

10 July 2020

Dear [REDACTED]

Thank you for your request of 14 May 2020 for the following information under the Official Information Act 1982 (OIA):

- *“all documents produced by RBNZ staff (whether published or not) or received by the RBNZ from 1 January 2020 to date in respect of the capacity of New Zealand operating banks to accommodate a negative Official Cash Rate”*

On 12 June 2020 we extended the time for making our response to 10 July 2020 because consultation was necessary for us to make a decision on your request.

We have interpreted your reference to “documents produced...or received” to mean your request is for formal documents such as reports, memoranda and minutes, and therefore we have excluded email correspondence from the scope of your request. If we have misinterpreted this aspect of your request please advise.

We have interpreted your request to relate to documents produced or received in the period 1 January 2020 through to 14 May 2020.

Our Response

Document being released

Please refer to Table 1 below and the accompanying notes for details on the document we are releasing. A copy of this document is attached to this letter. Where information has been redacted from this document we have done so under the following ground:

- s 9(2)(b) – releasing the information would disclose a trade secret or would be likely unreasonably to prejudice the commercial position of the person who supplied or who is subject of the information.

Table 1: Document being released

Item	Date	Document name
1	28 Apr 2020	ALCO – Project Hydrant – Bank’s preparedness for negative interest rates

Notes:

- This paper was prepared for the Reserve Bank's Asset and Liability Committee (ALCO), but was never tabled with that committee.
- A further ALCO paper dated 17 March 2020 was within scope of your request, but has not been released as the information it contained was incorporated into the 28 April 2020 paper (item 2 in Table 1 above).
- Appendix 1 of the 28 April ALCO paper (item 2 in Table 1 above) is the final draft of the 7 May 2020 letter referenced as item 3 in Table 2 below. We therefore refer you to the 7 May letter only.
- Appendix 2 of the 28 April ALCO paper (item 2 in Table 1 above) consisted of a table summarising banks' responses on their readiness to operate with negative interest rates. This information is contained in the document referenced as item 1 in Table 2 below. We therefore refer you to that document.

Documents that are already publicly available

For a list of documents within scope of your request that are already publicly available, please refer to Table 2 below. As these documents are already publicly available your request for these documents is refused under section 18(d) of the OIA. We have provided you with the appropriate links to enable you to access these documents.

Table 2: Documents that are already publicly available

Item	Date	Document	Link
1	Various	Extract from 29 Jan 2020 letter to banks and summary of bank responses	https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Monetary%20policy/ump/Letter-to-banks-on-readiness-for-negative-rates-and-responses.pdf?revision=50e16ce7-e60d-4a8e-9bad-36028fa19c61&la=en
2	20 Apr 2020	Readiness and preparation for negative interest rates (information supplied to Epidemic Response Committee)	https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Monetary%20policy/ump/Preparations-and-readiness-for-negative-interest-rates.pdf?revision=992f1535-e782-44e9-a7a3-bfaa9224570e&la=en
3	7 May 2020	Letter from Deputy Governor Geoff Bascand to banks on readiness for negative interest rates	https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Monetary%20policy/ump/May-2020-Letter-to-Banks-Negative-interest-rates.pdf?revision=19a9435a-f119-443c-90bb-999a4c1e51a0&la=en

Documents being withheld or refused in full

For a list of documents within scope of your request and which we are withholding or refusing in full, please refer to Table 3 below.

These documents have been withheld or refused under the following grounds:

- Out of scope – the information lies outside the scope of your request.

- s 9(2)(b) – releasing the information would disclose a trade secret or would be likely unreasonably to prejudice the commercial position of the person who supplied or who is subject of the information.
- s 9(2)(g)(i) – the information is withheld in order to maintain the effective conduct of public affairs through the free and frank expression of opinions by or between or to Ministers of the Crown or members of an organisation or officers and employees of any department or organisation in the course of their duty.
- s 18(d) – the requested information is or will soon be publicly available.

Table 3: Documents being withheld in full

Item	Date	Document Description	Withholding/refusal grounds
1	19 Feb 2020	ALCO Minute of Meeting	s 9(2)(g)(i)
2	28 Apr 2020	ALCO Minute of Meeting	s 9(2)(g)(i)
1	19 Feb 2020	ALCO (Asset and Liability Committee) – Project Hydrant – Preparing for a negative OCR	s 9(2)(b) s 18(d) Out of scope

The Reserve Bank has a statutory duty to make official information available unless there is good reason for withholding it. In this instance the Reserve Bank believes that there is good reason for withholding the requested information and that the public interest in releasing it does not outweigh the reasons for withholding we have listed above.

