

Reserve Bank Briefing: Terms of Reference for the review of key capital settings

To	Hon Nicola Willis Minister of Finance	Date	17 April 2025
Authorised by	Angus McGregor Acting Assistant Governor / General Manager Financial Stability	Report no	#6278
Prepared by	Shoko Seta, Adviser	Security	In-Confidence

Action Sought

Action sought	Deadline
<p>Note that the Reserve Bank intends to publish the Terms of Reference (Appendix 1) for its review of key capital settings in the week of 5 May 2025.</p> <p>Provide feedback on the Terms of Reference before 28 April 2025.</p> <p>Discuss this advice and the related report (RBNZ #6268) with officials.</p>	28 April 2025

Reserve Bank Contact for Telephone Discussion (if required)

Name	Position	Telephone
Katy Simpson	Manager, Prudential Policy	04 460 4385
Jess Rowe	Director Prudential Policy, Prudential Policy	04 474 8608

Actions for the Minister's Office Staff

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Note any feedback on the quality of the report.

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Attachments – N/A

Review of key capital settings: Terms of Reference

Purpose

1. This report seeks your feedback on the Terms of Reference for the Reserve Bank's review of key capital settings.

Background

2. We informed you of our intention to conduct a review of our capital settings on 21 March 2025 (RBNZ #6266 refers).
3. On 31 March 2025, the Chair of the Reserve Bank Board announced the review publicly at a hearing of the Finance and Expenditure Committee's (FEC) inquiry into banking competition.
4. On 14 April 2025, the Financial Stability Oversight Committee (FSOC) (a sub-committee of the Board with appropriate delegation) approved the Terms of Reference of the review (Appendix 1) and agreed to seek your feedback.

Terms of reference

5. The Terms of Reference sets out the purpose, approach, scope, methodology, timing and the role of external international experts.
6. The purpose is to reassess 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.
7. The scope is targeted to ensure the review considers the concerns raised by stakeholders about the Reserve Bank's regulatory capital settings – while allowing for announcement of substantive policy positions within six months for public feedback and reaching final decisions by the end of year. This timeline, and the efficacy of the review, relies on the underlying legislative framework remaining stable. Final decisions will be implemented in the rules made under the Deposit Takers Act 2023, and will also be applied to non-bank deposit takers and banks in advance, if feasible.
8. The scope covers:
 - Key developments since the 2019 Capital Review.
 - How our capital settings compare internationally (informed by an independent expert report).
 - The appropriate risk appetite for capital settings in New Zealand within the statutory parameters.
 - Proportionality of capital ratio requirements for different groups of deposit takers.

- The interrelationship between capital and the crisis management framework, including the balance between “going concern capital” (capital when a bank is operating normally, or under stress but still viable) and “gone concern capital” (capital that can be used to absorb losses if a bank is close to insolvency or fails).
9. This evidence-based review will build on existing work to review options for more granular risk weights, as set out in your December 2024 Letter of Expectations to the Reserve Bank. We are considering changes for residential mortgages, corporate lending and lending for housing for community housing providers, as well as housing co-operatives and on whenua Māori. We will also consider risk weights for rural lending.
 10. We expect to use international experts to:
 - a. produce credible independent reports, including the cross-country comparison and benchmarking New Zealand against other comparable jurisdictions;
 - b. provide challenge by reviewing the Reserve Bank’s analysis, options and recommendations; and
 - c. support FSOC and the Reserve Bank Board in reaching decisions.
 11. We intend to engage at least two experts with a deep understanding of banking systems, financial markets, regulation and policy. To ensure that the contributions of the experts are seen as credible to stakeholders our intention is to engage internationally recognised experts.

Postponement of our report back on the need for a statutory bail-in power

12. Under the Deposit Takers Act, there are no direct statutory powers to cancel liabilities of a bank or convert them to equity in a crisis (i.e. use as ‘gone concern capital’), although there are various ways the legislation can produce a similar result. In each case, the purpose is to lower fiscal risk and support an orderly resolution of a failed deposit taker.
13. In approving the policy for the DTA in 2021, Cabinet noted that the then Minister of Finance had asked officials to report back to the Minister on the need for statutory bail-in powers within 2 years of enactment of the DTA (i.e. by 6 July 2025) [DEV-21-MIN-0204 refers].¹
14. We consulted on our intended policy direction on statutory bail-in from August to November 2024, with submitters generally not in favour of statutory bail-in.
15. As bail-in and capital requirements are highly interrelated topics, subject to your approval, we propose to delay our scheduled July 2025 report back on the desirability of statutory bail-in powers and consider this issue alongside the review of key capital settings. We will report back on findings on the same timeframe as the review of key capital settings.

