NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Reserve Bank of New Zealand

on the

Liquidity Policy Review: Consultation Paper #1 (Issues and Scoping)

14 April 2022

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About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following seventeen registered banks in New Zealand are members of NZBA:
    - ANZ Bank New Zealand Limited
    - ASB Bank Limited
    - Bank of China (NZ) Limited
    - Bank of New Zealand
    - China Construction Bank (New Zealand) Limited
    - Citibank N.A.
    - The Co-operative Bank Limited
    - Heartland Bank Limited
    - The Hongkong and Shanghai Banking Corporation Limited
    - Industrial and Commercial Bank of China (New Zealand) Limited
    - JPMorgan Chase Bank N.A.
    - Kiwibank Limited
    - MUFG Bank Ltd
    - Rabobank New Zealand Limited
    - SBS Bank
    - TSB Bank Limited
    - Westpac New Zealand Limited

Introduction

NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand (RBNZ) on the Liquidity Policy Review: Consultation Paper #1 (Issues and Scoping) (**Consultation Paper**). NZBA commends the work that has gone into developing the Consultation Paper.

Contact details

3. If you would like to discuss any aspect of this submission, please contact:

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Summary

NZBA agrees that this is an appropriate time to review the liquidity policy (**BS13**). International best practice has evolved since 2010 when BS13 was introduced. Our members have had extensive correspondence with the RBNZ since 2010 on areas of the current BS13 that would benefit from clarification. We commend the RBNZ's intention to consider the issues our members have raised. Our responses to the questions in the Consultation Paper are below

#	Question	Answer
1	Are there other drivers that are relevant to the case for review?	We agree with the drivers listed in the consultation paper, being the liquidity thematic review, the 2021 liquidity stress tests, COVID-19 and the international liquidity framework. In addition, we note these additional drivers: • The BS13 policy is unclear in places and should be reviewed to ensure interpretation issues and unnecessary model complexity are removed and guidance provided where appropriate. • New Zealand bank liquidity settings should be calibrated appropriately to take into account New Zealand's other financial stability measures introduced since 2010 (i.e., the macroprudential toolkit, the Open Banking Resolution, the current transition to higher capital levels) - in addition to those proposed for the future (e.g., the Deposit Takers Act (**DTA**)). • It is also noteworthy that the products that banks transact in have evolved significantly since 2010 (e.g. the derivatives market has adopted the use of central clearing houses and margins) which also lends to increased market stability. • There appear to have been inconsistencies in the BS13 treatment by banks which we consider is relevant to the case for review.

2	Are there any areas of the current liquidity policy that you believe are not fit for purpose and should be an area of focus for the review?	We acknowledge that the RBNZ has corresponded with a number of our members on the current issues with the policy, and intends to address these issues as part of the review. There are a number of areas we believe should be a focus of the review, including:
		• Consideration of a materiality threshold for errors or miscalculation. The current stated objective of BS13 "… is to contribute to the smooth functioning of the financial system by reducing the likelihood of liquidity problems affecting a registered bank, and promoting registered banks' capability to manage such problems." Introducing a materiality threshold would not compromise this objective yet would assist banks to operationalise the policy without risk of non-compliance for immaterial errors.
		• Deposit treatment alignment with run-off risk including:
		    o treatment of deposits from Kiwisaver providers which are a stable funding source
		    o treatment of deposits covered by any deposit insurance regime.
		• Model complexity required to model the run-off risk, for example aggregation of third-party deposits with deposits directly from bank customers to assign a customer to a deposit size band.
		• More detailed guidance on liquidity stress testing expectations and contingent funding.

