



8 April 2025

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Official information request

Our ref: R00872

Tēnā koe s 9(2)(a)

Thank you for your Official Information Act 1982 (OIA) request received on 17 March 2025.
You requested:

I request under the OIA all advice send to the Minister of Regulation on the subject of the Reserve Bank's capital rules.

Information released

One document is in scope of your request: MFR2025-008 – *Regulation of Capital Adequacy Requirements for Banks*. I have decided to release this document to you, which is enclosed as **Appendix A**. Some information has been withheld under section 9(2)(f)(iv) of the OIA, to maintain the constitutional conventions for the time being which protect the confidentiality of advice tendered by Ministers of the Crown and officials.

Right of review

If you wish to discuss this decision with us, please contact hello@regulation.govt.nz.

You have the right to seek an investigation and review by the Ombudsman of this decision. Information about how to make a complaint is available at www.ombudsman.parliament.nz or freephone 0800 802 602.

Please note that we may publish this response (with your details removed) on the Ministry for Regulation website.

Ngā mihi

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Aisling Risdon

Head of Ministerial Services

Ministry for Regulation



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|--------------------------------|--|------------------------|----------------------|
| Minister and Portfolio: | Hon David Seymour, Minister for Regulation | | |
| Title: | Regulation of Capital Adequacy Requirements for Banks | Number | MFR 2025-008 |
| Date: | 5 February 2025 | Security Level: | IN CONFIDENCE |

Purpose To provide you with background information on capital adequacy requirements as they apply in New Zealand and overseas.

Minister Hon David Seymour, Minister for Regulation

Capital requirements decrease the risk of systemic failure, but at the margin increase the price of capital and create barriers to enter, and expand within, the retail banking market

Capital adequacy requirements aim to prevent unusually large bank losses (e.g. from loans) causing banks to fail. To minimise the chances of large financial shocks leading to individual bank closures (and follow-on financial system failure), the Reserve Bank of New Zealand (RBNZ) operates a suite of ‘prudential’ policies, including capital adequacy requirements for banks (“**capital requirements**”). Capital requirements set a minimum proportion of a bank’s funding that must be able to absorb losses, and (generally) come from its owners.

The benefits of capital requirements are that they reduce the probability of banks becoming insolvent (and potential cascading failures) and protect depositors (and public funds) by ensuring shareholders can bear almost all bank losses.

The downside in imposing capital requirements is that they increase the cost of lending and can consequently limit potential economic growth. Because shareholders know they are first in the line to absorb losses, they require a return in line with other investments of similar risk which is usually higher than other sources of bank funding, such as debt funding.

The process for setting capital requirements is set out in legislation, reflecting international best-practice. These legislative settings are outlined in **Appendix 1**.

The principles guiding capital requirements are generally agreed, but recent public discussion has queried the governance arrangements

The benefits and risks outlined above are well-established and widely agreed, and determining whether capital requirements are set at the right level requires careful judgement. For example, capital requirements were boosted worldwide in the Basel framework after they were shown to be too low in the Global Financial Crisis. In New Zealand, the calibration has been informed by a peer-reviewed modelling exercise by the RBNZ with detailed methods and assumptions available for public scrutiny.

Estimation of an appropriate risk appetite is also essential in the judgement of capital requirements. This depends on factors that are difficult to define – for example, the best estimate of the price of financial system failure (which is not known completely until it happens) and what the public considers to be a reasonable trade-off between financial stability and short-term economic efficiency.

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Additionally, those setting prudential policy (including capital requirements) should also:

- take a broad perspective of financial system risk and efficiency trade-offs
- consider the whole suite of prudential tools
- work in concert with, but somewhat independently from, other financial system regulators (e.g. the Financial Markets Authority as conduct regulator)
- keep up to date with global trends in thinking about financial stability, and competently commission and respond to expert advice, and
- be kept accountable for their performance.

Advanced economies have various arrangements for governance of prudential regulation, with some countries opting for boards of financial risk experts (some independent from central banks and others housed within) and others including prudential regulation among the governance of the wider set of central banks' functions (like the RBNZ).