¹ Bail-in powers enable the write-down of unsecured and uninsured creditor claims and the conversion of these claims into equity to address the recapitalisation needs of distressed banks without relying on public money.

Next steps

16. We plan to publish the final Terms of Reference on our website in the week commencing 5 May, likely alongside the Financial Stability Report.
17. We intend to provide you with roughly monthly updates on the progress of the review. We also intend to work closely with the Treasury.

Recommendation

We recommend that you:

- a) **Note** that the Reserve Bank intends to publish the Terms of Reference (Appendix 1) for its review of key capital settings in the week of 5 May 2025.
- b) **Provide feedback** on the Terms of Reference before 28 April 2025.
- c) **Discuss** this advice and the related report (RBNZ #6268) with officials.

Yes / No

9(2)(a)

Hon Nicola Willis
Minister of Finance

Angus McGregor
**Acting Assistant Governor / General
Manager Financial Stability,
Reserve Bank of New Zealand**

17 April 2025

Appendix 1: Terms of Reference

Purpose

The purpose of the review of key capital settings is to assess whether the Reserve Bank's prudential capital requirements for deposit takers are set at the 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.

Approach

The review will be informed by relevant findings of the Commerce Commission's market study into personal banking services and the Finance and Expenditure Committee's inquiry into banking competition.

We will consult publicly on key proposals. Responses to this consultation process, alongside a cost and benefit analysis and the use of independent international experts, will inform decisions made by the Reserve Bank Board.

As we consider feedback and options under this review, we will operate consistently with our legislative requirements (e.g. the purposes and principles of the Deposit Takers Act 2023), including having regard to the Financial Policy Remit and the Proportionality Framework.

Scope

This is an evidence-based review that will build on existing work to review options for more granular risk weights for residential mortgages, corporate lending and lending for housing for community housing providers, housing co-operatives and on whenua Māori. We will also consider risk weights for rural lending.

To achieve the purpose within the stated timeframe, the review will be limited to:

- An assessment of key developments since the 2019 Capital Review, including findings of the Commerce Commission's market study into personal banking services, the Finance and Expenditure Committee's inquiry into banking competition and developments in regulatory and supervisory settings.
- An assessment of how our capital settings compare internationally and a consideration of whether our capital settings are appropriate, given the risks that the New Zealand financial system faces. This will be supported by a report by an independent expert.
- A reassessment of the appropriate risk appetite for capital settings in New Zealand, based on our statutory parameters.
- Reviewing the degree of proportionality in the framework and considering any changes in capital ratios for different groups of deposit takers.

- Considering the balance between going concern and gone concern capital (including the share of Common Equity Tier 1 capital), the appropriateness of any Total Loss Absorbing Capacity requirements, and if we should continue to have 'Additional Tier 1 capital' as part of the New Zealand capital framework. It will also consider the interrelationship between capital and the crisis management framework.
- Utilising international experts to undertake research that will inform the options, review the Reserve Bank's options and recommendations, and support the Reserve Bank's decision makers in reaching decisions.

Role of international experts and the Treasury

At least two independent international experts will be involved in the review. In particular, international experts will be asked to:

- Produce an independent report on where New Zealand's current requirements sit relative to comparable jurisdictions' capital requirements and report on where they think New Zealand's capital requirements should sit relative to other countries, based on our risk profile.
- Review the Reserve Bank's analysis, options and recommendations and support the Financial Stability Oversight Committee in reaching decisions. This will help ensure that the Financial Stability Oversight Committee can best support the Reserve Bank Board's decision making on this review.

The Treasury will also play a role in challenging the Reserve Bank's analysis.

Timing

To prioritise certainty for deposit takers, the scope of the review is targeted to ensure that key concerns that stakeholders have raised are considered and can be addressed, while avoiding any unnecessary delays to the timeline to implement the Deposit Takers Act 2023. The Reserve Bank intends to run a short consultation on key proposals and recommend final decisions to the Reserve Bank Board by the end the of year.

Following the conclusion of the review, we intend to prioritise the implementation of any changes that may be agreed so that they come into force ahead of the Deposit Takers Act coming into force.