Reserve Bank of New Zealand
Te Pūtea Matua

Financial Stability Report.

November 2025

Purpose of the Financial Stability Report

The *Financial Stability Report* outlines our assessment of the state of, and risks to, New Zealand's financial stability. The *Report* is one of our key publications, and aims to raise public awareness of developments in the financial system. It is published pursuant to section 170 of the Reserve Bank of New Zealand Act 2021, which states that the *Report* must:

- report on risks and matters relating to the stability of New Zealand's financial system, and other matters associated with the Reserve Bank's prudential objective; and
- contain the information that is necessary or desirable to allow an assessment to be made of the effectiveness of the Bank's use of its powers to protect and promote the stability of New Zealand's financial system, and achieve the prudential objective.

Financial Stability Objective

Our prudential objective is to protect and promote the stability of New Zealand's financial system. A stable financial system is one where resilient financial markets, institutions and infrastructures enable a productive and sustainable economy, and ultimately prosperity and well-being for New Zealanders. By resilient, we mean the ability to anticipate, prepare, absorb, recover and learn from severe but plausible shocks and imbalances.

By protecting and promoting financial stability, we are committed to ensuring that all New Zealanders can safely save, make everyday transactions, access credit, invest, insure against risks and plan for the future. In doing this, we take into account competition, efficiency and proportionality, which enable the financial system to deliver choice and value for money for New Zealanders. This also supports an inclusive financial system that is accessible to people from all walks of life.

Our Analysis and Strategy

The *Report* outlines our assessment of the state, resilience, and vulnerability of the financial system and its component parts. We assess how global and domestic developments are affecting the financial health of New Zealand's households and businesses, and the performance and resilience of our financial institutions. We also highlight longer-term risks and issues that may affect financial stability.

This analysis feeds into setting our strategy and priorities for pursuing our financial stability objectives. These priorities, and progress towards achieving them, are also outlined in the *Report*, including actions to strengthen the regulatory framework, the use of our macroprudential policy tools to mitigate the build-up of systemic risk, work to enhance the resilience and risk management of regulated entities, and our enforcement activities.

REPORT AND SUPPORTING NOTES PUBLISHED AT:

www.rbnz.govt.nz/financial-stability/financial-stability-report
Subscribe online: www.rbnz.govt.nz/email-updates

A summary of New Zealand's financial system is published at:
www.rbnz.govt.nz/financial-stability/overview-of-the-new-zealand-financial-system

This *Report* uses data available up to 31 October 2025.

ISSN 1176-7863 (print)
ISSN 1177-9160 (online)

Financial Stability Report.
November 2025

Contents

Thank you to staff in the Financial Stability Group for the photography in this *Report*.

Cover image: Taranaki. Photo: Charles Lilly

Summary

The *Financial Stability Report* outlines our assessment of risks to financial stability. Financial stability is critical for ensuring that New Zealanders can safely save, borrow, and manage financial risk.

Financial stability risks remain higher than in recent years due to global uncertainty and underperformance in parts of the New Zealand economy. Trade tensions present risks to our exporters and have affected business confidence. Persistent weakness in the domestic economy is creating challenging conditions for businesses, exposing banks to credit losses. However, financial stress is not uniform across the economy, with lower interest rates and high agricultural export prices supporting some sectors. Banks also have robust financial buffers to absorb shocks.

Global economic fragmentation and policy uncertainty present risks to trading-partner growth. The outlook for trade relations between the US and China remains uncertain. Many central banks are easing monetary policy in response to projected lower growth and lower inflation. Policy uncertainty and a weaker labour market have contributed to softer economic activity in the US. China's growth outlook has improved, but risks remain. Investors have also become more concerned about fiscal sustainability risks in the US and some other advanced economies.

Recovery in global financial markets masks potential vulnerabilities. Global equity prices have rebounded from their lows earlier in the year. The strong recovery in US equity prices has been driven by technology and artificial intelligence firms. Equity prices could fall if earnings disappoint expectations.

Certain business sectors are more exposed to weak domestic demand than others. Conditions are particularly challenging for businesses reliant on discretionary consumer spending (see Special Topic 1). The non-performing share of business loans has increased, but is still low compared to previous downturns. Business credit demand remains subdued as capital investment is muted.

The agriculture sector has been supported by strong export prices. The US tariff rate on imports from New Zealand has increased. However, the impact of US tariffs on our exporters is expected to be manageable, particularly for standardised commodities such as meat. The impact of tariffs on incomes in our key trading partners and therefore demand for New Zealand exports remains a key risk.

Lower debt-servicing costs are alleviating stress in some areas. Mortgage debt-servicing costs are easing as borrowers reprice onto lower interest rates, and acute household stress has started to decline. Household credit demand is beginning to recover. Commercial property borrowers have also benefited from lower interest rates, but increasing vacancy rates remain a risk.

Protracted soft conditions in the housing market have challenged the construction industry. While house sales have picked up somewhat, national house prices have been broadly unchanged over the past three years. Following the introduction of debt-to-income restrictions last year, we plan to ease loan-to-value ratio restrictions from 1 December 2025.

Banks have increased their resilience to a range of shocks. Banks remain profitable and have continued to increase their capital ratios (see Chapter 4). The 2025 solvency stress test shows that banks are positioned to absorb loan losses and continue to provide credit if economic conditions worsen. We are reviewing key settings for capital requirements for deposit takers and aim to make final decisions by the end of 2025 (see Chapter 3).

Banks remain well funded in a low credit growth environment. Banks are competing more proactively for lending opportunities, supporting the availability of credit. The Depositor Compensation Scheme is now operational, contributing to increased deposits for some non-bank deposit takers.

Property insurance premium growth has moderated, but affordability challenges continue to grow. More favourable conditions in global reinsurance markets have contributed to this moderation (see Special Topic 2). In contrast, rapid growth in claims costs for health insurers has put the sector under strain and is driving up health insurance premiums.

We are increasing our efforts to monitor cyber risk. Our *Cyber Capability survey* shows that regulated entities are generally aligned with our guidance (see Special Topic 3). The findings will inform our approach to promoting operational resilience in regulated entities.

Chapter 01

Financial stability risk and policy assessment

Westhaven Marina, Auckland. Photo: Charles Lilly

Chapter 1
Financial stability risk and policy assessment

Risks to financial stability remain higher than in recent years owing to global uncertainty and subdued domestic growth. Trade tensions are weighing on the global growth outlook, posing longer-term risks to the performance of our export sector. Businesses reliant on discretionary consumer spending are experiencing increased financial stress. Lower interest rates are easing debt-servicing pressures, particularly for households with mortgages and for the commercial property sector. The banking system is resilient, with strong capital, funding, and liquidity buffers that provide capacity to absorb potential shocks and maintain credit supply.

In this chapter, we assess risks to financial stability, focusing on potential shocks to the financial system and its resilience to them. We consider key international developments that could materially impact New Zealand's financial system. We assess financial stress across key sectors of the New Zealand economy, including households, general businesses, and agriculture. We examine how vulnerabilities in these sectors may transmit stress to deposit takers and the wider financial system. We also report on the financial buffers held by deposit takers and assess their ability to absorb potential losses while maintaining the flow of credit to the economy.

Global financial markets have recovered, but concerns persist about asset valuations and market vulnerabilities

Confidence in global financial markets has improved since the broad-based US tariff announcement in April 2025, which had led to temporarily elevated market volatility. Equity markets have rebounded strongly from their April lows (figure 1.1), supported by progress in trade negotiations between the US and some other countries. The US dollar depreciated owing to the recovery in investor confidence and increased expectations of monetary easing in the US. Wholesale interest rates in advanced economies have been broadly stable.

Figure 1.1
International equity price indices
(index=100 in January 2020)

Source: Bloomberg.

The rebound in US equity prices has been driven by the strong performance of large technology and artificial intelligence firms. These firms' earnings are perceived by investors as relatively insulated from the effects of tariffs and changes in consumer demand. In contrast, equities more exposed to current economic conditions have been weaker. The price-to-earnings ratios of US equities remain elevated relative to history, leaving markets vulnerable to potential volatility if earnings expectations are not met. In addition, the IMF has highlighted the increased participation of non-bank financial institutions (NBFIs), such as hedge funds and private credit firms, in financial markets. The greater role of NBFIs may increase market volatility during periods of stress.[1]

Uncertainty remains high about the impact of US tariffs

The full implementation of the US tariffs announced in April was delayed by four months to allow time for trade negotiations. The US reached several trade agreements, including with the European Union, UK, and Japan. Despite this, the US effective tariff rate is generally estimated to be higher than over the past eight decades.

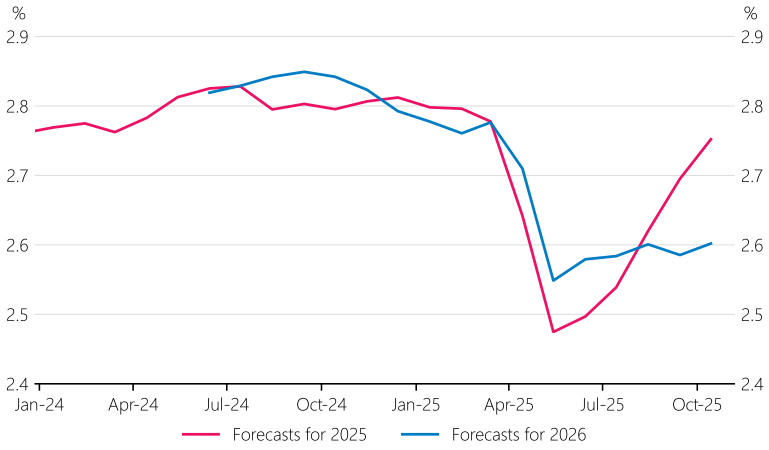
Higher tariffs are expected to weigh on global growth, though the timing and extent of this impact remain uncertain.[2] In August, the US imposed revised tariffs on most countries that had not concluded trade agreements. The tariff rate on New Zealand goods was raised to 15 percent, up from the 10 percent announced in April. Uncertainty about the outcome of US-China trade negotiations remains high. Ongoing legal challenges to US tariff measures add further uncertainty.

Global economic fragmentation and policy uncertainty present risks to trading-partner growth

Trade restrictions, policy uncertainty, and weaker consumer spending are putting pressure on demand in many of our key trading partners (figure 1.2). US private consumption growth slowed in the first half of 2025, reflecting increased household caution. Softer demand has contributed to a weaker US labour market, with employment growth slowing significantly over the past six months. Tariffs are expected to narrow corporate profit margins for some sectors, reducing their debt-servicing capacity and potentially increasing their borrowing costs.

Figure 1.2

Evolution of trading-partner growth consensus forecasts



Source: Bloomberg, RBNZ calculations

Note: This figure shows the evolution of Bloomberg consensus forecasts for annual GDP growth in New Zealand's trading partners in the 2025 and 2026 calendar years.

1 See the IMF's October 2025 *Global Financial Stability Report*, available at https://www.imf.org/en/Publications/GFSR/Issues/2025/10/14/global-financial-stability-report-october-2025

2 See Special Topic 2 in the May 2025 *Monetary Policy Statement*, available at https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/monetary-policy-statements/2025/may-0525/mps_report_may2025.pdf.

Growth in China has been supported by industrial production and export growth. China's economic outlook has improved moderately over the past six months, partly owing to fiscal support targeted at household demand. However, risks remain around the weak housing market, fragile consumer confidence, and high levels of local government debt.

Markets have become more concerned about fiscal sustainability risks in the US and other advanced economies.[3] This is evidenced by higher long-term government bond yields and a rise in the compensation investors demand for bearing credit risk. This concern reflects elevated sovereign debt levels, large fiscal deficits, and recently proposed US tax cuts. As the US Federal Reserve is gradually reducing its US government securities holdings, the bond market is becoming more reliant on more risk-sensitive private investors. This may cause sovereign yields to become more responsive to fiscal sustainability concerns over time.

Many central banks are easing monetary policy in response to projected lower growth and inflation

Inflation has continued to decline across advanced economies and remains low in China and other emerging Asian economies, which largely reflects subdued demand. The effect of tariffs on US inflation has been limited to date, reflecting pre-tariff inventory accumulation and tariff pauses for some countries. However, tariffs are expected to add to inflationary pressures in the US for the rest of 2025 and into 2026.[4]

The US Federal Reserve lowered its policy rate in September and October owing to concerns about the softening labour market, despite upside risks to inflation from tariffs. Market participants expect that central banks in the US, euro area, UK, and Australia may ease monetary policy over the next 12 months.

Trade tensions reflect the broader increase in geopolitical risks

Geopolitical risks to financial stability have increased over the past decade, reflecting escalating international tensions and trade disputes. New Zealand's export sector remains highly dependent on demand from the Asia-Pacific region, creating concentration risks. Further deterioration of global trade frameworks and a broadening of regional conflicts, including in the Middle East, would increase risks to energy prices and global growth. This would have an adverse impact on New Zealand as a small open economy reliant on international trade.

Our 2025 bank solvency stress test examines the resilience of major New Zealand banks to geopolitical tensions and global economic fragmentation, as well as targeted shocks for individual banks.[5] The stress test outcomes show that the major banks can withstand a severe recession caused by worsening geopolitical tensions.

3 See Chapter 1 in the IMF's October 2025 *Global Financial Stability Report*, available at https://www.imf.org/en/Publications/GFSR/Issues/2025/10/14/global-financial-stability-report-october-2025.

4 See Box B in the August 2025 Monetary Policy Statement, available at https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/monetary-policy-statements/2025/aug-20825/mps-report-aug-2025.pdf.

5 See https://www.rbnz.govt.nz/hub/publications/bulletin/2025/2025-bank-industry-solvency-stress-test-results.

High export prices and lower debt burdens support New Zealand's agriculture sector

Favourable conditions are continuing to support New Zealand's agriculture sector. Dairy prices remain high, with Fonterra maintaining an elevated midpoint forecast of $10 per kilogram of milk solids for the 2025/26 season. Dairy farmers will also benefit from a one-off payment from Fonterra's sale of its global consumer business. The meat sector is benefiting from high beef prices and a recovery in sheepmeat prices. Elevated commodity prices are generally driven by tight global supply, including declining US cattle stocks and lower dairy output in China. Falling interest rates, prior deleveraging in the dairy sector, and lower farm cost inflation are also improving farm cashflows.

The direct impact of US tariffs on our exports is expected to vary across products.[6] The US imports around 30 percent of our beef and sheepmeat exports. These are relatively standardised commodities that can be diverted to alternative markets fairly easily, and currently have high global prices. A 50 percent tariff on US goods imports from Brazil, one of the largest beef producers, may enhance the competitiveness of New Zealand beef in the US. In contrast, the wine sector, which also sends around a third of its exports to the US, is more exposed. This reflects the more differentiated nature of the product and its dependence on brand recognition, which make diversion to alternative markets more challenging in the short term.

A key risk is that the broader impacts of US tariffs and retaliatory measures negatively impact growth and incomes in our key trading partners. This could affect the financial performance of New Zealand exporters and could have negative spillovers to the financial system.

Some business sectors are more exposed to weak domestic demand

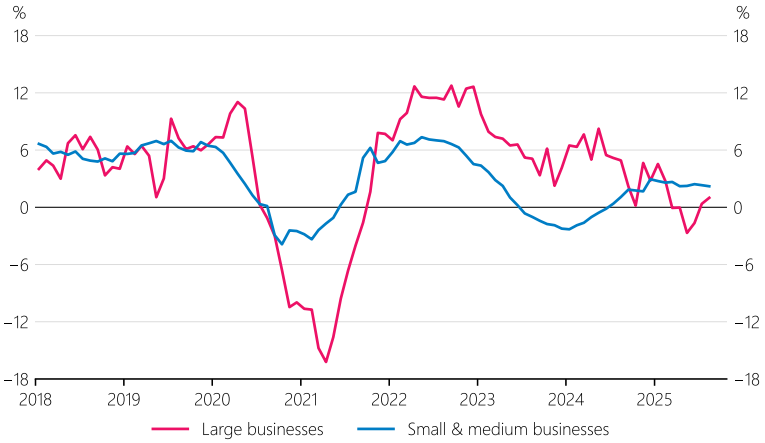
Domestic demand has remained subdued over the past six months, reflecting the combined effects of earlier high interest rates, low net migration, a weakening labour market, and global uncertainty. Annual GDP in the June quarter contracted by 1.1 percent from a year earlier. In addition, the unemployment rate rose to 5.2 percent in the June quarter, amplifying risks for both the household and business sectors. Weak consumer spending is constraining revenues and increasing cashflow stress for some businesses.

Business credit demand remains muted. Credit growth remains soft for smaller businesses, while lending to large corporates is unchanged over the past year (figure 1.3). Lending has been focused on working capital and maintenance, with limited appetite for major capital investment.

Figure 1.3

Business lending by firm size

(annual percent change)



Source: RBNZ *Bank Balance Sheet survey*.

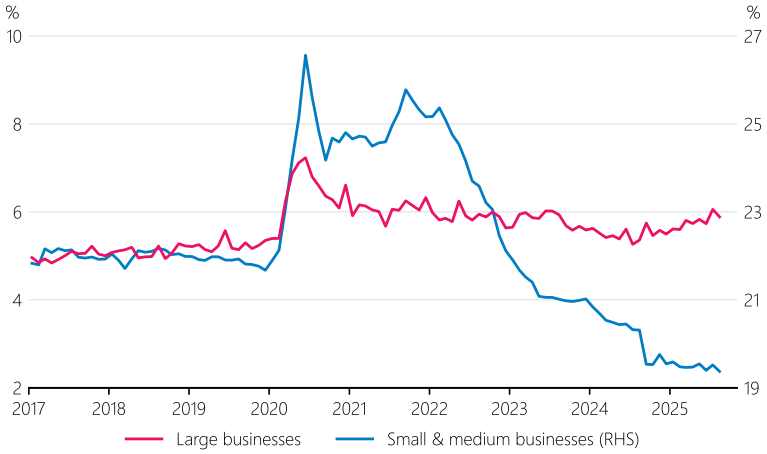
6 See Box B in the May 2025 *Financial Stability Report*, available at https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2025/may/financial-stability-report-may-2025.pdf.

Profitability has declined most sharply in sectors reliant on discretionary consumer spending, such as retail and hospitality (see Special Topic 1). Businesses continue to face elevated cost pressures, with rising energy and labour costs constraining cashflows. Smaller firms have experienced significant margin compression, reflecting limited capacity to pass on higher costs to consumers. Business deposits continue to decline relative to GDP for smaller firms (figure 1.4), indicating a steady reduction in cash buffers for managing stress.

Figure 1.4

Business deposits by firm size

(share of nominal GDP)



Source: Stats NZ, RBNZ *Bank Balance Sheet survey*, RBNZ calculations.

Lower debt-servicing costs are mitigating stress in some sectors

Declining interest rates are providing some relief to businesses' debt-servicing costs. Some firms entered the downturn with high cash reserves, which has supported resilience. Banks have maintained stronger lending standards since the Global Financial Crisis, which has limited the build-up of risky lending. Consequently, business arrears and non-performing loans remain relatively low, despite the challenging economic environment.[7]

Lower interest rates have benefited commercial property borrowers in particular, contributing to higher interest coverage ratios and improved repayment capacity. As a result, the share of commercial property borrowers assessed as potentially stressed or non-performing has fallen. Industrial properties and higher-quality retail and office properties are performing well, while secondary retail and lower-grade office spaces continue to face higher vacancy rates. Credit demand from commercial property borrowers remains sluggish, particularly for development lending. Competition for lending opportunities to commercial property development has strengthened, including from offshore lenders.