Performance of the regulator can be hard to quantify, particularly as widespread financial failure is both expected to be very rare and prevention is difficult to attribute to prudential policy settings. The decisions are technical (posing challenges to accountability by the general population), but further expert review of decisions could be undertaken using information such as the decisions made, the advice received and meeting minutes. The Treasury has a monitoring function for the Reserve Bank's performance and performs a second opinion function in relation to financial stability. The International Monetary Fund also regularly assesses the performance of the New Zealand financial sector and compares the prudential regime with international best practice.

New Zealand's total minimum requirements have not resulted in capital levels being out of step with overseas counterparts

Compared to New Zealand, many prudential regulators make more use of additional firm-specific requirements that reflect each bank's specific situation and internal operations. The United Kingdom, Republic of Ireland, France, and Japan for example each require total capital ratios of at least 10.5% (in line with Basel II conventions), but add additional requirements following risk assessments for individual banks. The additional requirements imposed cannot easily be compared across jurisdictions, but as a whole New Zealand minimum requirements for large banks (required from 2028) are not especially high compared to the actual total capital ratios kept by major banks worldwide (see **Table 1**).

Table 1 – Capital ratios (capital as a proportion of risk adjusted assets) in advanced economies

| Jurisdiction / Large bank | NZ minimum | ANZ (whole Group) | UK average | Allied Irish Banks | BNP Paribas [France] | Mitsubishi UFJ [Japan] |
|---------------------------|------------|-------------------|------------|--------------------|----------------------|------------------------|
| Period | 2028 | Sep-24 | Q3 2024 | Jun-24 | Dec 2023 | Mar-24 |
| CET1 | 13.5% | 12.6% | 16.0% | 15.5% | 13.2% | 13.8% |
| Tier 1 | 16.0% | 15.1% | 18.4% | 17.5% | 15.3% | 15.5% |
| Total | 18.0% | 17.2% | 21.4% | 20.4% | 17.3% | 17.8% |

CET 1, or “Common Equity Tier 1” capital, consists primarily of common shares, retained earnings, and other equity components. “Tier 1” capital includes all assets within the CET1 definition plus perpetual preferred stock that may have restrictions on how quickly they can be used to absorb losses.



Recent work reveals differences of view about appropriate capital settings

RBNZ review into capital requirements – 2017-2019

In 2019, the RBNZ made decisions based on the findings of its review of capital requirements arrangements. The review began in March 2017 and consisted of gathering evidence, modelling scenarios and public consultation. Much of the review was informed by the IMF's Financial Section Assessment Programme review New Zealand's financial sector regulatory framework in 2016.

The RBNZ's final decisions included a detailed, externally reviewed, Cost Benefit Assessment. This concluded that the benefits to New Zealand of lower risk of financial crises exceeded the cost, quantified as approximately 0.4% of GDP. The largest cost was lost economic output associated with average lending rate increases of around 205 percentage points (a small portion of the sum of factors affecting lending rates including profit margins and operational costs). The RBNZ increased capital adequacy rates in line with international conventions aiming to prepare for a one-in-200-year frequency financial shock. It also made technical changes to the capital adequacy rules in an attempt to equalise the impact of different methods of calculating risk.

The risk calculation changes responded to widespread criticism that the more sophisticated of the two accepted methods for calculating the risk of banks' asset portfolios (the 'internal ratings-based approach' or IRB) gave banks material advantages, but because it is resource intensive, was only available to larger banks. Put simply, for the same group of assets with a particular risk rating assigned through the less granular 'standardised' approach, the IRB allows banks to hold less capital for less risky assets, resulting in an overall lower risk rating. Prior to the Capital Review, this would lead to outcomes for IRB bank that were around 70-75% of the standardised approach. With the capital review changes, IRB banks outcomes are around 90% of what would be calculated under the Standardised approach. Practically, this results in smaller banks needing a larger amount of capital compared to larger banks, for an asset portfolio of the same risk. However, following the capital review, the largest banks also have high capital ratio requirements (a 2% 'domestic systemically important bank', or D-SIB buffer) - which has all but removed any advantage of the IRB approach over the standardised approach.

