterprise (**SME**): New Zealand would be the same as Australia, except for some additional granularity in Australia relating to commercial property. We intend to seek additional information to allow a more in-depth assessment of commercial property risk weights and impacts in New Zealand.
- Agriculture: no specific category for agriculture in Australia; however, our assessment is that risk weights in New Zealand would be lower than Australia's when the agricultural lending has an LVR of 30% or lower.
- Personal lending: lower for credit cards in Australia (75%) compared with 100% in New Zealand, but other personal lending is the same at a 100% risk weight in both countries.

Residential mortgages

Standard (not past due)

Summary of consultation proposal

We suggested in the Consultation Paper that there was potential scope to add more granular, lower risk weights for lower risk low-LVR RML. To this end, we suggested some specific changes to the risk weights for owner-occupier and property investor RML with LVR ≤ 60.

Consultation feedback

Almost all respondents supported introducing more granular risk weights, however most wanted further reductions than what we had proposed, to match the risk weights used by APRA and Basel.

Respondents that acknowledged higher risk in New Zealand compared with other jurisdictions suggested that higher risk was better reflected in capital ratio requirements rather than individual risk weights. A number of respondents also noted that the RBNZ Bank Financial Strength Dashboard shows that internal ratings-based (**IRB**) deposit takers have higher RML non-performing loans (**NPLs**) and expected losses than standardised deposit takers, despite deposit takers having relatively homogenous RML books.

Respondents also highlighted the following:

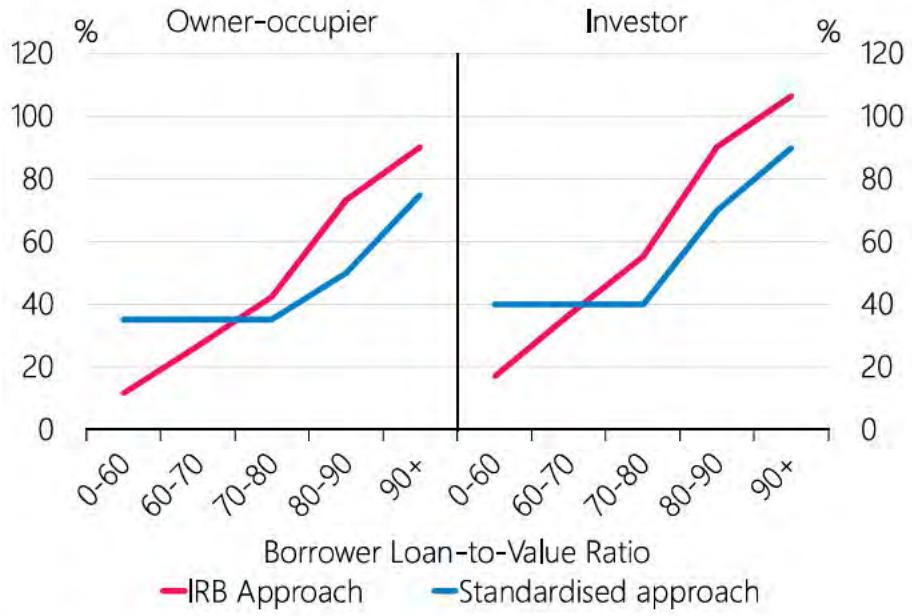
- The Consultation Paper proposals would give IRB deposit takers a significant competitive advantage for low-LVR RML. For example, a 50-60% LVR loan at an IRB deposit taker would attract a ~15% risk weight. Under the Consultation Paper proposals, the same loan at a standardised deposit taker would attract a risk weight twice as high at 30%.
- Standardised deposit takers have reported peak NPLs of just 0.3% for their mortgage portfolios over the last seven years. This is ten times lower than the implied probability of default (**PD**) for a 25% risk weight, suggesting a 25% risk weight may be overly conservative.
- Australian banks have a higher percentage of NPLs than banks in New Zealand. This suggests that New Zealand's risk weights should not be more conservative than Australia's.
- Setting higher risk weights than justified by actual risk leads to inefficient outcomes and higher-than-necessary costs.

Our assessment of the feedback and further analysis

The evidence presented in the submissions makes a strong case for reducing low-LVR RML risk weights to levels similar to those used by APRA.

One counterargument is that the absence of a significant loss experience in the New Zealand data indicates that risk weights should be at higher levels than implied in the loss analysis reported by some of the submitters. This has merit, but it equally applies to IRB modelling. However, as Figure 4 below shows, IRB risk weights are consistently lower than standardised risk weights at lower LVRs, but higher at higher LVRs.

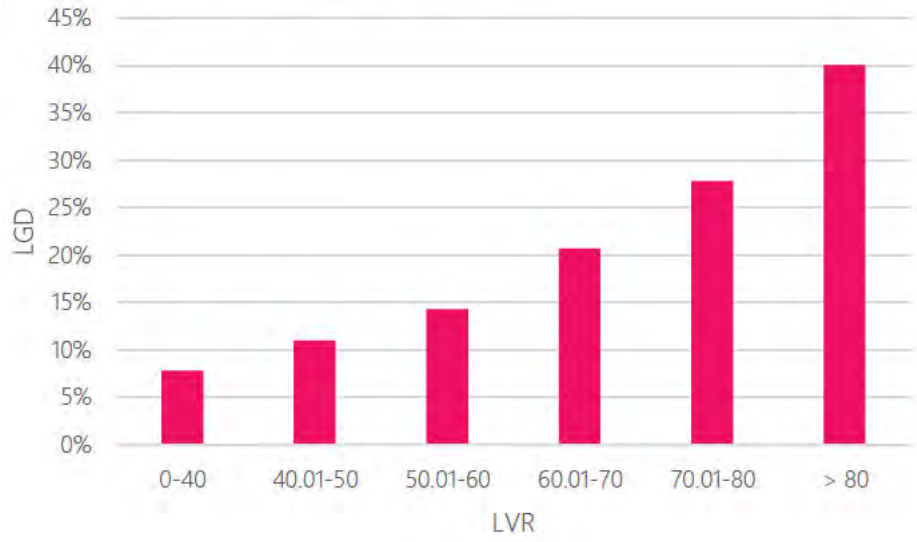
Figure 4: Average risk weights for residential mortgages, by LVR and borrower category



Source: How risk weights affect bank lending

We have also assessed stress test results from a range of previous RBNZ bank industry solvency stress tests. The graphs below compare stress test results across LVR buckets. In Figure 5 below, loss given default (**LGD**) accelerates quickly as LVR increases, and is nearly three times higher at 60-70% LVR compared with 0-40% LVR.

Figure 5: Mortgage stress LGD by LVR, 2022 stress test



The variability in stress test losses was reflected in the Consultation proposals; however, after reviewing evidence from submissions, we have concluded that there is more scope for granularity. For example, respondents argued for different risk weights for LVR 50-60% and LVR 60-70% where our Consultation Paper proposal had a risk weight of 35% for both these LVR buckets. The additional analysis submitted by respondents encouraged us to revisit these risk weights and our

stress test results, and we concluded that assigning different risk weights (30% and 35% respectively) to these two LVR buckets would better reflect actual risk.

Proposed response

We recommend amending the Consultation Paper RML risk weight proposals to match APRA risk weights at lower LVRs (≤70). However, at higher LVRs the existing RML risk weight proposals appear better aligned with IRB model outputs and stress test results. Therefore, there is significantly less justification for reducing risk weights at higher LVRs. Our revised RML risk weight proposals are shown in Table 15 below.

A number of submissions provided solid evidence that the low-LVR RML risk weights we proposed in the Consultation Paper were still too high. This conclusion is based on assessments of standardised deposit takers' historical losses, including comparisons with IRB loan performance and stress test results. These metrics support lower RML risk weights at low LVRs, which IRB can act upon, but standardised cannot. We have concluded that there is limited evidence to support maintaining our higher risk weights for low-LVR RML. Instead, our assessment is that New Zealand-specific risk factors are best reflected in capital ratio requirements.

At higher LVRs the evidence is more supportive of maintaining our higher risk weights. In particular, IRB models produce higher risk weights than our standardised risk weight proposals and stress tests show significantly higher losses at higher LVRs. There is little evidence to support lowering our standardised risk weights for high-LVR RML.

Lower risk weights for low-LVR RML would reduce capital requirements, all else equal. Lowering these risk weights may also encourage more lending to flow into housing. However, neither of these are strong reasons to retain higher risk weights for low-LVR RML, given our focus on aligning risk weights with actual risk. Based on the additional evidence submitted, keeping low-LVR RML risk weights artificially high in order to support higher capital requirements would be challenging to reconcile with our approach to prudential regulation.

The proposed changes below could result in an approximate overall reduction in risk-weighted assets (**RWA**), and overall capital, of 7%. For Group 1 deposit takers, it is an estimated 5.8% reduction, and for Group 2 it is an estimated 15.3% reduction. However, these estimates expect that the output floor will generally stop binding for three of the four Group 1 deposit takers, due to the combined effect of our lower standardised risk weights across the different lending portfolios. This occurs as the IRB risk weights will be more than 85% of the standardised version, due to the standardised risk weights falling. This means that those deposit takers would use IRB risk weights, so the full effect of the proposed changes to standardised risks weights will not affect most Group 1 deposit takers. If the output floor were to continue to bind, then Group 1's risk weights would fall 85% of the standardised risk weight reduction, and overall RWA and capital would fall further than the impacts provided above.

Table 15: Overview of original and revised proposals for standardised risk weights for RML

Loan type	RBNZ (%)	APRA (%)	Proposed (%)
Lenders mortgage insurance (LMI)/No LMI, non-property investment loan, LVR <=50	35	20	**20** (was 25% in consultation)
LMI/No LMI, non-property investment loan, LVR 50.01 - 60	35	25	**25** (was 30% in consultation)
LMI/No LMI, non-property investment loan, LVR 60.01 - 70	35	30	**30** (was 35% in consultation)
LMI/No LMI, non-property investment loan, LVR 70.01 – 80	35	35	35
No LMI, non-property investment loan, LVR 80.01 – 90	50	50	50
No LMI, non-property investment loan, LVR 90.01 – 100	75	70	75
No LMI, non-property investment loan, LVR > 100	100	85	100
LMI, non-property investment loan, LVR 80.01 – 90	35	40	35
LMI, non-property investment loan, LVR 90.01 – 100	50	55	50
LMI, non-property investment loan, LVR > 100	100	70	100
LMI/No LMI, non-property investment interest-only loan, LVR > 80, loan term > 5 yrs / unknown	N/A	100	N/A
LMI/No LMI, property investment loan, LVR <=50	40	25	**25** (was 30% in consultation)
LMI/No LMI, property investment loan, LVR 50.01 – 60	40	30	**30** (was 35% in consultation)
LMI/No LMI, property investment loan, LVR 60.01 – 70	40	40	40
LMI/No LMI, property investment loan, LVR 70.01 – 80	40	45	40
No LMI, property investment loan, LVR 80.01 – 90	70	65	70
No LMI, property investment loan, LVR 90.01 – 100	90	85	90
No LMI, property investment loan, LVR > 100	100	105	100
LMI, property investment loan, LVR 80.01 - 90	50	50	50
LMI, property investment loan, LVR 90.01 - 100	75	70	75
LMI, property investment loan, LVR > 100	100	85	100
LMI/No LMI, property investment interest-only loan, LVR > 80, loan term > 5 yrs / unknown	N/A	100	N/A

Past due

Summary of consultation proposal

In our Consultation Paper, we proposed aligning our past-due RML risk weights with APRA's to better reflect the underlying risk of the lending and more closely align with international benchmarks.

Our current approach to past-due RML risk weights is:

- The risk weight for RML without qualifying LMI that is a 90-day past-due asset is 100%.
- The risk weight for RML with qualifying LMI is the risk weight that corresponds to the LVR and LMI conditions as set out in Table C3.10 (see Table 15 above).[19]

Table 16 shows APRA's approach to past-due RML risk weights.

Table 16: APRA's risk weights for defaulted residential property exposures

	Risk weight (%)
Owner-occupied principal-and-interest with LMI	80
Owner-occupied principal-and-interest without LMI	100
Other standardised residential property with LMI	95
Other standardised residential property without LMI	120
Non-standard loans	150

Consultation feedback

Most respondents did not comment on the past-due proposal. Of those that did, two were opposed and some others just sought clarification of what the new risk weights would be but did not offer any strong views one way or the other.

The respondents that were opposed to the past-due risk weight changes cautioned that applying a 100% risk weight to past-due RML regardless of LMI or LVR would not accurately reflect the risk of the lending and could disincentivise deposit takers from supporting customers through hardship. They proposed an alternate approach, which would take into account both LMI and LVR for owner-occupied and investor RML.

Our assessment of the feedback and further analysis

Our current approach also applies a flat 100% risk weight to past-due RML regardless of LVR if the lending does not have qualifying LMI. Most lending in New Zealand does not have LMI, so this change is unlikely to affect deposit takers' approaches to supporting customers through hardship.

[19] Reserve Bank of New Zealand. (2024). *BPR133: IRB Credit Risk RWAs*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bpr133-irb-credit-risk-rwa-1-july-2024pdf.pdf

There is also currently no international justification for taking an alternative approach like that suggested by the respondents. The Basel approach is generally just to apply a flat 100% risk weight to defaulted mortgage exposures.

As we stated in the Consultation Paper, we have used data provided to us by deposit takers through our information request in October 2024 to calculate the impact of these proposed changes to standardised risk weights for RML past due on overall RWA. The overall share of loans in these categories is very small, making up approximately 0.7% of RML for Group 1 and 2 deposit takers.[20]

As a result, making the proposed changes to RML past due standardised risk weights would make very little difference to the overall RWA, and therefore capital levels, of deposit takers (approximately 0.2 percentage points). However, it would mean that these higher risk lending categories have a generally higher risk weight assigned to them which is more aligned with the actual risk of the lending.

Proposed response

The majority of submitters did not offer a view on this proposal and those that did, did not offer any additional evidence to justify revising our current proposal to past-due RML risk weights. We are therefore not recommending any amendments to this proposal.

Reverse mortgages

Consultation feedback

We did not consult on changes to reverse mortgage risk weights, but a few respondents highlighted this as an area where they would like to see some changes.

Respondents suggested that the recent changes to reverse mortgage risk weights were still overly conservative and should be more aligned with the newly proposed risk weights for property investor RML (while accounting for tail risks in higher-LVR lending) to reflect the added granularity and reduced risk weights. The most detailed proposal in this area suggested the following:

- Align reverse mortgage risk weights with those for investor residential mortgages, while ensuring that tail risks at higher LVRs are appropriately captured.
- Removing the 20% valuation discount and instead calibrating LVR buckets to reflect severe but plausible house price declines.
- A more granular LVR-based risk weighting schedule.

Our assessment of the feedback and further analysis

To support these suggestions, respondents provided a range of evidence regarding low loss rates on this lending. They also noted that this performance had been achieved across a range of economic cycles, including periods of declining house prices and rising interest rates.

[20] As at June 2024.

One respondent noted that under a range of assumptions, house price falls would need to be in excess of 60% to result in losses on reverse mortgages.

The evidence presented in the submission makes a strong argument for reducing risk weights. Many of these points have merit. We also acknowledge that with our proposed lowering of standard RML risk weights as part of this Review, including the further changes proposed in this paper, reverse mortgage risk weights are now high compared with other RML loans.

Proposed response

As noted above, we have some sympathy with the points raised in submissions. However, we are not recommending any changes to reverse mortgage risk weights at this point in time. Risk weights for reverse mortgages were adjusted in 2023, following a review period that exceeded one year.

As reverse mortgages were not part of our original package of proposals, we have not had sufficient time to recreate the financial modelling from our 2023 changes. Without this opportunity we do not feel comfortable recommending changes to the approach.

Nevertheless, we acknowledge that the risk weights are now relatively high compared with our revised RML risk weights. In light of this, the Board may wish to consider keeping options for change in this area open, with scope to carry out further analysis next year, prior to finalising any consequential changes to Banking Prudential Requirements, which we currently plan to revise and have in place before the end of 2026. This would need to be considered alongside other areas, such as securitisation where we have put forward a similar approach, noting of course that reverse mortgages would be much smaller in scope than securitisation.

Corporate

Summary of proposal and consultation feedback

SME lending and thresholds

Currently our standardised approach sets a 100% risk weight for any corporate lending that is not covered by a credit rating. In the Consultation Paper, we proposed creating two new sub-categories aligned with the APRA and Basel approaches:

- SME retail (75% risk weight)
- SME corporate (85% risk weight)

The proposed change was widely supported, and no amendments are proposed. Most feedback focused on the definitions and where the threshold would be set for SME loan eligibility. The threshold also interacts with the 'retail' treatment of SME lending in the IRB approach, where there is a limit of $1 million for qualification as a 'retail' loan for credit risk modelling. The current $1 million setting was put in place in 2008. APRA updated their threshold to $1.5 million (AUD) in 2024.

Other corporate

There is no granularity in the current approach to corporate exposures without a credit rating, which are risk weighted at 100%. This will change once the SME categories are introduced. Nevertheless, outside of those SME exposures, all unrated corporates would be treated the same. However, the risks are not the same across the group. For example, low-LVR commercial property lending will generally be lower risk than high-LVR commercial property lending.

In this context, BNZ raised concerns about the impact of the output floor. They suggested that with RML risk weights falling substantially, and no change in unrated corporate risk weights, outside of SMEs and agriculture, there will be additional incentives to direct lending into RML, if possible, and away from other unrated corporate lending. In their view, this would 'raise the bar' for unrated corporate lending and make this significantly less attractive to lend to. The output floor aspects of this are considered elsewhere in this Paper.

Our assessment of the feedback and further analysis

SME lending and thresholds

The proposed change was widely supported, and no amendments are proposed. We agree that the thresholds and definitions will be critical to implementation.

Other corporate

We have considered, and rejected the following approaches to add granularity to the framework:

- A new category for commercial property risk weights, based on LVRs. This is discussed in more depth below, where we note that we will consider this in 2026 subject to gathering and reviewing additional data from deposit takers and carefully reviewing available evidence.
- Introducing APRA's 'investment grade' subcategory with a risk weight of 85%, or 110% for a 'non-investment grade' exposure – we are not recommending this approach.

While this 'investment grade' sub-category has some appeal, the average impact is likely to be minimal with some risk weights going under 100% and some over. In addition, we would need to apply deposit-taker methodology, and any investment grade rating would need to meet a high bar. For example, it must be assessed as having "adequate capacity to meet its financial commitments in a timely manner" and be "robust against adverse changes in the economic cycle and business conditions". Our assessment is that this approach would add significant complexity and introduce further risk while having limited actual impact on aggregate risk weights.

Proposed response

SME lending and thresholds

s(9)(2)(f)(iv)

This can be confirmed during the Exposure Draft process. This will provide an opportunity for more detailed feedback. The impact of this change has not been incorporated into estimated changes in risk weights in this paper.

Other corporate

No additional changes are recommended at this time. However, in response to feedback from multiple respondents, other changes that can be made to corporate exposures regarding securitisation and infrastructure can be considered in separate work programmes, as discussed below.

Agriculture

Summary of consultation proposal

In our Consultation Paper, we noted that under the standardised approach, agricultural lending is likely captured under unrated corporate lending, as, like SMEs, it is unlikely they have pursued a credit rating due to the cost and barriers involved. This means that all agricultural lending likely receives the same risk weight under the standardised approach (100%), regardless of how risky the underlying lending is.

As a result, we proposed introducing three new exposure categories for agricultural lending to enable lenders using the standardised approach to assign risk weights based on the LVR, which would more accurately reflect the actual riskiness of this type of lending.

The risk weights that we proposed are shown in Table 17 below.

Table 17: Proposed standardised risk weights for agricultural lending

LVR (%)	Proposed risk weight (%)
LVR <=30	50
LVR 30 – 50	75
LVR > 50	100

Most respondents supported the additional granularity in agricultural lending, and the risk weights that were proposed. Of the few that didn't agree:

- One submission did not agree with introducing a separate category for agricultural risk weights at all due to this approach being inconsistent with international approaches such as APRA and Basel.
- One submission suggested the risk weights for agricultural lending should be higher and aligned with our proposed SME corporate treatment as they believe these types of lending have the same risk characteristics.
- Two submissions suggested that agricultural risk weights should be lower with each submission proposing a different alternate approach. One said this was to bring standardised risk weights closer to the risk weights applied by IRB deposit takers, while the other said this was to reduce the conservatism compared to the APRA and Basel approaches for 'very well-secured' lending.

Our assessment of the feedback and further analysis

None of the submissions provided robust analysis as to their reasons for disagreeing with our proposal.

The key assertions for those wanting even lower risk weights were around levelling the playing field between IRB and standardised deposit takers, and further alignment with APRA.

However, under the APRA framework, agricultural lending does not have its own risk weight category. Instead, it receives the following treatment:

- If secured by property, it will likely be captured as commercial property 'not dependent on property cash flows' (see Table 20 below). This gives a risk weight of 60% for LVR<60.
- If LVR>60, it will likely be treated as SME, unrated corporate or commercial property, resulting in a risk weight ranging between 75-110%.

Our proposed agricultural risk weights would likely be lower than they would be under APRA's framework at the low-LVR end and not too dissimilar to APRA at the high-LVR end. Table 18 below shows a comparison of our proposed agricultural risk weights and the treatment that agricultural lending likely gets under the APRA framework, based on the paragraphs above.

