Reserve Bank Capital Review

Media Briefing

22 February 2019

RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

Housekeeping

- Briefing material embargoed until 4pm today – at media's request.
- Draft speech provided under embargo. Final text released at 12.30pm on Tuesday 26th.
- Time for questions at the end.
- Media and Reserve Bank people on videoconference from Auckland.

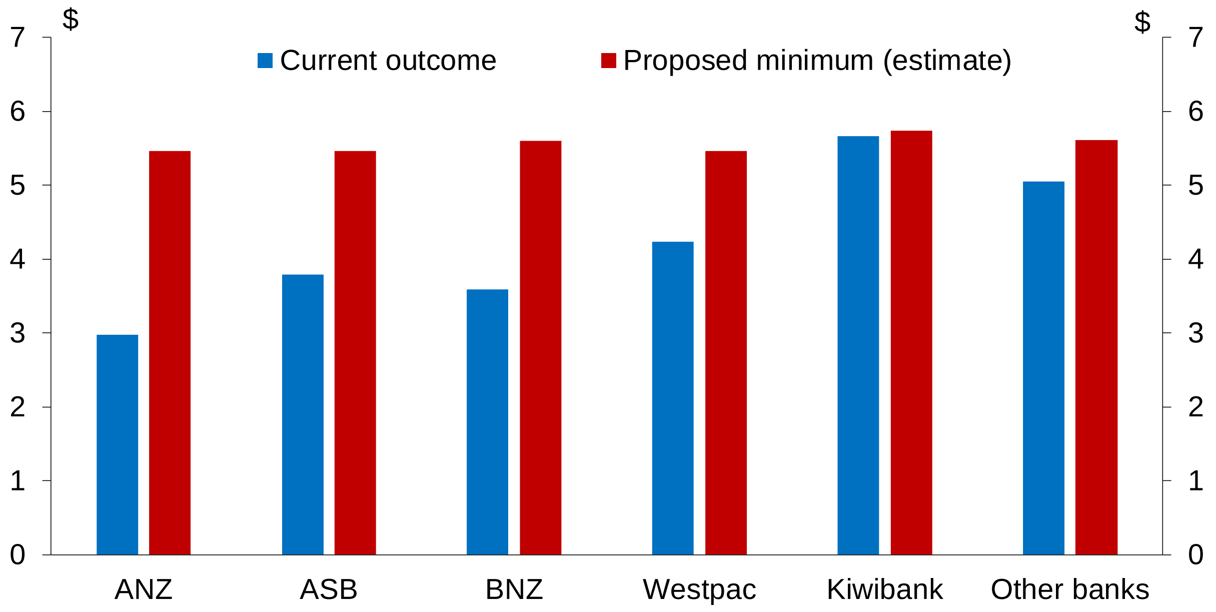
Opening remarks: Geoff Bascand

What we’re trying to achieve

- Stronger banks and stronger banking system - better able to survive large shocks.
- Protect New Zealand from the significant harm that accompanies a banking crisis.
- Protect depositors and potentially taxpayers from failing banks.
- Maintain investor confidence in New Zealand’s banking system.

A more level playing field

- Current Tier 1 capital per $100 of mortgage lending, Tier 1 capital at proposed minimum ratios (estimate using publicly available data)



Why we care

- The Reserve Bank's job is to promote a sound and efficient financial system.
- If a bank fails, then all of society suffers – not just the bank's customers.
- Our tolerance of bank crises has reduced given evidence of enduring, wide-ranging crisis impacts.
- We want banks to have enough capital, and the right quality capital, to withstand significant shocks.
- More capital reduces the likelihood of a bank failure.

What will it mean for society?

- Banks will be safer – the costs and risks of a bank failure are reduced.
- Interest rates (borrowing and lending) could change – but we don't expect by much. Lending margins above borrowing cost may expand by 20-40 basis points.
- Banks make profits from lending. The competitive market will continue and if one bank pulls back in a particular segment of lending, we expect another will step up.
- 20 banks operate in NZ, with 16 in the retail market.

What does it mean for banks?

