

Retail deposit guarantee scheme: Exit options

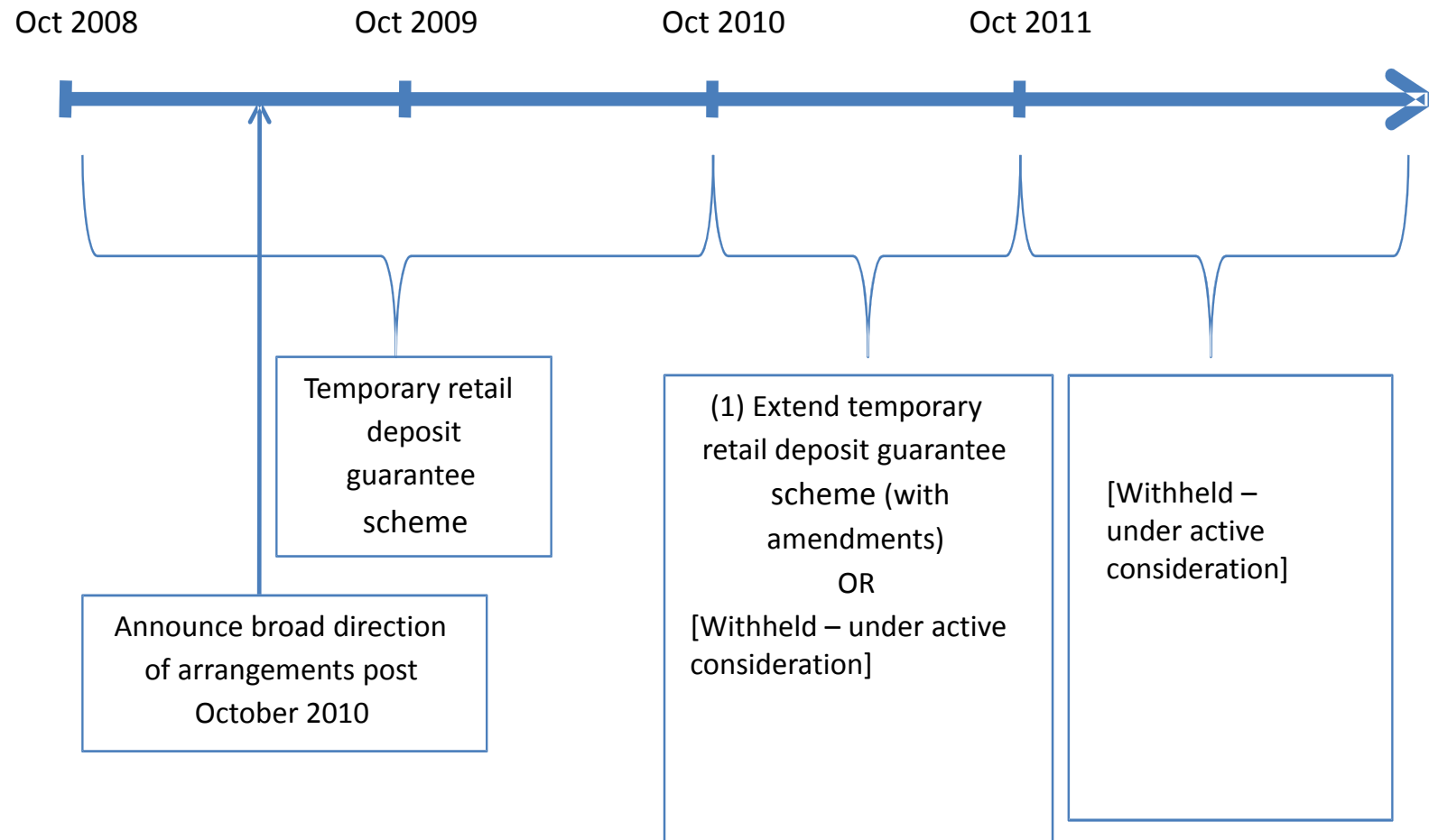
The Treasury and Reserve Bank

3 June 2009

Context: current scheme

- Generous 2 year “blanket” guarantee broad coverage (incl. non-banks), high cap (\$1m), and relatively low fees
- Achieved objective of promoting depositor confidence during financial turmoil (although counterfactual difficult to determine)
- Crown contingent liability of approx \$128bn
- Significant implications and distortions for non-bank sector
 - [Withheld – economically damaging]
 - Non-banks book growth (increasing Crown exposure)
 - “Wall” of maturities building up in lead up to schemes’ end
- Distortions in capital markets more broadly
- Funding sources have stabilised for banks since the scheme was introduced but remain vulnerable for non-banks

Timeline of options



Initial assessment – extension on tighter terms

- Need to make announcement soon to provide the market with certainty
- [Withheld – under active consideration]
- On balance, extending on tighter terms may reduce economic and fiscal risks, if well designed, and increase options for the Government
- Aligns timing with end of Australian scheme (Oct 2011)

Risks from exiting or extending

	Exit October 2010	Extending on tighter terms
Financial stability risks	<ul style="list-style-type: none"> -Liquidity issue for NBDTs through shortening maturities -[Withheld – economically damaging] -Some risk of depositor flight to Australia 	<ul style="list-style-type: none"> -Risk that economic conditions and confidence do not improve and liquidity issue re-emerges
Real economy risks	<ul style="list-style-type: none"> -Some risk of temporary disruption to some credit (vehicle, consumer, investment property) -Risk asset prices over correct, and reduce business working capital 	<ul style="list-style-type: none"> -Continues economic distortions (but risk based pricing helps to reduce)
Fiscal risk	<ul style="list-style-type: none"> - [Withheld – economically damaging] 	<ul style="list-style-type: none"> -Risks from increasing total exposure and longer duration -[Withheld – economically damaging]
Reduced options	<ul style="list-style-type: none"> -[Withheld – under active consideration] 	<ul style="list-style-type: none"> -Risk of expectation of continuing support

New NBDT regulatory regime bedded in prior to removal of any extended scheme

2008	Q3	RBNZ becomes regulator of NBDTs, and begins formally monitoring the sector (September)
	Q4	DGS introduced (October)
2009	Q1	
	Q2	
	Q3	Capital and related party measurement frameworks take effect Governance requirements NBDT risk management programmes required (September)
	Q4	
2010	Q1	Credit rating requirement (March)
	Q2	Liquidity framework takes effect
	Q3	Capital and related party requirement minimum standards take effect
	Q4	Scheduled end of DGS (October) Licensing requirements, fit and proper, and crisis management powers
2011	Q1	
	Q2	Liquidity minimum standards take effect
	Q3	
	Q4	Alternative end date of DGS (October)

Note the precise timing of future requirements, especially licensing, fit and proper, and crisis management powers is uncertain.

[Withheld – under active consideration

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On balance we recommend extension

Extension on tighter terms for say 12 months (signals any permanent arrangements will be less generous)

- Risk based fees on full book as far as possible
- Greater powers and flexibility to manage Crown risk in the guarantee scheme (e.g., ability to withdraw or alter the guarantee to manage institutional risk)
- Reduced coverage and potentially differential coverage for banks and non-banks
- Can have compulsion for banks, and opt in for non-bank depositing taking institutions

Next steps

- Cabinet decision and public announcement - late June
- Introduce legislation for guarantee and new powers in late July
- Need for urgency?
- Communications strategy will be critical – to ensure clarity of design and purpose, some negative reaction is inevitable