Table 18: Proposed RBNZ agricultural risk weights vs. APRA agricultural risk weights

LVR (%)	RBNZ proposed risk weight (%)	APRA risk weight (%)
LVR <=30	50	60
LVR 30-50	75	60
LVR>50	100	-
LVR<=60	-	60
LVR>60	100	75-110

Both submissions advocating for lower agricultural risk weights also stated that our proposed agricultural risk weights were still too conservative, referring to the lower IRB deposit takers' risk weights and the fact that agricultural lending is 'very well secured' with strong land collateral. One of these submissions stated that this distorts competition and creates a structural disadvantage for standardised deposit takers.

However, neither of these submissions, nor the other two that disagreed with our proposal (mentioned above) offered any additional evidence for us to analyse and help to review our Consultation Paper proposal - which was based on analysis of previous stress test results, the relative risk profile, comparative to other types of lending, and the wide range of risk weights that IRB deposit takers apply to loans in each of the LVR buckets.

Proposed response

Aside from the few dissenting submissions described above, our agricultural risk weights proposal was widely supported. We did not receive, and have not found, any evidence to justify changing our proposed approach to agricultural risk weights. Therefore, no amendments are proposed.

Commercial property

Summary of consultation proposal

In the Consultation Paper, we noted that stress tests showed significantly higher losses for aspects of commercial property. As a result, we suggested that there was potentially scope to add more granular, higher risk weights for these types of lending to more accurately reflect their comparative inherent riskiness.

The Consultation Paper floated the idea of creating a new category for unrated commercial property exposures to allow lenders to more accurately risk weight the lending according to the comparatively high risk it presents. This idea was also floated to address the likelihood of some unrated commercial property lending benefitting from the proposed lower SME risk weights, despite commercial property having a different risk profile from SMEs.

We suggested the risk weight could be set at a flat rate of 100% for all unrated commercial property lending in the first instance, due to a lack of available data that would allow us to assess a more granular option. However, we also asked deposit takers for more detailed data to be able to assess the appropriateness and potential impact of such a change.

Consultation feedback

The idea of the 100% flat risk weight on all unrated commercial property lending was strongly opposed by most respondents.

A key driver of this feedback was that the respondents considered such a risk weight to be too blunt and not sufficiently variable for the different levels of risk across different types of unrated commercial property.

In addition, some respondents noted that the default risk weight for such lending would already be 100% in the 'corporate' category, with the exception of SMEs where the proposed 75% or 85% risk weights would apply. These respondents suggested that adding a specific 100% risk weight would therefore add very little to the framework or the deposit-taker outcomes.

Most respondents did support creating a separate category for commercial property but instead suggested a range of alternative calibrations. Most favoured something similar to that used by APRA, shown below.

APRA approach

In Prudential Standard APS 112 Capital Adequacy (**APS 112**), APRA provide the following treatment of commercial property, which is defined as a property exposure that is not a residential property exposure and is not land acquisition, development and construction.[21]

Table 19: APS 112: Risk weights for commercial property exposures – dependent on property cash flows

LVR (%)	Risk weight (%)		
	≤ 60	60.01 - 80	> 80
Standard	70	90	110
Non-standard	150		

Table 20: APS 112: Risk weights for commercial property exposures – not dependent on property cash flows

Counterparty	Risk weight (%)	
	LVR ≤ 60	LVR > 60 or non-standard
Rated corporate	60, or the risk weights set by credit rating in APS112[22]	Risk weights set by credit rating in APS112[23]
All other counterparties	60	According to applicable risk weight in APS112 Attachment B[24]

To distinguish between these two categories, APRA provide a range of circumstances that qualify an exposure to be classified as 'commercial property exposures - not dependent on property cash flows'. This includes circumstances where an authorised deposit-taking institution has recourse to a borrower that meets a tightly limited set of criteria, including ones relating to the diversification of the property portfolio, with limits on geographic and sector concentration.

Our assessment of the feedback and further analysis

Although deposit takers suggested that the 100% risk weight on unrated commercial property would have little to no impact due to the current standardised risk weight approach, some

[21] Australian Prudential Regulation Authority. (2025). *Prudential Standard APS112 Capital Adequacy: Standardised Approach to Credit Risk.* https://www.apra.gov.au/sites/default/files/2024-07/Prudential%20Standard%20APS%20112%20Capital%20Adequacy%20Standardised%20Approach%20to%20Credit%20Risk%20-%20Clean.pdf
[22] Australian Prudential Regulation Authority. (2025). *Prudential Standard APS112 Capital Adequacy: Standardised Approach to Credit Risk.* https://www.apra.gov.au/sites/default/files/2024-07/Prudential%20Standard%20APS%20112%20Capital%20Adequacy%20Standardised%20Approach%20to%20Credit%20Risk%20-%20Clean.pdf
[23] Australian Prudential Regulation Authority. (2025). *Prudential Standard APS112 Capital Adequacy: Standardised Approach to Credit Risk.* https://www.apra.gov.au/sites/default/files/2024-07/Prudential%20Standard%20APS%20112%20Capital%20Adequacy%20Standardised%20Approach%20to%20Credit%20Risk%20-%20Clean.pdf
[24] Australian Prudential Regulation Authority. (2025). *Prudential Standard APS112 Capital Adequacy: Standardised Approach to Credit Risk.* https://www.apra.gov.au/sites/default/files/2024-07/Prudential%20Standard%20APS%20112%20Capital%20Adequacy%20Standardised%20Approach%20to%20Credit%20Risk%20-%20Clean.pdf

provided additional information which could be useful in assessing their alternative proposals for additional granularity in risk weights for unrated commercial property lending.

The key insights from the additional information provided were:

- Of those that provided additional detailed data, the vast majority of their commercial property lending had a risk weight under 80%.
- Some deposit takers were unable to supply commercial property exposure information by LVR.

The table below summarises the information provided by the deposit takers on their commercial property loan books.

Table 21: Deposit takers' commercial property exposures and additional information [Commercially sensitive]

s9(2)(b)(ii)	

The case for change

Currently, there is no granularity in unrated corporate exposures, which are risk weighted at 100%. This will change once the SME categories are introduced. Nevertheless, outside of those SME exposures, all unrated corporates would be treated the same. However, the risks are not the same across the group. For example, low-LVR commercial property lending will often be lower risk than high-LVR commercial property lending.

In this context, BNZ has raised concerns about the impact of the output floor. They suggest that with RML risk weights falling substantially, and relatively less change in corporate, especially for non-SMEs, there will be incentives to direct lending into RML, if possible. In their view, this would 'raise the bar' for corporate lending and make it significantly less attractive to lend to.

Providing a separate commercial property exposure group would be a way to add some granularity to the system. It could provide for lower risk weights in circumstances where risk is lower, based on the LVR.

A simplified approach could be to have one category of commercial property risk weights, based on APRA's 'dependant on property cash flows' category. We have limited information available about these exposures but estimate it would likely reduce RWA by 2-3%. This would have a significant element of risk, especially given the data gaps that we face, but could be considered as

part of a wider package to increase granularity of risk weights. Some of the risks could be managed by making a corresponding increase in capital ratio requirements, so that the additional reduction in capital from the greater granularity in risk weights is offset by extra capital from higher ratio requirements.

The case for no change

Providing for more granularity is appealing, as the losses should be lower for low-LVR lending. However, the main drawback from this is that we have limited information to be able to analyse the impact of such a change. Only two Group 1 deposit takers and three Group 2 deposit takers provided more detailed information; therefore, any estimates of likely impacts are speculative.

In addition, unlike RMLs, we do not have stress test results at different LVRs for commercial property. This means that we cannot verify the assumptions that losses are greater when LVRs are higher, nor do we have a sense of the sensitivity of losses to LVRs.

The absence of robust, reliable information increases the risks of making such changes to the framework, especially given the potential magnitude of the changes discussed above.

Proposed response

We recommend dropping the proposal to create a 100% risk weight category for unrated commercial property lending. It would likely only add unnecessary complexity to the system, with very little change in actual outcomes.

In the absence of detailed information about commercial property exposures, we suggest that any changes should be carefully calibrated to risk appetite. At this stage. If decision makers have higher risk tolerance, or are looking for further adjustments to options with a focus on granularity, then a simplified version of the APRA requirements outlined above could be considered.

Our preferred approach is to signal that we are open to considering changes during 2026, based on assessing the following material:

- Deposit takers providing detailed data about commercial property lending, by LVR where possible – we will design a template to collect this information.
- An assessment of IRB risk weight outcomes to consider if there is scope for standardised changes based on those results.
- We may also consider carrying out a stress test to assess the impacts.

Commercial property can be high-risk lending. We will therefore assess all the evidence carefully before committing to any changes.

Personal lending

Summary of consultation proposal

Personal lending is currently captured under 'other' exposures and has a 100% standardised risk weight. In the Consultation Paper, we suggested that there could be scope for risk weights to be more granular and moved higher to align with the current approach for Group 3 deposit takers.

This would mean creating new categories of secured and unsecured personal lending with 100% and 150% risk weights, respectively.

We considered that higher standardised risk weights may better reflect the actual risk of personal lending, which has consistently demonstrated higher loss rates than other lending types in our stress tests. This would also mean that personal lending requirements for Group 3 deposit takers would not change when the Deposit Takers Act 2023 (**DTA**) comes into force and they transition to the standardised regime. We sought feedback on this suggestion.

We currently have limited data on personal lending, making it difficult to assess the potential impacts from changing these risk weights. As part of the consultation, we sought more information from deposit takers about their personal lending exposures.

Consultation feedback

Deposit takers and industry groups gave feedback on this.

There was general support for creating new secured and unsecured categories of personal lending. Some deposit takers suggested that there should be additional granularity by also splitting out credit card exposures from other personal lending.

The suggestion that the risk weight for unsecured personal lending could be increased to 150% was unanimously opposed. There was also some opposition to retaining the 100% risk weight for secured personal lending. Submitters cited the following reasons:

- Standardised risk weights for personal lending would be significantly higher than IRB risk weights, which could have detrimental impacts on competition.
- The proposed risk weights would be higher than personal lending risk weights in other jurisdictions.
- Higher risk weights for personal lending could disincentivise deposit takers from offering this product and/or increase lending rates, forcing New Zealanders outside of the regulated banking system.
- The rest of the industry should not be aligned with Group 3 deposit takers because of the different nature of their activities and risk profiles.

Several submitters recommended adopting the APRA approach, shown below. This separates credit card lending and other retail exposures (defined as exposures to one or more individuals that are not property or margin lending exposures) and has lower risk weights than we suggested in the Consultation Paper.

Table 22: APS 112 Risk weights for retail exposures

	Risk weight (%)
Credit card exposures	75
Other retail exposures	100

A few deposit takers also recommended decreasing the risk weight for secured personal lending to 75% to align with Basel rules.

Our assessment of the feedback and further analysis

Little new evidence was provided by deposit takers in their submissions. Our analysis is mainly based on previous stress test results.

The table below summarises the average loss rate from our 2021, 2022 and 2025 stress tests for different lending types, along with the current average standardised and IRB risk weights.

Table 23: Average loss rate, IRB risk weight, and standardised risk weight for different lending types

Lending type	Average loss rate in stress tests	Average standardised risk weight	Average IRB risk weight
Owner occupier RML	0.42%	38%	27%
Residential investor RML	0.37%	42%	27%
Large corporate	1.52%	95%	50%
SME corporate	1.73%	90%	49%
Agriculture – dairy	0.96%	100%	74%
Agriculture – non-dairy	1.01%	99%	61%
Commercial property – investment	1.41%	98%	84%
Commercial property – development and other	2.67%	94%	88%
Credit card	1.48%	100%	65%
Other personal	4.67%	93%	92%

Note: The risk weight data in this table is from IRB deposit takers only.

Other personal lending

Secured and unsecured personal lending (excluding credit cards) are included together in the 'other personal lending' category in stress tests. Other personal lending has a significantly higher average loss rate than any other lending type, but it also has a slightly lower average standardised risk weight than most other categories.

The lack of granularity in the stress testing data makes it difficult to assess personal lending. While risk weights appear too low for overall risk compared to other lending types, it is not clear how

loss rates are split across secured and unsecured lending. It is therefore not clear whether a new category is necessary or what the relative risk weights should be, based on this data. However, adopting a 150% risk weight for unsecured personal lending would be significantly out of step with the approach taken in other jurisdictions.

One deposit taker argued that in general personal lending risk weights should be lower because there is a weaker historical correlation between personal lending defaults and economic conditions compared to other lending types. However, while stress test results can be volatile, they show that personal lending defaults could still increase significantly more than defaults for other lending types in a severe economic downturn. It is also important to note that we have not experienced a downturn as severe as what have modelled in stress tests in recent years. Although these scenarios are severe, we still consider them to be plausible, making it difficult to justify lower risk weights.

The same deposit taker also suggested that the risk weight for secured personal lending could be lowered to 75%, while retaining the 100% risk weight for unsecured personal lending to add granularity. This was based on their own lending experience which suggests secured personal loans are materially lower risk than unsecured loans. As already noted, other personal lending has significantly higher loss rates in stress tests than other lending types with similar standardised risk weights, so lower risk weights are not justified.

Credit card lending

Credit card lending has a similar overall loss rate to some other lending types including corporate lending, agricultural lending, and commercial property (investment). The current standardised risk weight for credit card lending (100%) is broadly aligned with these other lending types of similar risk.

The current risk weight seems appropriate. Several banks noted in their submissions that all credit card lending is treated as unsecured, so the standardised risk weight would increase to 150% if we implemented the approach we floated in the Consultation Paper. This would likely be too high given the relative risk. However, a risk weight of 75% to align with APRA would also likely be too low, as this would mean credit card lending would have one of the lowest standardised risk weights relative to the loss rate of any lending type (see Table 23 above).

There is some discrepancy between the current average IRB and standardised risk weights for credit card lending, but it is not as significant as for other lending types. This does not provide a strong argument for lowering the risk weight, but it may support not increasing it.

Impacts on deposit takers

Some Group 2 and Group 3 deposit takers provided data on their personal lending exposures. We have combined this with publicly available data to estimate:

- The impact on Group 3 deposit takers of moving from the current non-bank deposit taker (**NBDT**) regulations to the current standardised regime (i.e., the status quo).
- The impact on Group 2 deposit takers of moving from the current standardised regime to the current NBDT regulations (i.e. the suggestion in the Consultation Paper).

The results are shown below.

Table 24: Impact of moving from current NBDT regulations to standardised risk weights for personal lending on selected Group 3 deposit takers

s9(2)(b)(ii)			

Table 25: Impact of moving from current standardised to NBDT regulations risk weights for personal lending on selected Group 2 deposit takers

s9(2)(b)(ii)			

Overall, personal lending tends to be a relatively small part of deposit takers' balance sheets, so changing risk weights in either direction would have minor impacts on most entities. Material impacts are concentrated in a small number of deposit takers.

Most Group 3 deposit takers do not have any personal lending exposures, or only very low exposures, so they would be largely unaffected if they moved to lower risk weights under the current standardised regime. s9(2)(b)(ii)

Group 2 deposit takers would be slightly more impacted if they moved to the higher risk weights s9(2)(b)(ii)

Proposed response

We recommend not proceeding with changing our approach to personal lending and instead continuing with having one category of personal lending with a 100% standardised risk weight. Although submitters supported having more granular secured and unsecured categories, this cannot be justified based on the overall stress test results. More data would also be necessary to justify the calibration of risk weights given the strong opposition to our suggested increase in risk weight for unsecured personal lending.

If we were to make any changes to secured and unsecured personal lending, then it would also likely be appropriate to create another category for credit card exposures. This would allow credit card lending to retain the current 100% risk weight, instead of it being included in a new unsecured category with potentially higher risk weights.

If we retain the current approach, we should monitor the impacts on Group 3 deposit takers when they transition to the standardised regime. If we were concerned about the capital adequacy of individual deposit takers, we could consider overlays for those that would be more impacted s9(2)(b)(ii) This would be more appropriate for addressing risks than a blanket approach, given the highest risk is concentrated in a small number of deposit takers.

Community housing providers, housing co-operatives and whenua Māori

Summary of consultation proposal

In the Consultation Paper we proposed creating a new category for risk weighting exposures to CHPs and housing co-operatives. This proposal was largely supported by respondents, albeit with some dissenters. The proposal consisted of the following:

- A new standardised category of risk weights for CHPs and housing co-operatives.
- Require both standardised and IRB deposit takers to use the standardised risk weight.
- This category would be separate from RML, but the risk weight would be calibrated to same level as property investment RML.
- Exclude lending by third parties.
- Exclude property development lending – only provision of dwellings for accommodation would be covered.

Consultation feedback

Most of the feedback supported the general direction proposed in the Consultation Paper, with the majority supporting our 'Option 3' approach to create a new separate standardised risk weight category for CHP lending. A couple of submitters instead supported 'Option 2', which was to just treat all CHP and housing co-operative lending as RML, and another couple proposed a different approach for IRB deposit takers (covered in more detail below).

Multiple submissions included robust evidence that CHP and housing co-operative lending would be more similar in risk profile to owner-occupier RML rather than property investment RML and suggested that risk weights should be assigned accordingly. A couple of submissions also suggested that the risk profile for these types of lending may be even lower than owner-occupier RML.

Other feedback and our preliminary assessment in response are summarised below.

Our assessment of the feedback and further analysis

Whether to allow IRB deposit takers to use internal modelling, with changes to income-producing real estate (IPRE) treatment

ANZ and ASB opposed the proposed approach for IRB deposit takers. Instead, they proposed assigning CHP lending to the IPRE group of exposures and that IRB banks should model the exposures as part of IRB models.

IRB deposit takers currently use the IPRE category for CHP lending. However, Banking Prudential Requirement 133 – IRB Credit Risk RWA (**BPR133**) restricts the risk weights that can be applied to this type of lending under the IPRE approach:[25]

"*A bank must calculate the credit risk RWA on a specialised lending (**SL**) exposure subject to the slotting approach by multiplying the exposure amount determined under section C9.2 by the Unexpected Loss (**UL**) risk weight…*"

The lowest possible risk weight that can apply in this situation is 70%.

We consider a 70% risk weight to be too high for CHP lending, as set out in the Consultation Paper. Therefore, to fit CHP lending into this IPRE category, and reflect this treatment with a lower risk weight, we would need to remove the 70% restriction in BPR133.

To remove the restriction would be complex:

- The removal of the restriction would need to apply only to CHP lending, otherwise other IPRE lending, where we have not fully assessed the risk, would also benefit.
- We would then need to specify how the lending should be modelled – for example, it could be done with existing models but then allow LGD and PD to be fully modelled.

[25] Reserve Bank of New Zealand. (2024). *BPR133: IRB Credit Risk RWAs*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bpr133-irb-credit-risk-rwa-1-july-2024pdf.pdf

- We would need to consider whether to set a floor on the risk weight to replace the current 70%. For example, this could be set at the lowest possible standardised risk weight in existing proposals.

This complexity could be addressed, although not in the period available for decisions in December 2025. However, even if we resolved these questions, the benefits compared with a simpler standardised approach seem marginal.

Proposed response

We have rejected the proposal to allow IPRE modelling of CHP exposures by IRB deposit takers and are proposing to continue with standardised approach for all deposit takers. This is primarily driven by our assessment that allowing modelling would add complexity and eliminate consistency across deposit takers, without significant benefits. Further rationale supporting our preferred options is provided in subsequent sections.

Consider splitting CHPs and housing co-operatives

A number of respondents suggested that CHPs and housing co-operatives should be separated and treated differently, due to different features of these types of lending. These respondents cited that housing co-operatives have a different risk profile to CHPs for the following reasons:

- The 'mutualisation' of the economic risk of ownership is important for the lending risk. If a resident cannot meet their contractual obligations under the housing co-operative agreement, then in the first instance it is up to the other residents to deal with that problem.
- Housing co-operatives are usually not 'social housing' providers – they do not offer subsidised accommodation to those who would not otherwise be able to obtain accommodation in the rental market.
- Housing co-operatives involve a lease or right to occupy. The credit risk of any resident, usually from an affordable or market demographic, is supported by the other residents and the equity that exists in the co-operative.

Overall, respondents emphasised that the economic exposure of a lender to a housing co-operative is similar to that of a lender to an owner-occupier, except the risk is then further mitigated by the mutualisation amongst residents.

There is an extensive list of differences between the CHP and housing co-operative categories of lending. Based on this feedback, it does not seem sensible to group the two types of lending together. We have concluded that lending to housing co-operatives looks a lot more like owner-occupier RML than CHP lending or corporate lending.

Proposed response

We recommend separating housing co-operatives from CHPs. However, because housing co-operatives make up only a small group of loans – submitters suggest as few as 100 in New Zealand in total – it does not make sense to have a separate risk weight category for this group.

Therefore, our revised approach is to allow banks to treat this lending as RML. There is currently no barrier to banks taking this approach if they consider the lending to be RML, although the IRB

modelling requirements may affect this. However, it is possible that banks are not comfortable doing this without clear guidance from us.

Treating co-operatives lending as RML should be straight-forward for deposit takers using the standardised approach. However, it is possible that IRB deposit takers do not consider this lending to meet the RML features required for inclusion in IRB retail modelling. In particular, IRB-accredited deposit takers may regard the lending as being equivalent to the homogenous loans that can be pooled for modelling purposes. We are engaging with deposit takers further on this point, as a number of them made detailed submissions about CHP and housing co-operative lending. Some also supported separating these two types of lending but did not suggest a preferred approach to take post-separation. Details of how to manage these complexities will need to be addressed through the Exposure Draft changes to Banking Prudential Requirements (**BPR**) documents in 2026 and there will be an opportunity for stakeholder feedback

Calibration of the standardised risk weights

The topic that attracted the most attention was the calibration of standardised risk weights for CHPs and housing co-operatives. While most respondents supported establishing the new category, most stated that setting the risk weights at the same level as property investment RML was unnecessarily high. This criticism consisted of two main elements:

- LVR is not a good indicator of risk for CHPs – respondents suggested that Crown contracting arrangements are more important than LVRs as these contracts substantially manage risk.
- Even if LVR is a good indicator, CHPs are considerably lower risk than property investment RML, since CHPs are not exposed to market movements.

