Reserve Bank of New Zealand
Te Pūtea Matua

Market risk workshop

Deposit Takers Capital Standard

8 November 2024

Executive summary

- We consulted on updating our approach to capital requirements for market risk as part of the Deposit Takers Core Standards consultation.
- The market risk section of the Consultation Paper was drafted at a higher level than the rest of the consultation.
- Feedback was generally supportive of modernising the capital requirements for market risk but raised numerous issues and questions.
- We have updated our proposals in response to the feedback and internal work done since the consultation opened.
- Our updated proposals relate to Group 1 and Group 2 deposit takers.

Credit risk Approx. 85% of the capital charge	Operational Risk ≈ 10%	Market ≈ 5%

Interest rate risk in the banking book (IRRBB)	Market risk in the trading book

Consulted proposal

- Maintain NZ Pillar 1 capital requirements for market risk
- Combined framework for the banking and trading book based on Basel's Simplified Standardised Approach (MAR40), with elements of the current BPR140 included for parts of the banking book.

Updated proposal

• Pillar 1 banking book requirements based on the current BPR140 requirements for interest rate risk • This will mainly draw from section B of BPR140	Pillar 1 trading book requirements based on MAR40

Workshop agenda

- Background
- Feedback received
- Updated market risk thinking
- Impacts of the potential updated proposal
- How to divide the banking and trading books
- Other issues to work through
- Standardised credit risk weights information request

How we will run this workshop

- After each topic, we will open for questions and discussion. Please feel free to raise questions as we go.
- We won’t necessarily provide definitive answers today, but this discussion will help feed into our final advice to decision makers.
- No final decisions have been made. We want to use this workshop to outline of our initial thinking about possible responses to the feedback we received.
- We are looking for industry feedback on our emerging thinking to help identify problems and areas that may need further work.

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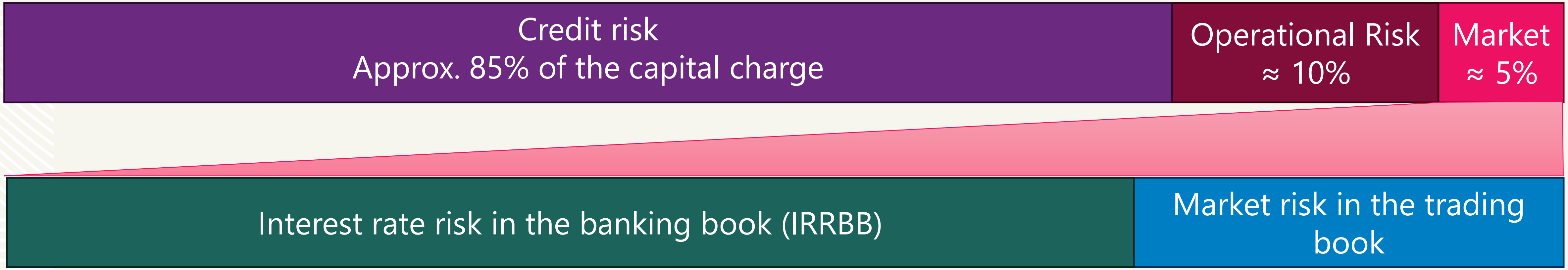
Background

The DTA Core Standards consultation

- We consulted on the Deposit Takers Core Standards from 16 May to 16 August.
- This included consultation on the Capital, Liquidity, Disclosure and DCS standards.
- The Capital Standard covered the minimum capital requirements for deposit takers in New Zealand across credit, operational and market risk.
- We are currently consulting on the non-core standards which closes on 22 November 2024.

Market risk is…



Market risk section of Consultation Paper

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Approx. 85% of the capital charge

Operational Risk
≈ 10%

Market
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Interest rate risk in the banking book (IRRBB)

Market risk in the trading book

Consulted proposal

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Questions

- Are there any questions about the background of this work?
- Are there any questions about the consulted proposal for market risk?

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Overview of feedback

Feedback received

This section is focused on the key feedback we received for market risk.

It does not cover all feedback or our responses to this. This will be covered in the DTA Core Consultation response document which will be released in 2025.

General feedback

Respondents were in general agreement that:

- now is the right time to review our market risk settings
- we should maintain a Pillar 1 approach for both the banking and trading books.

