17 May 2019

Ian Woolford
Financial System Policy and Analysis Department Reserve Bank of New Zealand
PO Box 2498
Wellington 6140

via email: CapitalReview@rbnz.govt.nz

BANK CAPITAL REVIEW

Introduction

1. Thank you for the opportunity to submit regarding the Reserve Bank of New Zealand's 'Capital Review Paper 4: How much capital is enough?'

2. The Wellington Chamber of Commerce (the Chamber) has been the voice of business in the Wellington region for 160 years since 1856 and advocates for policies that reflect the interest of Wellington's business community, in both the city and region, and the development of the Wellington economy as a whole. The Chamber is accredited through the New Zealand Chamber of Commerce network.

3. Business Central represents business interests throughout central New Zealand from Taranaki across to Gisborne and down to Nelson. Business Central is one of the four regional organisations comprising New Zealand's peak business advocacy group, BusinessNZ. In Wellington, our organisation operates the Wellington Chamber of Commerce, accredited to the New Zealand Chamber of Commerce network. Our organisation also delivers ExportNZ to Wellington and the Hawke's Bay.

4. As a member of Business NZ, we support their submission. We particularly support their view that increasing banks' cost of capital will result in higher borrowing costs to our members. In addition, we have included below additional feedback particularly important to our members.

5. The fundamental trade-off being considered is risk versus cost. How much risk is New Zealand prepared to carry of a bank failure, and how much cost is the country prepared to shoulder to mitigate this risk? Relatively recent domestic and international experience demonstrates this is not a hypothetical risk. However, while the costs of a bank failure were clearly illustrated by the South Canterbury Finance experience, among others, it must be acknowledged that mitigating this risk is also very costly.

6. The best way to analyse trade-offs is to conduct a cost-benefit study and publish the results for stakeholders to consider. Unfortunately, such analysis of higher bank capital requirements is lacking to-date in the Reserve Bank's document.

7. This lack of analysis leads to the question of what has been the Treasury's role in prudential policy setting to date? It is understandable that the Reserve Bank does not have this expertise in-house. This makes it even more important for the Treasury to be able to analyse the policy proposals, such as the Treasury does for many other government policy proposals with an economy-wide impact.

   We recommend the *Treasury is invited to conduct a thorough cost-benefit analysis as soon as possible and the Bank Capital Review process is paused while this takes place.*

8. It is essential that any such Treasury analysis includes the full suite of proposed policies affecting prudential regulatory settings, so as to provide a thorough and co-ordinated assessment of the Reserve Bank's package. For example, it should include assessment of a deposit insurance regime. Both higher bank capital requirements and deposit insurance will increase the cost of capital in New Zealand, the combined effect will have a material impact on the economy making such analysis vital.

9. An increase in families' and households' mortgage servicing costs will have a direct impact on their disposable income and, therefore, their wellbeing. For businesses, they will face a higher cost of capital, resulting in lower returns and slower economic growth. It will flow into reduced hiring intentions or delaying expansion into international markets. Many SME owners finance their working capital through personal home loans, so increased financing costs directly affects their bottom line. It could lead to banks deciding not to lend at all to some customers in this high-risk market segment.

10. These affects will cascade into other policy areas too, such as housing and social mobility. For example, if the costs of borrowing are higher than they otherwise would be, it follows that home-ownership will be lower. This runs counter to competing government priorities such as boosting housing affordability and encouraging home ownership. This reinforces the need for a wider analysis of the policy's effectiveness and benefits, an analysis which is best undertaken by the Treasury given their much wider policy mandate discussed above.

11. Higher borrowing costs are not theoretical. For example, UBS calculates the Reserve Bank proposals could add between 80 and 125 basis points to mortgage costs because of higher capital costs to the banks. UBS estimates the proposals will result in New Zealand having the highest bank capital requirements in the world, overtaking Norway. This is a financial cost that will be borne by the New Zealand economy year after year. Does New Zealand's banking industry risk profile justify the need for such stringent capital requirements? How much risk mitigation is too much?

12. Given the points raised in our submission, Business Central supports BusinessNZ's view not to support any increase in bank capital requirements.

Yours sincerely,

John Milford
Chief Executive
Wellington Chamber of Commerce, Business Central