We have discussed this feedback in-depth bilaterally with some of the respondents and now agree that our proposal was too conservative. We propose instead that the risk weights for owner-occupied lending should apply for CHP lending.

The most compelling evidence relates to the role of Crown contracts. Registered CHPs with a 25-year Crown contract effectively have a secure income stream for a prolonged time period s9(2)(f)(iv

These factors suggest that lending to a registered CHP, with long-term Crown contracts in place, is substantially lower risk than property investment RML and, in many cases, probably lower than owner-occupier RML.

However, for CHPs that do not have Crown contracts, the risk is likely to be higher and the LVR remains a useful proxy to measure this risk.

For example, a CHP could have a relatively high LVR (for example, around 60%) but have a 25-year service provision contract with the Crown, an operating grant from the Crown, and (in the future) a mechanism where the Crown bears the interest rate risk. Another CHP could have a lower LVR (for example, 30%) but no Crown contracts in place and therefore be more exposed to risks if their circumstances change. This would make the second CHP higher risk than the first CHP with the Crown contract, despite their comparatively lower LVR.

In addition, registered CHPs are regulated by HUD and face sizable governance obligations through that regulation and through charity regulations at the Department of Internal Affairs (**DIA**), making them lower risk than unregistered CHPs.

Proposed response

We have concluded that the difference in risk across the different types of CHPs is considerable. Treating them all the same way is unlikely to address the long-running concerns from the sector, nor is it likely to fully reflect risk within the approach to risk weights.

While the Consultation Paper generally proposed lower risk weights for CHP lending than available in the status quo, registered CHPs, with long-term contracts, can have higher LVRs but could face higher risk weights than unregistered CHPs with low LVRs, despite these larger CHPs often having the significant risk mitigants discussed above in place.

To manage these different scenarios, we recommend the following approach:

- CHP risk weights aligned with the relevant owner-occupier RML risk weight according to their LVR. This sets a baseline risk weight for all CHPs, reflecting the value of the security if the CHP defaults.
- Risk weights capped at a maximum of 30% for qualifying registered CHPs with long-term Crown funding contracts in place. This would mean that if their LVR was low enough to attract a risk weight of less than 30%, then that would apply, otherwise a maximum 30% risk weight would apply. This would ensure the risk weights for this type of lending more accurately reflect the lower risk profile compared to other CHPs without the risk mitigants in place.

Treatment of third-party providers

There are a range of service provision models across the sector:

A. CHP owns the property and has a long-term contract with the Crown.

B. CHP owns the property and has no long-term contract with the Crown.

C. CHP has a joint venture with a government agency where the risk is shared and ownership sits in a separate legal entity, partially owned by the CHP.

D. CHP leases dwellings from a third-party private property owner, with a contract in place that ensures the dwelling is available for the CHP for a specified period.

Our Consultation Paper proposals would apply to A and B but not C and D. Respondents have asked us to consider expanding coverage to C and D as these are likely to be growth areas in the future under wider policy direction.

Our primary concern with expanding the coverage to D relates to the practicalities of including projects connected to CHPs but provided by third-party providers, without inadvertently allowing this favourable treatment to apply to other non-CHP related projects that the third-party provider undertakes. Our assessment is that the approach taken in item C would limit these risks.

Proposed response

We recommend signalling that we are open to our proposals applying to the following service provision models:

- CHP owns the property and has a long-term contract with the Crown.
- CHP owns the property and has no long-term contract with the Crown.
- CHP has a joint venture with a government agency where the risk is shared and ownership sits in a separate legal entity, partially owned by the CHP.

This would be subject to producing sufficient clarity in Exposure Draft definitions to manage the risks. We are concerned that extending this further to cover borrowing by a third-party private property owner, with a contract in place that ensures the dwelling is available for the CHP for a specified period, introduces additional risk. Overtime, there may be ways that this can be managed, and we are open to considering further proposals, for example during the Exposure Draft stage, if there are ways to manage these risks.

Coverage of development projects

In the Consultation Paper, we proposed that only borrowing for dwellings would be covered in our new CHP treatment proposals, not borrowing for property development purposes. Almost all respondents agreed that the risks of property development in the CHP space are very different and should be excluded from this approach.

Proposed response

We propose keeping this aspect of the proposal unchanged, as the risks associated with property developments are higher than the risks of providing completed dwellings for accommodation.

Whenua Māori

We sought feedback about barriers to lending when whenua Māori is used as security, as well as any proposals for changes to prudential regulation to address barriers.

There were few concrete suggestions about whenua Māori lending. Respondents identified a handful of barriers, mainly relating to challenges around collective ownership, and concerns about how to manage that during default, rather the prudential regulatory settings. Some also suggested that lending for whenua Māori should have a separate, low risk weight category of lending.

Aside from risk weights, no respondents identified prudential actions that would reduce barriers to lending. In addition, we have not found any compelling evidence to indicate lending with whenua Māori as security is lower risk than any other sort of lending and do not see a strong rationale to reduce risk weights in these circumstances.

However, the general approach to lower risk weights for CHP lending will be available to lending secured by whenua Māori that qualifies.

In addition, we recommend that this topic remains open, especially for consideration of any guidance gaps that might be a useful step in the future.

Summary of proposed responses

Overall, we recommend proceeding with our Consultation Paper proposals, but with the following changes:

- Use owner-occupier RML risk weights rather than property investor RML risk weights for CHPs, with an additional sub-category that would set a maximum risk weight of 30% for registered CHPs with long-term Crown contracts regardless of LVR.
- Treat housing co-operatives as a separate form of lending from CHPs and allow banks to treat this type of lending as RML rather than introducing a separate category for such a small amount of lending.
- Consider expanding coverage to third-party borrowers, in limited circumstances, with details to be confirmed with input from the sector as part of the Exposure Draft process.
- Invite ongoing suggestions regarding regulatory guidance or other steps that can be considered to address barriers for lending with whenua Māori as security.

Other risk weights feedback

Infrastructure

Consultation feedback

A number of respondents identified a gap in our framework for the treatment of borrowing for infrastructure projects. This criticism is relevant for both the standardised and IRB approaches to credit risk.

Respondents asked us to consider a concessionary LGD for the development of public infrastructure projects, similar to Australia. APRA allows for a 25% LGD for operators of domestic large public infrastructure projects and utilities that have a tripartite agreement with the Australian Government. A lower LGD recognises that the underlying infrastructure assets support recovery values in the event of a default.

Respondents stated that borrowers who deliver large-scale public infrastructure, or who operate lifeline utilities (such as water, energy distribution and transmission, gas pipelines and fibre) are backed by assets with strong credit enhancement frameworks such as Public Private Partnerships and the Infrastructure Funding and Financing Act 2020. These are assessed as leading to a reduction of loss in default. Additionally, where borrowers operate under a Regulated Asset Base, regulatory oversight and pricing mechanisms help mitigate default risk, while the essential nature, and defensible value of the assets, further reduce potential losses. Their services are non-discretionary, demand is stable across economic cycles, and these assets are highly secure. This reduces default risk and supports the case for a lower standardised risk weight.

Our assessment of the feedback and further analysis

We agree that lending with the infrastructure features described above will have lower risk than lending without these characteristics.

Proposed response

While we agree that lending with the infrastructure features described above will have lower risk than lending without these characteristics, we have not had sufficient time to fully assess the risks or to identify how to incorporate this into the existing risk weights framework.

We propose making an in-principle decision that this change be incorporated into the framework, subject to completing detailed design work at a later date. If possible, we could consider carrying this out during the amendment of the Exposure Draft for Banking Prudential Requirements in 2026. This would include both the consideration of a concessionary LGD in the IRB framework and creating an equivalent standardised category of exposures. It may not be possible to complete this work in time for 2026 revisions to Banking Prudential Requitrements, in which case we may consider it at a later time, in order to include in the finalisation of the Capital Standard.

Securitisation

Consultation feedback

A number of respondents commented on the role of securitisation. Securitisation funding – particularly through warehouse facilities – for Group 2 deposit takers and non-bank lending institutions (NBLIs) is one mechanism by which Group 1 deposit takers support the development of competition in New Zealand's financial markets.

Securitisation, especially through warehouse facilities, represents a significant funding source for NBLIs in New Zealand. Respondents noted that Group 1 deposit takers commonly provide senior lending to NBLI securitisations via warehouse facilities, which are structured similarly to revolving credit facilities. In many cases, these share substantially the same features as wholesale market 'term' securitisations.

Respondents noted that our current requirements do not provide specific capital treatment for exposures to third-party securitisations, focusing solely on the context of bank-originated securitisations. Currently, as a result, Group 1 deposit takers providing funding to unrated warehouse facilities assign risk weights to these exposures as if they are corporate exposures, generally resulting in a standardised weight of 100%, subject to an output floor of 85%.

Respondents stated that this does not accurately reflect the underlying credit risk of such exposures. They stated that while the warehouse facilities are generally not externally rated due to the costs and operational demands required for obtaining and maintaining ratings, the underlying quality of the exposures would qualify for substantially lower risk weights, possibly as low as 20%.

As noted above, the cost of holding the additional amounts of capital under the current standards to fund these exposures is passed on to the NBLIs though either or both reduced funding and higher pricing. This, in turn, affects efficiency and competition.

Respondents suggested that, as in offshore jurisdictions like Australia, New Zealand should require warehouse funding deposit takers to hold capital based on the risk of the underlying exposure and structure, rather than on the credit risk of the originating deposit taker or NBLI borrowing entity.

Our assessment of the feedback and further analysis

We agree that our existing requirements limit the extent to which efficiently priced third-party securitisation can take place. Establishing an internationally comparable approach would be a complex task and likely to take at least 12-18 months to develop and consult, and then additional time for implementation. Doing so would have some merit, but would need to be prioritised in future work programmes.

Proposed response

We do not intend to advance this proposal at the current time due to the limited time available ahead of the 2025 Review decisions in December. However, we intend to review this during the next 12-18 months.

Securitisation is potentially a wide-ranging topic. Our proposed review will be tightly constrained to the issues described above regarding requiring warehouse funding deposit takers to hold capital based on the risk of the underlying exposure and structure, rather than on the credit risk of the originating deposit taker or NBLI borrowing entity.

This is much more limited in scope than issues canvassed in the EY Report titled "External Perceptions of the New Zealand Banking System" discussed at the Board in October – that report suggested considering wide ranging reforms, including encouraging risk transfer from deposit takers to investors and/or creating a New Zealand Freddie Mac/Fannie Mae. We have not considered these options for inclusion in the next stages of the work. They would be firmly outside of scope due to the complexity involved.

Therefore, we do not intend to carry out a review of existing approaches to securitisation, beyond the limited warehousing-related point described above. For example, we will not be reviewing our approach to securitisation requirements relating to circumstances where a deposit taker is originating or supplying assets to a special purpose entity, or other legal structure, for the purpose of securitisation and risk transfer, with consequent reductions in risk weights. We intend to carry over existing requirements in these areas into the DTA Standards, as currently set out in BPR160: Insurance, Securitisation, and Loan Transfers.

Other risk weight topics

Respondents raised a number of other changes that they would like made to the IRB and/or standardised approaches that were not part of the consultation. We have not reviewed these in the time available, and – given other priorities – do not recommend committing to further work on these at this stage:

- Review the unsecured LGD used in IRB calculations for non-retail lending as New Zealand IRB banks are likely using LGDs historically approved by the RBNZ that may no longer be appropriate.
- Review prescribed credit conversion factors for IRB and standardised approaches and consider alignment with Australia and Basel.
- In IRB modelling, assess whether the long-standing minimum LGDs for RML exposures are still suitable.

NBDT regulations

Summary of consultation

We sought comment on whether to apply the standardised risk weights to NBDTs before the application of the Capital Standard in late 2028.

Currently, the RWA approach for NBDTs is set out in the NBDT regulations, as part of the Non-bank Deposit Takers Act 2013 (**NBDT Act**). For many categories of exposures, these weights are higher than those used in the existing standardised approach, with the proposed new risk weights further widening this gap.

Therefore, on both fairness grounds and a desire for risk weights to correctly reflect the underlying risk, we proposed in the consultation to bring forward the shift to standardised risk weights for NBDTs to October 2026. However, initial modelling suggested that as a result of the new risk weights, NBDTs (particularly exposed to residential property) would see a material decrease in their capital requirements (for example, their capital ratios are modelled to increase by an average of 3.5pp due to the fall in RWA, although some NBDTs may only receive a minor benefit).

In the Consultation Paper, we raised concerns that applying the new lower risk weights earlier without a corresponding increase in minimum capital would be detrimental to the purposes of the NBDT Act, relating to the maintenance of a sound and efficient financial system. Currently, NBDTs are only required to have a minimum capital ratio of 8%, with no legislated buffer (this is up to the discretion of the trustee supervisor).

We therefore proposed we would advise the Minister of Finance, who ultimately advises the governor general, to increase the minimum capital ratio to 10% - noting that we are recommending that the final total capital ratio (including buffer) within the Capital Standard applying to Group 3 deposit takers should be 13%.

Consultation feedback

Overall, there was strong support for applying the standardised risk weights to NBDTs prior to 2028. Submitters suggested this should be done as soon as possible, to promote competition and increase lending capacity for NBDTs.

However, submitters noted that the adoption of the new risk weights would not result in regulatory relief for all NBDTs, or at least some would only see a small benefit. Nevertheless, industry (including the NBDT Association) supported changing the regulations immediately, noting that a three-month lead time was sufficient (that is, the time between publication of the new regulations and the commencement).

Submitters disagreed with the corresponding increase in minimum capital requirements. Industry noted that it could be disruptive if the minimum capital requirement within the regulations (pre 2028 state) was higher than the minimum capital requirement within the Capital Standard (post 2028), notwithstanding, that the total capital ratio (including buffer) would be higher than the 10% proposed.

Our assessment of the feedback and further analysis

Following consultation feedback and post-consultation workshops with NBDTs, we continue to support facilitating early adoption of the lower standardised risk weights for NBDTs. This will result in a significant benefit for the majority of NBDTs, and industry wish for these to be implemented as soon as possible.

Submitters' evidence that the risk weights may not benefit all NBDTs equally and, the somewhat theoretical (due to the existence of the buffer) issues of having the minimum increase in 2026 before falling again in 2028, is persuasive. Nevertheless, concerns remain around the soundness of the financial system given the very low capital an NBDT could hold once the new risk weights were in place. We recognise that this likely only exists for entities that primarily lend to low-LVR housing (that is, low risk lending), however, as the Reserve Bank does not currently supervise NBDTs, some caution is required.

We are therefore of the view the minimum capital ratio should increase by 1% (from 8% to 9%), rather than the 2% previously consulted on. Increasing to 9% also aligns with the minimum as part of the Capital Standard in 2028, mitigating disruption. Industry would still see a net benefit from the risk weight changes, and the NBDT Association outlined in their submission that this would be a sensible alternative. A 1% extra capital buffer would continue to apply to credit rating exempt deposit takers.

We recommend that the settings provided in Table 26 below are recommended to the Minister of Finance.

Table 26: NBDT transitional changes

Year	Minimum capital ratio	Total capital ratio (incl. buffer)	Risk weights	Supervised by
2025/26 (Current)	8%	8% (0%)	Current state: Regulations	Trustees
2026/27 (beginning 1 Oct)	9%	9% (0%)	Standardised: Regulations	Trustees
2027/28	9%	9% (0%)	Standardised: Regulations	Trustees
2028/29	9%	10% (1%)	Standardised: Capital Standard	RBNZ
2029/30	9%	11% (2%)	Standardised: Capital Standard	RBNZ
2030/31	9%	12% (3%)	Standardised: Capital Standard	RBNZ

Year	Minimum capital ratio	Total capital ratio (incl. buffer)	Risk weights	Supervised by
2031/32	9%	13% (4%)	Standardised: Capital Standard	RBNZ

Appendix 7: Additional Tier 1 (AT1)

Consultation feedback

We received 19 submissions in relation to the proposal to remove Additional Tier 1 (**AT1**). Responses were received from deposit takers in all groups as well as industry bodies, and individuals. Respondents overwhelmingly supported the proposal to remove AT1 from the capital stack. One market respondent (Forsyth Barr) observed that this would remove the ability for domestic investors to gain a quasi-equity exposure to the banking industry.

Respondents agreed with our analysis of the challenges presented by AT1, both from an issuers' and a prudential perspective. Respondents liked the alignment with the Australian Prudential Regulation Authority. Furthermore, the general simplification of the framework was seen as a positive, as well as providing benefits from a crisis resolution angle. There was no suggestion that we had omitted any relevant considerations.

Feedback broadly focussed on two aspects: what would replace the AT1 slice in the capital stack, and the nature of the transitional arrangements. This section focuses on feedback relating to the decision to remove AT1 – we discuss what the capital stack will comprise at paragraphs 4.34 to 4.75 of the Board paper.

Care needs to be taken with transitional arrangements

Respondents were keen to ensure the transition would be managed carefully, with clear and early communication, in order to avoid market disruption.

One large deposit taker (BNZ) s9(2)(b)(ii) asked for a clear grandfathering process for legacy instruments.

Another big deposit taker (ANZ) made the point that there was a risk of unintended consequences and that, in developing transitional provisions, we should take care not to penalise any deposit taker that has been proactive in trying to overcome the current challenges of AT1.

Many respondents raised the prospect of the change in policy constituting a regulatory event that would trigger the ability for deposit takers to redeem instruments early (subject to having the appropriate provisions in their AT1 instruments).[26]

There were mixed views on whether we should incentivise the early redemption of legacy instruments (for example, to remove any complexity or ambiguity that might arise in the context of a stress situation (WNZL)) or whether that would lead to unnecessary market disruption (Kiwibank).

Many respondents felt that grandfathering existing instruments to the first call date was an appropriate mechanism.

From a Group 3 perspective, one respondent (NBS) highlighted the need to have an adequate timetable to limit the impact of removing AT1 on smaller deposit takers, particularly those with a mutual structure. This respondent suggested a derecognition schedule (as Tier 1) as well as

[26] See D2.5(3) in Reserve Bank of New Zealand. (2023). *BPR110: Capital Definitions*. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr110-capital-definitions-oct-23.pdf

ongoing recognition of perpetual preference shares as Tier 2 capital would support a smoother transition. A hybrid approach was also suggested by another respondent (Chapman Tripp).

Our assessment of the feedback and other context/analysis

Impact on different groups

We are conscious this decision will impact deposit taker groups in different ways depending on their current capital structure.

Groups 1 and 2 deposit takers

As at the date of this document, AT1 instruments have been issued by three Group 1 deposit takers and one Group 2 deposit taker. Two of these also have transitional AT1 still in issue.[27]

For the larger deposit takers, AT1 provides a cheaper form of Tier 1 capital than Common Equity Tier 1. However, as previously discussed, there are a number of challenges that impact a deposit taker's ability to issue it. One large deposit taker has been able to utilise its corporate structure in a way that enables it to issue AT1 in an efficient manner, but this is not something available to the majority of current Group 2 deposit takers.

Group 3 deposit takers

There is one future Group 3 deposit taker with a significant amount of perpetual preference shares (**PPS**) in its capital structure. Otherwise, PPS have generally not been issued by non-bank deposit takers (**NBDTs**).

What submitters have told us is that the very small deposit takers are often more locally situated and connections to the community can be important. In some cases, they see issuing PPS (typically to existing customers or members) as more in line with this ethos than issuing wholesale debt to external investors (assuming they have the ability and market access to do so).

Proposed response

In light of the feedback, we recommend proceeding with the proposal to remove AT1 from the capital stack.

Proportional approach to transitional arrangements

We have considered the feedback received on transitional arrangements. There are some key elements to transitional planning that we have sought to balance with our prudential objectives. These are to:

- Avoid market disruption
- Reduce risk of unintended consequences
- Reduce/remove complexity and ambiguity
- Mitigate impacts on small deposit takers

[27] Transitional AT1 are the instruments issued prior to 2019 when the eligibility criteria for AT1 was significantly revised.

We have sought to reconcile these in a way that takes into account the different impacts on different groups. Our intended transitional arrangements are summarised in the table below. These arrangements are different for Groups 1 and 2 on the one hand, and Group 3 on the other.

For all groups, current AT1 capital instruments or PPS will be able to be treated as Tier 1 capital to some extent and for a limited period of time. However, no further AT1 eligible capital can be issued.

For Groups 1 and 2, the intention is for capital recognition for AT1 instruments to phase out completely.

For Group 3, a portion of existing issued PPS can be recognised as Tier 1 and a portion as Tier 2 capital during the transitional period. This balance will gradually shift until no PPS will be recognised as Tier 1 capital. However, Group 3 deposit takers will be able to continue to issue PPS (as an alternative option to subordinated debt) and for it to be treated as Tier 2 capital on an ongoing basis.

We will seek feedback from Group 2 deposit takers during the Capital Standard exposure draft process to see if there is demand for this approach to be extended to Group 2.

The table below provides a snapshot of how the transitional arrangements are expected to work.