Feedback topic: early engagement

- As the market risk section of the Capital Standard consultation was drafted at a higher level than other sections, respondents also wanted to be engaged in the process before the exposure draft came out.
- This workshop is a chance for us to layout our emerging thinking on this and to seek feedback on the high-level design.

Feedback topic: MAR40

While the feedback was generally supportive of the move to the BCBS Simplified Standardised Approach (**MAR40**), respondents raised quite a few questions or concerns about the specifics of how this would work with the banking book, including:

- Rate Insensitive Products
- Inclusion of specific interest rate risk
- The measurement basis of MAR40
- FX risk calculations
- The scaling factors in MAR40

Feedback topic: deposit takers without trading books

Deposit takers without trading books added specific feedback around the consulted proposal being a lot of work for limited benefit - especially at a time when there is a lot of other regulatory changes being made for the DTA.

They asked that we consider allowing banks without trading books to move away from calculating IRRBB daily as the number doesn’t change much compared to the trading book which can vary significantly day-to-day.

Questions

- Are there any concerns from submissions that we haven’t correctly noted or potentially misunderstood?

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Updated market risk thinking

Process for the updated proposal

- We have updated our thinking in response to feedback received to the DTA Capital Standard consultation.
- The proposal in this presentation is our initial thinking and has not been finalised, but we are looking for industry feedback on the updated proposal to help identify problems and areas that need further work.
- If required, we will hold further discussions next year on specific areas.

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Interest rate risk in the banking book (IRRBB)

Market risk in the trading book

Consulted proposal

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Updated proposal

- Pillar 1 banking book requirements based on the current BPR140 requirements for interest rate risk
- This will mainly draw from section B of BPR140

Pillar 1 trading book requirements based on MAR40

Updated banking book requirements

We propose the banking book requirements would remain based on the current BPR140 requirements.

However, this would be cut-down to only require for Interest Rate Risk in the Banking Book. This would include

- *Part A: Capital requirements for market risk,* cut down to remove the sections on currency and equity risks; and,
- *Part B: Capital requirement for interest rate risk*, which would remain but be narrowed down to only cover interest rate risk in the banking book.

The other sections of BPR140 would no longer be required.

Updated trading book requirements

We propose the trading book requirements would be based on the BCBS's Simplified Standardised Approach laid out in MAR40.

As this would no longer need to be updated to include the banking book, we would look to more directly adopt the MAR40 requirements into the Capital Standard.

This would help avoid many of the issues raised in the consultation about how the banking book would be incorporated into MAR40.

Potential impacts of the change

Advantages	Should be simpler to implement, especially for deposit takers that do not have trading books
	Potentially less compliance work
	The impact on capital should be minimal – this is not intended to change capital requirements
	Helps future proof the market risk requirements
Disadvantages	Could be more initial compliance work for deposit takers with trading books
	Need to split the banking and trading book, but also needed for operational risk

Questions

- Would this proposal be more workable than the consulted proposal?
- Does this address the main concerns in the submissions about how MAR40 would work with the banking book?
- What other issues would this raise that we would need to address?
- Are there other advantages or disadvantages we need to be aware of?

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How to divide the banking and trading books

Examples of the banking and trading book

Banking book products	Retail and SME credit (e.g. loans, mortgage, revolving credit facilities).
	Instruments for securitisation warehousing
	Real estate holdings
	Unlisted equities
	Instruments held to hedge a risk arising from any of the above instruments.
Trading book products	Instruments held as accounting trading assets or liabilities
	Instruments resulting from market-making activities
	Listed equities
	Trading-related repo-style transactions
	Options that relate to credit or equity risk.

How should the banking and trading book be divided?

We propose that the split between the banking and trading book would be based on the requirements in BCBS's *RBC25 – Boundary between the banking book and the trading book.*

The boundary definition mainly defines the Trading Book. Anything that is not included in the Trading Book definition is included in the Banking Book.

The split between the banking and trading book would also be used for the Operational Risk section of the Capital Standard.

Dividing the banking and trading book

The RBC25 definition of market risk in the trading book is "the risk of losses arising from movements in market prices".

