Submission

to the

Reserve Bank of New Zealand

on the

Consultation Paper: Further elements of Basel III capital adequacy requirements in New Zealand

13 April 2012

Submission by the New Zealand Bankers' Association to the Reserve Bank of New Zealand on the Consultation Paper: Further elements of Basel III capital adequacy requirements in New Zealand

NEW ZEALAND BANKERS ASSOCIATION
Level 14, Kordia House, 109-125 Willis Street, PO Box 3043, Wellington 6140, New Zealand
TELEPHONE +64 4 802 3358 FACSIMILE +64 4 473 1698 EMAIL nzba@nzba.org.nz WEB www.nzba.org.nz

Executive Summary

The New Zealand Bankers' Association key submission points on the Consultation Paper: Further elements of Basel III capital adequacy requirements in New Zealand, are as follows:

- NZBA supports the RBNZ's general principles of harmonisation and clear economic impact assessment of proposals when approaching Basel III implementation in New Zealand.
- RBNZ should provide further detail on its proposals to enable banks to provide fully informed responses, as part of a comprehensive consultation.
- RBNZ should align the New Zealand implementation of Basel III with the Basel Committee implementation guidelines or with the final APRA timelines, unless the RBNZ can show demonstrable benefits from early adoption.

RBNZ should demonstrate their assessment of the economic impact of proposed implementation of Basel III, to illustrate the costs and benefits of RBNZ proposals on the New Zealand banking industry.

About NZBA

NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a safe and successful banking system that benefits New Zealanders and the New Zealand economy.

The following thirteen registered banks in New Zealand are members of NZBA:

- ANZ National Bank Limited
- ASB Bank Limited
- Bank of New Zealand
- Bank of Tokyo-Mitsubishi, UFJ
- Citibank, N.A.
- The Co-operative Bank Limited
- The Hongkong and Shanghai Banking Corporation Limited
- JPMorgan Chase Bank, N.A.
- Kiwibank Limited
- Rabobank New Zealand Limited
- SBS Bank
- TSB Bank Limited
- Westpac New Zealand Limited

Issues

1. RBNZ Basel III Principles

NZBA recognises the general principles outlined in the Financial Stability Report, May 2011, which will guide the RBNZ's approach to the implementation of Basel III in New Zealand. In particular:[1]

- We will seek to coordinate our Basel III policy and implementation with APRA.
- We will undertake an economic impact assessment of the Basel III proposals and will consult with New Zealand banks prior to finalising our Basel III policy.

NZBA also recognises the principles noted in the RBNZ Consultation Paper: *Implementation of Basel III capital adequacy requirements in New Zealand*, which specifically relate to the core Basel III capital measures. In particular:[2]

- Adoption of the Basel III standards as a starting point, except where the standards are not appropriate for New Zealand circumstances.
- Have regard to international consistency and comparability (especially consistency with Australia)....

NZBA supports these guiding principles of harmonisation and clear cost/benefit analysis and sees them as crucial to the effectiveness of Basel III implementation in New Zealand

In light of the above, NZBA is increasingly concerned that the multiple discussion documents have not contained any published substantive analysis to support policy proposals relative to those by the Basel Committee or APRA. Members have found it difficult to quantify where and why the proposed New Zealand framework differs from international and Australian proposals, and then consider its merits.

To remedy this, we strongly believe that the RBNZ should be completing and contemporaneously publishing) a quantitative and qualitative cost/benefit analysis. This is analogous to the Government's commitment, identified in the *Government Statement on Regulation: Better Regulation, Less Regulation*, to only introducing regulation once fully satisfied that it is "required, reasonable and robust"[3]. The need for adequate problem definition is also supported by the quality assurance criteria in the current Treasury Regulatory Impact Analysis Handbook, which includes asking, "Do the options offer a proportionate, well-targeted response to the problem?"[4].

Producing this analysis will result in a more productive consultation process, as banks and the public will be better able to consider the rationale for the RBNZ's policy proposals and their impact to New Zealand businesses and the New Zealand economy. Striking a balance between prudential objectives and economic impacts should be open to informed debate, so we urge the RBNZ to consider this as we move forward with further consultation.

---

[1] Reserve Bank of New Zealand: *Financial Stability Report*, May 2011, page 38.

[2] Reserve Bank of New Zealand, Consultation Paper: *Implementation of Basel III capital adequacy requirements in New Zealand*, November 2011, paragraph 15.

3 Hon. Bill English and Hon. Rodney Hide, *Government Statement on Regulation: Better Regulation, Less Regulation* (17 August 2009), page 1.