Table 27: Transitional arrangements for AT1 capital

From	Deposit taker group	Change
1 October	Groups 1 and 2	We will update the Banking Prudential Requirements so that no further AT1 can be issued. However, any existing AT1 (or transitional AT1) will continue to be recognised as Tier 1 regulatory capital. Transitional AT1 will continue to be phased out according to the schedule in *BPR110: Capital Definitions*.
	Group 3	We are not making any changes to the treatment of PPS within the NBDT Capital Regs.
1 December 2028	Groups 1 and 2	The Capital Standard comes into force. Existing issued AT1 capital instruments will cease to be recognised as Tier 1 capital in accordance with a derecognition schedule. By 1 December 2031, AT1 will have been completely phased out.
	Group 3	The Capital Standard comes into force. Half of existing issued PPS will be recognised as Tier 1 capital, with the balance able to be recognised as Tier 2 capital. This balance will gradually shift such that by 1 December 2032, no PPS will be treated at Tier 1 capital but 100% of any PPS can be treated as Tier 2 capital.

From	Deposit taker group	Change
		We would make Group 3 PPS redeemable in the situation where it is Tier 2 capital in the same way as Tier 2 instruments are currently redeemable, subject to our agreement.

Group 1 and 2 phase out schedule

The table below sets out the maximum proportion of AT1 capital instruments in issue as at 1 October 2026, that Group 1 and 2 deposit takers may include in their total Tier 1 capital on any date on or after 1 October 2026. An indicative transition path is illustrated in Appendix 16.

Table 28: Group 1 and 2 phase out schedule

Group 1 and 2	Tier 1
1 Oct 2026 to 30 November 2028	100%
1 December 2028 to 30 November 2029	100%
1 December 2029 to 30 November 2030	67%
1 December 2030 to 30 November 2031	33%
1 December 2031 to 30 November 2032	0%

Group 3 phase out schedule

For Group 3 deposit takers, the table sets out the maximum proportion of Tier 1 capital requirements that may be met with PPS issued in accordance with NBDT Capital Regs with the balance able to be treated as Tier 2 capital.

What this shows is that, from 1 December 2032 onwards, any PPS issued by Group 3 deposit takers may only be treated as Tier 2 capital.

Table 29: Group 3 phase out schedule

Group 3	Tier 1	Tier 2
1 Oct 2026 to 30 November 2028	n/a	n/a
1 December 2028 to 30 November 2030	50%	50%
1 December 2030 to 30 November 2032	25%	75%
1 December 2032 onwards	0%	100%

This approach addresses transitional concerns

Avoiding market disruption

We consider that continuing to recognise existing AT1 as Tier 1 capital for a period of time mitigates the risk of significant market disruption as deposit takers will not be incentivised to immediately replace instruments in issue. Based on our analysis, half of existing issued AT1 instruments will have reached their first optional redemption date by November 2029 with the remaining existing issued AT1 doing so by November 2030.

In addition, deposit takers may seek to redeem AT1 instruments early if they included the provision for early redemption triggered by a regulatory event.

Therefore, deposit takers have scope to redeem their AT1 in an orderly manner (subject to meeting the requirements of *BPR120: Capital adequacy process requirements*).

We consider that the transitional arrangements enable early redemption but do not incentivise it.

Reducing risk of unintended consequences

By not changing the regulatory value of AT1 and phasing it out in a well communicated, clearly defined way, we expect that the risk of unintended consequences is low.[28]

Addressing complexity and ambiguity

There will be a degree of complexity while we phase out current instruments whilst introducing new requirements. However, we expect that clear and early communication about how the transition will operate will mitigate any concerns.

The interaction with the new requirements for the capital stack, including new Loss-Absorbing Capacity (**LAC**) instruments (if relevant) will be discussed as part of that section. We would also consult on the form of LAC next year.

Mitigating impacts on small deposit takers

This approach recognises the limited market access and issuance capacity that smaller institutions typically face, enabling them to maintain regulatory compliance while the transition is underway. By providing a period during which a proportion of PPS contribute to Tier 1, Group 3 deposit takers will have greater flexibility to adapt to the new capital framework.

Over time, the capital recognition will shift wholly to Tier 2, ensuring consistency with the broader regulatory objectives while minimising disruption for smaller entities.

We think this is a proportional response as concerns regarding AT1 primarily arise from the intended functioning of these instruments within the capital stack, rather than from their intrinsic characteristics.

[28] ANZ Holdings (NZ) Ltd issued wholesale notes to fund the purchase of PPS issued by ANZ. Interest under these notes is discretionary and non-cumulative unless a 'PPS De-recognition Event' occurs - defined as meaning ANZ Bank NZ is not entitled to treat any of the PPS as Additional Tier 1 Capital. *See* ANZ. (2024). *ANZ Holdings NZ Notes Information Memorandum*. anznz-holdings-information-memorandum-11-sep-2024.pdf

Appendix 8: Design and use of Loss-Absorbing Capacity (LAC)

If Option 2 (or a variant of it) is chosen we will need to consider the design of a LAC instrument, as these instruments are not currently in use in New Zealand. As discussed in the body of this paper, under Option 2 we are proposing that LAC requirements would apply only to Group 1 and would take the form of internal LAC issued by the New Zealand subsidiary to its Australian parent. The potential scenario of a future Group 1 deposit taker that is not a subsidiary of an international parent (whether based in Australia or another country) is discussed at the end of this appendix.

There are two key outcomes that LAC will need to meet if it is to deliver the financial stability and efficiency benefits we consider in our cost benefit analysis of Option 2. These outcomes are:

- LAC is designed to effectively recapitalise a distressed deposit taker under a range of crisis scenarios, while acknowledging that there will always be uncertainty regarding how a crisis will unfold in practice. If LAC works effectively, it will offset the lower level of Common Equity Tier 1 (**CET1**) in Option 2 by providing a back-up source of CET1 in a crisis.
- LAC qualifies for Tier 2 corresponding deductions under the Australian Prudential Regulation Authority's (**APRA**'s) rules. This was a key requirement for the support of Group 1 deposit takers in their submissions due to its impact on the flow-on costs facing each group.

A starting point for designing LAC is the existing requirements for Tier 2 capital. However, to achieve the outcomes above, the instruments should also incorporate conversion and write-off features.

Effective recapitalisation in a crisis

The decision to trigger LAC will require not just the support and expertise of Reserve Bank staff, but the buy-in of other agencies and Ministers. There are a range of outcomes that could occur following a decision (or declared intention) to trigger LAC, including:

1. **(Scenario 1)** The Australian parent chooses to down-stream additional capital in the form of CET1 to avoid LAC being triggered. This would have a cash cost to the Australian parent and would be a deduction from the parent's CET1, so additional external CET1 may be required to be raised by the Australian parent. The Reserve Bank would continue to hold the option to trigger LAC on existing instruments, but with a sufficiently sized capital injection this should not be required. We see this as the most desirable outcome.

2. **(Scenario 2)** LAC is triggered and written off, which successfully restores CET1 (and Tier 2) to at least the regulatory minimum. This would not have a cash cost to the Australian parent but would shift the APRA corresponding deduction from Tier 2 to CET1. The consequent reduction in parent CET1 would not be an issue when APRA has, or is planning to, bail-in the Australian parent as well, or if the Australian parent has surplus CET1. But it could be problematic in other scenarios where Australian authorities seek to avoid bail-in despite the parent facing a CET1 shortfall. Following the triggering of LAC, discussions would subsequently be held to determine a path to restore LAC to the regulatory minimum over a longer timeframe.

3. **(Scenario 3)** LAC is triggered and written off, but the full amount of prepositioned LAC is not enough to cover the capital needs of the New Zealand deposit taker. However, the Australian parent chooses to down-stream additional capital (as in Scenario 1 above), which successfully restores CET1 (and Tier 2) to the regulatory minimum.

4. **(Scenario 4)** LAC is triggered and written off, but the full amount of prepositioned LAC is not enough to cover the capital needs of the New Zealand deposit taker, and APRA is unwilling to allow additional parent capital support beyond the pre-agreed amount. In this scenario it may be difficult to avoid moving to a Multiple Point of Entry (**MPE**) fallback option whereby the subsidiary is separated from the parent, and/or the use of public funds to recapitalise the subsidiary.

5. **(Scenario 5)** A non-LAC response such as allowing the New Zealand bank to trade out of difficulty with a capital injection from the New Zealand Government or other financial support. This might occur in response to lobbying by the affected bank and/or the Australian government. For example, the Australian side may be concerned about possible litigation and an adverse market reaction and take a political decision to use public funds. In such a situation NZ authorities would have the choice between joining a government bail out as a junior partner to Australia or opting for our own MPE solution.

6. **(Scenario 6)** None of the options above are chosen even though the Reserve Bank retains the legal ability to trigger LAC. The Reserve Bank uses MPE bail-in to separate the subsidiary– which may itself result in losses being imposed on LAC using a different mechanism.[29]

The international experts have identified the use of LAC as a potentially challenging area, and we agree with this assessment. The challenges arise due to uncertainty around many factors, such as valuations, ongoing losses and the complex political economy dynamics that can play out during a crisis. The experts (and the international literature generally) tends to emphasise the risks of litigation and adverse market reactions as key risks of triggering LAC. Under our proposal to introduce internal LAC for subsidiaries of Australian banks only, these risks are lessened in New Zealand. However, they will still be relevant to APRA and the Australian government and s6(a) s6(a)

We note that similar challenges could also arise where a deposit taker without LAC is placed in resolution, although the lower CET1 buffer under Option 2 could result in these decisions needing to be made earlier.

In most scenarios above, we consider that crisis outcomes are likely to be better (or no worse than) under a counterfactual without LAC in place. However, given the many uncertainties around how a crisis will unfold in practice, this cannot be guaranteed.

For example, it is possible that the existence of a pre-positioned internal LAC framework could make the political economy of pivoting to an MPE separation approach more difficult under Scenarios 4 and 6 above, as the losses imposed in the process would be concentrated on the Australian parent entity, while they would be more dispersed in a situation where some subsidiary

[29] For example, a statutory or structural bail-in. These responses are outside the scope of the current review and will be decided by the Board in February 2026.

capital (e.g. tier 2 instruments) had been issued externally. Similarly, the level of internal LAC could be perceived as setting a 'cap' on the amount of support provided to the subsidiary, creating additional resistance to 'topping up' with additional parent capital under Scenario 4. In some scenarios, not having LAC available could even strengthen incentives on the Australian side to support the New Zealand entity with direct down-streaming of CET1 capital, if the goal is to keep the group intact s6(a)

s6(a)

Overall, the fundamental political economy issues will be present whether or not we adopt LAC. s6(a) To achieve these gains, we need to ensure that LAC is well-designed in technical terms but good design cannot alter the fundamental political economy. In other words, the most significant potential issue with LAC ('would we use it?') is not amenable to a technical fix.

If we choose a LAC option, we would need to design robust contractual triggers and will need to continue to collaborate with the Australian authorities on resolution planning and crisis exercises.

Recognition under APRA rules

Current Tier 2 instruments in New Zealand do not meet APRA's requirements, principally due to the lack of conversion or write-off features. This means that:

- *Internal* Tier 2 issued to the parent is deducted from the parent's CET1 (instead of its corresponding Tier 2) once it exceeds a given limit. This requires the parent to hold more CET1, raising its overall cost of capital.
- *External* Tier 2 issued by a NZ bank to the market does not qualify as capital for the Australian parent so the Australian parent has to issue its own Tier 2 (or CET1) resulting in the group incurring the additional cost of capital (compared to senior debt) twice. This is referred to as double issuance.

Option 2 removes the double issuance problem as all Tier 2/LAC issuance would be internal. However, the resulting internal instruments will need to qualify for corresponding deductions against Tier 2 to avoid increasing the amount of CET1 that the Australian bank needs to hold to support its ongoing investment in its New Zealand subsidiary and therefore the group's funding costs. It is for this reason that qualifying for Tier 2 under APRA's rules was a critical part of the Group 1 deposit takers' support for Option 2 in their submissions. While these costs are borne (or not) by the Australian parent rather than the New Zealand deposit taker, the costs may ultimately be passed onto NZ customers and therefore we think it is crucial to design LAC instruments that meet APRA's Tier 2 requirements.

s6(a)

We have engaged closely with APRA in developing our initial LAC instrument design features, to ensure these instruments would be eligible for the corresponding deduction approach from an ADI's Tier 2 capital. Further design decisions would be made during 2026; however, s6(a) we have not identified any impediments to recognition for corresponding deductions based on our initial design features. s6(a)

s6(a)

Proposed LAC instrument design features

The features below are designed based on international guidance issued by the FSB[30] to ensure LAC can (i) meet the APRA requirements, and (iii) retain sufficient discretion and flexibility within the Reserve Bank.

A LAC instrument, under Option 2, would have all of the features of an existing Tier 2 instrument as currently set out in part D3 of *BPR110: Capital Definitions* except for the removal of part D3.4 which prohibits conversion or write-off features. A LAC instrument would also include the following features, not currently present in Tier 2:

- Tier 2 and LAC would be the same instrument (as they already are in Australia). As such they would be equally ranking[31], and Tier 2 could also be converted to CET1 or written off.
- 100% of LAC would be held by a member of the banking group[32]. This requirement could be removed where the Group 1 deposit taker could not be supported in resolution by its parent – for example, if it was owned by New Zealand shareholders. This is discussed further below.
- LAC could either be converted into shares in the NZ licenced deposit taker or written off. Discretion for which occurred would remain with the Reserve Bank. However, for a wholly

[30] Financial Stability Board. (2017). *Guiding Principles on the Internal Total Loss-Absorbing Capacity of G-SIBs ('Internal TLAC')*. https://www.fsb.org/2017/07/guiding-principles-on-the-internal-total-loss-absorbing-capacity-of-g-sibs-internal-tlac-2/
[31] Senior to CET1, subordinate to senior debt and other creditors.
[32] Details over which entity directly held the LAC and how any losses or additional capital flowed through would be developed in 2026.

owned subsidiary of an Australian ADI, as all Group 1 deposit takers currently are, it is likely LAC would be written off rather than converted[33].

- LAC would be triggered when the Reserve Bank considered the deposit taker had reached the point of non-viability without the injection of public funds.
- The Reserve Bank would discuss with the home regulator before triggering LAC but the ultimate decision whether to trigger LAC would remain with the Reserve Bank.
- LAC would also include a home regulator trigger request so that APRA could advise that due to difficulty within the Australian parent (either with or without corresponding difficulties in the NZ deposit taker) they would like NZ LAC to be triggered. However the decision whether to trigger LAC is still expected to remain with the Reserve Bank. Due to LAC disappearing upon consolidation the main impact on the Australian parent of triggering NZ LAC would be to change the corresponding deduction from Tier 2 to CET1; however, it would also simplify the Australian parent's balance sheet which may assist their own recapitalisation.

The detailed design of a LAC instrument, and our related regulatory requirements, will require additional work over the course of 2026-28 if Option 2 is chosen. The existence of these instruments in other jurisdictions, along with the clear international guidance on internal LAC design and our engagement with APRA to date, provides a good basis for moving forward. However, it is important to note that adopting LAC in New Zealand will require time and resource, and will need to be prioritised accordingly.

Application to deposit takers who are not a wholly-owned Group 1

Under Option 2, we currently do not propose that LAC would be extended to Group 2 or Group 3 deposit takers given the nature of their business. Tier 2 for Group 2 and 3 would remain consistent with their current terms under BPR110. However, we may revisit this issue at a later point for Group 2 deposit takers as part of our implementation of the crisis management framework in the DTA. In that event, further public consultation would be undertaken on this issue.

However, we also need LAC requirements for Group 1 banks that would work in situations outside of a wholly-owned subsidiary of an Australian parent. This could arise from a restructure of an existing Group 1 deposit taker, growth of a Group 2 deposit taker or an acquisition either planned or more rapidly as part of resolution activity.

For a Group 1 deposit taker that was the wholly-owned subsidiary of a non-Australian parent, we would apply the same requirements as other Group 1 deposit takers (i.e. what we are proposing for our current Group 1 banks). But we would need to work on our relationship with the overseas parent regulator in the same way we currently work with APRA.

Any transition from Group 2 to Group 1 would likely be managed through a modification on a deposit taker's conditions of licence under section 25 of the Deposit Takers Act 2023. This could include a transitional period providing additional time for issuing LAC compliant instruments.

The Reserve Bank has the ability to vary the conditions of licence for individual deposit takers and would take this into account when considering a future (or potential) Group 1 deposit taker. This

[33] Within a wholly-owned group the economic impact of conversion compared to write-off are materially the same. However, we propose to retain discretion for conversion for other situations such as if a deposit taker had a minority owner(s).

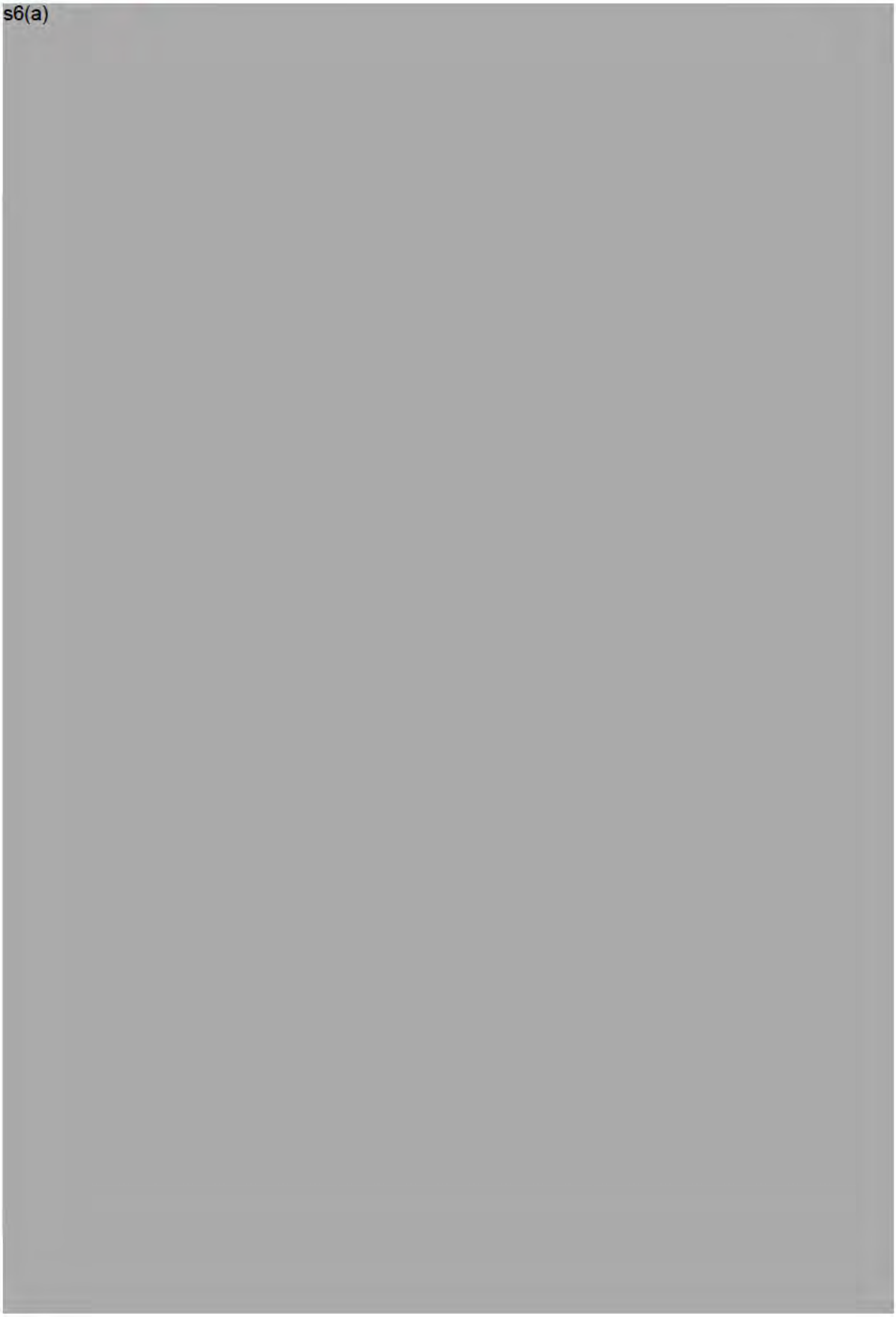
could include imposing requirements to hold Tier 2 instruments without contractual conversion or write-off clauses and were held internally or externally. Another option we could require is for a deposit taker to issue internal LAC with conversion clauses to a New Zealand holding company even where that holding company was owned domestically – this would allow us to put the holding company into resolution with fewer direct impacts on the deposit taker.

Once adjusting for deposit taker specific factors (for example, their own size or credit risk), Tier 2 instruments without a conversion feature or issued externally are not expected to have a higher price[34] than Internal LAC required for current Group 1 deposit takers. The removal of current Group 1 Tier 2 instruments from the debt markets in New Zealand would be likely to make the market smaller, but future Group 1 external instruments could still be issued alongside existing Group 2 and Group 3 Tier 2 and senior debt as well as debt by other issuers who are not licenced deposit takers.

[34] As tax transfer pricing rules require internal cross border instruments to be priced at the same interest rate as if they were issued to a third party.