Commerce Commission's market study into personal banking services – 2023

The Commerce Commission's market study into personal banking services ran from 10 August 2023 and concluded with the publication of a final report on 20 August 2024. This study covered competition in banking from many perspectives, and a section of the report focussed on regulation and capital requirements specifically. The RBNZ notes that it carefully considers competition and has a level of tolerance for failure of financial entities. It also emphasises that creating the conditions where banks are financially stable is essential for competition, as the banks can survive to compete after severe financial shocks (as opposed to large-scale consolidation). The Commission's view is that the banking industry already had high fixed regulatory costs that are proportionately higher for small banks, and that the RBNZ sets capital requirements in a way that hinders the competition and likely innovation from small banks and new entrants to the market. Recommendations from the Commission's final report recommended:

- making the standardised approach to risk calculation more granular to address the advantage large banks still have over small banks in terms of capital held (despite improvements following the 2019 decisions),
- that the RBNZ undertake a more thorough analysis of the impacts on competition and its benefits (over and above the current DTA requirements).

The Government agreed to all 14 recommendations from the Commission's final report. A new Financial Policy Remit to the Reserve Bank and letter of expectations from the Minister of Finance were issued in



December 2024. The [letter](#) and remit emphasised the importance of competition in the Bank's decision making in regard to prudential policy and outlined the Government's expectation of which upcoming RBNZ decisions should emphasise competition as key consideration. The RBNZ has announced it will explore opportunities for more granularity in some of the key standardised risk weights.

Finance and Expenditure Select Committee inquiry into banking competition – 2024

The Finance and Expenditure Select Committee (FEC) inquiry into banking competition received approximately 120 written submissions between 14 August and 25 September 2024. The Ministry understands the inquiry is still underway and a summary of findings is not yet available.

Summary of stakeholder views

Issues that have come up through the capital review and market study have been broad and wide ranging

From the Ministry's brief investigation into the views of key stakeholders, three issues came up most frequently which we detail below. We also summarise several stakeholder views brought to our attention by your office in **Appendix 2**.

- Many stakeholders query whether current capital requirements strike the right balance between preparing banks for tough times and efficiently allocating of capital in good times - some commentators suggested dropping small institutions' requirements further to better recognise their relatively small risk to the stability of the financial system.
- Many query whether preparing for a 1-in-200 year event is representative of New Zealand's real risk appetite.
- Lastly, many query whether the RBNZ is sufficiently qualified and accountable for prudential regulatory decision-making e.g. compared to groups of financial risk experts such as the Australian Prudential Regulation Authority.

There has also been some support for the view that the Minister of Finance should take the responsibility for key policymaking decisions (as distinct from implementation on individual instruments and institutions). Commentators mentioned that Ministers have accountability through Parliamentary scrutiny and general elections, and strong incentives to balance the competing imperatives around regulatory structure.

That is not to say that views were unanimously against raising capital requirements in 2019. Many stakeholders (both experts and laypeople) were supportive of the 2019 decision to increase capital requirements. Some regarded past lower capital ratios (employed to boost competition) as a key enabler of the Global Financial Crisis (GFC). This is often mentioned alongside lenders gaming principles-based regulation leading up to the GFC, emphasising the importance of active and effective regulatory supervision, and warning the RBNZ to not use increased capital requirements as a reason to relax its scrutiny of the financial system.

Other common views are outlined below:

Some submitters, including from smaller financial institutions, note that the standardised method of risk calculation still leaves small banks holding more capital, even after the 2019 adjustments.

There was recognition of long periods of financial stability in New Zealand and Australia, and the strong policy settings, macroeconomic settings, and well-capitalised banks that contribute to financial stability, suggesting that the risks posed by the capital requirements were not material. It should be noted however that past risk is not indicative of the future, and that these views probably understate the major banking distresses New Zealand and Australia experienced in the late 1980s (although these failures may not be considered systemic in hindsight).



