THE TREASURY
Kaitohutohu Kaupapa Rawa

Date: 3 April 2012

To: Minister of Finance

Aide Memoire: Open Bank Resolution Cabinet Paper

You are meeting with Treasury and Reserve Bank officials to discuss a draft Cabinet paper on the Open Bank Resolution. The paper outlines progress and next steps to ensure OBR can work effectively in practice.

Given the technical and detailed nature of this work, we have kept the Cabinet paper at a high level. In this meeting, we wish to ensure that you are comfortable with the work program over the next year. In addition to any specific questions you have about the Cabinet Paper we would like to discuss the following points:

Timeline for pre-positioning and encouraging compliance

One large bank cannot meet the Reserve Bank's proposed one year timeline due to an ongoing project that needs to finish first. Given the different readiness of banks and concerns about neutrality if some are pre-positioned earlier than others, the RBNZ proposes a deadline of 30 June 2013.

To achieve this RNBZ will introduce a condition of registration this year that banks pre-position by this date. Failure to meet this deadline would be a breach of conditions, offering RBNZ a wide range of potential sanctions, such as capital overlays. This approach should provide strong incentives for compliance.

Absence of deposit insurance makes New Zealand different

The Cabinet paper simply notes that applying haircuts across retail and wholesale creditors is an intended feature of OBR. This is consistent with the Financial Stability Board's principles for effective resolution which propose that all unsecured and uninsured creditors be treated equally. However, most countries have some form of deposit insurance or depositor preference, which will mean depositors' losses are limited.

[Withheld under s9(2)(d)]

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Reserve Bank view

The Reserve Bank previously provided advice to the Minister on the case for deposit insurance (summarised in a Cabinet paper in November 2010), indicating that it did not believe that DI was appropriate for New Zealand. This advice took account of the positive and negative implications of adopting a DI scheme. The Reserve Bank remains of the view that DI should not be a permanent feature of our financial system. Specifically, it notes that:

- Previous advice explicitly considered the impact of DI on preventing a retail bank run, noting that while it may be partly effective at preventing or slowing retail bank runs, it would not address wholesale bank runs, which present a significant risk for the major banks in New Zealand. This remains the case and is not changed by OBR [Withheld under s9(2)(d)]

- The Reserve Bank's liquidity policy means that New Zealand banks should have sufficient liquid assets to meet one week and one month mismatch ratios. This means that the bank is able to meet any requirement for funds in the short run. In addition, as lender of last resort, the Reserve Bank will be able to make liquidity facilities available to manage the impact of withdrawals during a crisis. Therefore, the Reserve Bank is of the view that a DI framework would be a costly way to manage perceived liquidity risks.

Ongoing work programme

Pre-positioning will deliver the main technical capability to implement OBR, but further work is needed to ensure it works effectively in practice:

- Legislative changes to the Reserve Bank Act and to support government guarantees.

- Both banks and authorities need to understand more about the information and operational requirements to implement OBR. This will require a more active supervisory approach than in the past with respect to pre-positioning banks for possible resolution.

- Requirements to manage the bank once its brought into OBR and how to exit

[Withheld under s6(b)(i)]

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