Appendix 9: s6(a)

s6(a)



Appendix 10: Output floor and scalar

Consultation feedback

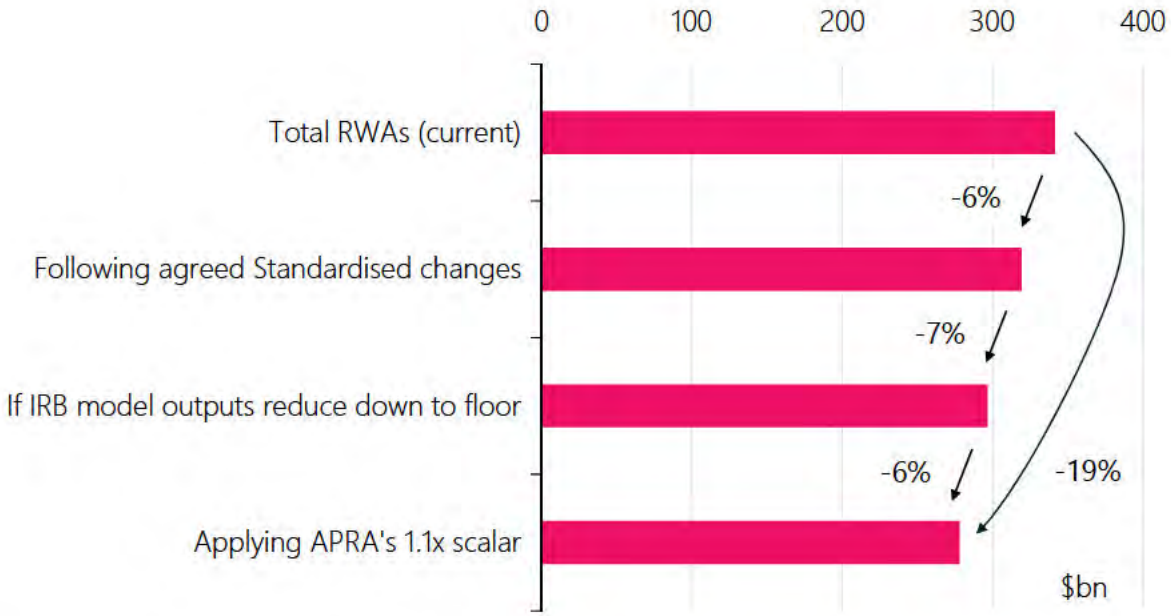
There was a strong divergence in views about the output floor for internal ratings-based (**IRB**) credit risk weights in stakeholder feedback. Group 1 deposit takers generally want a reduction of the output floor and/or IRB scalar to align with the Australian Prudential Regulation Authority (**APRA**) (72.5% output floor and 1.1 scalar). Group 2 generally want the output floor increased to 100% to support proportionality and competition.

Our assessment of the feedback and other context/analysis

While we understand the desire to align with APRA – and Basel – on the output floor and scalar, we would note that the Basel decisions to go with a 72.5% floor was a political compromise between EU and US supervisors, not a purely analytical decision.

As it stands, following the proposed Standardised risk weight changes, there would be scope for banks to propose changes to IRB models that could reduce RWA by up to 7%, because the floor will not be as binding as it currently is. Adopting APRA's calibration in NZ would further reduce capital needed by around 6%, reducing resilience. See Figure 6 below.

Figure 6: Total RWAs of Group 1 banks under proposed changes and potential adoption of APRA IRB calibration



There are range of arguments against a lower output floor and scalar:

- A lower output floor and scalar would likely overplay the extent of credit risk management benefits of IRB modelling and lead to a larger divergence in capital requirements for similar lending.
- Lowering the output floor would create a larger discount for IRB compared to the Standardised approach, which in the NZ context means a detrimental impact on proportionality between Group 1 and Group 2 and 3 deposit takers.

- The proposed Standardised risk weight changes already provide an effective relaxation of the output floor (on its own a 6% reduction in capital required for Group 1, see Figure 6 above). Further, APRA does not flow through our output floor/scalar at Level 2, so to the extent APRA's Level 2 capital requirements are the binding determinant of capital allocations within the group, a high NZ floor is less of a concern.

Similarly, there are arguments against a higher output floor and scalar:

- A higher output floor and scalar would reduce (or remove) the incentive to undertake more granular risk assessment that results from IRB modelling.

Proposed response

We propose retaining the 85% output floor and 1.2 scalar. These settings have been calibrated to a level that we consider is appropriate for New Zealand circumstances. It maintains some incentive for IRB modelling but limits the divergence in capital requirements for similar lending – which is particularly important in New Zealand, where we have significantly lower levels of resources to scrutinise IRB models than other jurisdictions.

We are open to standardised banks applying for IRB accreditation. As part of the new approach under the Deposit Takers Act 2023, we will publish a notice covering the process for those deposit takers applying to be accredited for using IRB models. This process will not be restricted to Group 1, and other deposit takers can apply, as is the case now under current regulations. Nevertheless, IRB modelling requires a depth of data and sophistication in systems that may not be practical for smaller deposit takers. It is a resource intensive process, with current IRB banks in New Zealand being able to benefit from the expertise and support available from their large Australian parents.

Appendix 11: Capital ratio option appraisal

This appendix sets out additional analysis on the capital ratio options set out in Table 30 below to support decision-making in conjunction with the updated cost benefit analysis presented in Appendix 13. As set out in the main body of the Board paper, we recommend Option 2a with Option 2 and Option 1 both viable options based on your risk appetite. We do not recommend Options 2b or 2c, or alignment with the Australian Prudential Regulation Authority (**APRA**) (Option 3, as discussed more fully in Appendix 12).

All the analysis in the appendix is based on:

- Removing Additional Tier 1 from the capital stack.
- Making further changes to risk weights to improve granularity and better align them with the actual risk.
- Retaining the output floor and scalar at their current settings.

None of this analysis includes the effects of further reductions in risk weights that may come about due to the further work we recommend we commit to or internal ratings-based model results moving lower and the output floor beginning to bind again. These changes would further reduce capital levels, possibly up to around 2% for the standardised approach.

Table 30: Capital ratio options

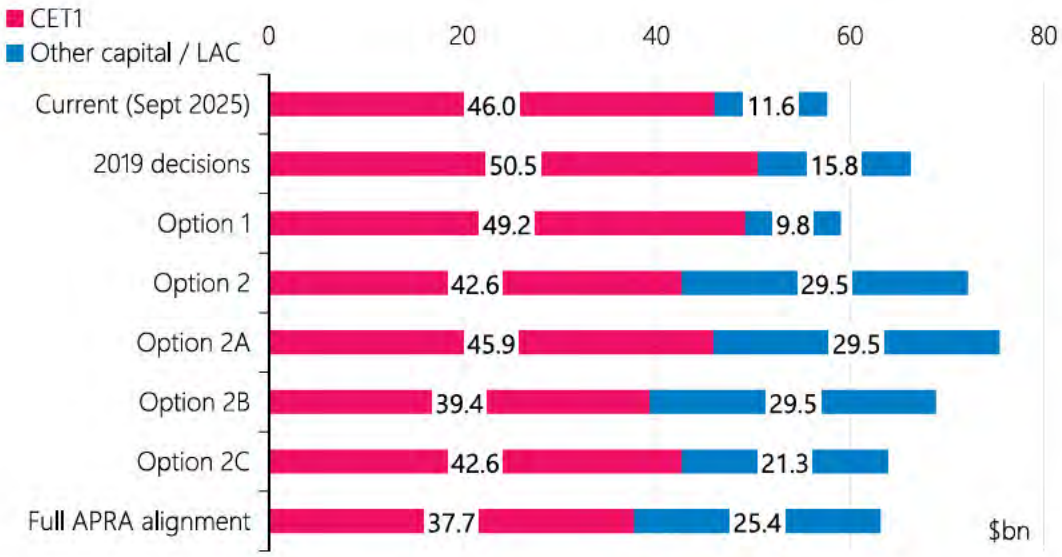
		Proposed option for: Group 2 and 3 (%)		**Proposed options for: Group 1 (%)**					
		Group 2	Group 3	Option 1 No LAC	Option 2 LAC	Option 2a CET +1%	Option 2b CET -1%	Option 2c Less LAC	Option 3 APRA
Minimum CET1		6	6	6	6	6	6	6	6
Minimum Tier 1		6	6	6	6	6	6	6	6
Minimum Total		9	9	9	9	9	9	9	9.25
Of which max Tier 2		*3*	*3*	*3*	*3*	*3*	*3*	*3*	*3.25*
LAC		-	-	-	6	6	6	4.5	**4.5**
Prudential Capital Buffer (all CET1)		5	4*	8	6	7	5	6	**4.5**
Of which Counter-Cyclical Capital Buffer		*1*	*0*	*1.5*	*1*	*1*	*1*	*1*	
Of which Domestic Systemically Important Bank buffer		*n/a*	*n/a*	*3*	*1*	*2*	*0*	*1*	
Totals	**CET1**	**11**	**10***	**14**	**12**	**13**	**11**	**12**	**10.5**
	Total + LAC	**14**	**13**	**17**	**21**	**22**	**20**	**19.5**	**18.25**

Nominal amounts of capital under different options

Figure 7 below shows how the Options presented this in paper changes would affect the amount of capital held by Group 1 deposit takers.

- Option 1 would require an increase in the amount of CET1 relative to current levels, though a reduction relative to 2019 decisions.
- Option 2, 2b and 2c and 3 would reduce the amount of CET1 relative to both current levels and the 2019 decisions by varying amounts, but would increase the amount of other capital.
- Option 2b would leave CET1 for Group 1 around where it is now while increasing other capital.

Figure 7: Nominal capital amounts for Group 1 under Consultation Paper and alternative options ($bn)



Note: These options all include our further refinement to risk weights, our current output floor and scalar, and a 1% management buffer assumption.

Table 31: Nominal capital amounts for Group 1 under Consultation Paper and alternative options ($bn)

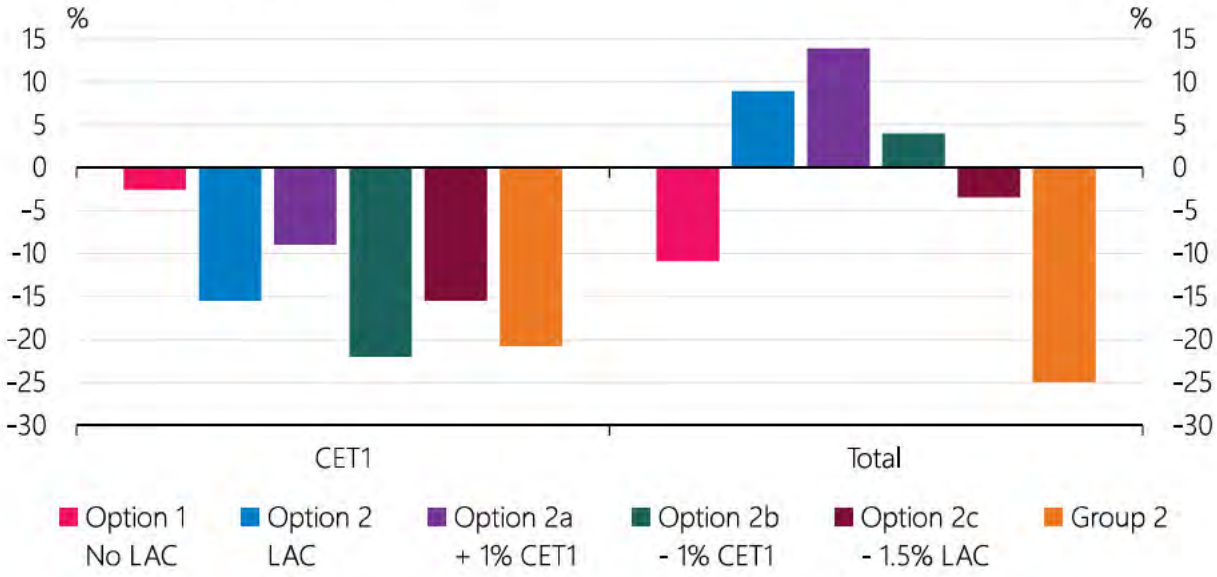
	Current (Sept 2025)	**Status quo:** 2019 decisions	**Option 1** No LAC	**Option 2** LAC	**Option 2a** + 1% CET1	**Option 2b** -1% CET1	**Option 2c** -1.5% LAC	**Option 3** APRA
CET1	46.0	50.5	49.2	42.6	45.9	39.4	42.6	37.7
LAC	11.6	15.8	9.8	29.5	29.5	29.5	21.3	25.4
Total	**57.6**	**66.2**	**59.0**	**72.2**	**75.4**	**68.9**	**64.0**	**63.1**

Note: These options all include our further refinement to risk weights, our current output floor and scalar, and a 1% management buffer assumption.

We have also considered how the options affect proportionality between Group 1 and Group 2.

As Figure 8 below shows, Option 2b buffer would mean Group 1 see a larger reduction in CET1 than Group 2 relative to 2019 – going against the proportionality and competition criteria. Option 2b increase the gap significantly, better meeting the proportionality and competition criteria.

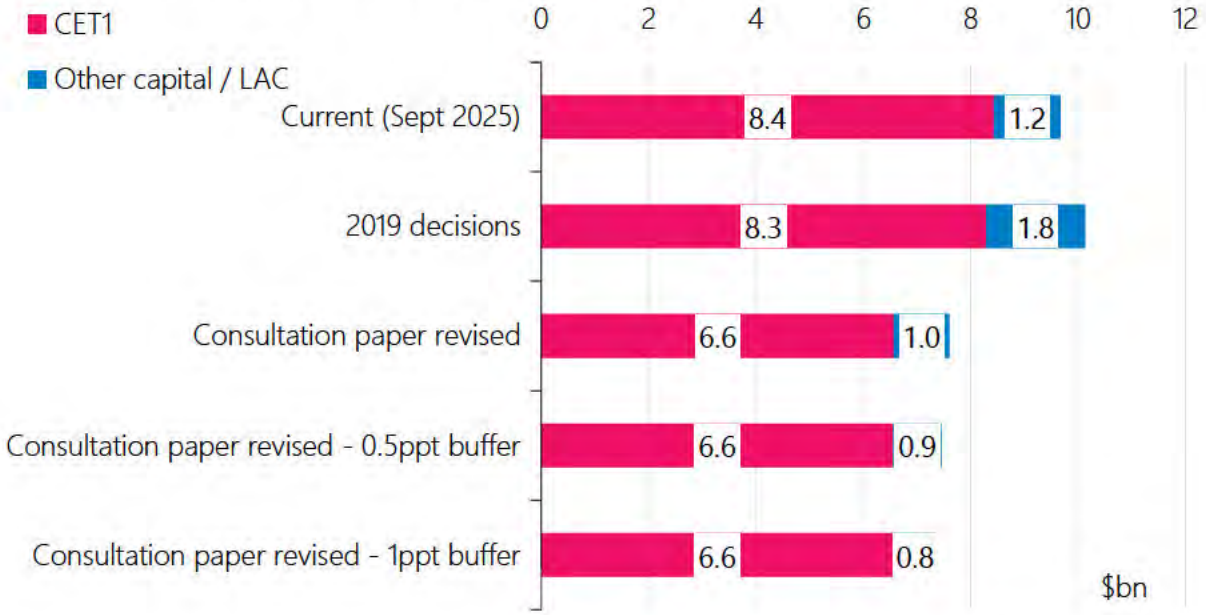
Figure 8: Percentage changes in capital required by different groups of deposit takers under different options, relative to 2019 decisions



Note: These options all include our further refinement to risk weights, our current output floor and scalar, and a 1% management buffer assumption.

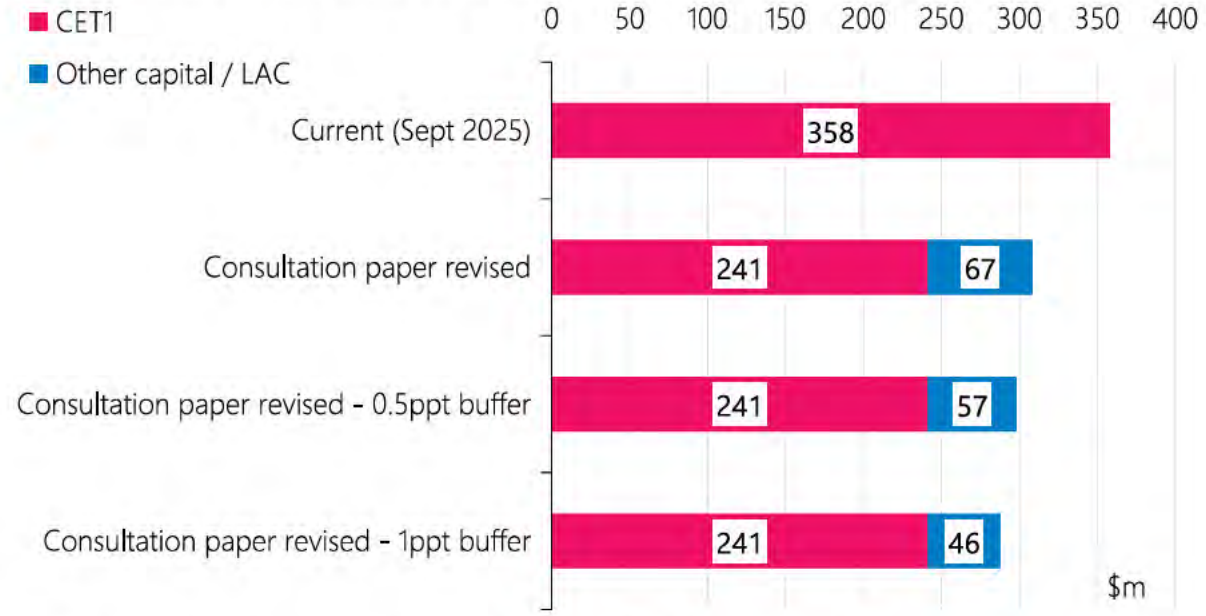
We have recommended against making further reductions to Group 2 and 3 capital ratios. Figure 9 and Figure 10 below show that Consultation Paper proposals, with the further refinements to risk weights proposed in this paper, already significantly reduce capital requirements for Group 2 compared to current levels. We modelled further reductions in the buffer but found these had limited impacts – at this point we would expect regulatory settings to be less binding (instead, factors like desired credit ratings and ICAAPs would be the main determinant of capital levels, as they were prior to the 2019 Capital Review).

Figure 9: Nominal capital amounts for Group 2 under different options



Note: Consultation proposal includes further refinement to risk weights and a 1% management buffer assumption.

Figure 10: Nominal capital amounts for Group 3



Note: Consultation proposal includes further refinement to risk weights and a 1% management buffer assumption.

International comparisons under different options

The Oliver Wyman report is an objective comparison of actual New Zealand bank capital ratios to banks in other countries once they have been adjusted for differences from Basel rules.

Oliver Wyman selected peer countries that are similar to New Zealand in size and economic and financial context to ensure these comparisons are relevant. However, it is not possible to control for all of these factors and on average the comparator countries have significantly larger banks than New Zealand. As one submitter suggested, this likely partly explain New Zealand's high observed capital ratios. To support the main findings of the report, Oliver Wyman also compare

New Zealand banks to a much larger set of similarly sized banks around the world. However, they do not adjust capital ratios for these banks to be consistent with international standards given the larger sample size. New Zealand is still above the median in that comparison, but around the upper quartile rather than being an outlier. Another issue mentioned by that submitter (and our experts) is that New Zealand's largest banks have foreign parents. Host regulators likely have an incentive to require higher capital ratios.[35] These factors should be taken into account when interpreting the result of the Oliver Wyman report.

Further, there are some factors relevant for setting prudent minimum capital ratios that the Oliver Wyman report is not aiming to consider. For example, some of the comparator countries are assessed as lower risk than New Zealand by S&P.

Figure 11 and Figure 12 below show where these options sit relative to peer's using the Oliver Wyman report and below we report how these compare to S&P Banking Industry Country Risk Assessment (**BICRA**) ratings:

- Option 1 would leave us at the top of comparator countries on a CET1 basis and near the bottom on a Total Loss-Absorbing Capacity (**TLAC**) basis. Option 1 is most similar to Hong Kong – who also are near the top on CET1 and near the bottom on total capital. Option 1 has higher CET1 levels than Hong Kong (22.4% versus 19.7%). However, S&P score Hong Kong as a 1 out of 10 on banking industry risk (e.g. lowest risk) in their BICRA Global report, whereas New Zealand is scored as 4 out of 10 – suggesting having higher CET1 levels somewhat higher than Hong Kong is appropriate for New Zealand.
- Option 2 leaves us lower than countries like Hong Kong, but still near the top on a CET1 basis, and with TLAC levels just above Ireland (a country's whose banking industry also scores 4 out of 10 on the S&P ratings). Comparing with Australia, CET1 levels are about 1 percentage point higher than Australia and TLAC around 3 percentage points above Australia – consistent with Australia scoring lower on risk than us (2 out of 10).
- Option 2a is similar to Option 2 – but shifts us above Hong Kong on a CET1 basis and the UK on a TLAC basis. The UK score 3 of out of 10 in terms of banking industry risk. It remains below Norway on both counts, despite Norway's banking sector being classified as lower risk than NZ (3 rather than 4) – though submitters noted Norway's results are dominated by one state-owned bank which may explain why they are an outlier.
- Option 2b and 2c and Option 3 all leave us below a large range of comparator countries that have lower risk than us.

  Israel has the same BICRA risk classification as New Zealand and has the lowest CET1 and TLAC results. But like Ireland, Israel has high risk weights on average, so they still hold an unusually high amount of capital per dollar of lending (see Exhibit 16 of the Oliver Wyman report)[36]. So we would not put much weight on their position in this comparison.