Lastly, there were technical critiques of the analysis provided by the RBNZ. For example, bank failure was presented as the cause of output losses in financial crises, while other credible drivers of losses (not requiring bank failure) were not modelled even though they are likely to have a significant impact (e.g. poor allocation of capital though poor lending standards).

The RBNZ acknowledges the uncertainty associated with the costs associated with bank failure, and responds to these issues and many other of the comments it received during the 2019 review in their "[response to submissions](#)" document.

Potential next steps

The use of discretion under existing settings can be discussed with the Minister of Finance in your capacity as the Minister for Regulation, and your views could be made clear through a letter to her. s 9(2)(f)(iv)

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Questions that could be considered to determine the appropriateness of regulation for capital requirements might include:

- Did the RBNZ present a convincing analysis of the potential costs of bank failure, and the benefits of setting capital requirements at their current levels?
- Is the risk appetite adopted by RBNZ for capital requirement modelling representative of that of the New Zealand public?
- Are those involved in the governance for setting, implementing, and administering prudential standards for the financial system suitably qualified, and appropriately enabled to act in the interest of New Zealanders?

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Appendix 1 – The legislative environment for setting capital adequacy requirements

The process for setting capital requirements is set out in legislation, reflecting international best-practice

Since the Reserve Bank of New Zealand Act 2021, the RBNZ Board determines banks' and non-bank deposit takers' minimum capital requirements. The instruments setting prudential requirements for banks and other deposit takers will be given effect through the Deposit Takers Act 2023 (DTA) and standards issued under the DTA. The main purpose of the DTA is "to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by promoting the stability of the financial system" and the RBNZ must have regard to twelve principles, including maintaining competition in the sector, avoiding unnecessary compliance costs and ensuring useful information is provided to market participants. In setting prudential standards, the RBNZ is also required to apply a proportionality framework that ensure that any standards appropriately balance the costs and benefits of regulation. The RBNZ consulted on prudential standards in 2024, and it is planned that they will come into force in July 2028.

The Reserve Bank Act 2021's Financial Policy Remit also allows the Minister of Finance to set out expectations regarding the RBNZ's financial risk management (with which the RBNZ board must act consistently, alongside its legislated objectives, functions, and its Statement of Intent). The last remit was issued alongside the Minister of Finance's letter of expectations to the RBNZ, articulating the government's expectations in light of the Commerce Commission's Market Study into personal banking. Note that the RBNZ must have regard to the Remit, however this essentially is still subordinate to the DTA's legislated main objective of financial system stability.

Legislative change through the DTA has a long pipeline

We sought an overview of the process for determining DTA settings from the RBNZ, which we provide below.

While the primary legislation sets out the overriding framework for prudential regulation of deposit takers, regulatory capital is set under a 'prudential standards' making process. The RBNZ advises that it is conscious of the uncertainty that could come about from its prudential decisions, and that efficiency losses can come about from implementing change. It says that this is why prudential standards are consulted on extensively, and why RBNZ spent 18 months developing the framework for applying prudential standards proportionally to entities of different sizes and risk profiles, subsequently consulting on prudential standards themselves. Stakeholders have invested significant time and effort over those 18 months in providing feedback on the new prudential standards (including new tiered capital requirements, with smaller entities facing a significantly lower requirement to reflect systemic risk), and these have been generally well received. Some smaller entities have even requested that the new capital standards be brought forward. Accordingly, Reserve Bank anticipates a delay would not be well received by industry and would result in significant wasted time and effort. RBNZ is now moving into policy approvals and drafting standards. The standards will again be consulted on as 'exposure drafts', and RBNZ currently expects them to be finalised in early 2027 – giving industry around a year and a half to be re-licenced under the new regime in 2028.

