Reserve Bank of New Zealand
Te Pūtea Matua

Proportionality Framework

For Developing Standards Under the Deposit Takers Act

March 2024

Contents

Introduction

This proportionality framework (the **Proportionality Framework** or **Framework**) sets out how the Reserve Bank of New Zealand – Te Pūtea Matua (the **Reserve Bank** or **we**) takes into account the proportionality principle when developing standards for deposit takers licensed under the Deposit Takers Act 2023 (the **Act**)[1].

The proportionality principle is one of the principles set out in the Act. The Reserve Bank must take into account this principle when exercising functions, powers and duties under the Act. The Act requires the Reserve Bank to prepare and publish a Proportionality Framework[2].

Under the Act, the Reserve Bank will be responsible for regulating and supervising deposit takers within a single regulatory regime. Deposit takers comprise a range of entities including banks, building societies, credit unions and finance companies. These entities are currently regulated separately as banks and licensed non-bank deposit takers (**NBDTs**) [3].

Operating within the financial system comes with responsibilities. Deposit takers must meet baseline requirements, so that financial stability is not compromised. However, this does not mean the Reserve Bank will take a one-size-fits-all approach to prudential regulation. Taking a proportionate approach – that is, balancing the costs and benefits of regulation in relation to different types of deposit takers – is important, as it means the public can benefit from not only a safe, sound and stable deposit-taking sector, but also one that can be diverse, innovative and inclusive. The framework is also intended to support consistency and coherence when developing standards under the Act.

This document sets out:

- the purpose of the Framework:
- considerations when using the Framework to help set requirements:
- how the Reserve Bank will group deposit takers for the purpose of issuing consistent proportionate standards:
- how the Reserve Bank will maintain the flexibility to fine-tune applicable requirements to deal with firm-specific circumstances:
- transition arrangements.

The Framework does not provide any details of requirements contained in specific standards (for example, on capital, liquidity and governance). Requirements will be set using the approach set out in the Framework.

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[1] The proportionality principle can be found in section 4(a)(i) in the Act
https://www.legislation.govt.nz/act/public/2023/0035/latest/whole.html#LMS469449

[2] Section 77 of the Act requires the Bank to prepare and publish framework for taking proportionality principle into account when developing standards. https://www.legislation.govt.nz/act/public/2023/0035/latest/whole.html#LMS813729

[3] Banks are currently regulated under the Banking (Prudential Supervision) Act 1989.
https://www.legislation.govt.nz/act/public/1989/0157/latest/whole.html#whole
NBDTs are currently regulated under the Non-bank Deposit Takers Act 2013.
https://www.legislation.govt.nz/act/public/2013/0104/latest/whole.html#DLM3918915

Scope of the Proportionality Framework

The Reserve Bank is required to take into account the desirability of taking a proportionate approach to regulation and supervision (section 4 (a)(i) of the Act). The Proportionality Framework has been prepared in accordance with section 77 of the Act, and sets out how the Reserve Bank takes into account the proportionality principle when developing standards.

The Framework does not set out our approach to taking into account the other principles in section 4 that are relevant to our regulation of deposit takers (such as the need to maintain competition within the deposit-taking sector). These principles will also be taken into account when developing standards.

The Framework does not comment on other approaches taken by the Reserve Bank, for example, its approach to supervision, enforcement, resolution or regulated entities other than deposit takers.

Purpose of Proportionality Framework

The Act sets out *'the desirability of taking a proportionate approach to regulation and supervision'*[4] as one of the principles that the Reserve Bank must take into account as relevant to the performance or exercise of its functions, powers and duties. The Framework sets out how the Reserve Bank takes into account this principle when developing standards for deposit takers under the Act.

In preparing the Framework, we have had regard to the following matters as required by the Act[5]:

- the size and nature of the businesses of different deposit takers:
- the extent to which a range of different requirements are necessary or desirable to promote the safety and soundness of each deposit taker:
- the relative importance of different deposit takers to the stability of the financial system.

The concept of proportionality can have different meanings and interpretations in different contexts. The Bank for International Settlements defines proportionality in the following way:

'Proportionality in financial system regulation and supervision may ensure that the applicable rules and supervision practices are consistent with banks' systemic importance and risk profile, and are appropriate for the broader characteristics of a particular financial system[6].'

The purpose of the Framework aligns with this definition.

It is important to note that the Framework does not necessarily mean reducing the strength of any particular standard. Taking a proportionate approach means balancing the costs and benefits of regulatory requirements in relation to different types of deposit takers.