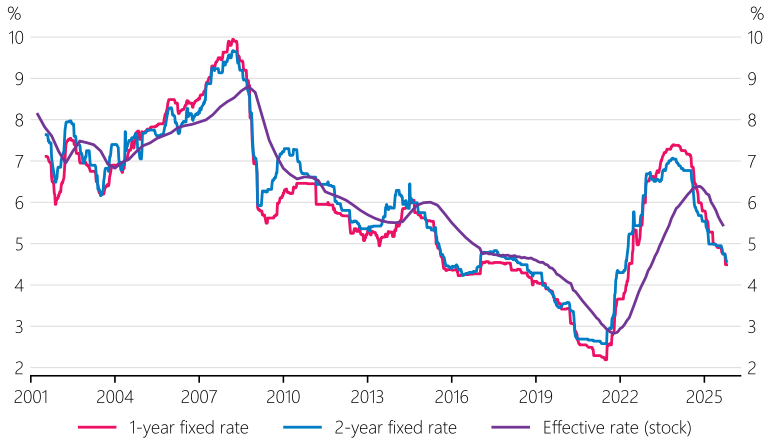
Household credit demand has picked up, while financial stress has stabilised

Household credit demand has begun to recover, supported by falling interest rates (figure 1.5). However, a subdued labour market, lack of confidence, and soft housing demand continue to hold back a stronger recovery in household lending. Personal consumer credit growth remains weak, reflecting household caution and low demand for traditional credit cards among younger borrowers.

7 Non-performing loans are those that are at least 90 days in arrears or considered impaired by banks.

Mortgage borrowers continue to shift from relatively high floating rates to lower fixed rates, as expectations increase that the OCR is nearing its trough in the current cycle. Mortgage borrowers are switching lenders more often to seek more favourable lending terms. Lenders are competing more aggressively for borrowers. Banks have continued to reduce their serviceability test rates for new borrowers as mortgage rates have declined.

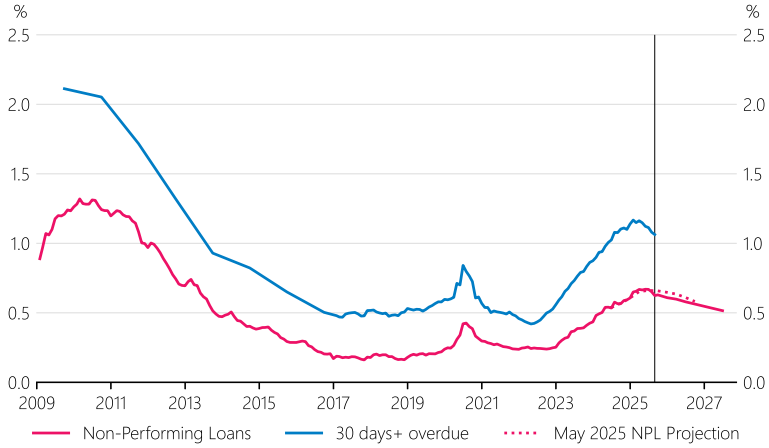
Figure 1.5
Bank mortgage rates



Source: interest.co.nz, RBNZ *Income Statement survey*.

Note: The effective mortgage rate is the average rate across the stock of mortgage lending.

Figure 1.6
Housing arrears and non-performing loan ratios
(share of lending by value)



Source: RBNZ *Bank Balance Sheet survey*.

Note: Non-performing loans are those that are at least 90 days in arrears or considered impaired by banks. This figure shows weighted averages (based on lending amounts) of the five largest banks' actual results and projections for their own lending. The projections are based on the economic outlook from our August 2025 *Monetary Policy Statement*.

Household stress has started to decline as debt-servicing costs have fallen. Fewer borrowers are now falling behind on debt repayments. Borrowers who had previously been in default are finding ways to mitigate stress with the lower debt-servicing costs. Longer-term arrears and impairments have stabilised, but have not improved materially yet. Banks expect non-performing loans to continue to decrease over the next year (figure 1.6), supported by improved borrower cashflows. Instances of mortgagee sales remain low.

We are easing LVR restrictions following the introduction of DTI restrictions

Our assessment is that risks associated with new mortgage lending are contained. House prices remain near the top of our range of sustainable estimates. New mortgage lending with relatively high debt-to-income (DTI) ratios and loan-to-value ratios (LVR) has picked up but remains low. Overall housing credit growth remains subdued as well. The DTI restrictions we introduced in July 2024 act as a guardrail to constrain the share of highly indebted lending if housing credit demand rises materially.

We are in the process of easing mortgage LVR restrictions from 1 December 2025.[8] We intend to increase the owner occupier speed limit to 25 percent from 20 percent for lending with an LVR above 80 percent, and increase the investor speed limit to 10 percent from 5 percent for lending with an LVR above 70 percent.[9] The introduction of debt-to-income (DTI) restrictions last year means LVR settings can be less restrictive on average. This includes looser default settings that we expect will be in place most of the time, except for when risks are particularly elevated.

While the likely impact of this easing on the housing market will be small, it will give banks slightly more flexibility. Over time, we expect this will help minimise the unintended impacts of the policy and support access to credit.

8 See https://www.rbnz.govt.nz/hub/news/2025/10/reserve-bank-to-ease-lvr-restrictions.

9 The speed limit sets a cap on the share of lending above a specified LVR threshold that a bank can provide.

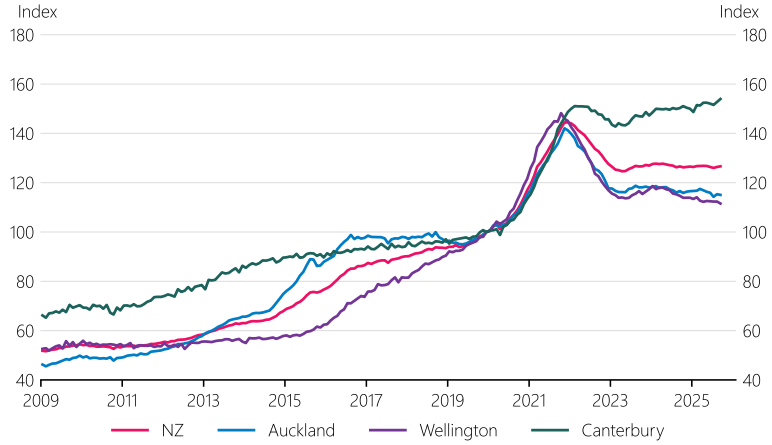
Housing market activity has picked up somewhat, although house prices remain flat

House market activity has picked up from its low point in 2023, supported by lower interest rates and policy changes. National house prices remain around 12 percent below their November 2021 peak and have been broadly flat over the past three years (figure 1.7). Elevated housing inventories in Auckland and Wellington are weighing on house prices, reflecting the soft labour market and low net migration, and offsetting stronger house price growth in parts of the South Island.

Figure 1.7

Regional house price indices

(index=100 in December 2019)

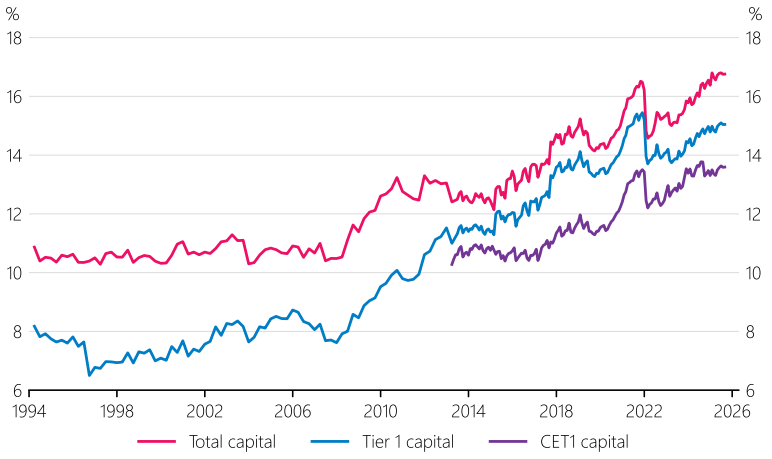


Source: REINZ, RBNZ estimates.

Figure 1.8

Bank capital ratios

(share of risk-weighted assets)



Source: RBNZ *Capital Adequacy survey*.

Low levels of net migration and a soft labour market continue to restrain housing demand. Falling rents and low expectations of capital gains are weighing on investor demand, although the reinstatement of interest deductibility for tax has provided some support.

Challenges in the construction sector are not expected to impair financial stability

The residential construction sector continues to face difficult economic conditions, including soft housing demand and high costs for labour, raw materials, and residential land. Some developers are turning to non-bank and offshore lenders for finance, as they often have less stringent presale requirements than banks.

Residential building activity remains subdued, with activity concentrated in townhouses rather than large apartment complexes. Established developers are in a relatively strong financial position, with high equity positions that reduce their vulnerability to cashflow stress. However, prolonged weak demand for new builds could put further pressure on more indebted developers.

Company failures and liquidations have increased over the past year, led by construction. This partly reflects an accumulation of tax arrears that have exposed these firms to increased enforcement activity by Inland Revenue (see Special Topic 1). Despite these pressures, banks' exposure to distressed construction firms is limited.

Banks have expanded their capacity to absorb potential credit losses

Banks have continued to increase their resilience. Capital ratios remain well above minimum requirements and have increased further as the higher requirements from the 2019 Capital Review have been implemented (figure 1.8). Banks also continue to hold high levels of provisioning, particularly against general business lending. Strong capital positions and provisioning place banks in a favourable position to absorb loan losses in a potential economic downturn, while providing credit to support the recovery.

We are reviewing key settings for capital requirements

Consultation on policy proposals for key capital settings closed in early October,[10] and we are currently assessing feedback alongside views from independent international experts. A final decision on capital settings is expected by the end of 2025 (see Chapter 3).

Competition and efficiency are important elements of our financial policy development. We have developed competition assessment guidelines for prudential policy,[11] partly in response to a Commerce Commission recommendation. The implementation of the Deposit Takers Act 2023 includes a proportionality framework to ensure that regulation is calibrated to the scale and complexity of different-sized deposit takers. We are seeking feedback on allowing a wider set of deposit takers to use the term 'bank' in a name or title, which supports an efficient and competitive deposit-taking sector.

Banks remain well funded and have strong liquidity positions

Core funding ratios remain elevated relative to regulatory requirements. Wholesale funding spreads have fallen to low levels in funding markets. Deposit growth has been robust in an environment of low credit growth, reducing the need for new issuance of wholesale funding. Despite this, banks have continued to raise funding in offshore markets to maintain investor relationships in preparation for a potential pick-up in credit demand. Banks' liquidity positions remain robust, despite some easing over the past year.

Our 2025 bank liquidity stress test assessed the resilience of 10 banks to liquidity shocks over a 6-month period. We found that banks' resilience to liquidity stress has declined slightly compared to the 2024 stress test, but remains stronger than in 2021.

The implementation of the Depositor Compensation Scheme (DCS) has not materially affected bank deposit flows or their pricing behaviour so far. Some non-bank deposit takers have reported an increase in deposit inflows, as depositors spread their deposits to maximise their coverage (see Chapter 4). This has also coincided with a sharp reduction in the differential between their deposit rates and bank rates. We remain at an early stage of the DCS and will continue to monitor developments.

10 See https://www.rbnz.govt.nz/hub/news/2025/08/rbnz-invites-feedback-on-review-of-capital-requirements-for-deposit-takers.

11 See https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/competition-assessment-guidelines-for-prudential-policy.pdf.

Pressures on general insurance premiums have moderated, but affordability challenges continue to grow

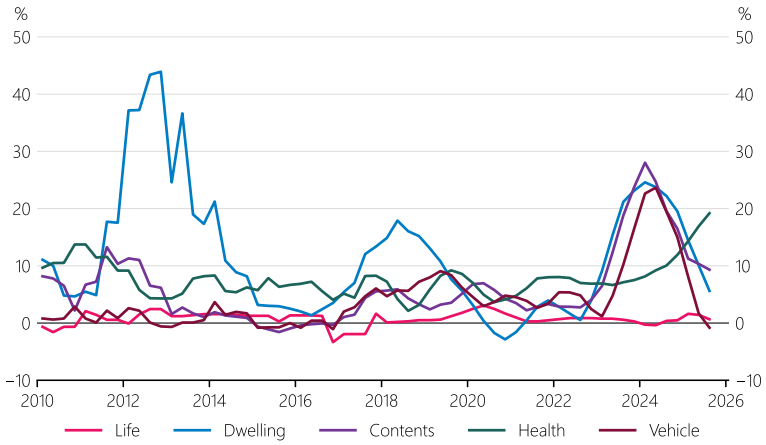
Growth in general insurance costs has continued to slow over the past six months, for both dwelling and contents insurance (figure 1.9). This reflects relatively benign weather, with no catastrophes approaching the scale of the 2023 flooding and cyclone events. This has resulted in lower aggregate claims volumes than the average levels observed over the past five years.

However, inflation in general insurance premiums remains above consumer price inflation. An increase in the Natural Hazards Commission levy would place additional upward pressure on insurance premiums. Insurers have continued to adopt more risk-based pricing of dwelling insurance. Rising premiums are gradually becoming less affordable for some policyholders.

Figure 1.9

Insurance premium inflation by type of insurance

(annual percent change)



Source: Stats NZ.

More favourable conditions in global reinsurance markets contributed to slowing inflation in general insurance premiums. A stronger supply of capital in global reinsurance markets has helped to limit reinsurance costs for New Zealand insurers. This development highlights the key role of global reinsurance markets in mitigating our exposure to natural disasters (see Special Topic 2).

In contrast, growth in health insurance premiums is accelerating (figure 1.9). Health insurance premiums have increased around 19 percent over the past year, as health insurers face pressure from increasing claims costs. Capacity pressures in private healthcare services are pronounced. Deferred medical procedures following the COVID-19 pandemic and the stretched capacity of the public health system have contributed to a shift towards the private health system.

Growth in claims cost has resulted in health insurers generating operating losses. Insurers' solvency positions remain above our requirements. However, further increases in claims costs could increase operating losses and exacerbate financial stress in the sector.

Improved data collection bolsters our effort to monitor cyber resilience

Our cyber resilience reporting requirements support the monitoring of cyber risks in the financial system. Analysis of data from our 2024 *Cyber Capability survey* shows that regulated entities are generally aligned with our guidance on cyber resilience, in terms of governance, capability building, information sharing, and the management of third-party risks (see Special Topic 3). Data collected from regulated entities and our collaboration with other domestic and Australian agencies will continue to inform our cyber risk monitoring and response.

Chapter 02

Special topics

Mount Victoria, Wellington. Photo: Charles Lilly

Chapter 2.
Special topics

This chapter covers topical issues relevant to financial stability in New Zealand.

In this ***Report***, we cover the following:

1. Financial stress in the business sector
2. Reinsurance and financial stability
3. Cyber and operational resilience: Results of the 2024 *Cyber Capability survey*

Selected special topics and boxes from the past 12 months

Topic	Publication
Borrowing beyond borders: Risks from New Zealand's reliance on overseas debt	May 2025 *Report* (Chapter 2.1)
Rise of the machines: How could artificial intelligence impact financial stability?	May 2025 *Report* (Chapter 2.2)
Increased tariffs raise financial stability risks	May 2025 *Report* (Box B)
The review of key capital settings	May 2025 *Report* (Box C)
The Grey Wave: Exploring the impact of an ageing population on the financial system	June 2025 Special Topic
Exploring vulnerabilities through reverse stress testing	November 2024 *Report* (Chapter 2.1)
Update on the housing market	November 2024 *Report* (Chapter 2.2)
Developments in financing channels outside the prudentially regulated sector	November 2024 *Report* (Chapter 2.3)

1 Financial stress in the business sector

Key Points

- Soft demand and reduced profitability are contributing to financial stress in many sectors, especially those reliant on discretionary consumer spending.
- Pandemic-era savings buffers have largely been depleted, particularly for smaller firms. Business failures are increasing as financial pressures accumulate.
- In contrast to other sectors, agriculture and commercial property are doing well given lower interest rates and high export prices.
- Business stress is leading to higher non-performing loans (NPLs), increasing potential credit losses for banks. However, these remain below levels seen in past downturns.
- Overall, conditions are expected to improve gradually, as profitability and debt-servicing capacity recover with strengthening demand.

Soft demand is creating challenging business conditions

Persistent weakness in demand has created difficult conditions for businesses through 2025. This is especially so in sectors that rely on discretionary consumer spending. Annual GDP in the June quarter contracted by 1.1 percent from a year earlier. Activity in the manufacturing and construction sectors declined over this period, while activity in the service sector plateaued.

Subdued discretionary spending by households has affected sales for many sectors. Business financial data show that sales in the construction, manufacturing, retail and wholesale trade sectors have been weak over the past two years. This is the period where business stress has generally been increasing.

Trade and geopolitical tensions are adding uncertainty. While the impact on exporters has largely been limited so far, the impacts of tariffs on trade patterns and supply chains are ongoing. Many exporters are diversifying into new markets to reduce their risk. However, setting up these alternatives takes time, investment, and infrastructure. In the short term, this can affect costs and profitability.

Weak demand is eroding profitability for many firms

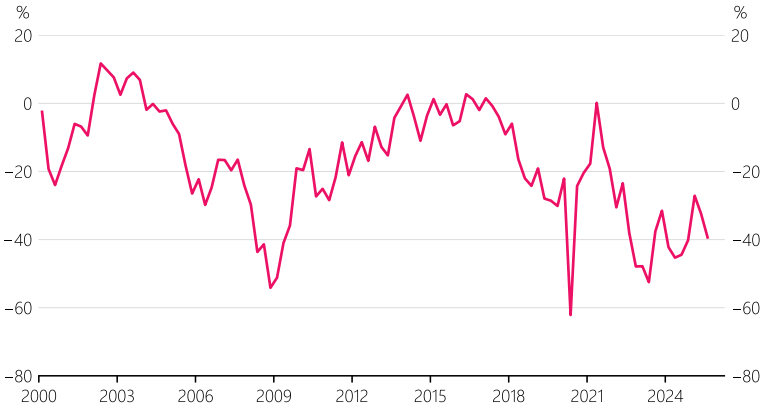
Sluggish sales have lowered business profits. Business surveys suggest a high proportion of firms have seen a reduction in profitability since early 2023 (figure 2.1). This proportion has been similar to that seen during the Global Financial Crisis in 2008/09.

Weak profitability has been concentrated in sectors reliant on discretionary consumer spending. The retail trade, hospitality, manufacturing, and construction sectors have been particularly weak (figure 2.2). Rental, hiring, and real estate services have benefited from some improvement in housing turnover, as house sales have picked up from the lows seen in 2023.

Figure 2.1

Surveyed responses to change in business profitability

(net percent)



Source: NZIER *Quarterly Survey of Business Opinion*.

Note: Net percentage of firms that experienced an increase in profitability in the past quarter.

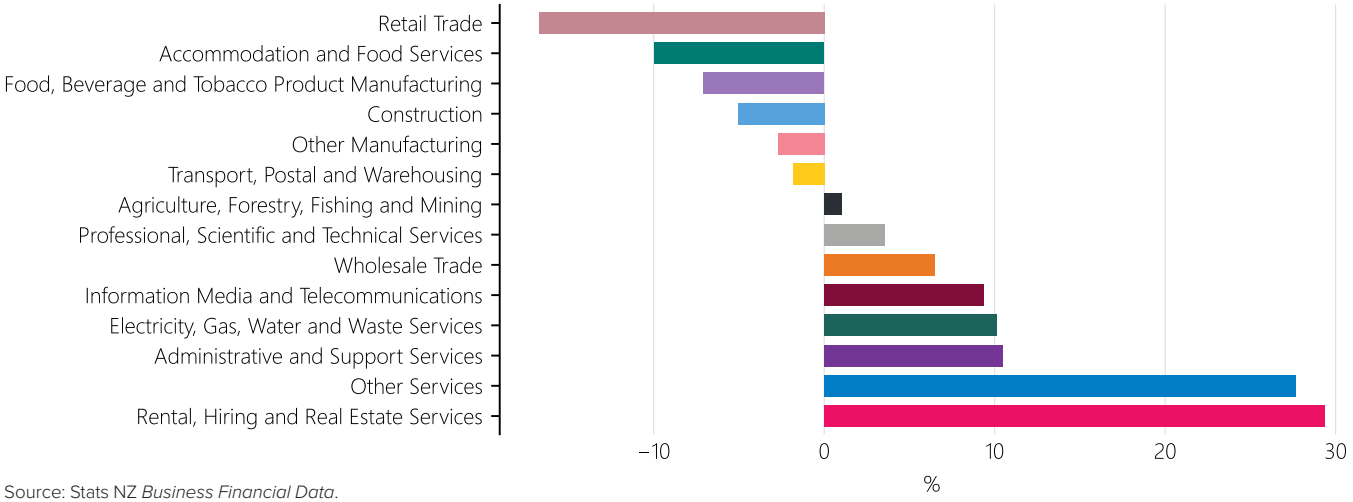
Business stress is affecting the financial system

When the economy is weak and business financial stress rises, it has a range of effects on the financial system. We discuss two main channels related to business liquidity and solvency (figure 2.3). Liquidity relates to firms' cashflow pressures, while solvency reflects their longer-term balance sheet strength.