The capital requirements for these risks would be based on MAR40 requirements, and the risks covered by the trading book include but are not limited to:

Trading Book	Default risk
	Interest rate risk
	Credit risk
	Equity risk
	Foreign exchange risk
	Commodity risk (for trading book instruments)
Potential banking book risks to include in the trading book calculation	Foreign exchange risk in the banking book
	Commodity risk (for banking book instruments)

Moving items between the two

RBC25 contains strict rules around moving assets or liabilities between the Banking and Trading Books. We are considering if these rules are appropriate in New Zealand or if we could operate a more ‘purpose-based’ approach.

This would provide deposit takers in New Zealand more discretion to move items between the two if required.

As we have capital requirements for both books and given the potential profit recognition and tax implications of moving assets or liabilities, we would expect it to be relatively rare for items to be moved.

Comparing the options

	Prescriptive option	Purpose-based option
Advantages	Provides clear and consistent rules on where each asset or liability goes.	Deposit takers know the purpose they acquire assets and liabilities for, and this approach allows these items to be quickly put in the correct place.
	Will likely have more consistency between deposit takers.	More adaptable for new instruments or markets.
Disadvantages	Could still end up with fringe cases that don't fit within the rules.	More subject to gaming – however, there can also be profit-recognition and tax implications of moving items between the banking and trading book.
	Greater risk of becoming out of date over time	

Questions

- Do you have a preference between the prescriptive and purpose-based approaches and why?
- Would the prescriptive or purpose-based approach be easier to implement and work with?
- Do you have a preference for if foreign exchange risk and commodity risk for banking book instruments is included in the trading book? If you have a preference, why?
- What percentage of fringe cases would you have? (*This can be provided to the Reserve Bank confidentially*)

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Other issues to work through

Other issues to work through

We would welcome feedback on other specific issues raised by the updated proposal that we need to work through. If you have any specific issues that you think we should consider then please send these to us by **10 December 2024**.

We are currently considering:

- Specific risk in the interest rate section of MAR40 and how this relates to the current credit risk requirements for interest rate risk.
- Frequency of IRRBB calculations.
- Inclusion and settings of scaling factors in MAR40.
- If currency risk for IRRBB should remain in the banking book calc (as it currently is in BPR140) or if this should move to the trading book calc.

Translating BPR140

We are also reviewing which parts of BPR140 would be translated into standards under this proposal and how to ensure that this doesn't count any trading book assets or liabilities to avoid double counting.

Question

- Are there specific areas you are concerned about being double counted under our updated proposal?

Specific risk charge

MAR40 adds a specific risk charge to interest rate securities to protect against adverse movement in the price of an individual security based on the credit-rating of the security.

This risk is currently part of the credit-risk framework for both the banking and trading book.

Key differences in the approach	Potentially a more accurate reflection of the risks represented by these instruments.
	Likely lead to holding less capital against the trading instruments.

Currency risk for IRRBB

BPR140 includes currency risk for interest rate instruments in the interest rate calculation by calculating this by currency.

We are considering if we keep it this way or if all currency risk is calculated as part of the trading book which would be better aligned with international practice and would be easier for deposit takers without trading books.

We welcome feedback on these two options.

Frequency of IRRBB calculations

We currently require daily calculation for the capital requirements for market risk. If we split the banking and trading books, we are considering if the IRRBB calculation needs to be run daily.

IRRBB is more stable than trading risk so there is less benefit in running it daily.

Running the calculation less frequently would better align with international practice; for example, APRA IRRBB requirement is "at least quarterly".

Scaling factors in MAR40

Submissions were concerned about the scaling factors in MAR40 and how they would influence lending and investment decisions. Splitting the banking and trading books should address some of this concern as the banking book will not be subject to the scaling factors.

BCBS set these scaling factors to address differences in risk that emerged during stress events like the GFC. As New Zealand deposit takers operate in a global trading environment we do not see a reason to alter these for the trading book.

Questions for deposit takers

- Does the splitting of the banking and trading book address the concerns in this area?
- If not, what are the key concerns about the scaling factors for the trading book?

Questions

- Do you have comments on any of these areas or our initial thoughts on them?
- Are there other specific issues with the potential approach that need to be addressed before the exposure draft?

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Standardised credit risk weights information request

Information request

- We have requested information about three different categories:
    - Corporate exposures
    - Residential mortgage lending exposures
    - Exposures to Community Housing Providers
- Any responses will help us to assess the impacts of suggested changes to the standardised credit risk weights framework.
- Responses are due by **10 December 2024**.
- Do you have any questions about the information request?

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Final remarks

Thank you for attending