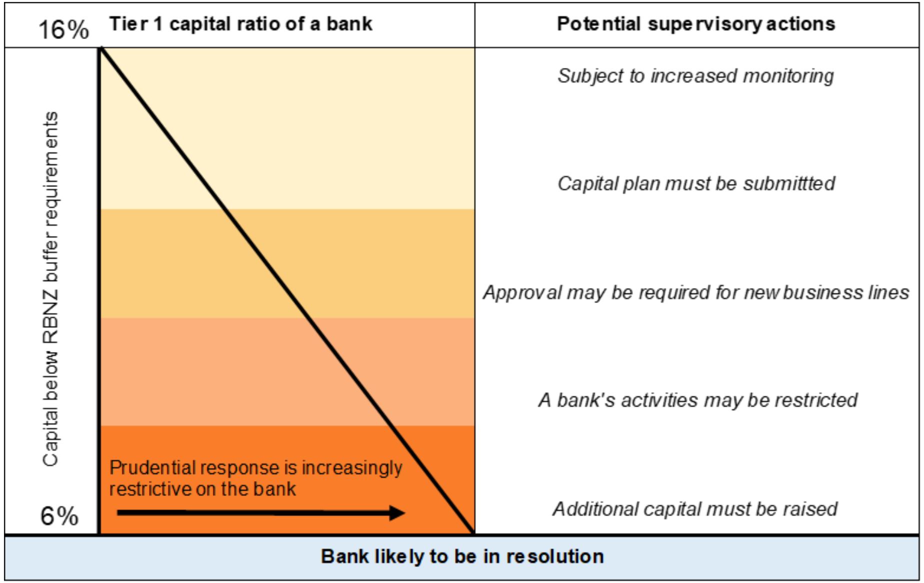
- More and better-quality capital. So that means banks will be safer – so will likely get cheaper credit.

- The big four banks would have five years to increase their capital ratio from the current 12% to 16%. We expect a combined increase in capital of around $20bn for the big four.

- Other banks have to increase their capital ratio from the current average of 14% to 15%. We expect a combined increase of around $0.9bn in capital for these banks.

Clarity on regulator-regulated relationship

- More efficient model approval process.
- Escalated Supervisory Response (ESR) – greater clarity about supervisory actions with a graduated buffer approach.



What will banks do?

- Banks will keep making their own decisions about how they manage their balance sheets. They have a number of options to raise the capital they need.
- They could retain more profits over several years (rather than paying out dividends to their owners) or they could raise more capital from shareholders.
- We estimate the big four banks could get there by retaining 70% of their net earnings over 5 years.
- The small bank sector might take a bit longer, around 7 years.

International comparison – Basel Committee

Fully phased-in CET1, Tier 1 and total capital ratios under the final Basel III standards