Figure 2.2

Change in operating profit by industry

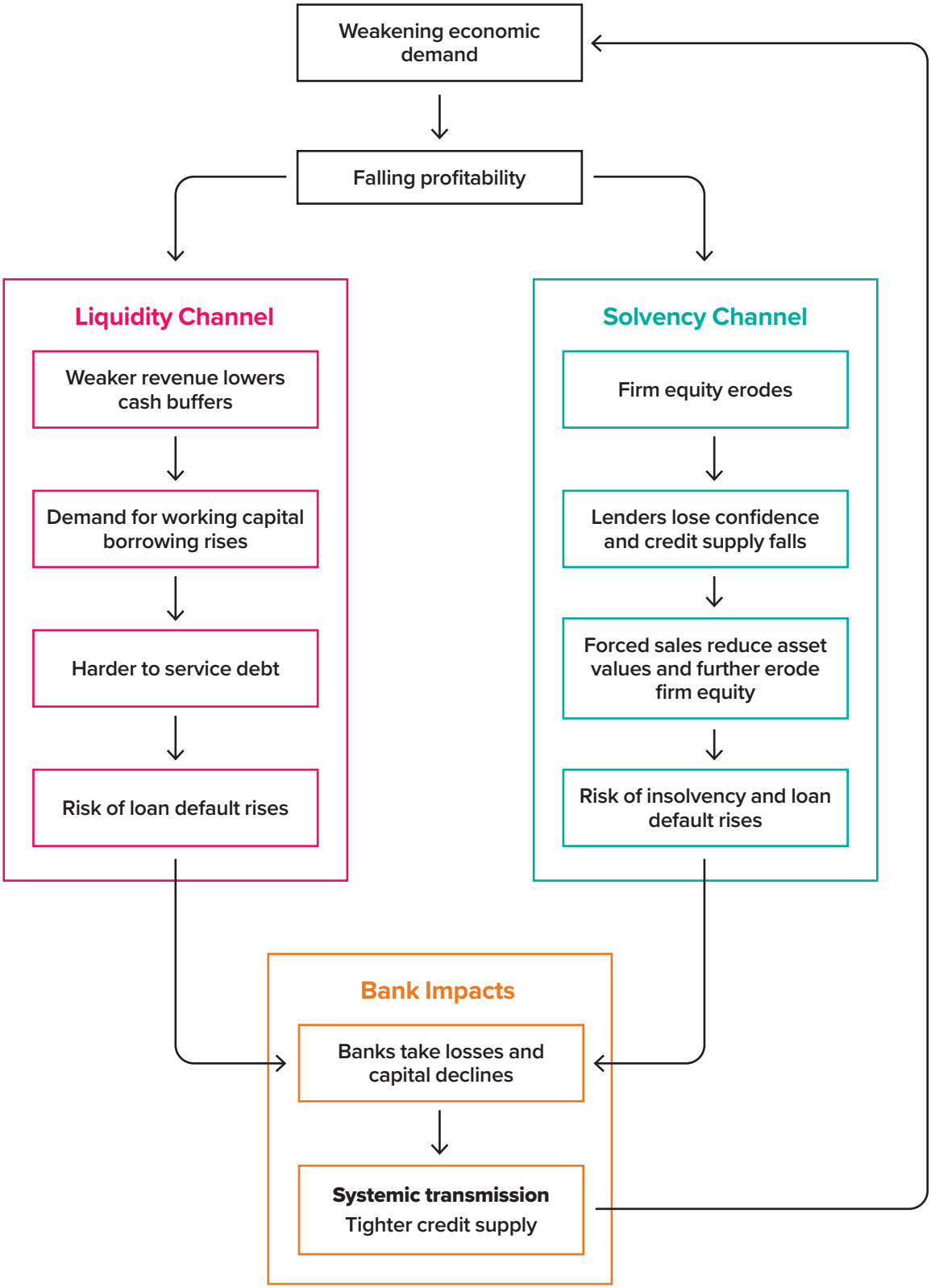
(over the two years to June 2025)



Source: Stats NZ *Business Financial Data*.

Figure 2.3

Transmission of stress between businesses and the financial system



Source: RBNZ.

Liquidity channel

The first channel is through business liquidity. Liquidity is about having enough cash, access to credit, or easily sold assets to cover short-term payments. Firms experiencing falling profitability may not have enough cash on hand to pay wages, tax, or suppliers.

Saving buffers built up during the pandemic have been depleted

During the COVID-19 pandemic, businesses generally benefited from fiscal support and low interest rates, which allowed them to build cash buffers. However, these buffers have been eroded over the past few years for small and medium businesses. Deposits for large firms have been more stable as a share of GDP (figure 1.4).

Where cash buffers have eroded, firms may rely on banks to provide working capital. Since the start of 2021, businesses have borrowed more through overdraft facilities. In our discussions with banks, they noted that smaller businesses, which have smaller balance sheets, have also had greater demand for working capital to meet ongoing cashflow pressures. However, larger firms, which have access to a wider range of funding sources, have also increased their use of overdraft facilities.

Cashflow pressures have eased for key indebted sectors

Debt levels differ across sectors. Businesses in the agriculture and commercial property sectors tend to be the most reliant on borrowing, reflecting the large upfront capital required in these industries. In other sectors, debt levels are generally lower and debt-servicing costs make up a smaller share of total expenses.

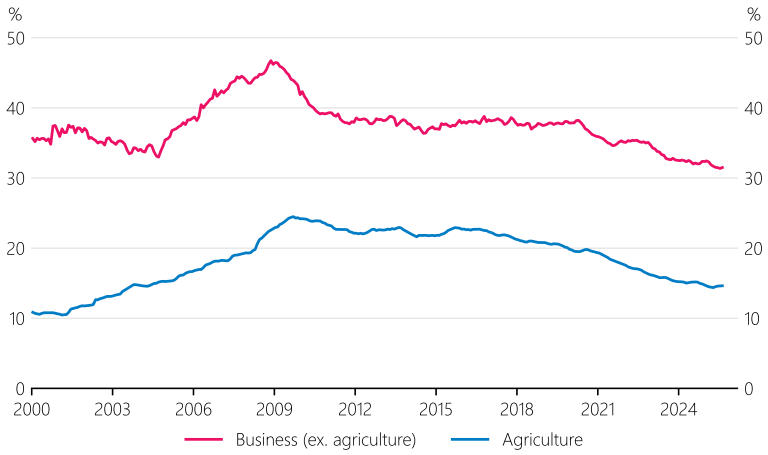
Lower interest rates and strong export prices over the past year have improved cashflow in the agriculture and commercial property sectors. The effective business lending rate has fallen from close to 8 percent to just below 6 percent, easing debt-servicing costs and supporting profitability, particularly in these sectors.

Aggregate business leverage has reduced since 2009 (figure 2.4). Business (including agriculture) credit has declined from 69 percent of GDP in 2009 to 46 percent. In particular, the dairy sector has significantly reduced its debt since 2015. Over the past decade, banks have maintained stronger lending standards, and business borrowers have become more resilient as a result.

Figure 2.4

Business and agriculture credit

(share of GDP)



Source: RBNZ *Bank Balance Sheet survey, Non-bank Standard Statistical Return*, Stats NZ, RBNZ estimates.

Highly indebted firms face heightened risk during downturns when they need to 'roll over' loans by reissuing or refixing debt. Firms already under liquidity strain may struggle to secure new loans on similar terms, or find banks less willing to extend credit. This can further tighten cash flow, even for solvent firms, and increase the risk of bankruptcy.

At present, however, weak credit demand and strong bank funding conditions have helped maintain credit availability.[12] Competition among banks for new business lending has led to lower borrowing rates in some sectors, while lending standards have generally remained stable at pre-COVID-19 levels.

Solvency channel

The second channel that business stress affects the financial system through is through business solvency — a firm's ability to meet its long-term obligations, meaning its assets exceed its liabilities. Persistent operating deficits can erode equity buffers and leave businesses unable to repay creditors.

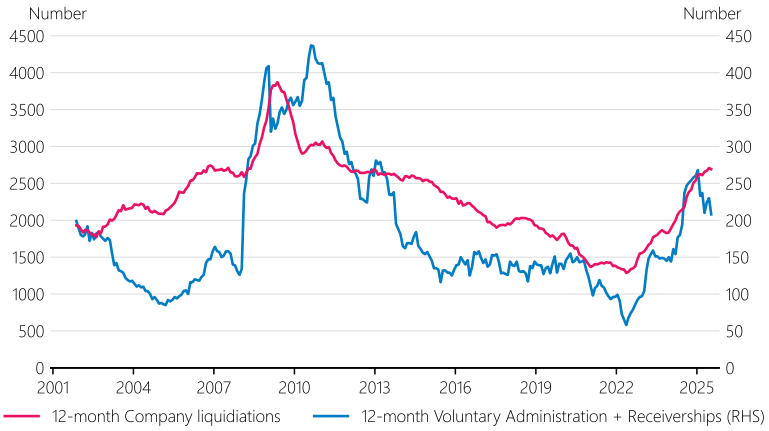
Firms with strong equity positions may be able to take on new debt to continue operating, but those with limited equity face mounting financial pressure as losses accumulate. Eventually, this can lead to insolvency.

Insolvencies are increasing as financial pressures grow

Rising insolvency rates show that profitability pressures have become unsustainable for some firms (figure 2.5). Company liquidations are now above historical averages, particularly among SMEs and consumer-facing industries such as construction and hospitality.[13] Centrix reports that around 70 percent of recent liquidations have been initiated by Inland Revenue. This suggests that some businesses are effectively treating unpaid taxes as a form of credit, highlighting their cashflow pressures.

Figure 2.5

Company liquidations and receiverships



Source: Companies Office.

12 See https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/statistics/series/c/c60/credit-conditions-survey-september-2025.pdf.

13 See Centrix Credit Indicator Report – September 2025 available at https://www.centrix.co.nz/wp-content/uploads/2025/10/Centrix-Credit-Indicator-Report-September-2025_Web.pdf.

Banks are reporting some signs of stress in their business loan portfolios

For struggling firms, banks (and credit rating agencies) may downgrade their credit risk ratings, leading to higher interest rates. We track the share of banks' business lending to firms they assess as high credit risk — referred to as potentially stressed lending (figure 2.6).

This share has risen over the past two years, reflecting a gradual increase in business stress. The rise has been particularly pronounced for smaller businesses, while larger corporates have seen a more moderate increase. Stress in the commercial property sector increased earlier, when interest rates were especially high, but has since eased.

Asset values are holding up

Another risk arises when financial stress within a sector prompts widespread asset sales as firms attempt to reduce leverage. Such sales can push asset values down, further eroding equity and intensifying balance sheet pressures.

At present, we do not see this as a major concern. Asset values are most relevant for the agriculture and commercial property sectors, both of which have been performing relatively well. Commercial property prices fell as interest rates rose in 2022 and 2023, but have increased over the past year. Dairy farm prices, while volatile due to low turnover, have remained broadly stable (figure 2.7).

Despite rising stress, most firms continue to meet their loan obligations

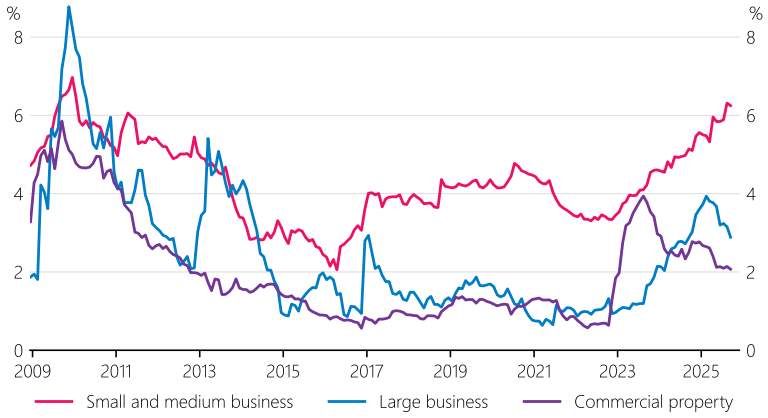
Business NPLs have increased only moderately over the past two years (figure 2.8). Prudent lending standards and general deleveraging have helped keep NPL rates well below those seen during the Global Financial Crisis.

However, some industries are experiencing more pronounced increases. Manufacturing, accommodation and food services, and transport, postal and warehousing have seen the largest rises (figure 2.9).

Figure 2.6

Potentially stressed lending

(share of total lending by sector, seasonally adjusted)

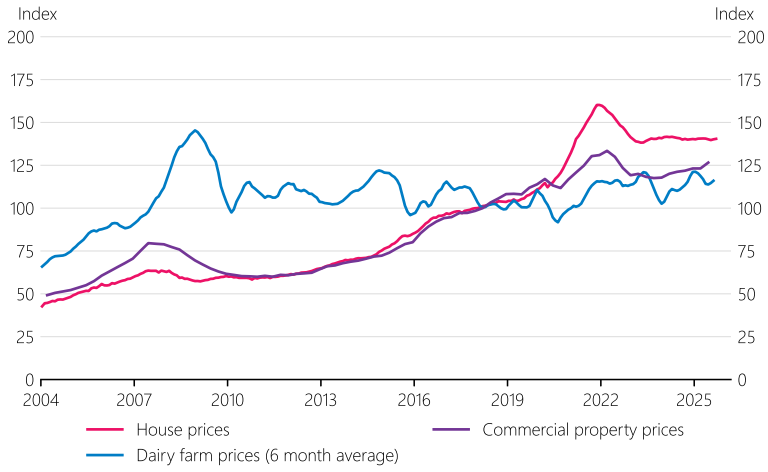


Source: RBNZ *Bank Balance Sheet survey*.

Figure 2.7

House, farm, and commercial property prices

(index=100 in March quarter 2018)

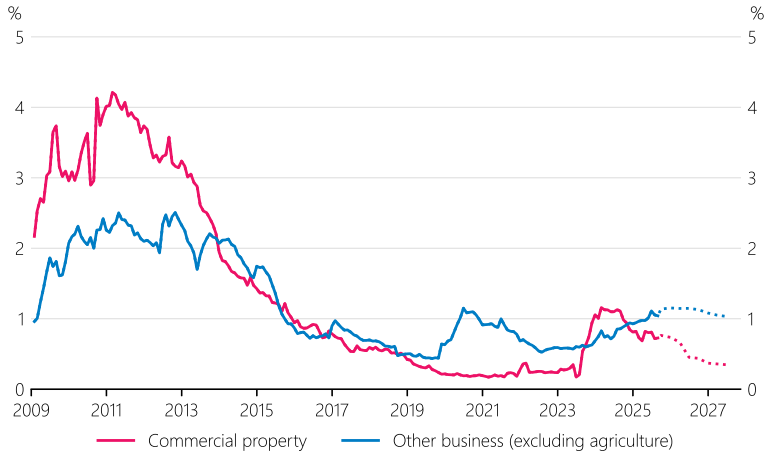


Source: REINZ, Jones Lang LaSalle.

Figure 2.8

Non-performing business loans and bank projections

(share of lending by value in each sector)



Source: RBNZ *Bank Balance Sheet survey*, private reporting.

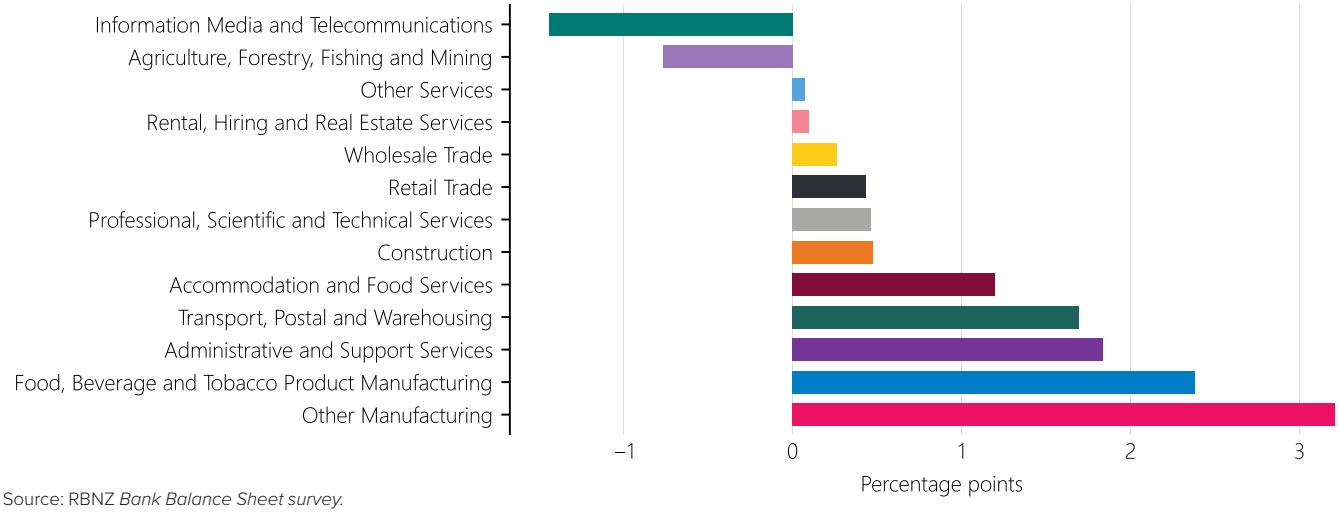
Note: Data before 2017 covers all banks, while data from 2017 onwards covers only the five largest banks. This aligns the historical series with the projections (dotted lines) that we collected from the five largest banks.

Projections are based on the forecasts in the August 2025 *Monetary Policy Statement*.

Figure 2.9

Change in non-performing loan ratio by sector

(over the two years to September 2025)



Source: RBNZ *Bank Balance Sheet survey.*

Figure 2.10

Non-performing agriculture loans and bank projections

(share of lending by value)

Source: RBNZ *Bank Balance Sheet survey, private reporting.*

Note: Data before 2017 covers all banks, while data from 2017 onwards covers only the five largest banks. This aligns the historical series with the projections (dotted lines) that we collected from the five largest banks.

The agriculture sector remains a relative bright spot

In contrast to the rise in most other sectors, NPLs in the agriculture sector have declined (figure 2.10). Elevated milk and beef prices, improving sheepmeat prices, and stabilising (albeit high) farm costs have supported strong financial returns for the rural sector. Lower interest rates and debt repayment have improved interest coverage ratios, bringing agriculture NPLs close to a 16-year low, particularly in the dairy industry.

However, the sector remains exposed to global and domestic risks. Rising geopolitical tensions could increase volatility in input costs and commodity prices, while dry weather in parts of the North Island has weighed on production for some farms. In addition, the meat-processing sector continues to struggle with excess capacity and low profitability. A key risk to the outlook that remains is the impact of tariffs on global demand.

Stress in weaker sectors could spill over to the broader economy and banks

The transmission of business stress to the financial system also depends on spillovers from weak sectors to the broader economy. As firms cut costs, the effects can spread to households and other businesses through job losses, higher unemployment, and reduced household incomes and spending.