[35] *See* page 3 in Deslandes, J., Dias, C., & Magnus, M. (2019). *Banking Union: Defusing the "home/host" debate.* https://www.europarl.europa.eu/RegData/etudes/BRIE/2019/634373/IPOL_BRI(2019)634373_EN.pdf

[36] Oliver Wyman. (2025). *Comparing New Zealand Bank Capital Ratios To International Peers.* https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/2025/oliver-wyman-rbnz-capital-review.pdf

Figure 11: International comparisons of TLAC levels under Consultation Paper and alternative options

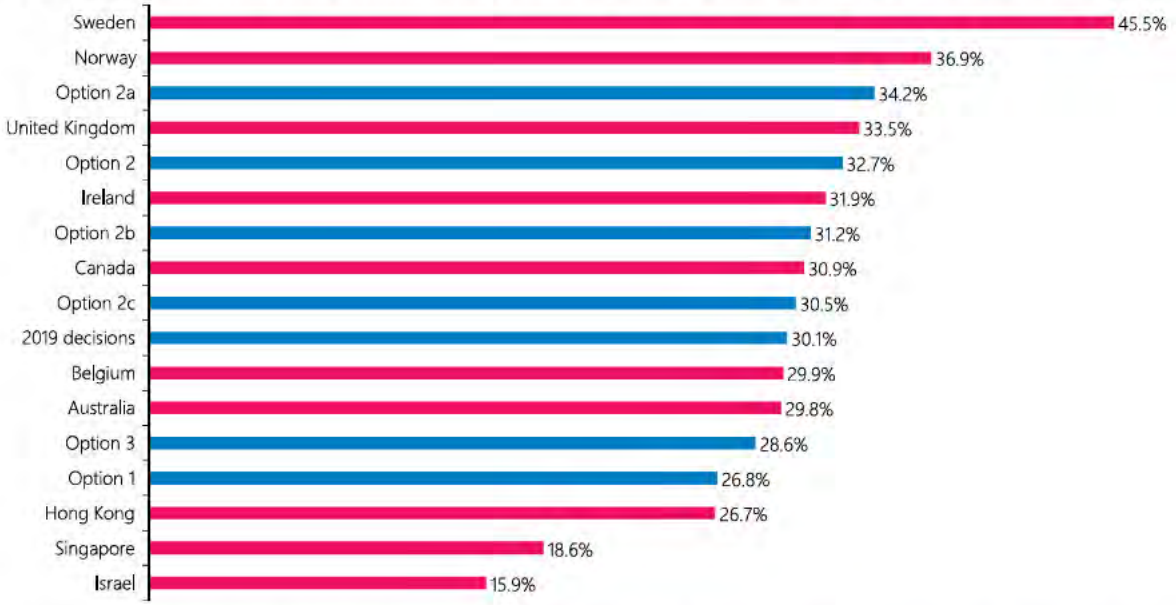
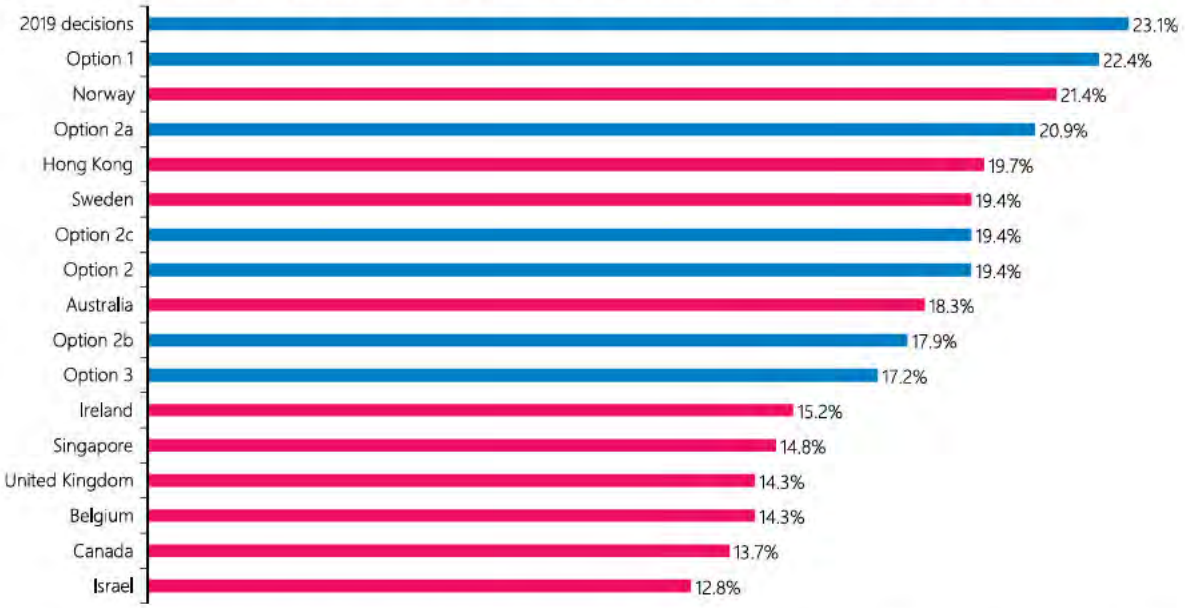


Figure 12: International comparisons of CET1 levels under Consultation Paper and alternative options



Note: This analysis includes our further refinement to risk weights, our current output floor and scalar, and a 1% management buffer assumption.

Criteria analysis under different options

We have updated the criteria analysis conducted on the two Consultation Paper options to include the further options considered here.

- Option 2a offers a good compromise between Option 1 and 2 – with the improved proportionality of Option 1 with a smaller reduction in going concern loss absorbency than Option 2. However, it leads to less of a reduction in funding costs.
- Option 2b, 2c and 3 performs worse than Option 1, 2 and 2.

Table 32: Criteria analysis for full range of options

		Financial stability criteria		Other criteria				
		Going concern loss absorbency	Crisis management	Proportionality	Competition	Simplicity/ achievability	Funding costs (green means lower)	International alignment
No LAC	Option 1	↓	↔	↑	↔	↑	↔	↑
LAC	Option 2	↓↓	↑	↔	↔	↓	↑↑	↑↑
LAC	Option 2a	↓	↑	↑	↔	↓	↑	↑↑
LAC	Option 2b	↓↓	↑	↓	↔	↓	↑↑	↑↑
LAC	Option 2c	↓↓	↔	↓	↔	↓	↑↑	↑↑
LAC	Option 3	↓↓	↔	↓	↔	↓	↑↑	↑↑

Stress test results under different options

We have used our most recent stress test results to test impact of the two main options in the 2025 Consultation Paper, including the risk weight changes, against the scenario used in the stress test. The economic scenario involves a worsening of geopolitical tensions which causes a severe slowdown in global economic activity and a recession in New Zealand with unemployment peaking at 10.5 percent, house prices falling by 35 percent, and gross domestic product declining by 6.5 percent. Trade-facing business is the hardest hit sector.

- On average, across the four largest deposit takers, in Option 1, capital ratios fall to around 13% - declining well into the buffer but remaining above the 9% minimum.
- In Option 2, with the lower CET1 starting point, the average ratio falls to 11%, with the biggest fall seeing a low point of close to 10% for one deposit taker.
- In even more severe scenarios, where house prices fall by a further 10%, the average capital ratio falls to just over 10% in Option 2 and 12% in Option 1.
- At these low ratios, strong dividend restrictions would be in place and recovery and restoration plans would be underway. In Option 2 we would likely be starting to consider if and when LAC instruments should be triggered. In Option 1, while there is a little more breathing room given the higher starting CET1 requirement, we would be assessing back-up options if restoration plans were unsuccessful, and or ratios continued to fall.

Figure 13: Impact on aggregate capital ratio under each scenario

Note: This analysis assumes a 0.75% management buffer. The sensitivity test assumes that house prices fall an additional 10 percentage points compared to the baseline scenario.

Appendix 12: Alignment with Australia

Consultation feedback

Major banks suggested an alternative version of option 2 where the amounts of capital and Loss-Absorbing Capacity (**LAC**) were reduced to the Australian levels (18.25% in total) would be superior to our proposal. These submitters tended to argue this would be less costly, while still sufficient in financial stability terms, and also suggested alignment with Australia was inherently a good thing.

Some technical aspects of this feedback were around 'compatibility' between Australian and New Zealand requirements. This included the desirability of not having external instruments (e.g. Additional Tier 1 (**AT1**)) that counted as NZ capital but could not count as capital for the wider group. A related point was the view that parent banks do not price capital in the subsidiary in the way that normal finance theory (Modigliani-Miller (**MM**)) would suggest.

Our assessment of the feedback and other context/analysis

Australia's capital framework is based on the idea that a small economy with reliance on wholesale funding should reduce the risk of financial crises by maintaining an 'unquestionably strong' level of resiliency. For that reason, they (like many countries) have pushed their total loss absorbency requirements well beyond the minimums in the Basel framework.

For New Zealand, which is smaller and even more peripheral to the global economy, the arguments for building resilience seem to apply even more than they do for Australia. For example, S&P deem New Zealand's banking industry risk the highest of the comparator countries in the Oliver Wyman report, and substantially riskier than Australia: they rate Australia as 2/10 and New Zealand as 4/10. So, we agree with the spirit of the Australian approach, but don't agree that their precise settings are appropriate for New Zealand.

s6(a) The largest Australian banks have around 21% total capital on average, and the components of that are at levels which are similar to the requirements we proposed in Option 2 (see table below). s6(a)

Table 33: Comparison of Group 1 capital requirements

	Option 1 (%)	Option 2 (%)	APRA requirements (%)	Observed capital ratios for Australian Group 1 equivalent banks (%)	Difference between requirements and observed ratios in Australia
Tier 1	14	12	10.5	~12.3	~1.8
Tier 2 (including LAC)	3	9	7.75	~8.65	~0.9
Total	**17**	**21**	**18.25**	**~21**	**~2.75**

We also note that APRA has made decisions under a different legislative mandate to us (in particular, we have a statutory purpose to avoid or minimise the use of public funds in a crisis), and this can naturally lead to a differently weighted decision. Also, adopting the APRA stack would likely lead to reductions in Common Equity Tier 1 (in $ terms) with capital repaid to the owners of the 4 largest NZ banks. It is also seen as less desirable than option 2 by the cost benefit analysis (see Appendix 13), although the difference is not dramatic.

In terms of the technical points made by some banks, we agree that it is desirable to reduce the extent to which NZ capital instruments (issued externally) are unable to count as group capital. The removal of AT1 is an important improvement in that respect. Option 2 offers a further improvement in this regard, because the Total Loss-Absorbing Capacity and Tier 2 under that option is issued internally to the parent. Furthermore, our detailed work with APRA on LAC design (see Appendix 8) has not identified any impediments on the internal LAC being treated as a deduction from Tier-2 capital for the Australian parents, which is consistent with how we modelled the likely costs of its issuance.

Option 2 also reduces the percentage distance between NZ requirements and APRA's more than Option 1, which we agree may reduce the costs of achieving our capital requirements from the point of view of the entire banking group. This is because APRA requires parent banks to keep sufficient capital in the parent firm (e.g. CBA-parent) and in the wider group (including ASB and other subsidiaries). If the distance between ASB and CBA's requirements gets large, CBA needs to hold more capital overall, so it can meet ASB's requirement while still having enough capital in the Australian parent firm. However, even in that situation, the resulting 'extra' capitalisation of the wider group will still affect the group's overall cost of funds, and (contrary to the suggestion from submitters) we consider our assumptions of a (limited) MM effect remain valid. The 3 independent experts were interested in the points in these last 2 paragraphs and we had a detailed discussion with them on those matters in recent weeks.

Proposed response

We do not recommend align New Zealand capital ratios with Australia. Through this Review, we are recommending changes to capital instruments and risk weights that make them more similar to APRA rules, but we think there are sound reasons for the required ratios to be different. In our public communications, we propose to largely summarise the points above.

Appendix 13: Updated cost benefit analysis (CBA)

This appendix outlines submitters feedback on the cost benefit analysis, how this feedback was considered, and our analysis of the options presented in the paper. A summary of the options analysed and CBA results are provided in Table 35 and Figure 14 below.

Feedback received and analysis undertaken

Overall, as expected, there was a mix of views received on the CBA. With submissions focused on three keys areas:

- **General feedback on the CBA:** including on the efficacy of the models used, and the results sensitivities.
- **Assumptions used:** specifically the impacts on lending rates and financial instability.
- **Options analysed:** including suggesting alternative options (including an Australian Prudential Regulation Authority (**APRA**)-like alternative).

General feedback

To recap our position in the consultation document:

- We used the same underlying approach to the CBA as in the 2019 Capital Review, this method had been thoroughly quality assessed both internally and by external experts. Similar assumptions to 2019 were used.
- The model measures the costs and benefits of the capital option changes through their impacts on New Zealand's expected gross domestic product (**GDP**).
- We made some minor adjustments to the model to reflect up-to-date market data, as well as modelling the impact of Loss-Absorbing Capacity (**LAC**).

There were a range of views on the continued use of the models used in 2019. A couple of market commentators have repeatedly questioned the use of the models, concerned they fail to take into account the full cost of overregulation and the flow on (or dynamic) negative impacts that excess capital causes on the New Zealand economy. Other submitters supported the CBA highlighting the high degree of transparency and thought the Bank should place a higher weighting on the results within the assessment criteria.

There was strong feedback that the use of the 2019 policy decisions was confusing, when trying to analyse what this meant for the change in capital levels and lending rates. Submitters suggested that current settings i.e. 2025 actuals, were a better comparator.

Submitters requested the CBA should include more distributional or incidence analysis, that is, where the benefits, costs and other impacts would lie if capital requirements changed. For example, to what extent would lending from Group 2 increase by or otherwise would the costs of lower capital fall on savers but the benefits fall on borrowers.

Response

Continued use of the 2019 framework

We recognise that the models used, and the results provided by the CBA models, are stylised and highly dependent on a handful of parameters. Nevertheless, we continue to see value in using and producing results from the CBA models. The models are based off credible well-recognised studies, for example, the 'cost of crisis' model uses a asymptotic single risk factor (**ASRF**) which is used widely by internal ratings-based banks globally. While the 'lending rate' model based on deposit takers' expected weight average funding costs (**WAFC**) had been reviewed by international experts in 2019, [37] and internally in 2024.[38]

Submitters raised strong points regarding the use of the 2019 policy decisions as the primary comparator for the CBA. It is conceptually difficult, and highly theoretical, to understand what it means for lending rates to decrease as compared to the 2028 settings. We have therefore sought to include 2025 actuals where possible, however, we continue to use the 2028 settings as the primary status quo as this is consistent with CBA guidance and would be the regulatory settings if no policy decisions were made.

Finally, we continue to expand the models to take into account the impact non-Domestic Systemically Important Bank requirements have on the cost of crisis, as well as providing additional Group 2 and Group 3 outputs and expectations from the models, including the dollar amount of capital required and risk-weighted assets (**RWA**). We continue to rely heavily on data associated with Group 1 deposit takers for our lending model; this is primarily because of the availability of data but also due to their market share. Nevertheless, we do recognise assumptions applying to Group 1 deposit takers may not apply to Group 2 and 3 deposit takers, for example, changes in cost of equity.

Assumptions used

Lending rates

The method consulted on used the same method as in 2019, that is, the benefit of lower capital requirements was calculated by estimating the amount of cost savings deposit takers will generate from replacing expensive equity financing with relatively less expensive debt financing (a Weight Average Funding Cost, WAFC, is calculated).

We then assume the cost savings generated are passed on to borrowers through lower lending rates. Lower lending rates were assumed to increase GDP on a 1:1 basis through stimulating economic activity and resulting in higher growth through increased investment.

As part of these calculations, we assumed equity owners will require a higher rate of return on their capital due to the increased risk the deposit taker will fail. The extent to which lower capital requirements, increase the required returns to equity holders is often termed the 'Modigliani-Miller (**MM**) offset'[39]. As in 2019, we assume a roughly 36% MM offset. Empirical evidence varies considerably between 0% to 100%, however, we are confident that the central assumption is

[37] Cummings, J. (2019). *External Review of the Reserve Bank of New Zealand's Capital Proposals.* https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/external-reviews/capital-review-external-experts-report-james-cummings.pdf
[38] Downing, R., Martel, J., & Tanuvasa, W. (2023). Biennial Assessment 2023 Monitoring Capital Review Implementation. Reserve Bank of New Zealand Bulletin, 87(3). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2024/rbb-2024-87-03.pdf
[39] This stems from the MM theorem which states that returns to equity will adjust to the point that lending rates will not change.

robust and the approach used was recommended by Dr. James Cummings, one of the 2019 Capital Review External Experts.

There were mixed views on the extent to which capital requirements impact lending rates.

Consistent with past feedback we have received, many submitters especially from industry, suggested we should be more optimistic regarding the impact lowering capital requirements has on lending rates. Medium-sized deposit takers pointed to empirical evidence that shows returns on equity are highly insensitive to risk for medium-sized deposit takers.[40]

Table 34: Different estimates on lending cost impacts

Change in lending costs compared to current (BPs)	Option 1: No LAC	Option 2: LAC	APRA proposed
RBNZ estimates	-2bps	-8bps	-14bps
s9(2)(b)(ii)			
s9(2)(b)(ii)			

Alternatively, in discussions with our international experts they have raised concerns that our estimates are too optimistic regarding the impact lower capital requirements have on lending rates. There arguments are based on two suggestions:

- The MM theorem holds – meaning funding costs should only reduce to the extent there is a tax advantage from debt funding compared to equity funding.
- 100% pass through of funding costs to lending rates is overstated. That is, due to the market dominance of the large deposit takers in New Zealand, Group 1 deposit takers may have the ability to hold lending rates relatively constant and channel more of the benefit of lower capital requirements to owners as super-normal profits.

Crisis costs

In the consultation, to calculate the cost of crisis the probability of crisis under each capital option is multiplied by an expected GDP impact. This returns the Net Present Value (**NPV**) of a crisis event.

The expected present value cost if a crisis event did occur is assumed to be 63% of GDP. This central estimate figure is guided by a Basel Committee on Banking Supervision (2010)[41] paper that assessed the long-term economic impact of banking crises.

As part of the consultation, we added a new minor crisis event to our analysis. This was introduced to improve our comparative analysis of introducing LAC. The cost of a minor event was set at 20%

[40] Clark, B., Jones, J. & Malmquist, D., 2023. Leverage and the cost of capital for US banks. *Journal of Banking & Finance*.
[41] Bank for International Settlements. (2010). *An assessment of the long-term economic impact of stronger capital and liquidity requirements.* https://www.bis.org/publ/bcbs173.pdf

cost. This level was guided by a Bank of England (2015)[42] paper that estimated an orderly crisis resolution reduces the cost of crisis by roughly three quarfters.

We received some concerns from submitters that our cost of crisis assumptions were too high, which resulted in an implicit bias towards overregulation. Other submitters suggested we should model alternative stress scenarios. The Treasury noted that the CBA was subject to inherent uncertainty about key modelling assumptions, including the assumed cost of a crisis. The Treasury suggested we undertake additional sensitivity analysis to assess whether results were robust to uncertainty.

Response

Sensitivities broadly reconfirm our option rankings for the CBA

Given the available empirical evidence and the lack of New Zealand specific studies or otherwise domestic crisis events, we continue to consider the assumptions used in the consultation as our best central estimates. However, we do agree with submitters that modelling tail end risks is highly sensitive to the underlying input and assumed distribution. The assumptions used within the models generally fall in the middle of estimates in academic studies as well as being internationally peer-reviewed. For example, there is evidence that points to both higher and lower estimates of the MM offset used and the costs of crisis (63% and 20% costs are used for a severe long-term crisis, and a shorter-term recoverable crisis, respectively).

We have completed a wide range of sensitivity analysis to understand how sensitive our conclusions are, including, testing:

- Lower crisis cost assumptions; and
- Variations to the lending rate assumptions, including a 50% pass-through, and different MM offsets.

Overall, the relative ranking of each option is broadly stable over a wide range of sensitivities, as shown by Table 36 below.

Net Wealth transfer impact

In 2019, following industry feedback we added a net wealth transfer impact to our full CBA. The Wealth Transfer impact recognises the lower interest payments that flow to foreign shareholders and creditors, due to the expected lower lending rates. This could be considered the direct benefits of the lending rate changes, while the previously discussed 'lending rate' benefit is about the indirect benefit on expected growth (via increased investment). The Wealth Transfer Impact is reduced by a tax adjustment.

As outlined, in his initial views Sir John Vickers is sceptical regarding the 'Wealth Transfer' impact that is included in the CBA. He questioned firstly why any lending rate benefit would materialise from lowering capital requirements, and secondly but relatedly, why industry would favour lower capital requirements if it resulted in a benefit to NZ borrowers at the expense of themselves.

[42] Brooke, M., Bush, O., Edwards, R., Ellis, J., Francis, B., Harimohan, R., Neiss, K., & Siegert, C. (2015). Measuring the macroeconomic costs and benefits of higher UK bank capital requirements. *Financial Stability Paper No. 35.* https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-paper/2015/measuring-the-macroeconomic-costs-and-benefits-of.pdf

Response

The lending rate impact is uncertain

We continue to include a 'Net wealth transfer impact' in the CBA. However, do recognise the uncertainty in modelling an expected lending rate impact. With this in mind, as noted above we have undertaken additional sensitivity adjusting lending rates to only increase by half as much as our central estimate, that is, a 50% pass through to borrowers.

As noted above, we do not assume full Modigliani-Miller effects, so lowering capital reduces WAFC. While this should mean reduced funds flowing to shareholders and foreign creditors, we think it can still be preferable to shareholders, not least because the rate of return on the (smaller) investment they have in the NZ bank is expected to rise when capital requirements fall.