This response required approximately 17 hours to prepare.

The Official Information Act allows charges to be imposed for the preparation of information that we send in response to OIA requests. The Reserve Bank is resourced to meet disclosure obligations for a reasonable level of requests and generally will not impose charges for small, simple or infrequent requests. In this instance we have chosen not to impose a charge due to the public interest in the requested information.

You have the right to seek an investigation and review by the Ombudsman of this decision. Information about how to make a complaint is available at www.ombudsman.parliament.nz or by Freephone 0800 802 602.

Please note that we intend to publish a copy of this response (with personal information removed) on the Reserve Bank's website www.rbnz.govt.nz/research-and-publications/official-information-requests. Responses to requests are published in order to improve public transparency and provide an additional resource for anyone seeking information.

Yours sincerely



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Reserve Bank of New Zealand | Te Pūtea Matua

MEMORANDUM FOR	ALCO / FSC-X
FROM	Michael Callaghan, Nick Mulligan, and Vanessa Rayner
DATE	28 April
SUBJECT	Banks' preparedness for negative interest rates
FOR YOUR	Information

Purpose

At its February meeting, ALCO requested information on bank feedback regarding negative interest rate functionality. The Head of Supervision wrote to the banks requesting they confirm their negative interest rate functionality. This note provides an update on banks' responses, and highlights steps to ensure that banks are prepared by a set date.

Executive summary and recommendations

Note that we do not have confidence that the banking system is currently prepared for negative interest rates.

Note that some banks are at early stages of testing of functionality and some results are only preliminary. The majority of banks need to undertake further testing and upgrade systems and documentation to be able to operate with negative interest rates.

Note that key themes were:

- Some banks are prepared to handle a negative OCR and negative penalty rates on our facilities (or fixes could be made in a timely manner). That said, manual workarounds and system patches are still needed in some cases, and testing is ongoing.
- A number of banks cannot operate negative interest rates on wholesale financial products.
- Treasury and markets systems are better prepared than retail systems, but some will require time to be prepared. Some banks note significant changes needed to documentation and systems for non-retail customers, which may reduce or slow the pass-through of negative interest rate policy.
- Significant work and changes would be needed for retail customer systems and documentation. Banks do not expect negative interest rates on retail products, based on international experience.
- Some banks are updating and standardising their documentation to insert a zero floor clause in loan facilities. A zero floor clause can create mismatch risk for firms who hedge interest rate risk with swaps, and the clause would limit the pass-through of monetary policy.

Note that we have drafted a letter to banks, requiring their systems to be ready for a zero or negative interest rates on RBNZ facilities, financial market products, and non-retail products by [1 November 2020].

Note that, in the draft letter, we recommend that banks engage with the New Zealand Financial Markets Association on market conventions for negative interest rates and with the New Zealand Bankers' Association on the merits of zero floor clauses in contracts.

We recommend testing of a negative interest rate for ESAS participants. ESAS participants are already required to test the ORRF once a year (at no cost) and we can make a similar imposition on them to test this at a negative rate.

Bank responses on negative interest rates functionality

Responses to Supervision's 29 January engagement letter on negative interest rate functionality suggests that the level of preparedness is mixed across banks. Appendix B shows key responses from the banks.

The feedback in this note is based on the responses to Supervision's 29 January engagement letter to the banks, as well as previous discussions with bank treasurers.

1. A negative OCR and market systems

Some banks indicated that they should be able to handle a negative OCR and negative penalty rates in our facilities (or fixes could be made in a timely manner) because trading platforms and treasury systems are generally prepared (or can be adjusted) for negative rates. That said, manual workarounds and system patches are still needed in some cases, and testing is ongoing. Some banks (including some of the large banks) have indicated that system upgrades are required to operate with a negative OCR and negative yielding financial products.

2. Non-retail banking

For some banks, there is significant work on systems and documentation required to implement negative rates for non-retail customers (commercial, agricultural and institutional).

Internationally, negative interest rates have tended to be passed on to large corporate depositors by banks. Therefore, an inability for banks to pass on negative interest rates to large corporate deposits could slow down monetary policy transmission and weigh on banks' profitability until it is resolved.

3. Retail banking

The most significant work and changes needed are for retail customer documentation and systems. However, banks generally aren't contemplating negative rates on retail customers, consistent with international experience.