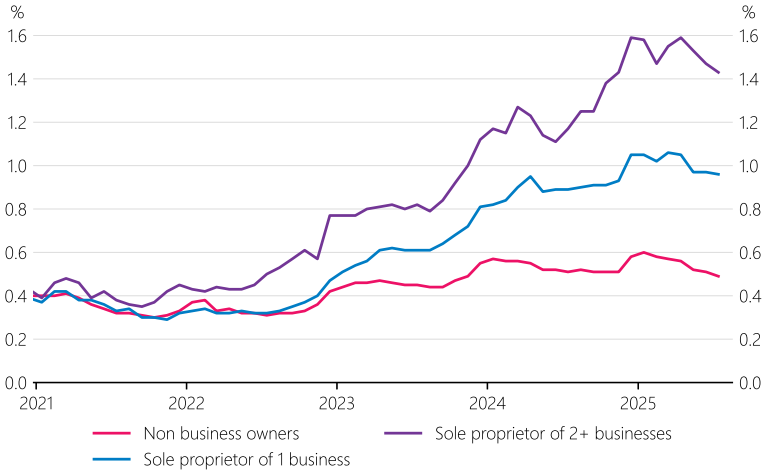
Mortgage borrowers who rely on business income are particularly exposed to business stress. Centrix data shows that past-due mortgage rates among business owners have risen more than for wage and salary earners (figure 2.11).

Many firms have also delayed investment. In our discussions with banks, they noted that new business borrowing has largely been limited to working capital and minor upgrades, rather than large-scale investment or merger and acquisition activity. This restraint is flowing through to other sectors. For example, building consent data suggests that non-residential construction activity is softening.

Figure 2.11

Mortgage lending past due for business owners

(share of mortgages more than 30 days past due)

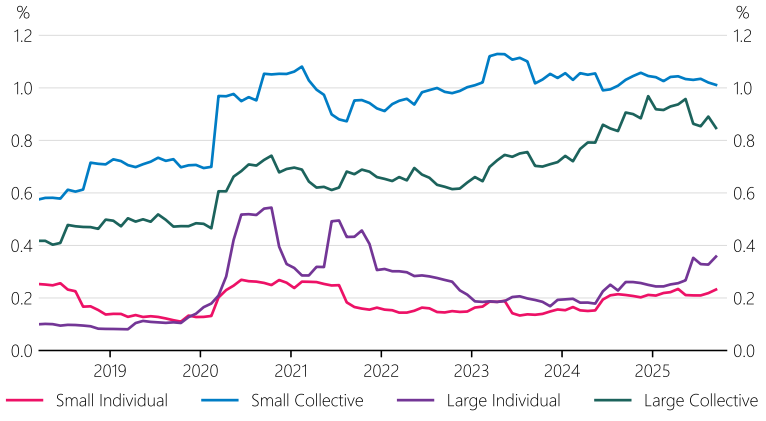


Source: Centrix.

Figure 2.12

Provisioning for businesses by size and type

(share of lending by value in each sector)



Source: RBNZ B*ank Balance Sheet survey*.

Business conditions should gradually improve as the economy strengthens

Economic conditions are expected to improve as OCR cuts lift demand.[14] There are some signs of demand increasing already. For example, retails sales volumes increased in the June quarter of this year.

Banks expect the non-performing share of commercial property loans to fall to a low level over 2026 and 2027 (figure 2.8). For other business loans, they expect the non-performing share to increase over the next couple of months before gradually decreasing also.

While this outlook is uncertain and conditions could deteriorate, overall risks to banks from business sector stress remain contained. This has been supported by prudent lending standards for some time. While banks may experience losses on some loans, they are in a strong position to manage and support customers.

Collective provisions, funds set aside to cover potential losses across groups of similar loans, remain elevated at or above the levels observed during the COVID-19 pandemic (figure 2.12). Individual provisions, which are targeted allowances for loans already showing signs of distress, are somewhat lower, indicating that relatively few business loans have deteriorated to the point of requiring specific recognition.

Lending is expected to remain subdued for the remainder of this year, driven by low demand, before increasing next year as economic activity picks up. We expect competition amongst banks to remain high as they look to extend lending to creditworthy businesses. Ongoing supply of credit is important to support the recovery in economic activity. Also, it is important for banks to maintain prudent lending standards so that borrowers remain resilient in future periods of financial stress.

14 See https://www.rbnz.govt.nz/hub/publications/monetary-policy-statement/2025/aug-08hgf/monetary-policy-statement-august-2025.

2 Reinsurance and financial stability

Key points

- Reinsurance markets underpin New Zealanders' access to many insurance products and support financial stability. They allow New Zealand insurers to transfer the cost of large risks to global capital markets, making cover for catastrophic events such as earthquakes economically viable.
- Global reinsurance markets are concentrated in a small number of large players, alongside many smaller reinsurers. Most of the large New Zealand general insurers obtain access to reinsurance through a joint scheme with their Australian parent insurer.
- Key drivers of global reinsurance capacity and pricing are the extent of recent large loss events and conditions in financial markets. These affect the amount of reinsurer capital and therefore supply of reinsurance.
- Shifts in risk perceptions and improved modelling over time also influence reinsurance terms and availability for different regions and types of events. For example, after the Canterbury earthquakes in 2010-11, global reinsurers reassessed the seismic risk profile of New Zealand, leading to a tightening in terms and rising reinsurance costs.
- The availability and cost of reinsurance are mostly driven by factors outside of New Zealand's control, creating a channel for global developments to influence domestic financial stability.
- Several years of higher-than-expected claims costs culminated in a significant upward repricing of reinsurance globally over 2022 and 2023. These pressures have since abated, contributing to a moderation in reinsurance pricing over the past year, reducing inflation in general insurance premiums for New Zealand households and businesses.

Reinsurance indirectly affects most New Zealanders

Insurance plays an essential role in the financial system, supporting households and businesses by transferring risks that would otherwise be borne individually. New Zealand's exposure to natural disasters such as earthquakes, floods, and cyclones makes insurance particularly important for supporting household and business economic resilience to these events.

A crucial but less visible element of the insurance industry is reinsurance. Reinsurance is insurance for insurers. It allows insurers to transfer part of the risks they take on from their customers to specialised global reinsurers. New Zealand insurers' access to the global reinsurance market is a key contributor to financial stability. In turn, conditions in global reinsurance markets directly affect the cost of insurance premiums New Zealand customers pay.

This Special Topic outlines what reinsurance is, how insurers use it, and how it contributes to New Zealand's financial stability.

Reinsurance is an important source of stability for New Zealand insurers

The primary role of reinsurance is to act as an efficient source of capital for domestic insurers. Under the Reserve Bank's solvency requirements, insurers need to have sufficient capital reserves or reinsurance to cover their liabilities for a 1-in-1000-year seismic event. Reinsurance is a mechanism by which insurers can manage very large or volatile losses that may be difficult to absorb on their own.

An insurer cedes part of its premium income to a reinsurer in exchange for reimbursement if losses from a defined cause (e.g. earthquake, flood, storm) exceed an agreed financial threshold. This means that insurers can provide cost-effective cover for high-severity, low-frequency risks.

Without reinsurance, insurers would experience difficulty in attracting sufficient volumes of capital to cover catastrophe risks. If such capital could be raised, the cost of holding it would make policies significantly more expensive. In practice, this would force insurers to narrow coverage or lower policy limits. This, in turn, would shift more risk back onto households, businesses, and the Crown, weakening financial resilience.

Reinsurance can therefore be thought of as a shock absorber that spreads the financial impact of very large loss events across a much larger international pool of capital.

In New Zealand, general insurers are the most intensive users of reinsurance. They use reinsurance to manage their catastrophe exposures in their property insurance, motor vehicle, and other liability portfolios. Around one third of the gross written premium across general insurers' commercial and personal lines is ceded to reinsurers.

The importance of reinsurance for general insurers in New Zealand reflects the high concentration of catastrophe risks relative to the scale and depth of the domestic economy and capital markets. Local insurers would likely struggle to provide sufficient coverage across the country to support their current insurance offerings without access to international risk-sharing arrangements.

Life insurers largely use reinsurance to support writing more business, especially new policies, than their own capital resources would otherwise permit.[15] They also benefit from the technical expertise of global reinsurers. Life insurance risks are generally less volatile and less exposed to large, aggregated loss events than property risks. By contrast, health insurers in New Zealand make very limited use of reinsurance, largely because their claims patterns are steady and more predictable, reducing the need for external risk transfer.

15 For new policies, it takes time for life insurers to accumulate sufficient revenue to cover the initial reserving and acquisition costs.

Following a natural disaster, prompt claims payments are critical for enabling households to recover, for businesses to continue operating, and for the banking system to remain stable. By absorbing large loss events, reinsurers help local insurers to meet claims and avoid depleting their capital, meaning they can continue offering cover. This helps to avoid spillovers to the value of the property collateral that secures much of bank lending, and supports households' and businesses' wealth and economic activity. Reinsurance is therefore a key channel through which domestic financial stability is influenced by international capital markets.

The global reinsurance market is dominated by a small number of firms

The reinsurance industry is relatively concentrated with a handful of major firms playing a prominent role. Munich Re, Hannover Re, Swiss Re, Renaissance Re, and Berkshire Hathaway are among the largest, as well as the Lloyd's market in London. Alongside these larger firms, there are many smaller reinsurers that contribute additional capacity to the market.

A small but growing supplement to the traditional reinsurance markets is through alternative capital providers, including hedge funds and pension funds, which offer catastrophe bonds or other instruments. In mid-2025 the traditional reinsurance market was estimated at USD 614 billion, with alternative markets at USD 121 billion.[16]

Reflecting the structure of the New Zealand general insurance market, many of the large New Zealand general insurers obtain reinsurance through joint schemes with their Australian parent insurer. New Zealand-specific risks are a material part of the trans-Tasman insurer groups' decisions about reinsurance cover. Insurers commonly have several dozen or more reinsurers participating in their reinsurance programmes.

Global reinsurers view Australia and New Zealand as a small but attractive market. Natural catastrophe exposures are relatively high, though typically not correlated with risks in the Northern Hemisphere such as hurricanes and wildfires in North America, and windstorms in Europe. Underwriting Australasian risks can therefore allow global reinsurers to diversify risks. Furthermore, the Australian and New Zealand insurance markets are well developed with high coverage levels and mature modelling of risks.

16 See https://www.aon.com/en/insights/reports/reinsurance-market-dynamics.

Insurers have a range of options when designing their reinsurance programmes

Reinsurance programmes can be structured in different ways as insurers seek to balance costs, capital relief, and protection from very high losses.

Insurers use both proportional contracts, such as quota share arrangements, and non-proportional contracts, such as excess-of-loss cover. In proportional contracts, a fixed proportion of all premiums and claims is transferred to reinsurers (table 2.1). In non-proportional contracts, the insurer and reinsurers negotiate a structure that sets out limits for which party covers which portion of loss, across different loss events. A recent trend for Australasian insurers has been the popularity of multi-year arrangements, which helps to stabilise contract terms over time.

Table 2.1

Key design features for a catastrophe reinsurance programme

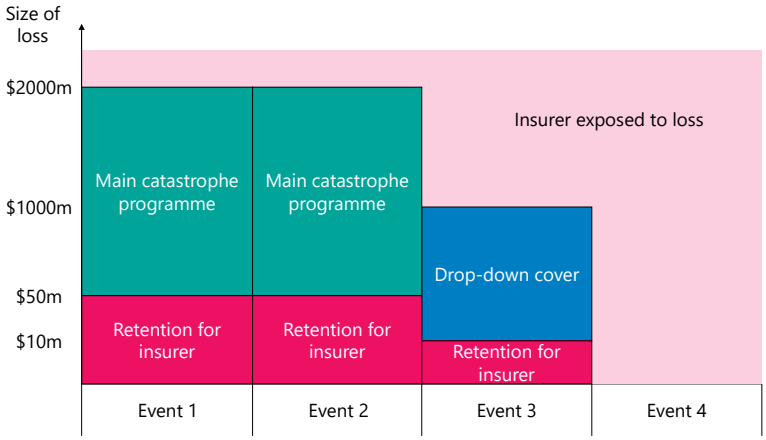
Feature	Explanation and implications
Attachment point	The level of loss the insurer absorbs from an event before the reinsurance responds. Lower attachment points (also called retentions) reduce losses for the insurer but increase reinsurance programme costs.
Vertical layers	Programmes can be structured with one large layer or several smaller layers of reinsurance for a given event, which sets out which party is exposed as losses from the event increase. Having multiple vertical layers allows for a diversification across reinsurers and more granular pricing, as reinsurers are able pick which portion of the loss (with associated probability) they want to cover. This also provides valuable diversification and reduces the risk that the programme is disrupted if any one reinsurer declines to renew it. Alternatively, a single vertical layer is potentially simpler to arrange and manage.
Event limits and reinstatements	Contracts typically specify the number of events covered per year, meaning an insurer will need to consider what further protection they need if one or two large events have already occurred. One option is to buy reinstatements once an event has occurred (restoring cover for additional losses). Alternatively, insurers can use drop-down layers, which extend capacity from the main programme to cover subsequent events, typically at a lower attachment point, allowing protection to respond sooner after an initial loss.
Proportional contracts, e.g. quota share arrangements	A fixed proportion of all premiums and claims is ceded to reinsurance (e.g. 50 percent). This helps to reduce the amount of capital needed for the amount of business written, by sharing risk (and premium revenue) with a reinsurer. Quota shares can also be structured with vertical layers, to limit the catastrophe risk retained by the insurer.
Multi-year programmes	Reinsurance programmes can span multiple years, providing stability in pricing and capacity. However, longer-term contracts reduce flexibility if risk conditions and market pricing change significantly.

Source: RBNZ.

A stylised example of a reinsurance programme for a general insurer is presented in figure 2.13. In this case, the New Zealand insurer retains the first $50 million of losses following each of the first two loss events, with the main programme then covering losses between $50 million and $2 billion. Following a third event, the insurer has arranged 'drop-down' cover to reduce its attachment point to $10 million, with additional cover of $990 million available. Unless cover is reinstated following three events, the insurer is exposed to all losses from a fourth event and subsequent events and must hold capital to support this risk.

Figure 2.13

Stylised example of reinsurance programme



Source: RBNZ.

The cost and availability of reinsurance are influenced by global and local conditions

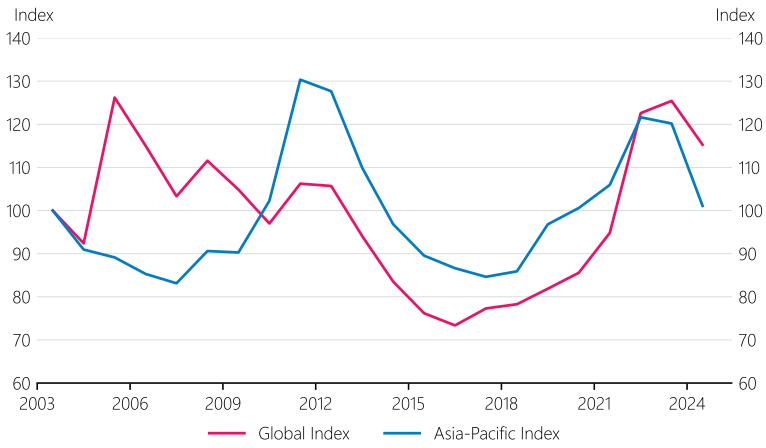
The cost and availability of reinsurance are driven by the available capital in the international reinsurance markets, financial market developments, and changes in underlying risks:

- **Large loss events**, such as major hurricanes in the US, can reduce reinsurer capital and lead to rising premiums globally. Because reinsurance is a global pool of risk, events occurring far from New Zealand still affect domestic pricing. Periods of heavy global loss events can lead to so-called 'hard' reinsurance markets, where premiums rise and coverage is more restrictive due to the scarcity of capital. Premiums can consequently rise as reinsurers seek to rebuild their capital and profitability. Several years of higher claims costs culminated in a significant repricing of reinsurance globally over 2022 and 2023 (figure 2.14), as well as changes to programme structures (e.g. attachment points).

Figure 2.14

Global and Asia-Pacific catastrophe reinsurance costs

(index =100 in 2004)



Source: Guy Carpenter.

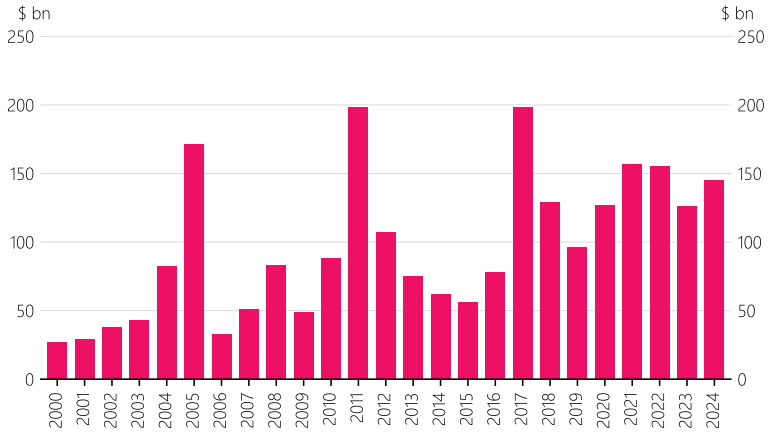
Note: These "Rate-on-Line" indices are measures of the premiums paid for reinsurance per $1,000 of coverage.

- **Financial market conditions** play a significant role. Reinsurers need to attract capital by offering attractive returns. A period of low interest rates will tend to draw new capital into the reinsurance industry, as well as boosting the value of reinsurers' investment portfolios, which consist of mostly fixed-income investments. This helps to increase risk capacity and moderate premium growth. Conversely, rising global interest rates can contribute to a hardening in reinsurance markets.

- **Long-term shifts in risk perceptions** also influence reinsurance terms by risk type and region. A heightened focus on the frequency and severity of weather-related events is evident in reinsurance terms, reflecting both recent experience and long-term climate considerations (figure 2.15). Advances in catastrophe modelling and data following major events also allow reinsurers to reassess their exposures and appetite for specific events and regions, as was the case for New Zealand seismic risks after the Canterbury, Seddon, and Kaikōura earthquakes over the 2010s.

Figure 2.15

Global insured losses from natural disasters



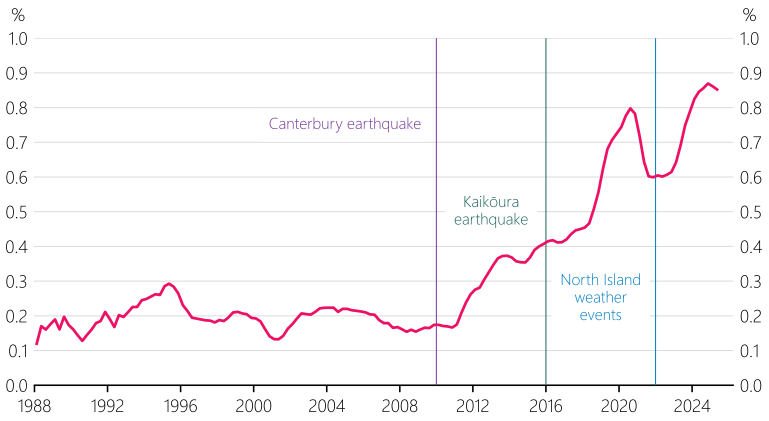
Source: Aon.

Note: Loss amounts expressed in 2024 US dollars.

Figure 2.16

Reinsurance expenses

(as a share of GDP)



Source: Stats NZ, RBNZ estimates.

Note: Reinsurance expenses are proxied by the value of "Insurance and pension services imports" in the Balance of Payments. Reinsurance makes up a large part of this series.

Implications for New Zealand insurance availability

New Zealand insurers have faced a marked increase in reinsurance costs over the past two decades, reflecting both increased costs and risk coverage (figure 2.16). Reinsurance now represents over 10 percent of the value of New Zealand's total services imports, at around $3.7 billion annually.

Following the Canterbury earthquake sequence in 2010 and 2011, global reinsurers reassessed the seismic risk profile of New Zealand, leading to a tightening in terms and rising premiums. The 2016 Kaikōura earthquake reinforced this trend, with the event leading to significant commercial property losses in Wellington. More recently, the 2023 Auckland Anniversary floods and Cyclone Gabrielle highlighted the significantly higher scale and cost of severe weather events that the country will face as global average temperatures rise.

