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The Treasury
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To whom it may concern,

I want to thank the Treasury for offering me the opportunity to comment on scoping phase 2 of the review of the Reserve Bank Act.

First, it is important to recognise that quality supervision has a price tag. For example, the Nederlandsche Bank (DNB), the central bank of the Netherlands, employs 1,849 people (1,705 fte), of which 588 for prudential supervision. Its prudential supervision budget is €145 million.¹ DNB supervises three large banks and about 20 smaller banks (of which some are small subsidiaries of foreign banks). DNB also supervises pension funds, investment firms, etc. Consequently part of the larger budget reflects the size of the banking sector. It also includes tasks that are not relevant for New Zealand. On the other hand, the largest banks are supervised by the ECB, and much of the rule-making takes place in Brussels. Nevertheless, with 250 people, the RBNZ employs a workforce about one-seventh the size of DNB's. Even adjusting for size and scope, it is not obvious to me that prudential supervision in New Zealand can be conducted effectively with a workforce that is $\pm 15\%$ the size of its Dutch counterpart.

Second, the Reserve Bank relies too much on disclosures alone. I agree that disclosures are important and necessary. However, the complexity of regulation calls for more intrusive and active supervision. It is naive to think that the Bank Financial Strength Dashboard, combined with an awareness campaign and educational efforts offer a lasting solution. Such campaigns and educational initiatives tend to be short-lived, their effects wither away. As a result, there is a risk that the Dashboard initiative may lose momentum going forward.

The public also needs to know what (proprietary) bank information the Reserve Bank can access. One cannot expect the public to monitor as effectively as the Reserve Bank can, given that the RBNZ has access to more (bank specific) information. See also my last point.

Stress test results should be published. The RBNZ could take a leaf from the EBA book on stress testing. The EBA discloses all stress test data and associated information, scenarios, methodologies, dashboards, etc. This enables the public to better assess the quality of EU banks, also because risks tend

¹Data from the 2016 annual report: <https://www.dnb.nl/en/news/dnb-publications/annual-report>.

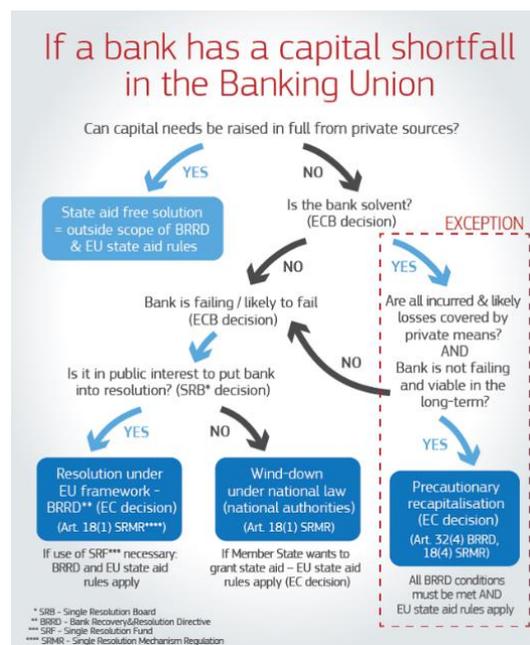
to build up in quiet times. The RBNZ dashboard may show splendid results on a going-concern basis, but the public also needs to know how our banks perform under stress.

In Europe, the publication of the stress test results is a big event, with intensive press coverage. Having such an event in New Zealand could lead to increased media attention and stimulate interest in our banks. Publishing stress test results would reinforce BRRD monitoring and it would contribute to financial stability.

Third, I would suggest the RBNZ to moderate its position on moral hazard. There will always be moral hazard. However, there are tools to address moral hazard behaviour: There are fit and proper tests, there are Basel Core Principles for Effective Banking Supervision, there are capital requirements and risk weights, etc. Moral hazard can be managed, it is not something to obsess about.

New Zealand could therefore be more open to the idea of bailing out banks. Dutch bank ING demonstrate some of the virtues of bail-out. This bank was bailed out, but it faced stiff penalties and its activities were restricted for some time. It had to divest its insurance operations. Only in 2014, ING managed to repay the support it received, including penalties. It is not obvious to me how the stiff penalties and activity restrictions encourage moral hazard behaviour.

In addition, even today, EU rules allow for state support. That is, under conditions.² For example, burden sharing is required:



Fourth, the RBNZ could align its supervision model more closely with Basel rules. The review of regulatory capital seems to indicate that the Reserve Bank is departing from Basel rules and FSAP recommendations.³ I commented on this on my CapitalIssues.co blog, see [here](#), and [here](#). In addition, I miss Pillar 2, specifically the way Europe has implemented it, with a required part and a guidance part.

²See http://europa.eu/rapid/press-release_MEMO-17-1792_en.htm.

³See paragraph 44 of the [FSSA report](#) of 10 April 2017.

[Article 104](#) of the European Capital Requirements Directive offers supervisors many additional powers to address risks other than credit risk, market risk, and operational risk. I would like to see the Reserve Bank being given similar powers. I also miss the leverage ratio requirement and additional buffers for large or systemically important banks.

Lastly, I would like to see a more transparent and accountable Reserve Bank. We receive very little information about the decision making processes of the RBNZ. A case in point is the Kiwibank regulatory capital case of 2017. This was an embarrassing episode for sure, but equally embarrassing is that, to date, it is still unclear what motivated the Reserve Bank to make the decisions affecting Kiwibank regulatory capital instruments.

Another case is the review of bank capital. It is unclear why the RBNZ decided to simplify bank capital. Where is the legal basis for the revision, where is the empirical evidence that supports the simplification? More importantly, what if banks or investors object to such initiatives of the Reserve Bank?

Please let me know if you have any questions,

Kind regards,

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