4 The Treasury, *Regulatory Impact Analysis Handbook* (2 November 2009), page 39.

2. Detail

NZBA submits that, along with cost/benefit analysis of the Basel III proposals, further detail is required to allow affected banks to identify all of the potential impacts on their businesses, in order for them to provide fully informed responses.

Despite this being the second round of consultation, there is still insufficient detail to understand the ramifications of the proposals on capital deductions, possible changes to counterparty risk weights and the potential operation of the countercyclical capital buffer.

Further detail should also be released in respect of the eligibility rules that will guide the issuance of conforming tier 2 instruments. This is of particular concern given the accelerated grand-fathering proposals.

3. Aggressive Implementation

Alignment with the Basel III implementation guidelines or with the final APRA timelines should be the default timetable for the industry, unless the RBNZ can demonstrate benefits from early adoption.

While the RBNZ has proposed to delay the implementation of the capital conservation buffer in full by one year to 1 January 2014, that is still two years ahead of the timeline proposed by APRA and considerably further ahead of the Basel III implementation guidelines. NZBA recognises that the RBNZ has indicated that it intends to adopt aspects of Basel III before implementation by the international community. However, NZBA strongly supports the RBNZ guiding principle, “We will seek to coordinate our Basel III policy and implementation with APRA”. NZBA sees no compelling benefits arising from early adoption and indeed, significant costs in doing so.

Firstly, early adoption will mean New Zealand will forego the benefit of global debate around Basel III and fail to benefit from the market adjustments that are anticipated to take place during the international transition period.

Secondly, aggressive implementation timelines will impose significant costs on New Zealand banks, which will result in higher costs of capital for New Zealand. The proposed tier 2 grandfathering timeframes will significantly impact the eligibility of existing capital instruments across the banking industry in New Zealand. In particular, $3 billion to $5 billion of non-core capital (including hybrid, upper tier 2 and parent funded sub-debt instruments) will be derecognised by 1 January 2014. The New Zealand market does not have the capacity to absorb the compliant capital instruments needed to replace this amount within this aggressive time frame. The proposals have not addressed the potential impacts and difficulties of raising significant sums of new capital in the New Zealand market, or offshore, in such a short timeframe.

Over 90% of the New Zealand banking system is provided by subsidiaries of Australian banks, which are currently also involved in a Basel III consultation process with APRA. However, there appears to be no evidence of harmonisation between the two regulators in respect of their approaches, or in terms of minimising costs to the industry. NZBA considers that a more harmonised trans-Tasman approach to the implementation of Basel III should be adopted by the RBNZ.

4. Economic Justification

NZBA submits that, without a positive assessment of the economic impact of RBNZ's proposed implementation of Basel III, the implementation timeline should at least mirror APRA's.

NZBA supports the RBNZ guiding principle, "We will undertake an economic impact assessment of the Basel III proposals and will consult with New Zealand banks prior to finalising our Basel III policy". In particular, NZBA considers that this assessment should consider the consequences of early adoption of Basel III provisions, and the implications of applying a more conservative approach than the Basel III standards.

In particular, RBNZ has already imposed conservative risk weights for all Basel asset classes. As a result, New Zealand banks already have significant implicit capital buffers within their Basel II capital ratios. However, further conservative overlays are proposed in the form of the operation of the capital conservation buffer, the lack of the cap on the size of the proposed countercyclical capital buffer and the grandfathering of eligible tier 2 instruments.

RBNZ should undertake a regulatory impact assessment to analyse the potential impacts of this conservative approach on the competitiveness of New Zealand banks trying to attract offshore capital for funding. NZBA considers that this conservative approach will not be rewarded by foreign capital markets in terms of lower funding costs and will actually impose costs on the industry that will flow through to borrowing customers. With so much of New Zealand's financial industry based on subsidiaries of global or regional banks, that conservatism will make it harder for them to justify deploying capital into New Zealand.

In line with the RBNZ's general principle, "We will seek to coordinate our Basel III policy and implementation with APRA", NZBA considers that, in the absence of demonstrable benefits from adopting requirements that diverge from global industry standards, harmonisation with other regulators should guide the RBNZ's implementation of the new capital rules.

Conclusion

NZBA would welcome an opportunity to meet and discuss this submission in further detail.

If you would like to contact anyone in respect of this submission, please feel free to contact Matthew Herbert, Policy Adviser, New Zealand Bankers' Association on +64 4 802 3350 or by email at matthew.herbert@nzba.org.nz.