# Retail Deposit Guarantee scheme: Exit options

14 July 2009

### Exit and transition objectives

#### Financial system stability through depositor confidence

Current systemic risks are manageable

#### Economic growth and efficiency

- Minimise economic distortions from risk subsidy and life support for non-viable institutions
- Encourage private sector solutions
- Maintain current and future essential financial services and market competition
- Avoid undue disruption to credit markets

#### Manage fiscal loss

- Limit extent of liability
- Avoid unnecessary failures, maximise recovery
- Avoid costly and ineffective intervention strategies

## Matrix of broad strategy options Recommend option 4

Additional Management Options

	•	
	3. To enable	4. To enable
	more orderly	more orderly
Yes	transition /	restructuring /
	payout.	transition /
		payout.
	1. Status quo.	2. Maintain
	Most	confidence &
No	uncertainty	ability of NBDTs
		to attract
		deposits.
!	No	Yes

**Extension of Scheme** 

## Extend or not? On balance, fewer and less severe economic and fiscal risks with transition scheme

Objectives	Exit October 2010 - risks	Transitional scheme - risks
Financial system stability through depositor confidence	Upon exit systemic risk is manageable. [	Upon exit systemic risk is manageable. [
Economic growth and efficiency	Withheld – economically damaging	Withheld – economically damaging
Fiscal risk	Simultaneous failures may lead to lower asset recovery-risk of higher fiscal loss than with transitional scheme.	Though total exposure likely to increase and will last longer, expect fiscal loss to be no higher than with immediate exit.

## Prime Minister – if scheme extended it must aid transition

This proposal aims to:

- Reduce economic distortions has more risk adjusted pricing
- Manage fiscal risk and reduce reliance on guarantee reduce cap on depositor cover and risk management tools
- Withheld economically damaging
- More active risk management contractual tools to restrict undesirable growth and risk taking

This proposal does not go as far on active management e.g. legislative powers to direct mergers, take corporate control

### Critical design features Fees: focus on efficiency or affordability?

Credit rating	Option 1: efficient (bpts) (Treasury)		Option 2: affordable	
	Finance companies	Banks, Credit Unions, Building Soc	(bpts) (Reserve Bank)	
AAA	7.5	7.5	7.5	
AA	7.5	7.5	7.5	
A+	10	10	15	
А	15	15	15	
A-	20	20	15	
BBB+	30	25	25	
BBB	40	30	25	
BBB-	50	35	25	
BB+	150	45	50	
BB-	300	55	50	
Objectives	<ul> <li>Reduce economic distortions</li> <li>Risk pricing allows market for unguaranteed deposits</li> <li>[Withheld – economically damaging]</li> </ul>		•Simpler but less risk sensitive •Reduces the risk that some NBDTs that are viable in the medium term become non-viable in the short-term	

#### **Background:** fee impact

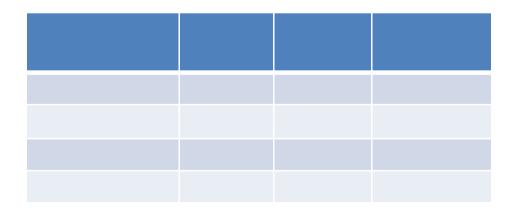
## Option 1: efficient Aggregate fees and net interest income

	Fees estimate*	paid	Fees as % NII
Banks			
Savings			
institutions			
Finance			
companies			
Total			

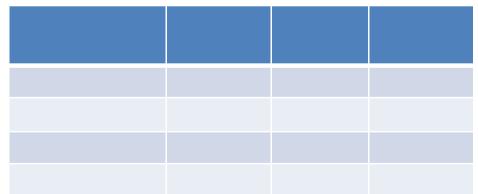
### Option 2: affordable Aggregate fees and net interest income

	Fees estimate*	paid	Fees as % NII
Banks			
Savings institutions			
Finance companies			
Total			

#### Withheld – economically damaging



#### Withheld – economically damaging



## Stronger eligibility criteria Credit rating required to minimum of BB

- •
- •
- Withheld economically damaging

#### New management levers

#### **Objectives:**

 Manage undesirable growth and undue risk taking

#### Proposed new levers (using deed):

- More active management levers including restricting undesirable asset acquisition and deposit growth – contractual penalties (withdrawal of guarantee or financial penalty)
- Authorisation required for change of ownership

### Stronger legislative levers would be possible but have consequences:

 Issue binding management directions e.g. prevent assets acquisition or deposit growth – potentially cuts across commercial rights but provides stronger options

#### **Resolution options**

#### **Objectives:**

 Standard resolution where possible i.e. payout and wind-up

[Withheld – commercially disadvantage Crown ]

#### **Resolution options:**

[Withheld – commercially disadvantage Crown ]

## Prime Minister requested more active approach

- Tighter regime for weakest institutions weakest institutions excluded from proposal, ability to restrict risky behaviour for those included
- No guarantee on growth restrict undesirable growth but allow growth where it improves viability of NBDT sector
- More active exit management
  - Care about continuity of service and asset recovery
  - Proposal provides some active management tools: commercial penalties to manage negative behaviours; continuity of service; commercial transactions; statutory management
  - Further asset protection tools e.g. legislative takeover and directions –
     not clear benefits would outweigh costs
    - Crown may not maximise asset value capability and incentives
    - Taking a punt on asset values could go either way
    - Transfer powers would override other property rights

### Proposed timeline

Aug 09

• Announce transitional DGS with cross-party support to pass legislation. Publish detail design and expiry date. Announce intention to consult on permanent arrangements.

Sep <u>09</u>

- Legislation under urgency. Applications open.
- **RB** Act: Introduce capital and related party frameworks with year to comply.

Mar 10

• RB Act: Credit rating requirement.

Sep 10

- •RB Act: Compliance with capital and related party requirement.
- •[Withheld economically damaging]

Oct 10

- Tighter transitional scheme introduced.
- **RB Act**: Crisis management powers, fit and proper.
- Oct 11? [V
- Transitional scheme ends.
  - [Withheld under active consideration]