[4] Refer section 4(a)(i) of the Deposit Takers Act 2023
https://www.legislation.govt.nz/act/public/2023/0035/latest/whole.html#LMS469454
[5] Refer section 77(3) of the Deposit Takers Act 2023
https://www.legislation.govt.nz/act/public/2023/0035/latest/whole.html#LMS813729
[6] Refer the *High-level considerations on proportionality* published by Bank for International Settlements' Basel Committee on Banking Supervision: https://www.bis.org/bcbs/publ/d534.pdf

Setting Requirements in Standards

In order to take into account the proportionality principles when developing standards, we look at either or both of the following dimensions:

- the *strength* of requirements (for example, higher vs lower capital requirements):
- the *comprehensiveness* of requirements (for example, using detailed and precise vs simple and approximate methodologies to calculate capital ratios).

We adjust the strength and comprehensiveness of requirements in standards to balance the costs and benefits of regulation.

The two dimensions will assist the Reserve Bank in setting requirements consistently. For example, we expect that systemically important deposit takers will be subject to strong and comprehensive requirements, while small deposit takers will be subject to proportionately strong and simple requirements.

In addition, the dimensions can guide us in considering which standards should apply to each deposit taker. In general, we expect that most standards will apply to all deposit takers, with requirements set in a proportionate manner. However, there may be cases where some standards are not needed for certain deposit takers or groups of deposit takers (for example, due to their size and/or business model).

Grouping of Deposit Takers

Licensed deposit takers are allocated into groups to support the consistent application of requirements in each standard to similar deposit takers. This allows requirements to be set proportionately for the scale of business undertaken by each group and the risks posed by the group. It will help to enable a consistent application of requirements for similar deposit takers.

Prudential requirements in each standard could be different for each group, the same for all groups or the same for two groups and different for the third. They will be decided on a standard-by-standard basis, taking into account the principles set out in section 4 of the Act.

We expect that in most instances the requirements/standards that apply to individual deposit takers will be those that are applied to the group to which they are allocated (subject to the approach to variation outlined below).

For some standards we may take a principles-based approach rather than a rule-based approach, or a combination of the two[7]. Where we take a principles-based approach, we might apply the same prudential requirements to all deposit takers. Principles-based regulations can support proportionate requirements, as deposit takers can design systems or put arrangements in place that are adequate, effective and appropriate for the scale and nature of their businesses.

Basis for Grouping Deposit Takers

The grouping of licensed deposit takers is established based on the factors required in section 77(3) [8].

Deposit takers that are incorporated in New Zealand

The grouping of deposit takers that are incorporated in New Zealand ('locally incorporated deposit takers') has been established based on the average 'total assets'[9] of these deposit takers over a rolling year. We use data held by the Reserve Bank to calculate the total assets. The data are sourced from the Bank Balance Sheet Survey[10] and the Non-bank Deposit Takers Survey[11].

In the Framework, the Reserve Bank uses total assets as the sole indicator for establishing the grouping of locally incorporated deposit takers. A simple and transparent indicator helps deposit takers to easily foresee prudential requirements and plan for their future growth. The Reserve Bank's analysis based on the data currently available identified no significant difference between an asset-based grouping and groupings using a broader range of indicators including the nature of businesses.

Using average data over a rolling year will smooth out any short-term fluctuations in the size of a deposit taker's assets and provide a reasonable longer-term assessment of a deposit taker's size. This will also help deposit takers to transition smoothly between groups and predict and prepare for their future regulatory requirements.

[7] An example of a principle-based requirement in relation to risk management could be 'a firm must ensure that its risk management framework is adequate, effective and appropriate for the scale and nature of its business'.
[8] Refer section 77(3) of the Deposit Takers Act 2023 https://www.legislation.govt.nz/act/public/2023/0035/latest/whole.html#LMS813729
[9] The 'total assets' are defined in the definitions for the bank balance sheet survey and the Non-bank Deposit Takers Survey.
[10] The bank balance sheet survey https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/resources-for-banks/surveys/bank-balance-sheet-survey
[11] The Non-bank Deposit Takers Survey https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-non-bank-deposit-takers/resources-for-non-bank-deposit-takers/nbdt-surveys/non-bank-deposit-takers-survey

The Reserve Bank monitors each deposit taker's total assets. If a change in grouping is required, the Reserve Bank will transition the relevant deposit taker in accordance with the transition arrangements outlined below.

The Reserve Bank may also update the Framework if the result of a periodic assessment warrants the update.

Prospective new deposit takers will be allocated to a group based on its existing asset base. If a prospective new deposit taker has not yet generated sufficient data to determine its group, we may use its business plans submitted to the Reserve Bank as part of its licence application. The Reserve Bank will look into its anticipated size after an initial period of growth, and how it expects to meet regulatory requirements. As part of that licensing discussion, the Reserve Bank will likely determine the group that the new deposit taker will be in after an initial growth period and consider whether the deposit taker has a realistic path to compliance with those regulatory requirements.