Alternative options should be explored

We consulted on two main options as part of the consultation. Some submitters argued the range of options analysed was too limited and an APRA-like option should be tested.

Results and sensitivities

Following feedback and further analysis we have refined the models and explored alternative assumptions:

- Included additional capital stack options for analysis, including an APRA-like alternative.
- Provided lending rate impacts for changes in scalar and output floor.
- Measured the expected benefit of Risk Weight changes on each deposit taker.
- Updated the models to reflect the proposed post-consultation changes to RWA.
- Adjusted the definition of a 'crisis' to one that absorbs all Tier 2 capital, in order to not overstate the benefits of LAC.
- Completed additional sensitivity analysis on lending rate changes, including pass-through assumptions, as well as lower cost of crisis assumptions.
- Attempted to provide further disaggregated outputs, for example Group 2 and 3.

Below, the following options have been analysed. The cost-benefit analysis for each option is provided, then subjected to a range of sensitivity checks.

Table 35: Analysed options

	Status quo: 2019 decisions	**Option 1** No LAC	**Option 2** LAC	**Option 2a** + 1% CET1	**Option 2b** - 1% CET1	**Option 2c** - 1.5% LAC	**Option 3** APRA
Risk weights	No changes	✓ Proposed changes	✓ Proposed changes	✓ Proposed changes	✓ Proposed changes	✓ Proposed changes	✓ Proposed changes
Output floor	85%	85%	85%	85%	85%	85%	85%
Tier 1	G1: 16% G2: 14% G3: 11%	G1: 14% G2: 11% G3: 10%	G1: 12% G2: 11% G3: 10%	G1: 13% G2: 11% G3: 10%	G1: 11% G2: 11% G3: 10%	G1: 12% G2: 11% G3: 10%	G1: 10.5% G2: 8% G3: 8%
Tier 2	G1: 2% G2: 2% G3: 2%	G1: 3% G2: 3% G3: 3%	G1: 3% G2: 3% G3: 3%	G1: 3% G2: 3% G3: 3%	G1: 3% G2: 3% G3: 3%	G1: 3% G2: 3% G3: 3%	G1: 3.25% G2: 3.5% G3: 3.5%
LAC	G1: 0%	G1: 0%	G1: 6%	G1: 6%	G1: 6%	G1: 4.5%	G1: 4.5%

Summary results

Figure 14: Total Net Benefit – central estimate and sensitivity ranges (% change in expected GDP)

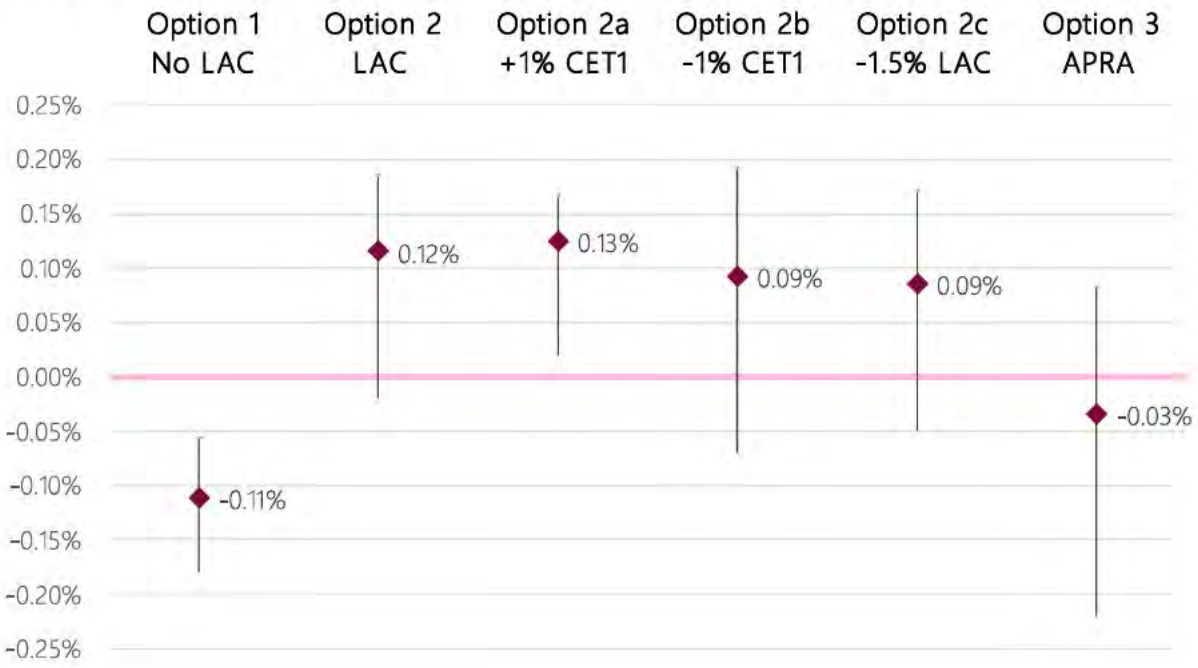


Table 36: Total net benefit with sensitivities

		Option 1 No LAC	Option 2 LAC	Option 2a + 1% CET1	Option 2b - 1% CET1	Option 2c - 1.5% LAC	Option 3 APRA
Indirect impact on Expected GDP	Lower lending rates	0.09%	0.15%	0.11%	0.18%	0.15%	0.20%
	Higher bank failures	-0.27%	-0.15%	-0.08%	-0.24%	-0.19%	-0.41%
	Net expected GDP benefit	-0.18%	-0.01%	0.03%	-0.06%	-0.04%	-0.20%
Direct impact	Net wealth transfer cost	0.07%	0.12%	0.09%	0.15%	0.12%	0.17%
Total net benefit, compared to 2019 decisions		-0.11%	0.12%	0.13%	0.09%	0.09%	-0.03%
Sensitivity range of total net benefit		**-0.18%, -0.06%**	**-0.02%, 0.19%**	**0.02%, 0.17%**	**-0.07%, 0.19%**	**-0.05%, 0.17%**	**-0.22%, 0.08%**

The results are tested with the following sensitivities as described in Table 37.

Table 37: Option sensitivities

Sensitivity and description	Lending rate	Crisis costs	Overall impact and result
Central estimate	100% pass through ~37% MM offset	-63% GDP if crisis occurs -20% if minor crisis occurs	
Sensitivity 1 Equity (CET1) and debt (Tier 2 and marginal) costs do not adjust as capital requirements changes	**100% pass through** **~0% MM offset**	No change to central estimate assumptions	Larger lending rate benefit from lower capital
Sensitivity 1a WAFC savings are not fully passed onto borrowers, 50% is absorbed by the deposit taker.	**50% pass through** **~37% MM offset**	No change to central estimate assumptions	Smaller lending rate benefit from lower capital
Sensitivity 2 Equity (CET1) and debt (Tier 2 and marginal) costs adjust more than expected from capital requirements changes	**100% pass through** **~74% MM offset**	No change to central estimate assumptions	Smaller lending rate benefit from lower capital

Sensitivity and description	Lending rate	Crisis costs	Overall impact and result
Sensitivity 3 Cost of crisis is reduced from 63% to 50%.	No change in central estimate assumptions	**-50% GDP if crisis occurs** **-20% if minor crisis occurs**	Smaller crisis cost from lower capital
Sensitivity 4 Cost of minor crisis is reduced from 20% to 15%	No change in central estimate assumptions	**-63% GDP if crisis occurs** **-15% if minor crisis occurs**	Lower cost from triggering LAC

Detailed results from the sensitivity analysis are provided in Table 38 below.

Table 38: Sensitivity results table

		Option 1 No LAC	Option 2 LAC	Option 2a + 1% CET1	Option 2b - 1% CET1	Option 2c - 1.5% LAC	Option 3 APRA
Sensitivity 1: No MM – Larger lending rate impact							
Indirect impact on Expected GDP	Lower lending rates	0.11%	0.19%	0.14%	0.24%	0.20%	0.27%
	Higher bank failures	-0.27%	-0.15%	-0.08%	-0.24%	-0.19%	-0.41%
Transfer of wealth	Net wealth transfer cost	0.09%	0.15%	0.11%	0.20%	0.16%	0.22%
Total net benefit, compared to 2019 decisions		**-0.07%**	**0.19%**	**0.17%**	**0.19%**	**0.17%**	**0.08%**
Sensitivity 1a: 50% Pass through – Smaller lending rate impact							
Indirect impact on Expected GDP	Lower lending rates	0.04%	0.07%	0.06%	0.09%	0.08%	0.10%
	Higher bank failures	-0.27%	-0.15%	-0.08%	-0.24%	-0.19%	-0.41%
Transfer of wealth	Net wealth transfer cost	0.04%	0.06%	0.05%	0.08%	0.06%	0.08%
Total net benefit, compared to 2019 decisions		**-0.18%**	**-0.02%**	**0.02%**	**-0.07%**	**-0.05%**	**-0.22%**
Sensitivity 2: Double MM - Smaller lending rate impact							
Indirect impact on Expected GDP	Lower lending rates	0.06%	0.11%	0.09%	0.13%	0.11%	0.14%
	Higher bank failures	-0.27%	-0.15%	-0.08%	-0.24%	-0.19%	-0.41%
Transfer of wealth	Net wealth transfer cost	0.05%	0.09%	0.07%	0.11%	0.09%	0.12%
Total net benefit, compared to 2019 decisions		**-0.16%**	**0.04%**	**0.08%**	**-0.01%**	**0.01%**	**-0.15%**

		Option 1 No LAC	Option 2 LAC	Option 2a + 1% CET1	Option 2b - 1% CET1	Option 2c - 1.5% LAC	Option 3 APRA
Sensitivity 3: Reduction in cost of crisis from 63% to 50%							
Indirect impact on Expected GDP	Lower lending rates	0.09%	0.15%	0.11%	0.18%	0.15%	0.20%
	Higher bank failures	-0.21%	-0.16%	-0.09%	-0.23%	-0.18%	-0.36%
Transfer of wealth	Net wealth transfer cost	0.07%	0.12%	0.09%	0.15%	0.12%	0.17%
Total net benefit, compared to 2019 decisions		**-0.06%**	**0.11%**	**0.11%**	**0.10%**	**0.09%**	**0.01%**
Sensitivity 4: Reduction in cost of minor event from 20% to 15%							
Indirect impact on Expected GDP	Lower lending rates	0.09%	0.15%	0.11%	0.18%	0.15%	0.20%
	Higher bank failures	-0.27%	-0.11%	-0.04%	-0.19%	-0.15%	-0.36%
Transfer of wealth	Net wealth transfer cost	0.07%	0.12%	0.09%	0.15%	0.12%	0.17%
Total net benefit, compared to 2019 decisions		**-0.11%**	**0.16%**	**0.16%**	**0.14%**	**0.12%**	**0.02%**

Appendix 14: Counter-Cyclical Capital Buffer (CCyB)

Consultation feedback

Long-run CCyB set at 1%

There were mixed views on our proposal to reduce the long-run CCyB (i.e. the rate we would set the CCyB at most of the time) from 1.5% to 1% of risk-weighted assets (**RWA**).

Some respondents (mainly Group 2 deposit takers out of those that commented) suggested that the long-run CCyB should be higher than 1%. They suggested that a CCyB of 1% (reduced in a downturn) would not likely give deposit takers enough incentive to extend more credit during a downturn (and hence support economic recovery) and that a higher long-run CCyB gives additional flexibility in responding to a range of shocks. Further, if the long-run CCyB was higher, it was suggested that the PCB should not also increase (i.e. the capital conservation buffer component of the PCB should be reduced to reflect a higher long-run CCyB).

Some respondents (mainly Group 1 deposit takers out of those that commented) agreed with a long-run CCyB of 1% (which aligns with Australia). However, they stated that more guidance is needed under which conditions the settings of the CCyB would be changed (particularly during a period of stress) and how that would interact with the broader capital framework (including the Capital Buffer Response Framework (**CBRF**)).

Not applying CCyB to Group 3 deposit takers

There were mixed views on our proposal to not apply the CCyB to Group 3 deposit takers.

Some respondents supported the proposal, agreeing that it would not have a big impact on the financial system overall and would be consistent with our approach to using other macroprudential tools.

However, a few respondents disagreed, as applying the CCyB to Group 3 deposit takers would provide these deposit takers with some relief to capital requirements during a downturn. It was also suggested that not applying the CCyB to Group 3 deposit takers may lead to a competitive imbalance as Group 1 and 2 deposit takers would have more scope to continue to lend during a downturn (if the CCyB is reduced), whereas Group 3 deposit takers may not.

Our assessment of the feedback and other context/analysis

Long-run CCyB of 1%

We acknowledge that a long-run CCyB of 1% may not provide deposit takers enough incentive (if reduced to 0%) to extend more credit during a downturn and agree that that a higher long-run CCyB gives additional flexibility in responding to a range of shocks. However, if the CCyB makes up a large proportion of the PCB, cutting it to zero may allow a deposit taker to reduce its capital to a level that undermines its safety and soundness. Alternatively, a deposit taker may not make use of the entire CCyB (if reduced to 0%) as they may not wish to get too close to minimum capital requirements.

That being said, if we felt that cutting the CCyB to 0% did not go far enough in a particularly severe systemic stress, we could encourage deposit takers to use their remaining buffers. We will design the Capital Standard to allow deposit takers to use all capital buffers subject to meeting dividend restrictions, which is consistent with international practice.

We also note that under Option 1 and Option 2 in the Consultation Paper, if the long-run CCyB was greater than 1%, then reduced to 0%, Group 2 deposit takers could end up with lower capital requirements than Group 3 deposit takers (in percentage terms), which may be inconsistent with proportionality. This was a key consideration in proposing to set the long-run CCyB at 1%.

We agree that guidance is needed under which conditions the CCyB would be reduced, then restored to its long-run level. We will consider this as part of the updated macroprudential policy framework that we intend to publish in mid-2026.

Not applying CCyB to Group 3 deposit takers

Under the Lending Standard, we do not intend to apply other macroprudential tools such as loan-to-value ratio and debt-to-income restrictions to Group 3 deposit takers. Consistent with that approach, we proposed to not apply the CCyB to Group 3 deposit takers. Given the small size of the Group 3 sector, the impact on aggregate lending (and overall financial conditions) would be small if we applied a CCyB to Group 3 deposit takers.

We acknowledge the point that applying the CCyB to Group 3 deposit takers may provide these deposit takers with some relief to capital requirements during a downturn. However, it is noted that many Group 3 deposit takers are less able to increase their capital levels quickly (for example, by issuing capital instruments or retaining profits) compared to most Group 1 and 2 deposit takers. This could be particularly challenging after a downturn when restoring the CCyB to its long-run level.

Proposed response

Long-run CCyB of 1%

We recommend proceeding with our proposal to set the long-run CCyB at 1%.

Not applying CCyB to Group 3 deposit takers

We will proceed with our proposal to not apply the CCyB to Group 3 deposit takers.

Other issues related to the scope and application of the CCyB

On 27 February 2025, the Board approved for consultation a range of policy positions related to the scope and application of the CCyB. We intended to consult on these issues in March 2025, incorporating feedback into the draft Capital Standard (and associated guidance). However, that consultation was delayed due to the Review of Key Capital Settings. Given that the CCyB forms part of the capital stack, some aspects of the intended CCyB consultation were included in that review – namely the long-run level of the CCyB and whether the CCyB should apply to Group 3 deposit takers.

We consider that the other aspects of the intended CCyB Consultation Paper do not warrant a standalone consultation as they are technical and relate to the implementation of the CCyB.

Therefore, we plan to incorporate these issues into the consultation on the exposure draft of the Capital Standard. Our intended approach to these issues is set out in Table 39 below.

Table 39: Issues on scope and application of the CCyB

Consultation topic	Proposal agreed by Board in February 2025	Approach
The application of the CCyB to Group 3.	Not apply CCyB to Group 3 (to align with our other macroprudential policies, including the proposed Deposit Takers Act 2023 Lending Standard, recognising Group 3 deposit s9(2)(f)(iv)	s9(2)(f)(iv) –

s9(2)(f)(iv)

Appendix 15: Leverage ratio

International expert's feedback

The leverage ratio is part of the Basel capital framework. It compares capital to a non-risk-weighted measure of a bank's balance sheet. The Basel leverage ratio is Tier 1 capital divided by the leverage exposure measure (which takes into account on and off-balance sheet exposures). The Basel minimum is 3% (for the large banks in Australia it is 3.5%). Thorsten Beck has questioned the absence of this measure from the NZ framework.

Our assessment of the feedback and other context/analysis

The leverage ratio was included as part of the post-global financial crisis (**GFC**) global framework because it was felt it was necessary to have a backstop to ensure firms would still have some capital even if the risk-weighing system and normal capital requirements were failing to measure risk accurately. This could happen for example if the models or rules being used to determine risk-weighted assets (**RWA**) were inadequate (e.g. zero risk weighting of some credit exposures, and off-balance sheet exposures not being adequately captured).

The Reserve Bank considered the case for adding a leverage ratio requirement as part of the 2019 Capital Review and decided against doing so. It has consistently suggested the leverage ratio requirement adds complexity but would not add safety in the New Zealand context. Average risk weights in New Zealand are high for two main reasons and this means a leverage ratio would be unlikely to bind:

- New Zealand banks have simple business models with balance sheets that are predominately made up of loans that they have themselves originated. In other economies (US/Europe) a lot of loans are securitised, and banks hold a lot of securities instead of loans. Securities can have very low risk weights and may be complex (increasing the risk of risk modelling failures – e.g. recall mortgage backed securities during the GFC).
- As shown by Oliver Wyman, RBNZ – like the Australian Prudential Regulation Authority – has relatively high risk weights.

The combination of these effects means that RWA relative to the size of banks' balance sheets is comparatively high for New Zealand banks ($348bn relative to $612bn of accounting assets for the four major banks, as at September 2025). While we do not have a precise estimate for the "exposure amount" NZ banks would report for a Basel leverage ratio, provided Tier 1 capital is at least 6% of RWA, the leverage ratio would likely be above the minimum Basel requirement of 3%. Table 40 below provides an estimate of where NZ banks' Basel leverage ratios would currently be, compared to their parent banks.

Table 40: Leverage ratios of major Australian and NZ banks, September 2025

Bank	Total RWA	Total Assets	RWA as % of total assets	Leverage exposure	Tier 1 capital	Leverage ratio
ANZ	496,145	1,353,799	37%	1,453,694	68,874	4.7%
CBA	458,547	1,297,671	35%	1,424,842	62,541	4.4%

Bank	Total RWA	Total Assets	RWA as % of total assets	Leverage exposure	Tier 1 capital	Leverage ratio
NAB	440,557	1,109,062	40%	1,229,142	60,516	4.9%
WBC	450,048	1,125,356	40%	1,282,207	64,978	5.1%
ANZ NZ	110,407	209,990	53%	231,651*	16,920	7.3%
ASB Bank	77,574	138,424	56%	152,703*	11,124	7.3%
BNZ	86,978	135,603	64%	149,590*	12,637	8.4%
Westpac NZ	73,082	128,272	57%	141,503*	10,664	7.5%

Source: Company financial statements, RBNZ Bank Financial Strength Dashboard.
Note: Data in $m of local currency. CBA data as at June 2025.
*Leverage exposure for NZ banks estimated as 110% of total assets, based on the Australian bank average.

A leverage ratio could potentially support international comparability (e.g. when credit analysts or rating agencies compare NZ banks to international peers). However, in Australia at least, the leverage requirement does not seem to be closely monitored by stakeholders (e.g. not discussed in the Reserve Bank of Australia's Financial Stability Report).

Thorsten Beck has noted that we have proposed to reduce Tier 1 capital requirements and also reduce RWA. This slightly increases the change that a leverage ratio requirement could become binding. The Australian data above suggests some banks could hit their leverage requirement before they hit their minimum Common Equity Tier 1 ratios if they lost capital in a downturn. But because NZ RWA (as a % of total assets) will still be significantly higher, even after our risk weight reductions, this is less likely in NZ.

We also note that adding a leverage ratio and associated disclosure requirements to the NZ framework would be a bit more complicated than it would appear at first glance. This relates to complexities around defining the exact measure of exposures that is the denominator of the ratio – there are issues around the treatment of netting of derivatives and collateral (see e.g. Basel LEV30).

Proposed response

Given the Terms of Reference, and that the issue was considered in the 2019 Capital Review, we do not recommend introducing a leverage ratio requirement through this Review. We are open to reconsidering the merits of a leverage ratio requirement in New Zealand in the future, particularly if there are further international developments. This would likely be in 2027 at earliest, once the majority of the implementation of this Review's decisions are complete.

Appendix 16: Implementation plan

Table 41 below sets out our high-level plan to implement the decisions resulting from the Review – this plan covers the two categories of options (an option with Loss-Absorbing Capacity (**LAC**) and an option without LAC).

All changes will be reflected in the Capital Standard, due to come into force on 1 December 2028. We will reflect the changes in the exposure draft of the Capital Standard due to be consulted on from June to August 2026. The exposure draft will not include any material related to LAC requirements if the Board decide to go with an option with LAC – instead, there would be a policy consultation on the details of LAC instruments separately in 2026.

Items in section 80 of the Deposit Takers Act 2023 (**DTA**) ("Bail-In Standard") would be set out in the Capital Standard at a later date. A wider crisis management framework will be formed through various workstreams including a report to the Minister of Finance on the need for an additional bail-in powers under the DTA, the development of a crisis preparedness standard and the preparation for the statutory Statement of Approach to Resolution (**SOAR**).