Reinsurance market outcomes are not shaped by New Zealand factors alone. Global reinsurers often treat Australia and New Zealand as a unified catastrophe exposure region. As a result, severe storm and flood events in Queensland and New South Wales, such as the 2022 East Coast floods, also affected reinsurers' pricing and appetite for New Zealand.

Reinsurance costs affect premiums for households and businesses

For households and businesses, developments in reinsurance markets are most visible in rising premiums and changes to terms. For example, following the Canterbury earthquakes, most home insurance policies changed from replacement value contracts to the more predictable sum insured contracts. This was based on the loss experiences of insurers and reinsurers, who faced a significant rise in the cost of claims because of construction cost escalation through the rebuild phase. A sum insured approach also provides more assurance on the maximum extent of exposure for insurers.

Improved modelling and data on natural hazards have also enabled the insurance industry to adopt more risk-based pricing of property insurance. Some examples of this are differentiating seismic risks by region, and flooding risks by property location (see Special Topic 2 in the May 2024 Report).[17] Insurers that can demonstrate to their reinsurers that they have an improved understanding of the risks they are taking are able to obtain more favourable premiums and terms. This provides them with a competitive pricing edge, reinforcing the industry trend toward more detailed risk modelling.

The Natural Hazards Commission complements private insurers in accessing reinsurance

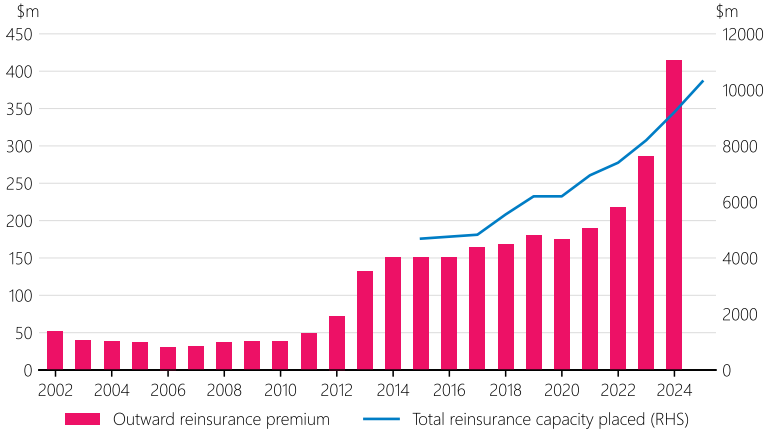
The Natural Hazards Commission (NHC) plays an important stabilising role in supporting New Zealanders' access to insurance, by covering the first layer of losses to residential dwellings from natural disasters under its NHCover scheme.[18] NHC runs its own reinsurance programme, with over $10 billion of coverage currently (figure 2.17). The scale of NHC's reinsurance programme has grown as the extent of first loss protection under NHCover has increased in recent years. NHC effectively operates on behalf of New Zealand households to engage directly with global reinsurers, without the need for private insurers to act as intermediaries.

NHC helps to bring cost-effective additional reinsurance capital into New Zealand's risk pool. Unlike private insurers, NHC is not subject to the Reserve Bank's solvency capital rules, and it benefits from a Crown backstop. This means it can structure its reinsurance around very high-attachment, low-frequency layers of cover, which attract comparatively lower costs. In the current financial year, NHC's reinsurance provides cover once an event's claims exceed $2.2 billion. Private insurers instead buy reinsurance at much lower attachment points (often corresponding to 1-in-5 to 1-in-10-year events) to manage more frequent portfolio shocks.

This complementary layering means NHC's reinsurance programme provides protection for residential dwelling losses only in particularly severe events, while private insurers focus on providing cover for residual risks not included in NHCover. Overall, this deepens reinsurance capacity and reduces costs for New Zealanders. The importance of NHC's role was highlighted in our 2024 stress test of general insurers, where claims on NHC exceeded half of the scenario's total losses.[19]

Figure 2.17

NHC reinsurance programme



Source: NHC (previously Earthquake Commission) annual reports, press releases.

Conclusion

Reinsurance is a crucial part of the insurance industry's ability to protect New Zealand households and businesses from large and catastrophic loss events. Reinsurance acts as an efficient source of capital that transfers risks to global markets and helps New Zealand to absorb shocks. This enables cover for risks that would otherwise be unaffordable, supporting financial stability and economic resilience. However, the availability and cost of reinsurance are also to a large extent driven by factors outside of New Zealand's control, creating a channel through which global developments can impact New Zealanders.

17 See https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2024/may-2024/fsr-may-24-special-topic-2.

18 NHCover is a first loss scheme, meaning that it covers the first $300,000 (plus GST) of any natural hazard losses covered under the Natural Hazards Insurance Act 2023.

19 See https://www.rbnz.govt.nz/hub/publications/bulletin/2025/2024-general-insurance-industry-stress-test-results.

3 Cyber and operational resilience: Responses from the 2024 *Cyber Capability survey*

Key Points

- Cyber and operational risks continue to be key risks to financial stability as the use of digital technology in the financial sector increases. Geopolitical and interconnectedness risks remain elevated.
- The 2024 *Cyber Capability survey* was completed by banks, non-bank deposit takers (NBDT), and insurers. The responses indicated that the industry is generally well positioned and largely aligned with Reserve Bank guidance, specifically in relation to governance and capability building.
- We continue to monitor emerging risks, such as the adoption of artificial intelligence (AI).
- Looking ahead, we will further enhance our response to cyber and operational risk, including by expanding our collaboration with other agencies and industry, as well as progressing work on policy and associated guidance.

Heightened cyber and operational risks continue to be a concern for the financial sector

The financial sector's growing digital footprint, reliance on third parties, and the pace of technology transformation increase the likelihood that operational incidents propagate across institutions and market infrastructures. These risks are amplified by global pressures, such as heightened geopolitical tensions, digital interconnectedness, and increased attacker capability. These increase both the likelihood and potential impact of cyber and technology incidents. In New Zealand, these pressures coincide with significant technology transformation programmes in the financial sector, which put further focus on the short- to mid-term operational and cyber risk environment.

We conducted our first *Cyber Capability survey* in 2024

Across the financial sector, cyber and technology resilience remains a prominent area of investment, board awareness, and regulatory focus. We introduced a periodic *Cyber Capability survey* for regulated entities to assess their capabilities against our 2021 *Guidance on Cyber Resilience* (the Guidance).[20] This was introduced as part of our *Cyber Data Collection*.[21] The survey has four key pillars:

(i) governance;

(ii) capability building;

(iii) information sharing; and

(iv) third-party management.

The window for the first set of submissions closed on 1 October 2024 and was followed by a period of data verification. Subsequent submissions are due annually for large entities, and biennially for others.[22]

The discussion below draws from the first set of submissions, with a total of 121 responses from banks, NBDTs, and insurers

Entities reported general alignment with our Guidance

At an industry level, the survey responses indicated a sector which is largely in alignment with the Guidance. This indicates mature governance, investment, collaboration, and supplier oversight. However, given the self-assessment nature of the survey, these findings must also be considered alongside ongoing operational performance. This includes restoration times, effectiveness of incident simulations, and management of third parties. Operational performance is monitored through our engagement with regulated entities, ongoing data collections, and incident reporting.

20 See https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/cyber-resilience/guidance-on-cyber-resilience.pdf.

21 See https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/improving-cyber-resilience-for-regular-entities.

22 Large entities are defined as those with total gross assets of at least $2 billion.

Governance

Governance refers to the decisions and actions of those in charge of an entity. Cyber resilience governance is concerned with the overall formation, execution, and evaluation of a cyber risk management approach.

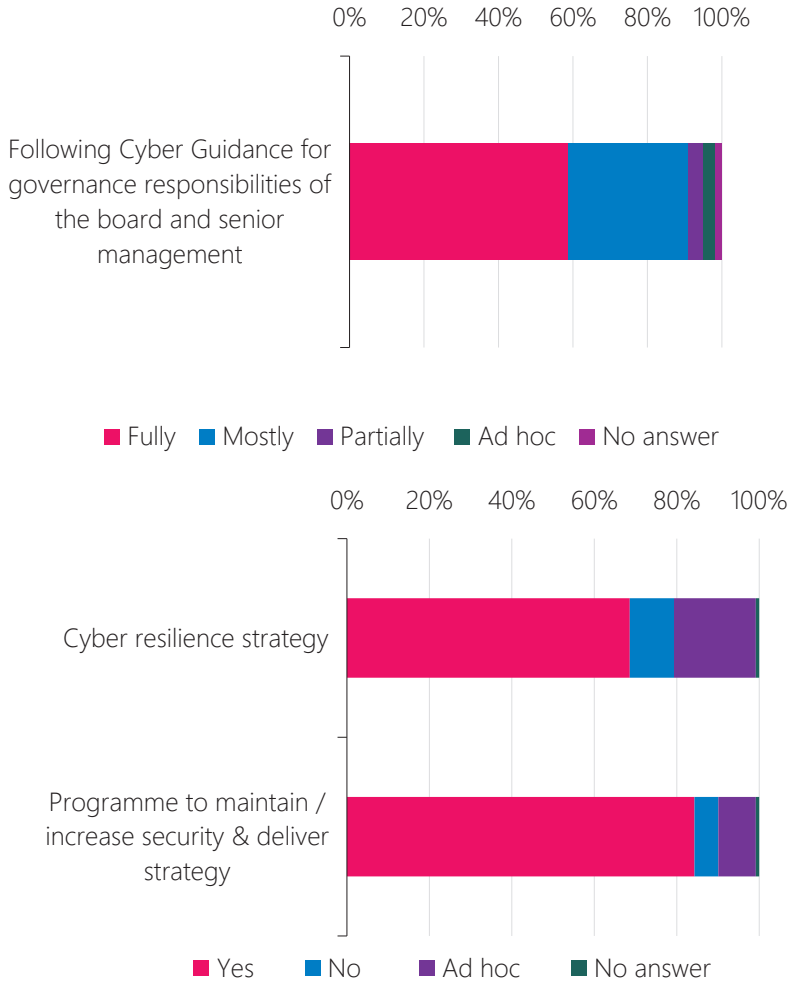
In response to the *Cyber Capability survey*, institutions stated that cyber considerations are well integrated into their wider enterprise risk management and are visible in decision-making. The majority of survey respondents reported having a formally documented work programme in place to maintain and increase their cybersecurity readiness (figure 2.18 (a)-(b)).

In addition, 91 percent of entities responded that there was a dedicated Chief Information Security Officer or senior executive accountable for the entity's cyber resilience strategy and framework. This demonstrates clear ownership, which in turn drives funding discipline and effective oversight.

Furthermore, 93 percent of respondents reported having a regular, organisation-wide cyber training programme. This typically includes staff awareness initiatives and rehearsals of incident management, which indicate investment in human resilience and appropriate preparedness.

Figure 2.18 (a)-(b)

Governance practices



Source: RBNZ 2024 *Cyber Capability survey.*

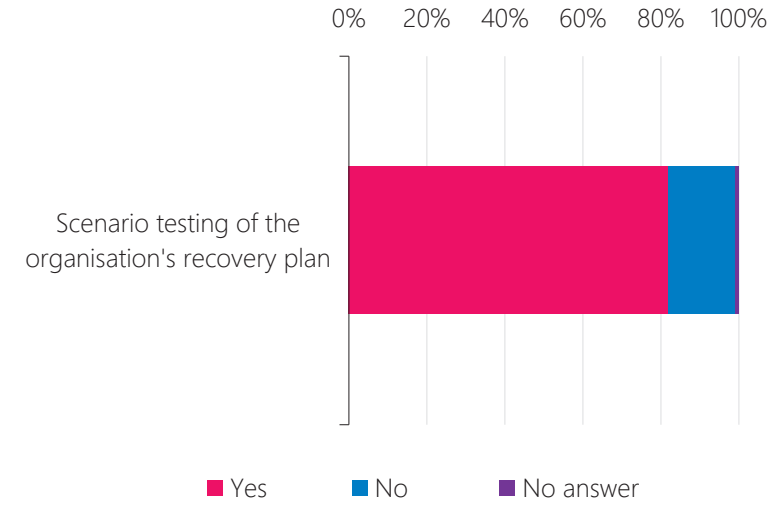
Capability building

Capability building encompasses five technical building blocks that form the foundation for robust cyber resilience. These building blocks are: identifying, protecting against, detecting, responding to, and recovering from cyber threats and incidents.

Most survey respondents indicated sustained investment in people, processes, and technology to maintain detection, response, and recovery capabilities. The majority also have a response and recovery plan for cyber breaches and use scenario testing to stress test recovery plans, supporting entities to identify vulnerabilities in their processes and systems (figure 2.19).

Figure 2.19

Capability-building practices



Source: RBNZ 2024 *Cyber Capability survey.*

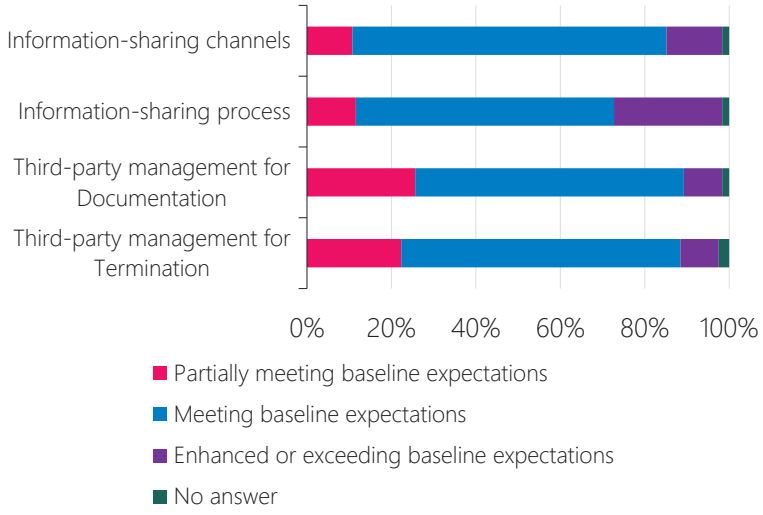
Information sharing

A crucial component of a collective response to cyber threats is the sharing of information and how quickly it can be acted upon. In addition to providing insight into the cyber threat environment, it is also crucial for an entity to understand the adequacy of its cyber risk mitigation measures.

Most respondents reported established pathways for timely incident notification and participation in sector forums that support situational awareness, supporting fast, coordinated responses when incidents arise. Entities indicated they contribute to and draw from information-sharing arrangements to track evolving threats and good practice (figure 2.20).

Figure 2.20

Information-sharing practices and third-party management at survey respondents



Source: RBNZ 2024 *Cyber Capability survey.*

'Baseline' indicates in line with the expectations set out in our Guidance.

Third-party management

Organisations generally rely on a multitude of third-party service providers (including related parties, such as parent companies or subsidiaries) to support core business functions.[23] It is common for these third-party entities to have access to an entity's data and its internal systems. If used prudently, third-party services may reduce an entity's cyber risk, especially for entities where in-house infrastructure may be prohibitively expensive. However, usage of third parties also provides an ideal environment for cyber criminals looking to infiltrate or disrupt an organisation.

The majority of institutions reported that they have appropriate oversight of critical service providers,[24] which includes contractual obligations and incident reporting. Effective documentation can support entities to identify external dependencies and areas of interconnection. However, a number of respondents (26 percent of all entities) reported they were partially meeting the baseline expectations set out in our Guidance for *Documentation*. This indicates that these entities do not fully maintain an up-to-date inventory of their third-party providers (figure 2.20). This could potentially expose gaps in third-party visibility that may hinder risk assessment, incident response, and concentration-risk management. 22 percent of respondents also reported they were partially meeting the baseline expectations for *Termination*, indicating that there is not a fully established termination/exit strategy in place. This may expose respondents to the risk of vendor lock-in should they need to change vendors for any reason.

23 This is addressed further in our BS11 Outsourcing Policy https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs11-sept-2022.pdf.

24 A critical service provider is a person or entity that provides any activity, function, process, or service that, if lost (even for a short period of time), would materially affect the continued operation of an entity, the market it serves, and the broader financial system. Such a loss could also materially affect the data integrity and reputation of an entity, and confidence in the financial system.

Technology infrastructure can be vulnerable to disruption

Cyber threats target identity systems, shared service providers, and software supply chains, and can spread quickly across firms and sectors. Transformation risk comes from large change programmes such as core system replacement and modernisation where errors, bottlenecks, or sequencing issues can interrupt critical services and undermine confidence in the financial system.

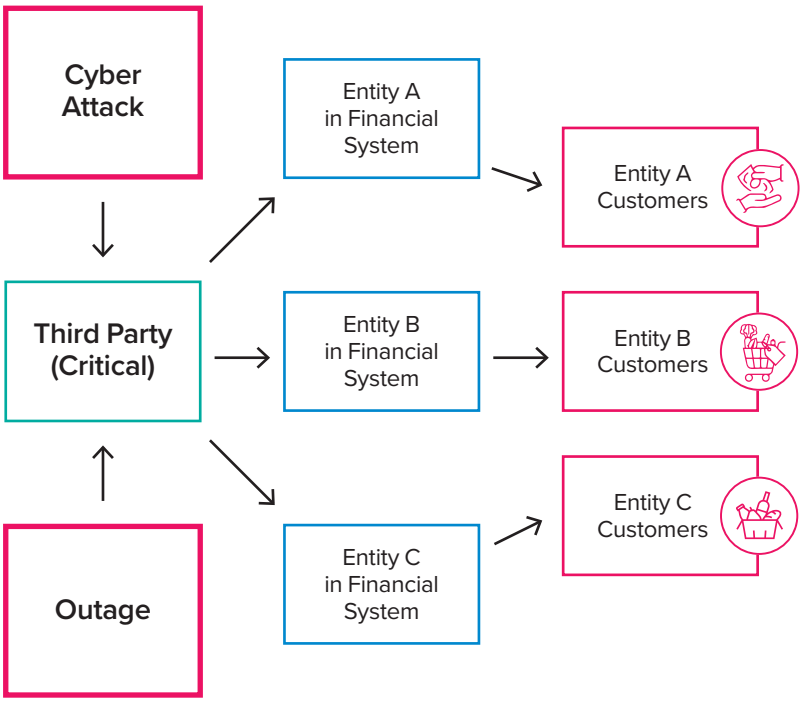
Cyber threats are a key risk

Cyber risk remains elevated across the financial sector. The immediate effects are most visible in customer channels and payment processing. When recovery takes longer than expected, payment settlement can be delayed. Significantly prolonged disruption may impact entities' liquidity buffers and, if uncertainty persists, can undermine confidence in the availability of core financial services.

Concentration in cloud, identity, and network services increases the chance of correlated disruption. A single fault, misconfiguration, or targeted attack at a common third-party provider can potentially affect multiple institutions at once, amplifying impact and complicating restoration plans. These knock-on effects illustrate the potential risk that third parties pose to an individual organisation, as well as the scale of interconnectedness through large vendors (see figure 2.21).

Figure 2.21

Potential impacts resulting from the interconnectedness of third parties



Source: RBNZ.

Transformation risk is also key

Large change programmes such as core system replacement, payments modernisation, and cloud migration carry execution risk. If sequencing is imperfect or defects go undetected, disruptions can delay the work programme.

Customer and data migration are key stress points. Real-world demand and customer behaviour often differ from testing. Data problems can undermine accuracy, affecting how staff utilise information and the extent to which customers are able to use data. If a change needs to be reversed, this may lead to delays in the work programme and potentially reduce system stability. If instability persists, trust in key services may be affected.

Emerging technologies can heighten system risk and also present opportunities for innovation

As discussed in the previous *Financial Stability Report*, the use of AI remains at an exploratory stage across the financial sector.[25] Current developments are generally limited in scope but adoption is accelerating. AI can increase operational efficiency and enhance threat detection, but there are also associated risks.

Use of AI by third-party vendors increases the exposure of the financial industry to AI risks. This in turn increases the need for enhanced third-party risk management, especially given that many vendors are now incorporating some form of AI into their products for their customers.

When used by attackers, Generative AI (Gen AI) can be weaponised to mass-customise scams and spam messages. Additionally, Gen AI creates variation in malware development so each iteration may look different when used in an attack. This can complicate detection controls that rely on fixed patterns.