Internationally, retail deposit rates tend not to fall below 0 percent due to the risk of cash hoarding. There is generally an expectation that -0.50 to -0.75 percent would be a low for the OCR, and retail interest rates have tended to remain bound at 0 percent at similar policy rates internationally.

A negative interest rate on retail customers is not generally being contemplated by banks and adjusting retail documentation and updating systems is generally not seen as a priority.

4. Other points

Zero interest rate floor clauses

Some banks are updating and standardising their documentation to insert a zero interest rate floor (zero floor) clause in loan facilities. A zero floor clause can create mismatch risk for firms who hedge interest rate risk with interest rate swaps, and the clause would limit the pass-through of the OCR when BKBM hits 0 percent.

The RBNZ may be concerned about the conduct and mismatch risk of these zero floors, as well as the constraint it imposes on the effective pass-through of monetary policy. It would be useful to engage with the industry on this, and possibly to approach it from the customer side via public communication so that those entering the contracts are applying pressure to have those clauses removed.

Three solutions have been deployed against negative interest rates overseas: simple interest rate cap swaps, a shift to fixed rate loans, or applying the zero floor protections in the facility agreement only to loans that are not counter-hedged with the lender.¹

Preparedness across banks

s 9(2)(b)

Market convention on negative rates

██████ noted a lack of interbank market conventions in relation to negative interest rates make it difficult to assess the systems testing undertaken. ██████ suggested that market conventions are established, in terms of whether the borrower would deduct interest from principal owed on maturity date or whether the negative rate would be achieved via another mechanism (e.g. interest paid upfront by the depositor). ██████ noted ISDA interest rate swaps agreements include contractual provisions for negative rates, and either a Negative Interest Rate Method (where the fixed payer is required to pay the negative floating rate payment to the floating-rate payer) or a Zero Interest Rate Method can be used.

Tax guidance on the treatment of negative interest rates

██████ also highlighted a lack of guidance from Inland Revenue regarding the tax treatment of negative interest rate transactions.

Competing regulatory initiatives and prioritisation

A number of banks noted a number of competing compliance initiatives underway at the moment (note this was prior to the RBNZ's decision to delay most regulatory initiatives), and are considering prioritisation of negative interest rate functionality among this. Some banks were looking for guidance from the RBNZ on how high a priority we placed on negative interest rate functionality.

Ensuring negative interest rates functionality in the NZ banking system

Uncertainty about banks' negative interest rate functionality adds some concern over our ability to implement a negative OCR if needed, so we have put forward a timeframe for banks for when they should have their systems in order. A proposed letter to the banks is shown in Appendix A.

In the letter:

- We have noted that the RBNZ views negative interest rate functionality as high priority.
- Within six months, bank systems must be prepared for a negative OCR, including transactions at a negative interest rate on the RBNZ's standing facilities and on ESAS balances above credit tiers (in the event these are reintroduced). This includes

¹ See Chapman Tripp (2019), <https://www.chapmantripp.com/publications/negative-interest-rates-and-the-corporate-borrower>

consideration of negative interest rates across a broader range of financial market securities. Thorough testing is expected with results to be submitted to the RBNZ.

- Within six months, banks should also prepare their non-retail systems and documentation to be able to function with negative interest rates. Banks that do not achieve this will face costs (margin squeeze) if they cannot pass on negative interest rates to non-retail depositors.
- We consider negative interest rate functionality on retail customer documentation and systems a lower priority at this stage, based on international experience where retail rates tend to be bound at zero.

Recommendations

Note that we have proposed a letter to banks shown in appendix A. This would give us confidence that we can take the OCR negative, even if there may be reduced or slower interest rate pass-through due to constraints in retail systems and documentation. The intention is for this letter to be reviewed by Supervision followed by the Governor and Deputy Governor if there is agreement on the priority of this work.

Note that we consider negative interest rate functionality on retail customer documentation and systems a lower priority at this stage, based on international experience where retail rates tend not to become negative.

Note that, in the draft letter, we recommend that banks engage with the New Zealand Financial Markets Association on market conventions for negative interest rates and with the New Zealand Bankers' Association on the merits of zero floor clauses in contracts.

We recommend testing of a negative interest rate for ESAS participants. ESAS participants are already required to test the ORRF once a year (at no cost) and we can make a similar imposition on them to test this at a negative rate.

Appendices 1 and 2 have been removed. Please refer to accompanying letter for details.