In per cent

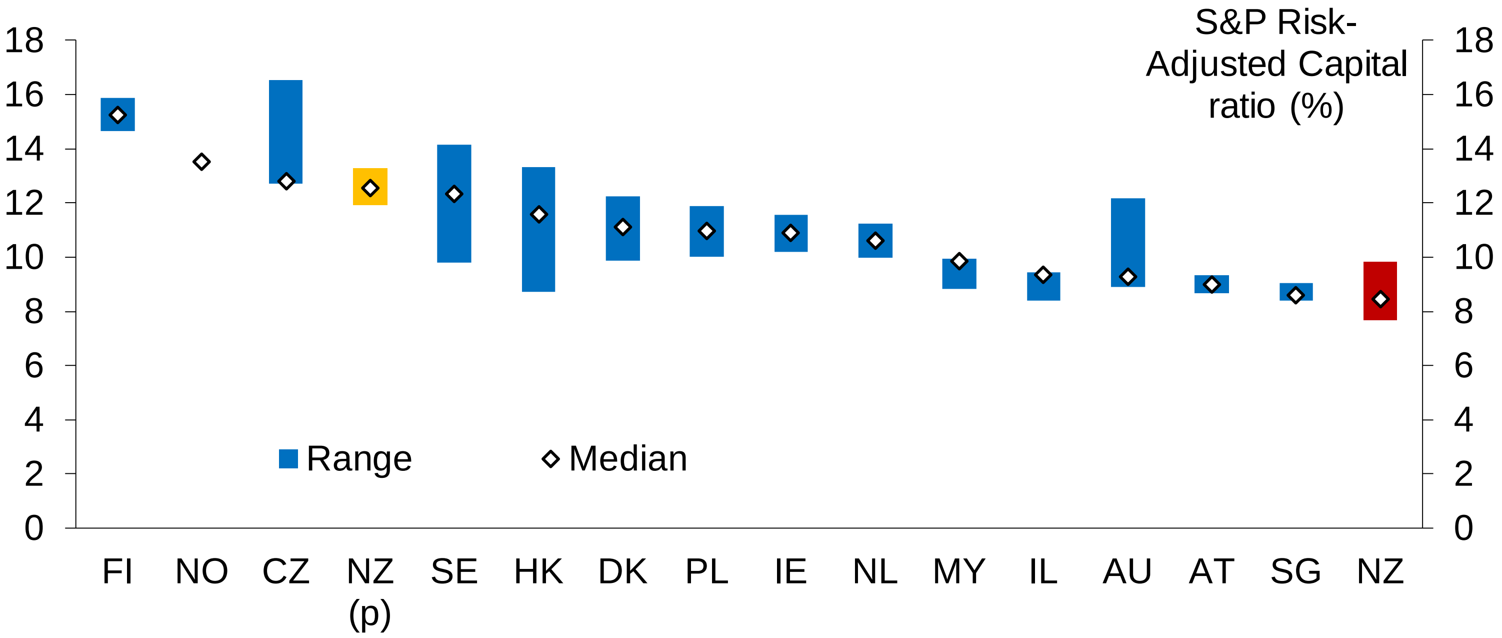
Table C.10

	Group 1 banks			Of which: G-SIBs			Group 2 banks		
	CET1	Tier 1	Total	CET1	Tier 1	Total	CET1	Tier 1	Total
Max	54.0	56.8	58.3	15.6	18.6	20.1	70.9	70.9	70.9
95th percentile	21.8	22.4	24.0	15.4	17.8	19.9	27.1	30.1	33.1
75th percentile	13.9	15.1	17.2	13.4	15.6	17.8	15.9	16.5	19.7
Median	12.3	13.4	15.1	12.0	13.6	15.5	13.4	13.6	15.4
25th percentile	10.8	11.7	13.3	10.2	11.4	12.7	11.0	11.1	12.3
5th percentile	8.7	9.8	11.0	8.3	9.6	10.9	9.4	9.4	11.0
Min	7.1	7.2	10.0	8.1	8.9	10.6	3.9	4.0	4.0
Weighted average	12.2	13.3	15.2	12.0	13.3	15.1	12.6	13.1	15.1

Source: Basel Committee on Banking Supervision.

- Limitations: NZ application of Basel framework on average is more conservative than other jurisdictions. Peer group includes banks with less comparable business models to NZ banks.

International comparisons – S&P



- Limitation: Standard and Poor's Risk-Adjusted Capital methodology relies on S&P's economic risk assumptions

(Peer group: 4 largest NZ banks, large retail and commercial banks in each country; NZ (p) = pro forma)

Proposed transition

Quarter / year	Proposal
Q3 2019	• Confirm final Capital Ratio decisions • New AT1 instruments need to meet revised standards
Q4 2019	• Start of transition to higher ratios • Implement changes to IRB framework (floor / scalar)
2020	• Dual reporting • Revised Standardised Measurement Approach (Op Risk) • Leverage ratio requirements • Transition to higher capital ratios
2021	• Transition to higher capital ratios
2022	
2023	
2024	

Timeline – near term

- Speech from Deputy Governor Geoff Bascand (26 Feb).
- Another industry forum penciled in, Auckland (March).
- Analytical note on Risk Appetite Framework (March).
- Open to further discussions with industry during the consultation period, including bilateral meetings if desired.
- Consultation closes (3 May).
- Reserve Bank publishes submissions (June).
- Release of final decisions, accompanied by Regulatory Impact Statement (Q3).

Further work

- Consultation on further elements of the framework:
  - Near term:
    - Identification framework for systemically important banks (March).
    - Internal model change process (workshop with affected banks).
  - Later in 2019 and beyond:
    - Mutual capital instrument.
    - Leverage ratio design (if decision made to proceed).
    - Escalating Supervisory Response framework and trigger points.
    - Strategy for setting the countercyclical capital buffer.
    - Operational risk framework (pending APRA finalisation).
    - Tier 2 (subject to current consultation).
- Dovetail with changes to Banking Supervision Handbook as Capital Review decisions are implemented.

Questions ?