Governance oversight remains central to adopting AI, especially in relation to how data are used and managed. AI tools perform only as well as the data they are trained on and the prompts they receive. Therefore, controls that protect data quality and prevent loss are fundamental to adoption of AI. Human oversight is an equally critical safeguard. Material AI-enabled decisions must be reviewable and subject to effective controls. Where tools are developed and run externally, entities depend on the vendor's design choices and safeguards. Where tools are developed in-house, outcomes depend on the institution's own controls and data quality.

This is fast-moving field. Capabilities are evolving quickly, many services are global in nature, and the balance of benefits and risk continue to shift.

Managing cyber and operational risks is critical to the resilience of the financial system

Our approach combines setting clear expectations across the sector with direct engagement with individual entities. To that end, we are working to formalise our expectations for the management of cyber- and technology-related risk.

As a part of implementation of the Deposit Takers Act 2023, we will issue an Operational Resilience Standard which will set requirements for how deposit takers manage their Information and Communication Technology (ICT) risk. The Government also intends to amend the Insurance (Prudential Supervision) Act 2010 to provide the Reserve Bank the ability to issue standards, including relating to risk management (comprising policies and processes for specific risks).

By working alongside regulated entities, we aim to build capability, support effective governance, and encourage ongoing investment in cyber and operational resilience. Where appropriate, entity-specific engagement helps ensure that all firms, regardless of size or maturity, continue to develop the skills, systems, and practices needed to withstand evolving threats and maintain confidence in the financial system.

25 See https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2025/may/special-topic_rise-of-the-machine.pdf.

Collaboration

Effective supervision of cyber risk in the financial sector contributes directly to financial stability. We have been working closely with domestic and international regulators and government agencies, alongside industry, to support preparedness for collective responses to future cyber incidents in the financial sector. We expect to strengthen these relationships further throughout 2025/26, both bilaterally and via regular attendance at industry forums.

In particular, we place strong emphasis on partnering with the Council of Financial Regulators, recognising the importance of sharing insights to enhance the cyber resilience of the financial system. The work programme also extends to the Trans-Tasman Council on Banking Supervision, which facilitates cross-border collaboration across New Zealand and Australia. On a day-to-day basis, we continue to work closely alongside our counterparts at the Financial Markets Authority and the National Cyber Security Centre to exchange intelligence on emerging sectoral patterns, agree key focus areas, and identify opportunities to collaborate both on a business-as-usual basis and during live incidents.

Chapter 03

Regulatory developments

Avon River, Christchurch. Photo: Charles Lilly

Chapter 3.
Regulatory developments

This chapter provides details on recent policy and supervisory developments in the deposit-taking and insurance sectors. It includes an update on the review of capital settings for deposit takers, amendments to the Insurance (Prudential Supervision) Act 2010 (IPSA), and highlights open policy consultations on the use of restricted words and the regulatory perimeter.

We consulted on key capital settings for deposit takers, and final decisions are due by the end of 2025

The review of capital settings for deposit takers was announced in March 2025 in response to inquiries by the Commerce Commission and Parliament's Finance and Expenditure Committee into banking competition.

Between August and October 2025, we sought public feedback on a consultation paper setting out our proposals for key capital settings. The consultation paper covered new evidence, legislative and policy changes, and international developments since the last review of capital settings in 2019. It also considered the appropriate amount and form of capital for the three groups of deposit takers.

We also published an independent report by *Oliver Wyman* comparing New Zealand banks' capital ratios to peer countries.[26] The report found that, after adjusting for methodological differences, New Zealand's major banks' current Tier 1 capital ratios are higher than most international peers. However, it also found that New Zealand banks have lower total loss-absorbing capacity than banks in many comparative countries.

Our consultation paper included two options for overall capital ratios that would bring New Zealand more in line with international peers.

- **Option 1** maintains an emphasis on having a large buffer of high-quality going-concern capital. However, the prudential capital buffer is smaller compared to the 2019 decisions.
- **Option 2** takes an alternative approach by significantly reducing the prudential capital buffer and introducing a new requirement for Group 1 deposit takers to have additional gone-concern, loss-absorbing capacity.

Our paper also included proposals to remove Additional Tier 1 capital and to introduce more granular standardised risk weights for some lending types. These changes should improve the overall efficiency of our capital settings, regardless of overall capital levels.

Taken together, our proposals would materially change the amount and composition of capital that banks are required to have compared to the 2019 Capital Review decisions. We expect this to result in slightly lower average funding costs for deposit takers relative to the 2019 decisions, while still promoting financial stability.

26 See https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2025/may/special-topic_rise-of-the-machine.pdf.

The consultation period closed on 3 October 2025. We are currently reviewing the feedback we received, which will help to inform our final decisions on key capital settings. We will consider this feedback alongside a cost benefit analysis and reports from independent international experts.

We intend to make final decisions by the end of 2025, with decisions incorporated into the Capital Standard under the Deposit Takers Act 2023 (DTA).

We are amending IPSA, with changes proposed to take effect in 2028

IPSA provides the legal framework for our regulation and supervision of the insurance sector. In August 2025, Cabinet decided to make amendments to IPSA to implement the findings of the IPSA Review (the Review), which first commenced in 2016.[27]

Review findings

The Review found that:

- New Zealand's insurance regulatory environment needs modernising; and
- the insurance market and industry participants would benefit from closer alignment with international best practice.

The proposed amendments take into account industry feedback received from public consultation under earlier phases of the Review. They also account for a number of independent reviews, including:

- the IMF's 2016 assessment against the International Association of Insurance Supervisors' Insurance Core Principles,[28] and
- the 2019 Trowbridge-Scholtens report on the Reserve Bank's supervision of failed insurer CBL Insurance Limited.[29]

Key policy themes

The amendments can be categorised into eight broad themes:

- **Amending the principles** of IPSA to:
  - incorporate a proportionate approach to regulations and supervision, including a proportionality framework for standards issued under IPSA, and
  - consider international regulatory practice.
- **Adjusting the regulatory scope** of IPSA to provide clarity around which entities are in and out of scope of prudential regulation and supervision.
- **Empowering the Reserve Bank to issue a range of 'standards'** (a form of secondary legislation) to clarify obligations on insurers and allow it to sanction insurers in the event of non-compliance.
- **Adjusting the current fit and proper regime** that applies to directors and senior officers of insurers to ensure the Reserve Bank has better oversight of insurers' choice of appropriate senior officers.
- **Simplifying the regulatory approvals regime** in relation to significant transactions involving the sale and purchase of insurance business.
- **Introducing a broader range of supervisory tools** for the Reserve Bank to better support the monitoring and assessment of the financial health of insurers and their compliance with prudential requirements.
- **Introducing additional enforcement powers** to provide a more graduated set of enforcement powers which align with other prudential legislation.
- **Updating the distress management provisions** to modernise the Reserve Bank's powers to deal with insurers in financial difficulty.

27 See https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-insurers/how-we-regulate-and-supervise-insurers/our-policy-work-for-insurer-oversight/review-of-insurance-prudential-supervision-act-2010.

28 See https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/fsap/fsap-review-assessment-of-observance-insurance-core-principles-2017.pdf.

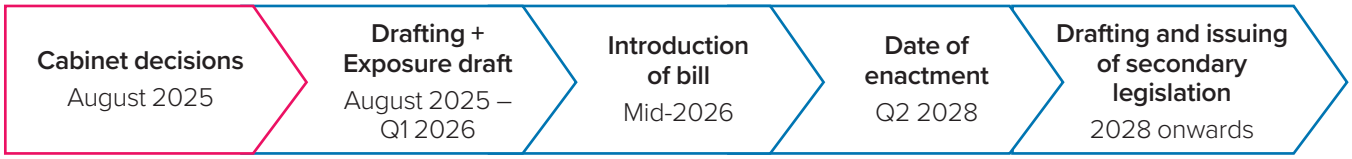
29 See https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/insurers/cbl-rbnz-final-report.pdf.

Timeline

The proposed timeline for the IPSA amendment Bill is set out in Figure 3.1.

Figure 3.1

IPSA amendment Bill timeline



Source: RBNZ.

We have published Competition Assessment Guidelines for prudential policy

Competition is important for an efficient financial system and is one of the principles we are required to consider under legislation such as the DTA and IPSA.

Following the Commerce Commission's market study into personal banking services, we have developed **Competition Assessment Guidelines for prudential policy**. The guidelines respond to a specific recommendation by the Commerce Commission and expectation of the Minister of Finance, outlined in her 2024/25 letter of expectations to the Reserve Bank.

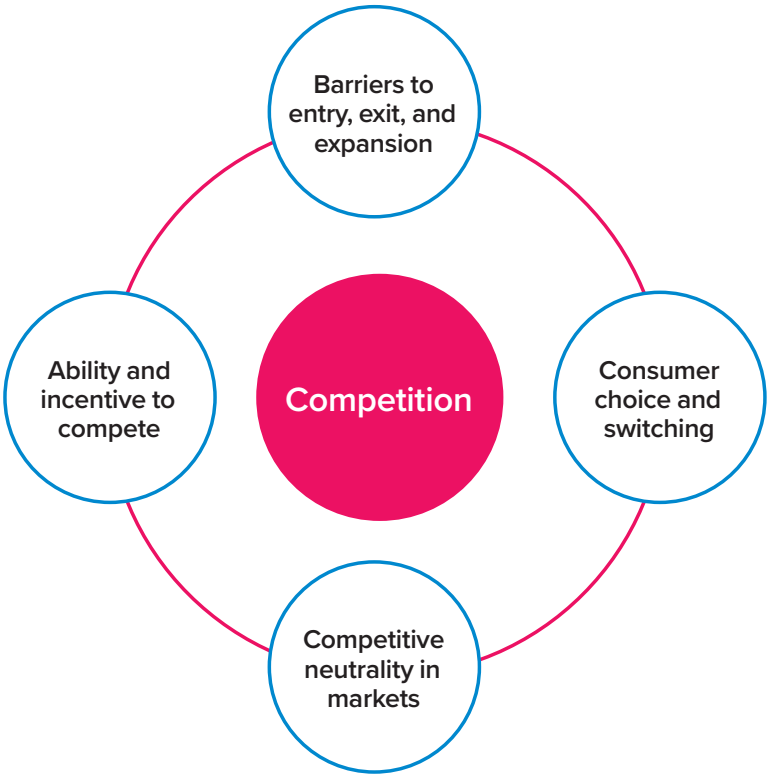
Published in October, the Guidelines:

- explain how and why we can and should think about competition;
- discuss when competition should be a factor in decision making;
- outline a process for considering competition;
- set out concepts that are fundamental to competition analysis; and
- provide a framework for competition analysis, applied to prudential policy.

Competition assessment is complex. A particular policy or regulatory initiative may affect competition through a single channel or multiple channels. The impacts may also differ in the short run versus the long run. Initiatives that may affect competition and warrant close consideration of their competitive effects are those likely to affect businesses and consumers in one of four ways (figure 3.2).

Figure 3.2

When policy or regulation may warrant closer consideration of competitive effects



Source: RBNZ.

Our guidelines provide a robust and consistent framework to support policy teams in identifying and assessing competition impacts early in the policy development process. This in turn helps us to explore, where appropriate, alternative ways of achieving regulatory objectives while also enabling better outcomes for competition.

We are consulting on the use of the term 'bank'

Before the DTA comes into force, we are required to set out our policy on the use of restricted words. The DTA will permit us to authorise entities to use 'bank' or 'banking' in a name or title. We are currently consulting on proposals for who should be authorised to use these restricted words. This consultation is open for submissions until 24 November 2025.

As part of moving to a single regulatory regime under the DTA, we are also proposing to authorise all licensed deposit takers to be able to use restricted words in their name or title. This will support competition within the deposit-taking sector by treating similar institutions consistently.

We are also proposing to continue authorising certain overseas banks to carry on limited activities in New Zealand using restricted words in their name or title, provided that these banks do not have a physical presence in New Zealand.

After considering the consultation responses, we will announce final policy decisions in 2026.

We are consulting on regulations related to the regulatory perimeter

These regulations under the DTA seek to clarify the boundary of the regulatory perimeter. This defines the types of entities that are subject to regulation, before licensing of deposit takers commences. The licensing period is currently expected to begin on 1 June 2027.

If implemented, proposals would have the effect of maintaining the current prudential perimeter under the Non-Bank Deposit Takers Act 2013 (NBDT Act) and the Banking (Prudential Supervision) Act 1989. This would be achieved through excluding from regulation under the DTA:

- the same classes of entities that have been declared not to be an NBDT for the purposes of the NBDT Act, if they would otherwise meet the definition of 'deposit taker'; and
- overseas banks that have no physical place of business in New Zealand.

We are not proposing to expand the regulatory perimeter to include any additional classes of entities. We discuss but do not propose the possibility of excluding some smaller entities that are undertaking borrowing and lending from being required to license.

Feedback is also sought on three minor proposals that are required for the smooth implementation of the DTA. These relate to the definition of an Australian Financial Authority, classes of lending that the Lending Standard applies to (e.g. macro-prudential tools), and the form of infringement and reminder notices.

This consultation is open for submissions until 24 November 2025.

The exposure drafts of the new DTA standards will be consulted on in three tranches

We are developing standards under the DTA containing requirements that deposit takers must comply with as part of their prudential obligations. The next stage for the DTA standards is the exposure draft consultation phase. This is an opportunity to test whether the policy consulted on previously is being implemented correctly and for feedback on more detailed policy questions. We will consult on both exposure drafts of the standards and supporting guidance (where relevant).

We will consult on the exposure draft of the standards in three tranches (figure 3.3). This will more evenly split up the consultation material to better spread the engagement load on industry, and, following the review of key capital settings, allow us more time to draft the standards. Tranche 1 will be consulted on from October 2025 to January 2026, and will include the Liquidity, Depositor Compensation Scheme (DCS), Lending and Incorporation (Outside New Zealand) standards. We will also consult on our Group Supervision Policy as part of this process.

We intend to issue the DTA standards in May 2027 and commence the standards from December 2028.

We continue to monitor the industry through prudential supervision as well as targeted stress testing and thematics

Relationship Charter Survey

The Relationship Charter sets out principles for maintaining the best regulator-regulated relationships possible, and commits the Reserve Bank and the financial sector to a mutual understanding of how both parties will work together to achieve this. In this year's Relationship Charter Survey, 97 percent of regulated entities rated their relationship with the Reserve Bank as 'good' or 'very good'. Half of the stakeholders highlighted our communication as a key strength. We will consider the valuable suggestions about how we could do things better and make changes where appropriate.

Figure 3.3

Tranches and consultation timelines of the DTA standards

Tranche 1

Oct 2025 to Jan 2026

- **Depositor Compensation Scheme**
- **Liquidity**
- **Lending**
- **Incorporation (Outside New Zealand)**

Tranche 2

February to May 2026

- **Disclosure**
- **Governance**
- **Risk Management**
- **Restricted Activities**
- **Reporting**

Tranche 3

June to September 2026

- **Capital**
- **Operational Resilience**
- **Outsourcing**
- **Open Bank Resolution**
- **Related Party Exposures**

Source: RBNZ.

Licensing of banks and NBDTs under the Deposit Takers Act

There will be an 18-month licensing window for existing banks and NBDTs from 1 June 2027 to 1 December 2028. Entities will need to demonstrate they have the ability to meet the requirements of the core DTA standards to be granted a licence under the DTA. The licensing framework we implement to obtain and assess information from banks and NBDTs will be tailored to suit the 18-month timeframe. Whilst the assessment of licence applications for existing firms will consider the full range of matters which banks and NBDTs will need to comply with under the core standards, the focus will be on the changes to existing regulation being brought in by the core DTA standards.

Banks and NBDTs are already engaging with us in preparation for the DTA. We will provide further details about licensing throughout the process.

Stress-testing programme

The 2025 bank solvency stress test included two scenarios to enable us to assess bank and system resilience to geopolitical shocks. The stress test also had a third scenario, which tested banks' ability to manage a failure in their current transformation plans. The five largest banks participated and have used the results from these scenarios to inform and improve their capital management and contingency funding plans. We are considering repeating parts of the exercise for small banks next year, recognising their more limited resourcing. A *Bulletin* article with the findings from the 2025 bank solvency stress test was recently published.[30]

In 2026 we will conduct a Life and Health Insurance stress test involving eight of the largest entities. This will be a Reverse Stress Test, where each insurer is required to determine a severe but plausible scenario which reduces their solvency below zero before significant management actions. The instructions for entities are expected to be finalised this year, with submissions due by the end of June 2026.

Risk management thematic

Our thematic review on risk management practices in the deposit-taking sector is progressing well. We recently completed engagements with relevant staff and board members of participating entities, and are now in the final analysis phase. The engagements were informative and provided valuable insights into each entity's overall approach to managing risk.

The review will enhance our understanding of industry practice, identify areas for improvement, and promote the sharing of good practices that will help uplift risk management capability in the sector. Insights from the review will also inform the development of guidance for the risk management standard under the DTA. We expect to publish our thematic report and provide feedback to participating entities in early 2026.

The next thematic review will focus on the risk management practices of general insurers and is likely to commence in February 2026.

30 See https://www.rbnz.govt.nz/hub/publications/bulletin/2025/2025-bank-industry-solvency-stress-test-results.

Chapter 04

Institutional resilience

Mount Ruapehu. Photo: Chris McDonald

Chapter 4.
Institutional resilience

New Zealand's financial system continues to build its resilience to potential shocks. Capital buffers across the banking system remain high and above regulatory minimums. Bank profitability has been above the historical average. The resilience of the non-bank deposit taking (NBDT) sector continues to vary, in part due to a lack of scale impacting cost structures. The Depositor Compensation Scheme (DCS) is now operational, contributing to increased deposits for non-bank deposit takers. While general insurers have recently benefited from fewer significant claims, profitability in the health insurance sector has deteriorated due to increasing claims costs.

Banks	
Solvency	• High levels of capital allow banks to absorb unexpected credit losses during periods of stress, maintain investor and depositor confidence, and continue providing credit in a downturn. Bank capital ratios remain well above the current regulatory minimums (figure 4.1). • Banks' Common Equity Tier 1 (CET1) capital has grown by more than risk-weighted assets in the past 6 months. This means that banks' capital ratios are continuing to increase, building resilience to potential shocks. • The Reserve Bank is undertaking a review of key capital settings to support financial stability while promoting long-run economic growth. We are considering feedback from our recent consultation and will make the final decisions by the end of the year (see Chapter 3). • In this year's bank solvency stress test, we examined the impact of a geopolitical scenario.[31] This featured macroeconomic stress, increases in trade barriers and trade policy uncertainty, and a general worsening of geopolitical risks. A second scenario added a bank-specific crisis to the first scenario, stemming from a cyber-attack. In this scenario, we tested banks' resilience to a simultaneous depletion of liquidity and capital buffers for the first time. • The stress test outcomes showed that banks are well placed to withstand a severe scenario induced by geopolitical stress. However, restoring capital buffers would require significant actions and time.