To bring in changes in some capital settings ahead of the Capital Standard coming into force in late 2028, we will need to change the existing rules for banks (the Banking Prudential Requirements (**BPRs**) and work with the Minister to seek Cabinet approval to change existing regulations for non-bank deposit takers (**NBDTs**). We have plans to do this at pace over 2026. These changes would not include introducing LAC.

We plan to transition to new capital settings in a phased way to give deposit takers time to adapt, similar to the approach taken following the 2019 Capital Review. Our intended phased approach is set out here for the Board's consideration as part of its decision making:

- If the Board decides on Option 1, we would increase capital ratio requirements by around 1% per year (i.e. the same rate as banks have been adjusting under the 2019 decisions) - noting many banks are ahead of current requirements and lower risk weights will offset much of the increase in ratio requirements. Table 42 below illustrates indicative transition path for Options 1.
- If the Board decide to introduce LAC and decides on Option 2, we would increase prudential capital buffer (PCB) by 0.5ppt to the steady-state level of 6% until the commencement of the DTA and then gradually replace part of the PCB with LAC. Table 43 below shows an indicative transition path for the moderate implementation of Option 2. We intend to publicly consult on these three implementation options as part of the policy consultation on LAC in 2026. Depending on the incremental percentage point per year, the transitional period would be complete in:
    - December 2033 (Slow implementation),
    - December 2031 (Moderate implementation)
    - December 2030 (Fast implementation) – s9(2)(f)(iv)
- If the Board decides to remove Additional Tier 1 (**AT1**) capital:

- We would continue to recognise existing issued AT1 capital under the updated BPRs given the short period of time that they will remain in place – though we would not allow banks to issue any new AT1 instruments;
- Under the Capital Standard, we would allow Group 1 and 2 deposit takers to count remaining AT1 towards their Tier 1 requirements on a reducing basis before complete derecognition; and
- We would allow Group 3 deposit takers to count a maximum of one-half of their perpetual preference shares (**PPS**) as Tier 1 capital (with the rest as Tier 2 capital) for a period of time, with this ratio changing such that, eventually, PPS will only be able to count as Tier 2 capital.

Table 41: High-level implementation plan

Date	No-LAC option chosen	LAC option chosen
December 2025	**18 December:** High-level policy decisions announced, including publication of a media release, independent experts' reports and Consultation Paper submissions.	
H1 2026	**February 2026:** Full documentation published including summary of submissions with our detailed responses, an updated cost benefit analysis and full implementation schedule. **Late February 2026:** Expected cabinet meeting seeking approval for changing NBDT regulations to give effect to changes for NBDTs ahead of Capital Standard coming into effect in late 2028. **March/April 2026:** Short consultation on updated drafting of BPRs to give effect to changes for banks ahead of Capital Standard coming into effect in late 2028. **June 2026:** Short consultation on updated drafting of NBDTs regulations to give effect to changes for NBDTs ahead of Capital Standard coming into effect in late 2028.	
	June-August 2026: Consultation on Capital Standard exposure draft and guidance (rules for all deposit takers from late 2028) and policy consultation on crisis preparedness.	**June-August 2026:** Consultation on Capital Standard exposure draft and guidance (rules for all deposit takers from late 2028). Policy consultation on crisis preparedness standard and a "Bail-in Standard" covering LAC requirements, alongside the publication of indicative resolution strategies.
H2 2026	**1 October 2026:** target date for updated BPRs to come into force, covering new risk weights and first annual step changes in capital ratios. **1 October 2026:** target date for updated NBDT regulations to come into force with new risk weights and annual step change in capital ratios.	
2027		**February-April 2027:** Consultation on an exposure draft of a "Bail-in Standard" setting out LAC requirements.
	May 2027: Consultation on exposure draft of Crisis Preparedness Standard	

Date	No-LAC option chosen	LAC option chosen
	31 May 2027: Final Capital Standard issued. **1 October 2027:** Annual step change in capital ratios.	
2028	**1 December 2028:** Capital Standard (including the LAC requirements if a LAC option is chosen) commences, annual step change in capital ratios. **Late 2028:** Crisis Preparedness Standard issued.	
2029 and beyond	**TBC:** Implementation of new capital ratio requirements expected to be complete in 2029.	**TBC:** Finalise transition to new capital ratio requirements and introduce LAC requirements.
	Mid-2029: Publish the Statement of Approach to Resolution.	

Note: The AT1 component illustrates the path for a deposit taker with the maximum 2.5% of AT1 at the start of the transition period. For deposit takers that have not used the full 2.5% allowance, the maximum amount of AT1 they can count as Tier 1 will be relative to the level of AT1 they had at the start of the transition period. See Appendix 7 for detail about AT1.

Table 42: Indicative transition path of Option 1 for Group 1 deposit takers

	Minimum Common Equity Tier 1 (CET1)	Minimum Tier 1 (of which max AT1)	Minimum total (of which max Tier 2)	Prudential Capital Buffer (PCB) – all CET1	LAC	Total capital + LAC
Dec 2025	4.5	7 (2.5)	9 (2)	5.5	0	14.5
Oct 2026	4.5	7 (2.5)	9 (2)	6.5	0	15.5
Oct 2027	4.5	7 (2.5)	9 (2)	7	0	16
Dec 2028	6	6 (2.5)	9 (3)	7	0	16
Dec 2029	6	6 (1.675)	9 (3)	8	0	17
Dec 2030	6	6 (0.825)	9 (3)	8	0	17
Dec 2031	6	6 (0)	9 (3)	8	0	17

Table 43: Indicative transition path (moderate implementation) of Option 2 for Group 1 deposit takers

	Minimum CET1	Minimum Tier 1 (of which max AT1)	Minimum total (of which max Tier 2)	Prudential Capital Buffer (PCB) – all CET1	LAC	Total capital + LAC
Dec 2025	4.5	7 (2.5)	9 (2)	5.5	0	14.5
Oct 2026	4.5	7 (2.5)	9 (2)	6	0	15
Oct 2027	4.5	7 (2.5)	9 (2)	6	0	15
Dec 2028	6	6 (2.5)	9 (3)	6	1	16
Dec 2029	6	6 (1.675)	9 (3)	6	2	17
Dec 2030	6	6 (0.825)	9 (3)	6	4	19
Dec 2031	6	6 (0)	9 (3)	6	6	21

Note: The AT1 component illustrates the path for a deposit taker with the maximum 2.5% of AT1 at the start of the transition period. For deposit takers that have not used the full 2.5% allowance, the maximum amount of AT1 they can count as Tier 1 will be relative to the level of AT1 they had at the start of the transition period. For details, please see Appendix 7.

Appendix 17: Glossary

Additional Tier 1 (AT1) capital	The second highest quality of capital behind Common Equity Tier 1. Under current Reserve Bank policies, Additional Tier 1 capital is made up of perpetual preference shares that offer fixed dividends, no redemption date and which limit other rights of the holder. Preference shares rank ahead of ordinary shares in a liquidation.
Australian Prudential Regulation Authority (APRA)	An independent statutory authority responsible for the prudential supervision of financial institutions in Australia.
Bail-in	A crisis management strategy that seeks to recapitalise a deposit taker that is likely to fail (or has failed) by writing down, or converting into ordinary shares, selected capital instruments and liabilities. There are different ways bail-in can be effected using different legal mechanisms.
Banking Industry Country Risk Assessment (BICRA)	A methodology used by S&P Global Ratings to evaluate the strength of banking systems around the world. It scores banking systems on economic risk and industry risk. Banking Industry Country Risk Assessment reports are typically updated monthly.
Basel (Basel I, II, III) framework	A set of standards developed by the Basel Committee on Banking Supervision, which is the primary global standard setter for the prudential regulation of banks. The most recent of these frameworks is Basel III, introduced in December 2010.
Capital buffer (or **'prudential capital buffer'** or **'CET1 buffer'**)	Absorbs losses during stress and protects deposit takers from breaching their minimum capital requirements. The capital buffer must be made up of entirely Common Equity Tier 1 capital. The capital buffer can be made up of a number of components (see definitions below): a Conservation buffer, Domestic Systemically Important Banks Capital buffer and Counter-Cyclical Capital Buffer.
Capital ratio	A deposit taker's capital divided by its risk-weighted assets (see definition below). A capital ratio is a key indicator of the financial strength of a deposit taker, measuring the losses it can withstand relative to the risk of the deposit taker's business.
Capital Requirements (or **'Prudential Capital Requirements'**)	The minimum investment in a deposit taker that must be funded through the issuance of capital instruments (e.g. Common Equity Tier 1, Additional Tier 1, Tier 2 and Loss-Absorbing Capacity) and amount of capital that the Reserve Bank requires deposit takers

	to have. It includes minimum capital requirements, prudential capital buffers and requirements regarding the approach to risk weights.
Capital Review decisions in 2019 (or **'2019 Capital Review'**)	These decisions introduced higher capital requirements for registered banks under the Bank (Prudential Supervision) Act 1989 which are split into two broad categories: minimum capital requirements (see definition below) and capital requirements (see definition above). The combined impact of these is in the process of gradually shifting up to 18% of risk-weighted assets (see definition below) for the four largest banks. An outcome of the 2019 Capital Review was to no longer recognise convertible debt securities for capital purposes.
Capital stack	The full set of capital instruments for a deposit taker. It includes Tier 1 and Tier 2 capital instruments (see definitions below).
Capital Standard	One of the standards that banks and non-bank deposit takers will be licensed against under the Deposit Takers Act 2023. This will replace existing prudential requirements to form new capital rules for deposit takers. Decisions from the 2025 Review of key capital settings will be incorporated into the Capital Standard.
Common Equity Tier 1 (CET1) capital	The highest quality of capital as it is permanently available to absorb a deposit taker's financial losses. Common Equity Tier 1 capital includes shareholders' investment (ordinary shares) and the deposit taker's retained earnings.
Community Housing Providers (CHPs)	Generally not-for-profit groups that meet housing needs through a range of affordable rental and home ownership options.
Conservation buffer	A type of prudential capital buffer that applies to all deposit takers. The conservation buffer promotes capital resilience by requiring deposit takers to maintain capital levels above their minimum capital requirements.
Cost benefit analysis (CBA)	This involves estimating, where possible, the monetary value of all the costs and benefits of a decision to determine an expected net impact of the decision. A cost benefit analysis is one tool that the Reserve Bank uses to compare different policy options.
Counter-Cyclical Capital Buffer (CCyB)	A type of prudential capital buffer that the Reserve Bank may increase or decrease over the financial cycle. Increasing the Counter-Cyclical Capital Buffer aims to build deposit takers' capital resilience and guard against financial stability risks. Lowering the Counter-Cyclical Capital Buffer enables deposit

	takers to operate at lower capital levels during periods of financial system stress, to promote their ability to continue lending to support the economy.
Credit Contracts and Consumer Finance Act 2003 (CCCFA)	This sets the legislative framework for credit contracts, consumer leases and buy-back transactions of land. Its primary purpose is to protect the interests of consumers in connection with these activities.
Crisis event	For the purposes of the cost benefit analysis (see definition below), this means an event where all deposit takers' capital is absorbed by losses.
Crisis management	This refers to the responses of the Reserve Bank, deposit takers and other relevant stakeholders to manage the impact of financial distress when it arises. This is both when there is the potential for recovery, and when a deposit taker is likely to fail (or has failed).
Crisis management framework	This includes the powers, regulations, policies, tools, strategies and processes in place that inform and enable the Reserve Bank and deposit takers' actions in response to financial distress and potential failure. It also includes business-as-usual preparations and the governance and testing of these arrangements, to ensure they operate effectively in practice.
Debt-to-income (DTI)	This measures the amount of debt a borrower has, relative to their gross income. Debt-to-income restrictions are a macroprudential tool used by the Reserve Bank to limit the portion of banks' new lending towards home loans that exceed debt-to-income thresholds. Debt-to-income restrictions aim to reduce the probability of default.
Deposit taker	An entity that meets the definition of deposit taker in clause 2 of Schedule 2 of the Deposit Takers Act 2023.
Deposit Takers Act 2023 (DTA)	Legislation that provides for the prudential regulation of deposit takers. From 2028 it is intended that the Deposit Takers Act 2023 will replace the Banking (Prudential Supervision) Act 1989 and the Non-bank Deposit Takers Act 2013.
Domestic Systemically Important Banks (D-SIBs)	Banks whose failure would result in significant disruption to the New Zealand financial system and economy due to their size, interconnectedness, lack of substitutability, and complexity. ANZ, ASB, BNZ, and Westpac are currently identified as Domestic Systemically Important Banks.

Domestic Systemically Important Bank Capital buffer (D-SIB buffer)	A type of prudential capital buffer that applies to deposit takers that are identified as Domestic Systemically Important Banks. A Domestic Systemically Important Bank Capital buffer promotes higher capital strength of deposit takers and lowers their probability of failure.
Finance and Expenditure Committee (FEC)	A select committee of the New Zealand parliament. The business that the committee looks at includes economic and fiscal policy, taxation, revenue, and banking and finance. In June 2024, a Select Committee inquiry commenced on banking competition, which also focused on rural banking.
Financial Policy Remit (FPR)	Specifies or provides for matters that the Minister of Finance considers are desirable for the Reserve Bank to have regard to in relation to our financial stability objective, the objectives or purposes of our prudential regulation, and acting as a prudential regulator and supervisor. The Financial Policy Remit is issued by the Minister of Finance under the Reserve Bank of New Zealand Act 2021.
Global financial crisis (GFC)	The period of extreme stress in global financial markets and banking systems between 2007 and 2009.
Going concern capital	Instruments that absorb losses while the deposit taker remains an economically viable entity. These instruments help maintain ongoing operations and market confidence.
Gone concern capital	Instruments that absorb losses once the deposit taker is no longer economically viable. This includes a regulator led bail-in using crisis management powers, as without that intervention the deposit taker could not have continued operating or sustained market confidence.
Gross Domestic Product (GDP)	A way of measuring economic activity and income in a country in a given period of time. Gross Domestic Product is all the consumption, investment, government spending, and net exports (exports less imports) in an economy. Changes in Gross Domestic Product are New Zealand's official measure of economic growth.
Group 1, 2 and 3 deposit takers	Categories of deposit takers that are set out in the Proportionality Framework. Group 1 includes deposit takers with total assets NZ$100 billion or more. Group 2 deposit takers have total assets of NZ$2 billion or more, but less than NZ$100 billion. Group 3 have total assets of less than NZ$2 billion. We allocate deposit takers into groups to support the consistent application of

	requirements to similar deposit takers, and to allow for requirements to be set proportionately for each group.
Internal ratings-based (IRB) approach	Allows accredited deposit takers to use the internal models-based approach to calculate their risk weights for credit risk; otherwise, they must use the standardised approach. Accredited deposit takers are sometimes called 'Internal ratings-based banks' or 'IRB banks'. Risk weights for other types of exposures, including operational risk and market risk, must be calculated using the standardised approach.
Lenders Mortgage Insurance (LMI)	Protects a lender from incurring losses in the event that a borrower defaults on a home loan.
Loan-to-value ratio (LVR)	A measure of how much a bank lends against mortgaged property, compared to the value of that property. Loan-to-value ratios are used in credit risk weights for some exposures, including residential mortgage loans, in the standardised approach to credit risk. Separately, loan-to-value ratio restrictions are a macroprudential tool used by the Reserve Bank to limit how much new high loan-to-value ratio lending banks can make. We vary these restrictions in response to changing financial system risks. Tighter loan-to-value ratio restrictions help to reduce the number of highly leveraged borrowers and lower loss given default, supporting the stability of the housing market and reducing the risk of a sharp correction in house prices.
Loss-Absorbing Capacity (LAC) instruments	Debt instruments that make up part of a deposit taker's funding and are pre-positioned to allow for bail-in. A Loss-Absorbing Capacity requirement would be in addition to the minimum capital requirements and capital buffers. LAC can be issued to other members of a deposit taker's group (internal Loss-Absorbing Capacity) or to other parties (external Loss-Absorbing Capacity).
Loss given default (LGD)	The proportion of exposure at default that is expected to be lost following default, calibrated to economic downturn conditions.
Loss rate	The cumulative impairment expense over a given time period as a proportion of the opening exposure.
Minimum capital (ratio) requirements	The minimum capital ratio must be met in order to be licensed and operate as a deposit taker. If a deposit taker has a capital ratio below the minimum requirement, it is likely to be in financial distress from a prudential perspective.

Modigliani-Miller (MM) theorem	States that changes in a firm's funding structure (i.e. the ratio of equity finance to debt finance) would have no impact on its weighted average cost of capital. Increases in profitability through the greater use of leverage when capital is lower will be offset by a higher unit cost for the remaining equity capital, since that equity becomes relatively riskier. Therefore, in the context of banks, if the Modigliani-Miller theorem holds fully, changes in capital requirements should have no effect on the cost of lending.
Non-bank deposit taker (NBDT)	An entity that meets the definition of non-bank deposit taker in section 5 of the Non-bank Deposit Takers Act 2013.
Non-bank Deposit Takers Act 2013 (NBDT Act)	Legislation that provides for the Prudential regulation of non-bank deposit takers. It is intended that the Non-bank Deposit Takers Act 2013 will be replaced by Deposit Takers Act 2023 from 2028.
Output floor	A limit on the internal ratings-based (see definition above) approach for deposit takers that calculate the credit risk-weighted assets (see definition above) using the internal ratings-based approach. When determining its capital ratio, the risk-weighted assets for credit risk cannot go below 85% of the risk-weighted assets that the deposit taker would calculate under the standardised approach (see definition below).
Pillars 1, 2, and 3	Components of the Basel framework (see definition above). Pillar 1 requirements are minimum capital requirements to cover credit risk, market risk and operational risk. Pillar 2 includes additional capital requirements for other risks identified as part of the supervisory review process. Pillar 3 covers disclosure requirements and is designed to enforce market discipline on banks.
Probability of default (PD)	The likelihood that a credit exposure will default, averaged over a range of economic conditions. It is expressed as an annual rate.
Proportionality Framework	Sets out how the Reserve Bank takes into account the proportionality principle when developing standards for deposit takers licensed under the DTA. See *Group 1, 2 and 3 deposit takers* defined above.
Regulatory impact assessment	An analysis of the likely impact of proposed regulatory changes.

Recapitalise	The process of restoring a deposit taker's capital to an adequate level by generating new capital from external sources or bail-in.
Residential mortgage lending (RML)	Defined in section C3.2 of BPR131: Standardised credit RWAs. It is a loan secured by a first ranking mortgage over a residential property used primarily for residential purposes by the mortgagor, a related party of the mortgagor, or a tenant of the mortgagor
Risk-weighted assets (RWA)	An adjusted picture of a deposit taker's financial position (for example, its loan portfolios and other investments, and its operational and market trading activities) that takes into account the risk profile of that financial position.
Scalar	A scaling factor that must be applied to risk-weighted assets for credit risk calculated using the internal ratings-based approach. A New Zealand deposit taker must multiply its risk-weighted assets for credit risk calculated using the internal ratings-based approach by 1.2 when determining its capital ratio.
Sensitivity analysis	Shows the impact of changing one variable in a model at a time, or changing a small set of closely related variables, while holding everything else constant. Sensitivity analysis shows how different model calibrations affect the conclusions that can be drawn when there is some uncertainty around the model parameters.
Single point of entry (SPE)	A model of recovery or resolution where the group the deposit taker is part of is kept together. For example, under our preferred single point of entry model, the Australian parent entity would transfer or 'down-stream' sufficient capital to the New Zealand subsidiary to restore its viability in a crisis.
Small and medium-sized enterprise (SME)	In the internal ratings-based approach, banks may separately address exposures to small and medium-sized enterprises in a separate retail small and medium-sized enterprise sub-category of exposures. A loan that is extended to a small business and managed as a retail exposure, and that does not qualify as residential mortgage lending, is eligible for retail treatment where the banking group's total business-related exposure to the borrowing enterprise (on a consolidated basis, where applicable) is less than NZ$1 million.
Standardised approach to credit risk	One of the two methodologies available to calculate risk-weighted assets for deposit takers' credit risks. The standardised approach requires deposit takers to use Reserve Bank specified

	rules to determine the risk weights to apply to different types of loans and other assets.
Statement of Approach to Resolution (SoAR)	A document that will be issued under the Deposit Takers Act 2023 setting out the Reserve Bank's expected resolution strategies and intended approach to co-operating with relevant stakeholders when performing or exercising its functions powers or duties under the crisis management provisions of the Deposit Takers Act 2023. The Deposit Takers Act 2023 requires the Reserve Bank to publish this statement and regularly review it. The first Statement of Approach to Resolution is expected to be published by mid-2029.
Terms of reference	The 2025 Review of key capital settings sets out the purpose, approach, scope and timing of the Review. See 2025 Review of key capital settings - Reserve Bank of New Zealand - Te Pūtea Matua.
Tier 1 capital	Is made up of a combination of Common Equity Tier 1 capital and Additional Tier 1 capital. See definitions of these types of capital above.
Tier 2 capital	Comprises certain types of reserves and subordinated debt instruments that do not qualify as Common Equity Tier 1 capital or Additional Tier 1 capital, but are available to absorb losses ahead of more senior creditors of the banking group in a winding up.
Total capital ratio	Defined in BPR100: Capital Adequacy. Measured as total capital divided by total risk-weighted assets.
Total Loss-Absorbing Capacity (TLAC)	An international regulatory standard requiring global systemically important banks to have sufficient equity and bail-in debt that can absorb losses and recapitalise the deposit taker during a crisis, minimising the application of government funds.
Weighted Average Funding Cost (WAFC)	A deposit taker's average funding cost across all funding sources.
Whenua Māori	Māori freehold land.