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

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 (bpts) (Reserve Bank)
	Finance companies	Banks, Credit Unions, Building Soc	
AAA	7.5	7.5	7.5
AA	7.5	7.5	7.5
A+	10	10	15
A	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	•Reduce economic distortions •Risk pricing allows market for unguaranteed deposits [Withheld – economically damaging]		•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 paid estimate*	Fees as % NII
Banks		
Savings institutions		
Finance companies		
Total		

Withheld – economically damaging

Option 2: affordable

Aggregate fees and net interest income

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

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 09
- 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?
- Transitional scheme ends.
- [Withheld – under active consideration]