Changing the primary legislation would have a flow-on effect to the current DTA implementation programme and result in regulatory uncertainty. RBNZ has advised that, if legislative change is proposed to the DTA (and assuming a full legislative process), there would likely be significant regulatory uncertainty for approximately 18 months and a delay to the full implementation of the DTA until approximately 2031.



Appendix 2 – Selected stakeholder views

S&P Global – 2021

S&P Global’s “Global Market Intelligence” division published an article [“World's toughest capital requirements in New Zealand may squeeze credit”](#) citing New Zealand’s minimum capital requirements as “double that of European lenders and significantly higher than in Australia”. The article outlines the impacts of increasing capital ratios, which can increase the cost of capital, and can cause banks to cut riskier exposure such as loans to small business (or could see banks restructuring e.g. by stopping capital intensive services like life insurance).

It also noted the extent to which transition from the previous capital requirements requires greater capitalisation (requiring \$5.4 billion of fundraising at the time). The article canvasses views of individual experts noting that there are ways to manage risk other than capital adequacy requirements, and that these should be considered seriously prior to increasing requirements.

The Ministry’s view is that the article’s claim that New Zealand’s capital levels were “double that of European lenders and significantly higher than in Australia” was misleading, as it did not take into account that the 18% requirement in New Zealand was all inclusive, whereas lower minimum levels in other countries mentioned did not count additional requirements applied at the discretion of the macroprudential regulator. The claimed disparities between New Zealand and Australia are no longer the case, and in practical terms, New Zealand’s level capital requirements are not unusual among large banks in Europe and Asia.

ANZ submission to the Commerce Commission Market study into personal banking - 2024

ANZ acknowledges the need for regulation to balance financial system stability and competition and gave support to exploring a more granular standardised approach to calculating risk, matching actual risks more closely to those calculated. It acknowledged that a country’s risk tolerance was an essential consideration in setting capital levels and was satisfied the RBNZ’s analysis, in particular that it had weighed the pros of financial stability against the cons of creating barriers to entry and expansion in the market.

Kiwibank submission to the Commerce Commission Market study into personal banking - 2024

Kiwibank saw potential to improve competition in the banking sector and supported the idea of a Financial Policy Remit with the Minister of Finance expressing her expectation for the RBNZ to make rules in favour of systemic competition. It hinted at more proportional tailored regulation, noting fundraising challenges for small banks, and that the failure of small banks posed less system risk compared to large ones.

New Zealand Initiative “Why the RBNZ’s “gold-plating” may be costing you” - 2024

The New Zealand Initiative warned against the primacy of a financial stability objective on the grounds that it results in a [gold-plated regulatory regime](#) that does not give appropriate weight to economic efficiency of the banking system. It noted cost estimates of the 2019 capital requirements changes being 0.32% by the RBNZ, and as high as 1% by some commentators. It suggests adding a goal of efficiency, or a requirement to consider “net-benefit”, to the Reserve Bank Act 2021 to balance the objective of financial stability.

The New Zealand Initiative noted that while the modelling provided by the RBNZ was peer reviewed, issues raised by stakeholders about the quality of their analysis were not addressed. It recommended an independent review on the 2019 changes with a focus on net benefits to society.

They also queried the capability of the RBNZ board to make decisions about specific settings, suggesting that prudential regulatory decisions would be better made by an expert group (either an independent entity, or a Committee of the RBNZ, mirroring the Monetary Policy Committee). “Each option would ensure that prudential regulatory strategies and performance are evaluated by a body with an expert understanding of its potential benefits and costs.”



Lastly, they suggested extra government resources devoted to keeping the RBNZ to account, with periodic reviews of the RBNZ's regulatory strategies and performance undertaken by the Ministry for Regulation.

Federated Farmers submission to the Commerce Commission Market study into personal banking - 2024

Federated Farmers' view largely mirrored the New Zealand Initiative's and advocated for capital ratios that protect against 1-in-100 year crises. They also recommended aligning the risk-weighted assets (RWA) for agricultural loans with residential mortgages, as these loans are backed by high-value agricultural land.