31 See https://www.rbnz.govt.nz/hub/publications/bulletin/2025/2025-bank-industry-solvency-stress-test-results.

Asset quality and credit growth	• Non-performing loans have remained broadly stable at around 0.8 percent of lending over the past 12 months (figure 4.3). Early arrears, which can be a leading indicator of impaired lending, have declined, supported by lower debt-servicing costs. Weak economic activity and unemployment are adding to debt-servicing challenges in some sectors. Banks expect non-performing loans to ease as many stressed borrowers will shift to lower rates in the next 6 months. • Loan-loss provisioning has declined moderately over the past 6 months but remains close to historical averages (figure 4.3). This indicates that banks may expect a gradual improvement in borrower stress. • Credit growth remains subdued across most sectors. Demand for credit from businesses is weak, reflecting global uncertainty and weak economic conditions (see Special Topic 1). The strong cashflow in the agriculture sector is primarily being used to pay down debt and farm maintenance. Weak credit demand has meant that lending competition is strong as banks compete for a limited pool of creditworthy customers.
Profitability	• Banks have remained profitable over the past 6 months, supported by the stabilisation of asset quality and elevated margins. • Return on assets has been broadly stable over the past year and is slightly above its 10-year average, at 1.04 percent (figure 4.4). Return on equity has declined as banks have increased their capital ratios. • Net interest margins (NIMs) remain elevated, supported by non-interest-bearing deposits and capital (figure 4.2). Returns on these funding sources move with interest rates, so they can be volatile. Banks use replicating portfolios to convert these variable returns into fixed returns, which smooth NIMs over the interest rate cycle (See Box A). As a result, the previously high interest rate environment is still feeding through to higher returns, even as rates decline. Competition for deposits and refinancing activity is putting some downward pressure on NIMs.
Liquidity	• Banks' liquidity mismatch ratios, which are a measure of their short-term liquidity positions, remain well above required levels (figure 4.6). Substantial holdings of primary liquid assets are supporting the 1-month mismatch ratio. • Our 2025 *bank liquidity stress test* examined the resilience of 10 banks to liquidity shocks over a 6-month period. We used the same scenarios for the past 5 years. The average length of time before banks can no longer meet deposit outflows (the survival horizon) improved from 10 weeks in 2021 to 13 weeks in 2025 (figure 4.7). However, there has been a slight decline in the survival horizon since 2024. • Settlement account balances have been decreasing as COVID-19 stimulus programmes such as the Large Scale Asset Purchase (LSAP) Programme and the Funding for Lending Programme (FLP) wind down. The remainder of the outstanding FLP funding will mature by the end of this year. Banks have been replacing declining settlement account balances with higher holdings of government bonds in their liquid asset holdings.
Funding	• The core funding ratio is elevated (figure 4.8), indicating that banks have a high share of funding from stable, long-term sources. This reduces the likelihood of having to raise funds under stressed market conditions. • Banks' funding conditions are strong, with deposit growth outpacing credit demand. Wholesale funding markets have been resilient after the volatility earlier in the year. Funding spreads are now near their lowest levels since 2021, supported by strong demand as investors diversify away from equities towards fixed-income assets. Demand for Australian and New Zealand bank debt has been particularly strong. • Banks have not needed to raise significant wholesale funding given strong deposit inflows. However, banks remain active in wholesale markets to take advantage of the favourable funding conditions and prepare for an expected pick-up in credit demand.

Non-bank deposit takers (NBDTs)

- New Zealand's NBDT sector consists of building societies, credit unions, and deposit-taking finance companies. With a total lending of $2.3 billion or 0.4 percent of total bank lending, the sector is very small relative to the banking sector, but provides services to a relatively large and diverse customer base.
- Lending by finance companies has continued to grow over the past 6 months. These entities tend to lend in areas where there is less active competition from banks. In contrast, growth in lending by credit unions and building societies has been subdued for the past 3 years, reflecting weak economic conditions, competition from banks, and the previously high interest rate environment.
- Non-performing loan ratios for building societies, credit unions, and charities remain elevated, but the ratio for finance companies has decreased modestly in recent months (figure 4.9).
- On 1 July, the DCS was implemented. This protects eligible depositors' funds at deposit takers against losses of up to $100,000 per institution. Deposits at NBDTs have increased over the 2 months since July, particularly in finance companies (figure 4.13). This growth may reflect depositors spreading their funds across institutions to increase their coverage under the DCS. At the same time, the spread between term deposit rates offered by banks and NBDTs has narrowed as the premium that NBDTs need to offer to attract funds has decreased. Finance companies have used the extra deposits to expand low-LVR mortgage lending and increase holdings of liquid assets, such as government bonds and bank deposits. We will continue to closely monitor the effects of the DCS on NBDTs and the wider financial system.
- As part of the DTA, to support competition in the deposit-taking sector, we are consulting on the proposal to authorise all licensed deposit takers (including NBDTs) to use restricted words such as 'bank' or 'banking' in their name (see Chapter 3). Our preferred option is to authorise all licensed deposit takers to use restricted words in their name or title. Combined with the DCS, this proposal supports a more competitive playing field for deposit takers of different sizes.

Insurers

Health Insurance

- The health insurance sector has come under strain over the past 2 years, with sustained operating losses reducing solvency margins by nearly 40 percent. Insurers' capital levels remain well above regulatory minimums. However, ongoing cost pressures mean premium increases will be needed to restore profitability so that the sector can sustainably provide services to policyholders and support the wider health system.
- Escalating claims costs have been the dominant source of strain in the sector. From 2020 to 2022, medical cost inflation was within a typical range, accompanied by broadly proportionate premium increases (see Chapter 1, figure 1.9). In recent years, capacity pressures in the public health system have resulted in more people turning to the private system. This increased utilisation of private health care has added to claims cost inflation. These domestic pressures are reinforced by global cost drivers, including the adoption of high-cost technologies, supply-chain disruptions, and rising labour costs.
- By 2023, many health insurers were reporting quarterly losses. Claims cost escalation intensified during 2024. The persistence of these pressures required insurers to reprice substantially.
- From the second half of 2024, materially larger premium increases were implemented across the industry, both to recover earlier shortfalls and to restore profitability on a forward-looking basis. This contributed to strong growth in insurance revenue, with each of the past 4 quarters roughly 15 percent higher than the same quarter a year earlier. Despite this, the health insurance sector has continued to make losses to date. This reflects the lag between premium increases and the corresponding uplift in revenue, as policies are repriced gradually.

Sector and Policy Responses

- In response to recent claims cost escalation, health insurers are repricing premiums, redesigning products, and implementing cost-management strategies. These measures intend to ensure products remain affordable and available in a high-inflation environment, but can result in narrower benefits or higher cost-sharing for customers.
- The Reserve Bank has intensified its supervision of the sector and is closely monitoring solvency trends. Health insurers are now being included in the Reserve Bank's stress-testing programme to assess resilience under scenarios of continued escalation of these pressures. The Reserve Bank is also engaging directly with health insurers to ensure that responses support both the long-term sustainability of the sector and the resilience of households and the broader financial system.

General and Life Insurance

- Profitability in the general insurance sector has remained strong, supported by premium increases implemented following the severe weather events of early 2023. While the pace of repricing has since eased from its peak, earnings have been sufficient to fund substantial dividends and a strengthening of solvency margins across the industry.
- Profitability in the life insurance sector has been improving from previously subdued levels. However, returns on equity remain low compared with other sectors and with alternative uses of capital, maintaining pressure for further pricing or product adjustments.
- While solvency margins in the life insurance sector remain well above regulatory requirements, they have trended lower in recent years. This reflects a mix of insurers' capital-management decisions, such as larger dividend payouts and recalibrated target buffers, and technical changes in how solvency capital is measured, particularly for long-dated contracts. These factors have lowered reported margins, though overall capital positions remain adequate.

Financial Market Infrastructures (FMIs)

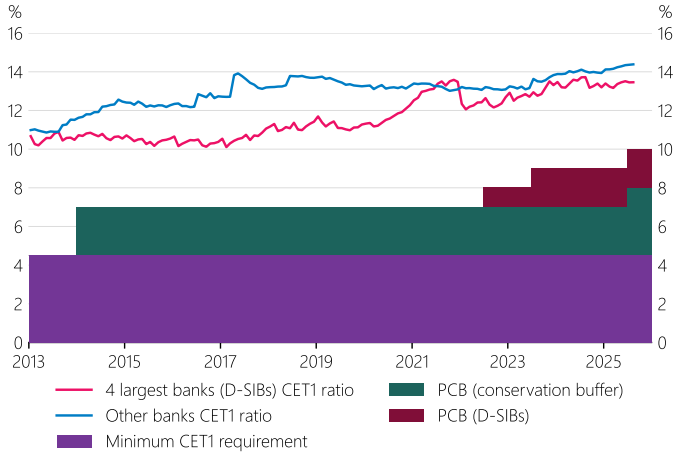
- New Zealand's financial market infrastructures (FMIs) support the smooth functioning of our financial system. Reliable FMIs build trust in everyday financial activity by ensuring that transactions are settled securely and on time. FMI system availability remained high over the past year at 100 percent for each designated FMI.[32] Maintaining cyber resilience is a key area of focus for FMIs. There have been no material incidents since late 2024, when new reporting standards were introduced (figure 4.14).
- FMIs often outsource or use third-party systems in their day-to-day operations, such as for information technologies, database services, and messaging platforms. A key supervisory focus across designated FMIs has been on how well they are selecting and managing their providers of critical services. In addition, we are monitoring how well the payment industry is implementing the new SWIFT ISO 20022 messaging standards. SWIFT sets messaging standards that enable domestic and international interbank payments. The new ISO 20022 standards enable richer, structured data and improved payments analytics. All participants are on track to meet the November 2025 cut-off.
- Work is underway, including jointly with the Financial Markets Authority, to consider designating three additional FMIs. We consulted on a proposal to recommend the designation of the High Value Clearing System (HVCS). The HVCS plays an important role in New Zealand's financial system by clearing large payments, such as house settlements, and supporting their settlement. We will publish a summary of the consultation submissions and next steps.
- Approving FMI rule changes is a core function for us as supervisors, as rules define the scope of the designated FMI. Since May we have approved three rule changes. The first two changes clarified that ESAS is a single system with common rules for all participants, rather than separate agreements with each participant. The third added new requirements to clearing participants regarding the business continuity and disaster recovery plans for the New Zealand Clearing and Depository Corporation, a clearing and settlement system for financial markets.

32 We collect system availability and cyber incident data for four of the five designated FMIs. The exact definition of system availability differs depending on both the type of system and its hours of operation.

Charts

Figure 4.1

Common Equity Tier 1 ratio for locally incorporated banks

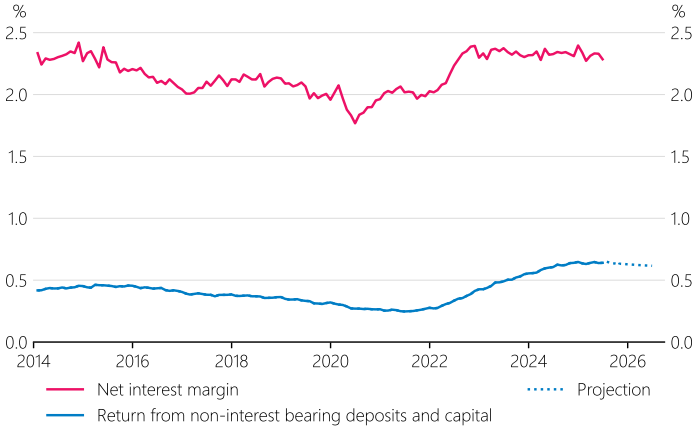


Source: RBNZ *Capital Adequacy survey.*

Note: PCB is prudential capital buffer.

Figure 4.2

Bank net interest margins

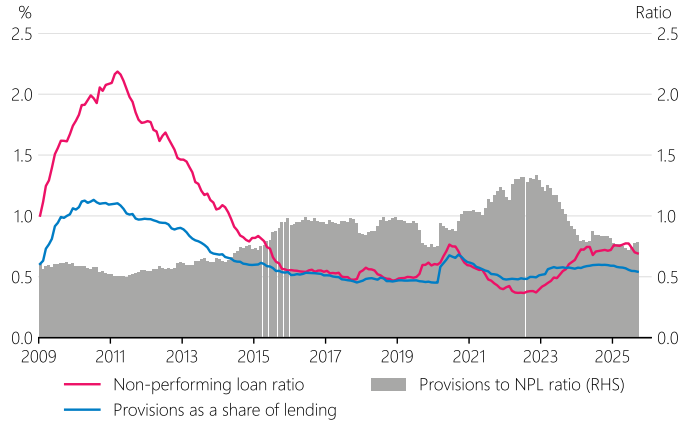


Source: RBNZ *Income Statement survey.*

Note: The return from non-interest-bearing deposits and capital is estimated by applying yields to each balance. The yields are mostly based on rolling averages of the 3-year and 5-year swap rates, with a small weight on the 3-month bank bill rate. The resulting yields are used to approximate the net interest income benefit from these sources. The projections assume swap rates remain unchanged at current levels.

Figure 4.3

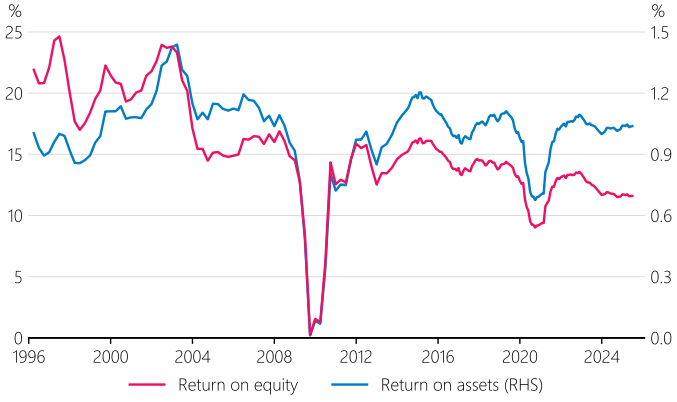
Bank non-performing loan and provisioning ratios



Source: RBNZ *Bank Balance Sheet survey.*

Figure 4.4

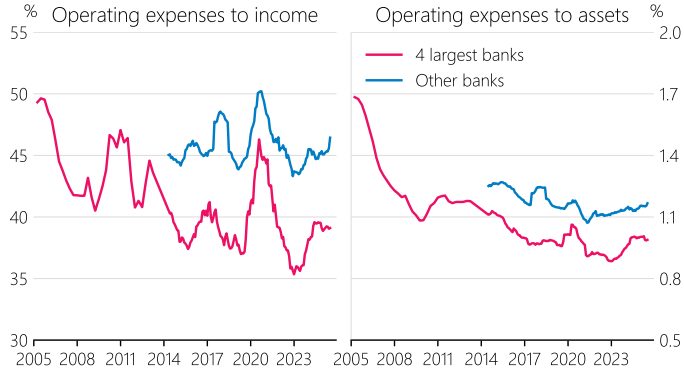
Bank profitability ratios



Source: RBNZ *Income Statement survey.*

Figure 4.5

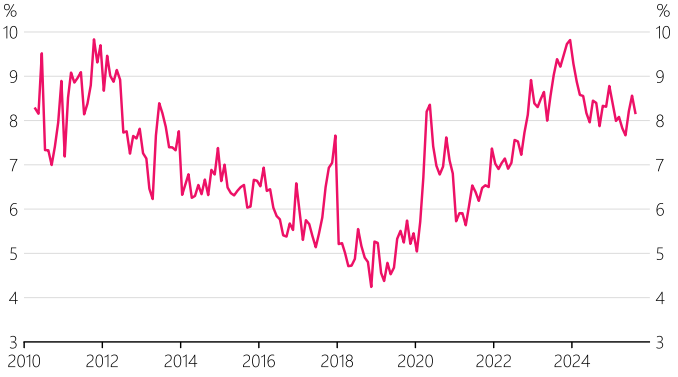
Bank operating expense ratios



Source: RBNZ *Income Statement survey.*

Figure 4.6

Bank 1-month liquidity mismatch ratio

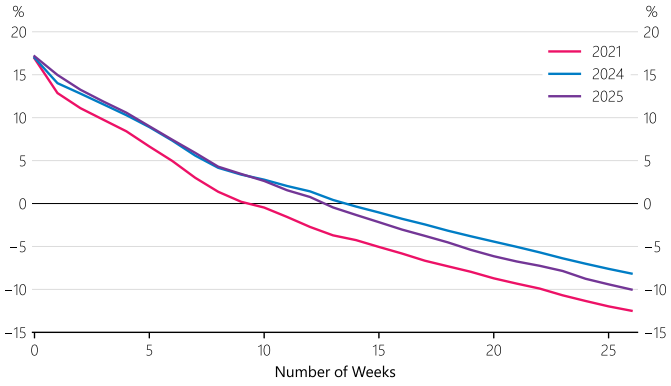


Source: RBNZ *Liquidity survey.*

Figure 4.7

Annual bank liquidity stress test

(net liquidity position over 26 weeks, average across banks)

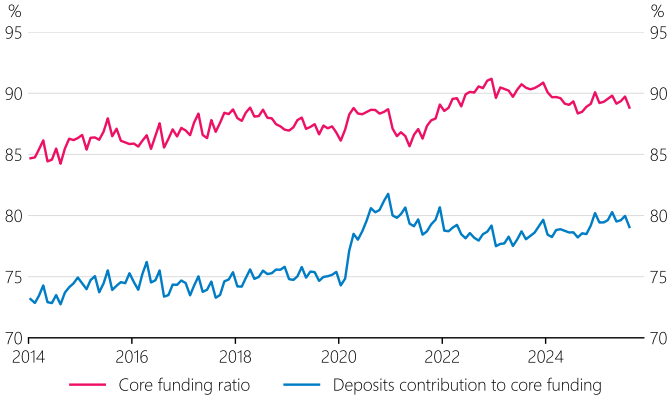


Source: RBNZ *Liquidity Stress Test*.

Note: Net liquidity position is liquid assets less deposit outflows as share of total funding

Figure 4.8

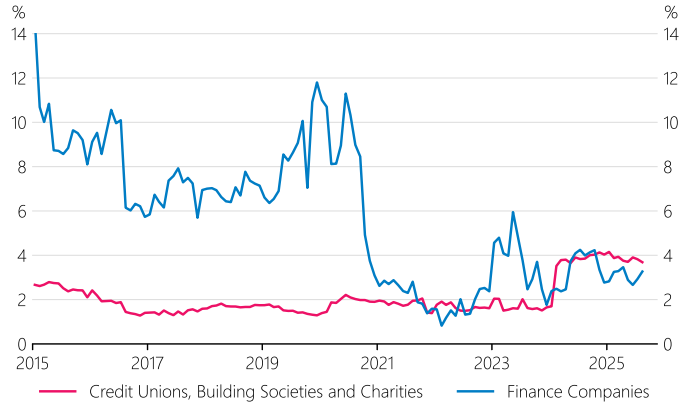
Bank core funding ratio



Source: RBNZ *Liquidity survey.*

Figure 4.9

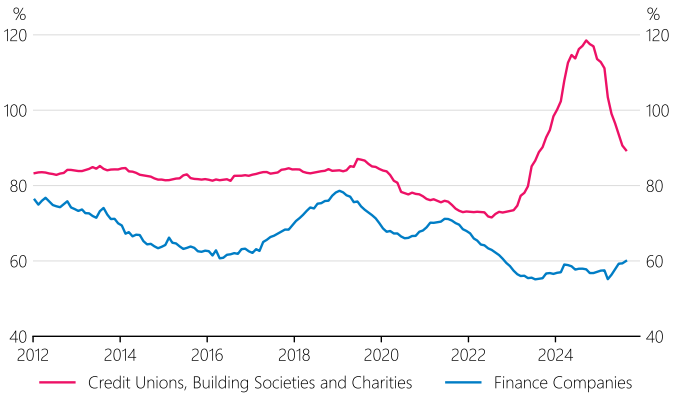
NBDT non-performing loan ratio



Source: RBNZ *Non-bank Deposit Takers survey.*

Figure 4.10

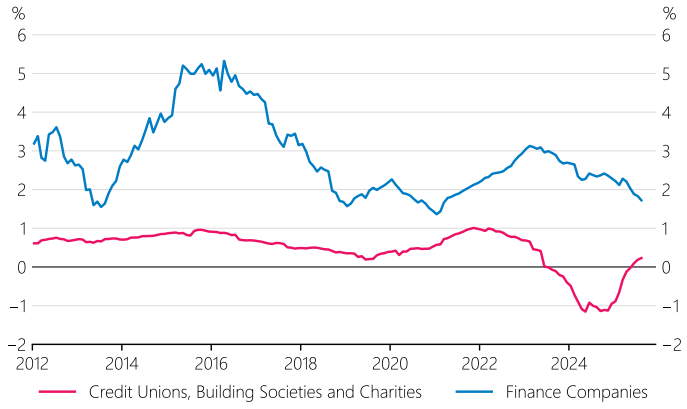
NBDT cost-to-income ratio



Source: RBNZ *Non-bank Deposit Takers survey.*

Figure 4.11

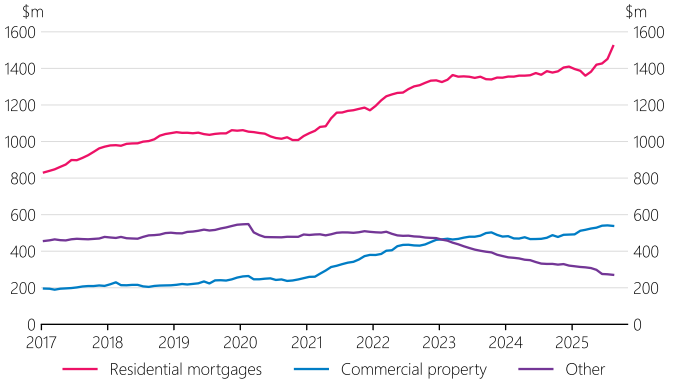
NBDT return on assets ratio



Source: RBNZ *Non-bank Deposit Takers survey.*

Figure 4.12

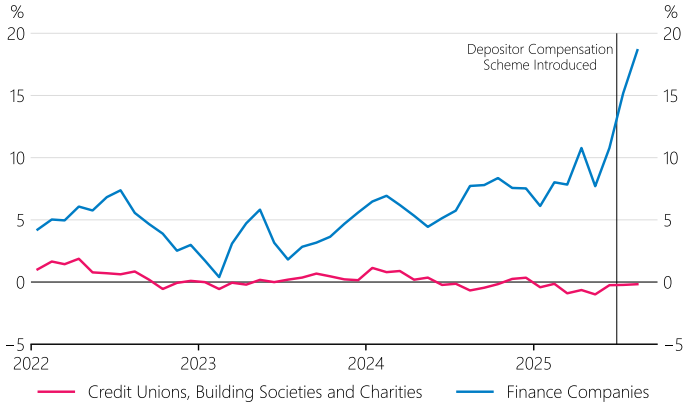
NBDT lending by sector



Source: RBNZ *Non-bank Deposit Takers survey.*

Figure 4.13

3-month growth in deposit funding by NBDT sector

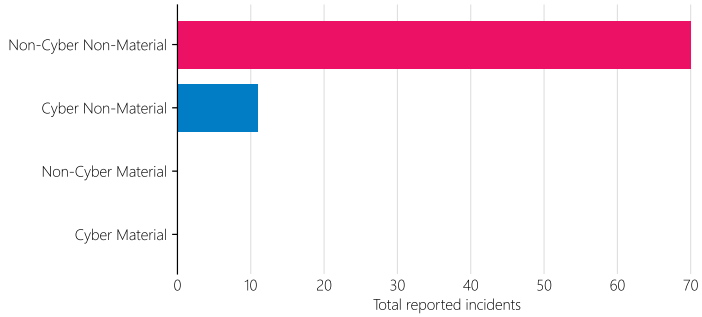


Source: RBNZ *Non-bank Deposit Takers survey.*

Note: Data are seasonally adjusted.