		• We note that the 2021 industry liquidity stress tests were designed to test tail risks[1] and as such caution should be applied with using them to set liquidity management thresholds. • That liquid asset eligibility considers the quality of the assets as well as the ability to liquefy the assets in a short period in financial markets, for example the treatment of AAA rated securities. • Consistency between repo eligibility and BS13 eligibility limits (i.e., in relation to haircuts and encumbrance ratio). • Removing the one-week mismatch ratio, which NZBA considers superfluous to liquidity risk management and appetite setting for banks. We do not believe there is a material informational benefit provided by the one-week ratio and we view the one-month ratio as more than adequate and appropriate for addressing one-week period risk. • The definition of "one-month", for BS13, is currently based on the calendar month. We think this should be simplified and aligned with BCBS as "30 days". • Customer bucketing is currently too broad and should be adjusted to reflect expected customer behaviour more accurately. • Customer-type definitions in addition to "non-financial institutions" and "financial institutions". • The economics of the relevant foreign currency term debt issuances and its associated risk mitigant instrument, being the Cross Currency Interest Rate Swap (**CCIRS**), should be explicitly recognised in the policy (which it isn't currently). This would provide a more accurate and complete representation of a bank's balance sheet position, as these foreign currency term debt issuances are hedged using CCIRSs. • BS13 does not currently contemplate the proposed DTA and its numerous supporting documents (which are yet to be drafted). It is clear however, that the DTA should significantly impact outflow assumptions for certain deposit products and therefore any liquidity policy amendments must fully consider the DTA requirements once they are finalised. • There should be consideration of the impact on RBNZ market operations and implementation of monetary policy. The paper identifies that some of the banks' liquid assets are not marketable securities; banks instead rely on RBNZ facilities to provide liquidity – the key asset class falling into this category is internal Residential Mortgage Backed Securities (**RMBS**). Banks cannot currently transact these assets in the market, with the only way to turn them into cash being to repo them with RBNZ. The use of internal RMBS have been an important channel for the RBNZ to provide liquidity to the banks and promote market confidence. If the new rules disallow internal RMBS or make them prohibitively expensive then it will have implications for execution of monetary policy and financial stability in future crises.
3	Do you have any initial views on whether we should consider the BCBS liquidity framework as	NZBA considers that it would be prudent to consider the advantages and disadvantages of alignment with or moving to the BCBS liquidity framework. In principle, NZBA is supportive of RBNZ considering the BCBS liquidity framework as part of the LPR. We note however, that any proposed changes to New Zealand banks' overall liquidity metrics as part of the LPR should only be contemplated on the basis that they provide a better assessment of liquidity risk than the Reserve Bank's current approach.

[1] RBNZ 2021 industry bank stress test correspondence (April 2021)

	part of the review (noting that views on this question will be sought again in the next consultation paper)?	
4	Is the proposed scoping of this review sufficiently comprehensive? Are there any issues that should be examined that are not mentioned in this consultation paper?	We suggest including in the scope of the review regular Q&A sessions with industry to discuss feedback received during consultation, following which, the RBNZ can provide explicit written guidance on areas that are ambiguous. As noted above, the RBNZ should also consider the impact of the Deposit Takers Act and other regulatory change.
5	Are the proposed principles for the Liquidity Policy Review appropriate? Should any principles be added, removed, or amended? If so, please provide specific feedback on how this should be done	The principles are broadly appropriate, and we make the following comments: • **Principle One**: we agree that stress scenarios should be used to calibrate quantitative liquidity metrics, but the scenarios used should be both plausible and allow the bank to survive for a period sufficient to address the root cause of the liquidity stress - noting crisis management is likely to be quickly invoked. • **Principle Two**: we agree that the liquidity policy should encourage banks to make reasonable efforts to use private sector liquidity but equally it should not cause unnecessary financial market disruption. There is potential for excessive reliance on the private sector in the immediate term which could exacerbate stress across the financial system and lead to a wider and deeper crisis. A balanced approach is imperative. • **Principle Three**: we generally agree with this principle, but suggest that care must be taken to ensure the policy maintains a level playing field and does not adversely impact competition. • **Principle Four**: we support this principle and consider that a principles-based approach to qualitative liquidity metrics is appropriate as individual banks are best placed to have regard for their own circumstances, including balance sheet dynamics and potential crisis funding sources. • **Principle Five**: we suggest that this principle should also state that the requirements are sufficiently clear to promote and facilitate consistent interpretation. • **Principle Six**: we support this principle and suggest complexity of each element included in the quantitative liquidity metrics should be assessed against the potential materiality of the impact on overall bank liquidity. In addition to the above guiding principles, the RBNZ should add that it will also have regard to its other stability mechanisms (either implemented or proposed) which reduce the probability of a bank specific liquidity risk.

6	Is the proposed process and approximate timeline for the review appropriate?	We consider the process and approximate timeline is broadly appropriate with the following recommended changes/additions: • The minimum 60-day consultation period should be extended to 3-4 months. In addition, depending on the scale of policy change for liquidity calculations, further time may be required to prepare QIS results. • The third consultation should ideally include an initial proposal for revised metrics to allow banks to provide feedback ahead of draft policy. • The timeline could also include an estimated transition period. We acknowledge that the timeline to implement will depend on the scope of changes (and impact on customers, processes, and models), but we would like to engage with the RBNZ on this.
7	Do you have any additional feedback on the proposed issues and scoping of the Liquidity Policy Review?	The Consultation Paper is silent on a review of outflow assumptions, focusing more on liquid assets (i.e. what is a liquid asset, access and cost of RBNZ facilities) rather than the liabilities. There are however some fundamental questions on the outflows, including treatment of term deposit breaks and treatment of undrawn lending commitments.