Overseas licensed deposit takers

Overseas licensed deposit takers ('branches of overseas incorporated deposit takers' or 'branches') are grouped together and will be subject to a different set of standards.

Their nature of business and legal structure necessitate requirements that are distinguishable from those of the licenced deposit takers that are incorporated in New Zealand. An overseas licensed deposit taker is part of a body corporate incorporated outside New Zealand and is regulated and supervised by both the Reserve Bank and the relevant overseas supervisor. Overseas licensed deposit takers will be, in New Zealand, restricted to engaging in wholesale businesses and will not be permitted to take retail deposits or offer products or services to retail customers[12].

The Reserve Bank therefore separately develops standards for overseas licensed deposit takers.

Three Groups of Locally Incorporated Deposit Takers

Locally incorporated deposit takers will be divided into three groups for the purposes of developing standards:

Group	Description of deposit takers
Group 1	Deposit takers with total assets of NZ$100 billion or more. The deposit takers in Group 1 are recognised as the domestic systemically important banks (D-SIBs)[13].
Group 2	Deposit takers with total assets of NZ$2 billion or more, but less than NZ$100 billion.
Group 3	Deposit takers with total assets of less than NZ$2 billion.

[12] For details, refer the review of policy for branches of overseas banks https://www.rbnz.govt.nz/have-your-say/review-of-policy-for-branches-of-overseas-banks

[13] The Reserve Bank will replace the current framework to identify a D-SIB with the Proportionality Framework on the day that the standards under the Act come into force. Those deposit takers that are allocated in Group 1 under the Proportionality Framework will be recognised as D-SIBs.

The Reserve Bank will adjust the strength and comprehensiveness of requirements to balance the costs and benefits of regulation when developing standards for each group (see the Setting Requirements in Standards section above). Deposit takers in Group 1 are likely to be subject to strong and comprehensive requirements.

Variation from the Three Groups

The simple and transparent asset-based grouping approach helps deposit takers to foresee prudential requirements and plan for their future growth. It also provides for the consistent application of standards to deposit takers in each group.

However, the Reserve Bank acknowledges that this approach may not be appropriate in every circumstance. There may be a circumstance that requires a variation to requirements for a particular deposit taker or a particular type of deposit takers.

Variations to prudential requirements could be actioned in three ways:

- *variations to requirements in standards.* Considering the circumstances of a particular type of deposit taker, the Reserve Bank varies requirements applicable to the particular type of deposit takers in standards. A particular type of deposit takers will be subject to the requirements that are specifically varied for the type of deposit takers:
- *variations to requirements through licence conditions for individual deposit takers.* Considering the circumstances of a particular deposit taker, the Reserve Bank specifies standards or requirements in standards applicable to the particular deposit taker in its licence condition:
- *'opt-in' to higher prudential requirements.* There may also be circumstances where a deposit taker assesses that it is desirable to opt in to higher prudential requirements (for example, due to its growth strategy or the nature of its business model). In such circumstances, a deposit taker could also choose to comply with the standards applied to a higher group. The Reserve Bank would specify applicable higher standards in the deposit taker's condition of licence.

Where the Reserve Bank considers that a variation is required, we will consult the individual deposit taker.

Transition Arrangements

We expect that some deposit takers may need to transition between groups when their sizes change due to business growth or reorganisations. We also expect mergers or acquisitions to occur from time to time. This section outlines a mechanism for transition.

We consider it desirable that requirements applicable to individual deposit takers change smoothly, which helps to prevent unnecessary adjustment costs and uncertainty for deposit takers. It also ensures that deposit takers are subject to adequate standards regardless of where they are in their growth cycle. Therefore, in such circumstances a deposit taker will be given an appropriate period to transition to a new group.

Where a deposit taker is likely to move from one group to another, for example due to growth, supervisors will engage with the deposit taker on how this may alter the standards applied to that deposit taker. Should change be required, the implementation of any new prudential requirements will be completed in agreement with the supervisors.

The section above outlines the basis for undertaking the initial allocation of each deposit taker to a group. The allocation of a deposit taker to a group will be periodically reviewed by the Reserve Bank to ensure that the deposit taker’s grouping remains appropriate over time.

Review of the Proportionality Framework

The Framework will be reviewed periodically in order to ensure that it remains fit for purpose. In particular, the Reserve Bank will ensure that the Framework remains aligned with deposit takers' sizes, the nature of their businesses, their relative importance to financial stability and the need to promote the safety and soundness of each deposit taker.

The dollar value thresholds for the transitions between groups will also be reviewed periodically to ensure that they remain appropriate for the scale of the deposit taking sector in New Zealand.

The Reserve Bank will update the Framework if warranted by the results of the periodic review.