Figure 4.14

Total FMI incident occurrences from 2024 onwards



Source: *Financial Market Infrastructures.*

Table 4.1

Key metrics for registered banks

Metric	Value (%, end of September)					Regulatory minimum (%)	Comment
	2021	2022	2023	2024	2025		
Tier 1 capital ratio	15.4	14.0	14.0	14.9	15.0	10.5*	Capital ratios continue to increase as higher minimum regulatory requirements are phased in.
Mismatch ratio (one month)[1]	6.2	7.1	8.9	7.7	7.4	0	Mismatch ratios are decreasing as the Reserve Bank reduces the amount of settlement cash in the system.
Core funding ratio	87.3	90.6	90.3	88.5	89.5	75	Banks' core funding ratios remain strong, supported by increased deposit funding and low credit growth.
Annual return on assets (after tax)	1.00	1.09	1.03	1.02	1.04		Return on assets has been stable over the past four years.
Annual return on equity (after tax)	12.4	12.8	11.9	11.4	11.7		Capital growth has weighed on banks' return on equity over time, but returns have stabilised recently.
Net interest margin (quarterly, annualised)	2.00	2.14	2.36	2.34	2.32		Net interest margins have continued to remain elevated as interest rates have declined.
Non-performing loan ratio	0.45	0.38	0.56	0.72	0.69		The non-performing loan ratio remains elevated but has decreased recently, supported by improved debt servicing capacity.
Annual credit impairment expense (% of average loans)	-0.06	0.03	0.13	0.08	0.02		Impairment expenses have been low in recent times, reflecting the improved outlook for non-performing loans.
Cost-to-income ratio	42.3	38.7	39.5	41.5	42.3		Digitalisation and lower occupancy costs are improving operating efficiency, but recently weaker total income, is offsetting these gains.

Source: RBNZ *Capital Adequacy survey, Liquidity survey, Income Statement survey, Bank Balance Sheet survey.*

1 Mismatch ratio (one month) is presented as a three-month moving average to remove short-term volatility.

* Includes the capital conservation buffer of 3.5 percent of risk-weighted assets, which banks must maintain to avoid dividend restrictions. For domestic-systemically important banks, the capital conservation buffer is 5.5 percent as at July 2025, and the regulatory minimum for their Tier 1 capital ratio is set at 12.5 percent of risk-weighted assets.

Table 4.2

Key metrics for NBDTs (for year ended June)

Metric	Segment	2021	2022	2023	2024	2025
Total assets ($m)	Finance Companies	296	357	416	498	678
	Credit Unions, Building Societies and Charities	2,526	2,660	2,657	2,665	2,626
Total loans ($m)	Finance Companies	237	300	341	423	514
	Credit Unions, Building Societies and Charities	1,797	1,938	1,956	1,804	1,767
Net interest margin (%)	Finance Companies	4.42	4.24	5.06	4.55	3.57
	Credit Unions, Building Societies and Charities	3.48	3.75	3.70	3.34	3.27
Capital ratio (%)	Finance Companies	15.7	17.2	19.6	18.7	17.5
	Credit Unions, Building Societies and Charities	13.4	13.3	13.6	13.6	14.3
Non-performing loan ratio (%)	Finance Companies	1.9	1.9	4.8	4.1	2.6
	Credit Unions, Building Societies and Charities	1.2	1.4	1.4	3.3	3.1
Return on assets, before tax (%)	Finance Companies	1.9	2.4	3.0	2.4	1.7
	Credit Unions, Building Societies and Charities	0.8	0.9	0.0	-0.9	0.1
Number of entities	Finance Companies	6	6	6	6	7
	Credit Unions[1]	8	7	5	3	3
	Building Societies	3	3	3	3	3
	Charities	1	1	1	1	1

Source: RBNZ *Non-bank Deposit Takers survey.*

1 Firefighters Credit Union merged with Credit Union Auckland in June 2022. Westforce Credit Union, Steelsands Credit Union, Fisher & Paykel Credit Union and Credit Union Auckland merged with First Credit Union in August 2022, December 2022, October 2023 and June 2024 respectively.

Box A
How a bank manages the pricing of loans and deposits

Interest rates are a key tool that banks use to compete for lending opportunities and for depositors' funds. When setting rates, banks need to balance their market share with short- and long-term profitability considerations, alongside sound risk management.

This Box introduces the concept of funds transfer pricing (FTP), explains how a bank manages its exposure to interest rate and liquidity risks through its treasury operations, and discusses how FTP can influence banks' business decisions.

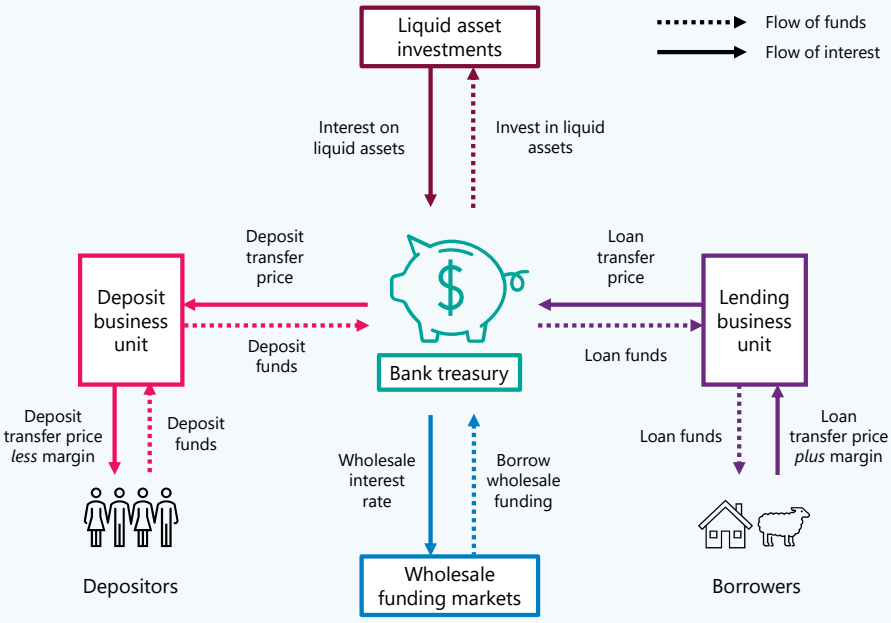
Banks are typically structured into multiple business units – such as rural and commercial banking, home lending, and retail deposit-taking. FTP is the framework that banks use to allocate the costs of funding and returns from lending activity across these units. This provides a benchmark for a bank to assess the contribution that different business units make to the banks' overall profitability. For example, banks can assess how much interest income the home loan unit makes above the costs of funds it employs, and the risks being taken. FTP helps to ensure that a bank is pricing its loan and deposit products effectively, while centralising risk management. It can also be used to adjust the shape of a bank's balance sheet over time.

Treasuries play a central role in banks

When deciding the interest rate for a loan, a business unit may not know where and at what cost the funds for that loan were obtained. Similarly, a deposit-gathering business unit does not know what loans those deposits will be funding, or how much interest the bank will earn on that lending.

A bank's treasury effectively operates as a 'bank within a bank'. It receives funds from deposit-gathering business units and allocates the funds to lending business units. It uses FTP to send price signals to the business units about the cost of funds and return on funds (figure A.1).

Figure A.1
A bank treasury's role in funds transfer pricing



Source: RBNZ.

In this role, the treasury also centralises the management of interest, funding, and liquidity risks. For example, many borrowers like to gain interest rate and cashflow certainty by fixing their interest rate. From a bank's perspective, being on the other side of a fixed-rate loan means they are open to interest rate risk, which can leave them exposed to economic gains or losses if market interest rates move unexpectedly.

Each business unit is charged appropriately for the funds they use, or credited for the funds they provide, meaning that they have a more stable view of the margin they contribute to the bank. This frees up business units to focus on objectives like portfolio growth and market share.

How a bank estimates its cost of funds

To determine the cost to the bank of funding at different time horizons, a bank takes several steps to construct an internal funding cost curve as part of its FTP methodology:

- Setting a base rate: creating an interest rate curve that provides a foundation view of interest rates at different repricing terms. New Zealand's major banks' loan portfolios are larger than their deposit portfolios, meaning wholesale funding is used to close this gap. Typically, they use wholesale interest rates such as the OCR and interest rate swap rates at different maturities as funding cost benchmarks, since these reflect the opportunity cost of creating new loans or taking in new deposits.
- Incorporating additional funding premiums: adjusting the base rate curve to account for deposit stability, loan duration, and the bank's own credit risk premium. A bank typically pays a credit risk premium above the swap rate when sourcing funds in wholesale markets, and a term premium for longer duration funding. A corresponding amount is added for different loan and deposit offerings based on their expected duration.
- Adding liquidity costs: some types of funding can be withdrawn at short notice. Similarly, loan facilities that customers can draw down on at a future date generate liquidity risks for the bank. To manage liquidity risks, banks hold a buffer of liquid assets. These assets typically earn less interest than loans. Therefore, the FTP framework assigns a higher cost to funding and lending offerings with greater liquidity needs.

The exact FTP methodologies that banks use varies, depending on the complexity and nature of their business models. Smaller New Zealand banks often have simple business models that don't rely as much on wholesale funding. When setting interest rates, they may find it more appropriate to use average deposit costs rather than a wholesale market funding curve with risk adjustments.

While setting the base rates is relatively straightforward, and based on objective metrics like wholesale interest rates, there is a larger role for discretion and judgement in the other parts of the FTP methodology.

Moving from the internal transfer price to the customer interest rate

Once it has constructed an internal funding cost curve, a bank will use this to determine the appropriate cost for different loan and deposit offerings. To calculate a home loan rate, for example, the bank treasury will assign a loan transfer price at the appropriate term on the internal funding cost curve to the home lending business unit.[33]

33 Typically, banks use an assumed behavioural maturity for a loan, rather than the legal contractual maturity. A home loan with an initial contractual maturity of 30 years will on average tend to mature well before this, typically within 5 to 10 years. This happens for a variety of reasons, including accelerated principal repayments, or the loan being restructured when the borrower sells their home to purchase another one.

Starting from the transfer price, the home loan business unit will add allowances for:

- Expected losses: the bank expects a small proportion of loans to incur losses in any given year, which is accounted for through pricing.
- Capital charges: capital enables the bank to absorb large but infrequent unexpected credit losses. The bank needs to fund a portion of its lending with capital (e.g. equity) to meet its regulatory capital requirements set by the Reserve Bank. The amount of capital depends on the riskiness of the lending.[34]
- Operating costs: the cost of systems and people needed to create and manage the loan.

The difference between the final customer rate that the bank charges and the sum of these components represents the profit that the lending business unit is contributing to the bank as a whole (figure A.2).

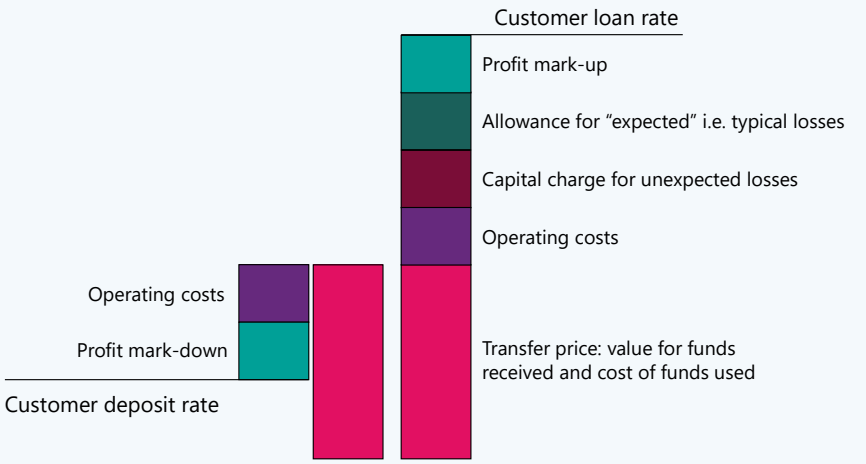
On the funding side, the bank treasury will assign transfer prices to deposit-gathering business units to compare the interest rates paid on each type of deposit. The transfer prices reflect the value of the funds they receive. For example, a 6-month term deposit rate offered using the FTP methodology will be based on the internal funding cost curve, adjusted for the expected maturity of the deposit. Typically, deposits are a very stable source of funding for banks, and so the average maturity of deposits is often longer than their contractual maturity. For instance, a bank may assume that an on-call or 6-month term deposit will in practice have an average maturity of 2 to 3 years.

To calculate the deposit rate paid to customers, the deposit-gathering unit then deducts operating costs, and the profit that the deposit-gathering business unit is contributing to the bank from the transfer price (figure A.2).

Some deposits, such as transaction accounts, pay minimal or no interest. As a result, they provide funding for much less than the transfer price, creating an important source of profit for many banks. Transaction balances represent around 18 percent of total bank funding currently. Changes in interest rates would result in volatility in banks' profitability from these types of deposits as the OCR changes. Banks use hedging strategies to smooth out these changes in profitability over OCR cycles (see Chapter 4).[35]

The FTP framework provides different business units with neutral and clear pricing signals, which then allows them to set deposit and loan interest rate offerings in the market based on factors like market share ambition and desired profitability. In turn, by centralising liquidity and interest rate risks, FTP gives the bank's management a more objective measure of each unit's contribution to the bank's overall profitability.

Figure A.2
Stylised components of deposit and loan pricing



Source: RBNZ.

34 See the RBNZ *Bulletin* article "How risk weights affect bank lending" (https://www.rbnz.govt.nz/hub/publications/bulletin/2024/how-risk-weights-affect-bank-lending) for further discussion on the role of risk weights and regulatory capital requirements in banks' lending decisions.

35 Commonly New Zealand banks use interest rate swaps to convert their stable zero-interest deposit funding into a "replicating portfolio" that mimics a more market-sensitive funding structure. Instead of treating these deposits as zero-interest, zero-duration liabilities, banks construct a replicating portfolio of interest rate swaps with staggered maturities, for example dividing the value of these deposits into a 5-year rolling portfolio, with 1/60th of the portfolio maturing every month. The FTP framework can incorporate the replicating portfolio by assigning a transfer price to the deposits that is equivalent to a 5-year funding instrument.

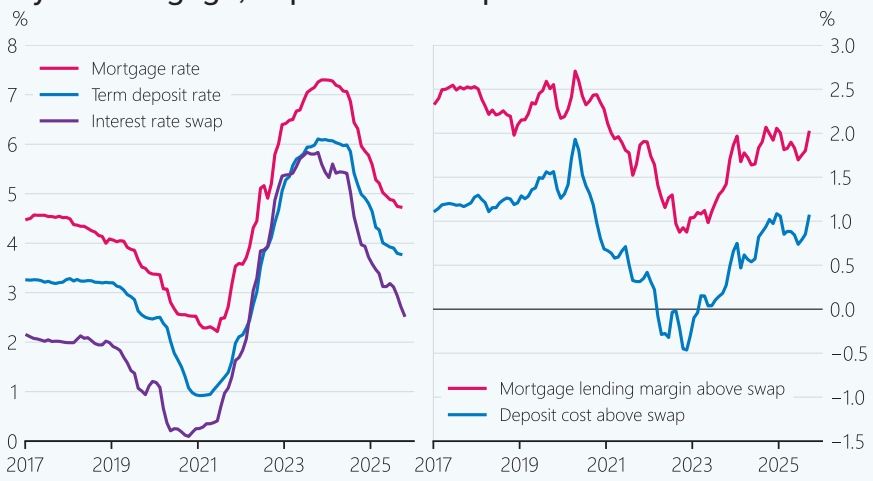
Adjustments and risks with funds transfer pricing

Banks in New Zealand each have their own FTP methodologies, and these can be adjusted over time depending on macroeconomic conditions or specific business goals. Banks continuously assess their FTP methodologies to ensure that appropriate pricing signals are being sent to business units, and apply adjustments based on judgement to achieve their strategic objectives.

For instance, during the period of monetary policy tightening between 2021 and 2023, wholesale interest rates rose significantly faster than deposit rates (figure A.3). At this time banks were able to maintain relatively lower term and savings deposit rates, improving the profitability of these products from an FTP perspective. This reflected conditions of an abundant supply of deposits compared to demand (a consequence of the higher COVID-level period of savings, higher levels of liquidity, and weakening credit demand).

Figure A.3

1-year mortgage, deposit and swap rates



Source: RBNZ *Retail Interest Rates survey, Reuters*.

The impact of this development on margins would have depended on the nature of each bank's FTP framework. Banks whose FTP frameworks closely aligned their internal funding cost curve with wholesale interest rates would have seen their loan margins decline during this time as the spread between lending rates and wholesale rates narrowed. In contrast, those banks whose methodologies put more weight on actual deposit costs would have seen less change in their loan margins. Such differences in FTP methodologies would influence how profitable a bank sees their loan book at a point in time, and how hard they compete with one another on loan pricing and for market share.

In addition to responding to macroeconomic developments, banks can use their FTP methodologies to tilt the composition of their balance sheet over time. For example, adjustments to pricing of the different components can be used to encourage longer-term deposits, assign higher costs for a bank's liquid asset holdings, or to enhance the competitive position of specific business units for strategic purposes.

Reserve Bank of New Zealand
Te Pūtea Matua