The Treasury

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[1]

5 August 2019

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Review of the Reserve Bank Act – Phase 2: second round of consultation

Introduction

Back in January I made a submission to the Treasury[1] in the first round of consultation on the Review of the Reserve Bank Act and followed this up with a submission to the Reserve Bank (RBNZ) in February in relation to RBNZ review of Banks' Capital Adequacy.

Both submissions addressed the protection of depositors funds, since this has a direct impact on the risks of the harms associated with a bank failure and hence the need for procedures (like OBR) and regulatory determined capital ratios designed to protect bank customers and the banking system against a potential Bank failure, or to mitigate those harms.

This submission is made in response to the second round of consultation on Phase 2 of the Review of the Reserve Bank Act, following in principle decisions made by the Minister.

Some changes to the proposal have been made to reflect those decisions and my improved understanding since the first round. I apologise for any errors or wrong assumptions made in the earlier submissions (e.g. regarding ESAS borrowing and lending rates) – or in this one, but do not believe they have any material effect on what is proposed.

[1] https://treasury.govt.nz/sites/default/files/2019-02/rbnz-p2-4064255.pdf

The main purpose of this submission is to address the matters identified in Chapters 4 and 5 of the Consultation Document 2A: i.e

- the regulatory definitions and perimeter of deposit and deposit taker; and
- the detail of the deposit protection scheme,

but I include comments on issues in other Chapters of the 2A consultation document.

Chapter 2: What financial policy objectives should the Reserve Bank have?

The Minister has made an in-principle decision for the RBNZ to have a single high level financial policy objective of financial system stability. This is supported.

There will be many views about the priority for different secondary objectives and how to express them, apply them and monitor and achieve them.

My three comments here are that:

1. **No new Deposit Taker Act is needed**: Consistent with the objective of improved coherence of approach to regulating both Banks and NBDTs (and any potential new financial entities) and having a clean and clear governance framework for the RBNZ, I see no need for a separate Deposit Takers Act. Appropriate rules and requirements should be either dealt with in the Reserve Bank Act, or in regulations made under that Act (as is the case with the FMCA).

   In a world where there are ever increasing clamours for intervention by statutory law to direct the conduct of society, to show that "something is being done", and decreasing reliance on common law principles and practice, we are seeing major growth in the number of statutory instruments.

   Every effort should be made to simplify and streamline existing and replacement legislation to minimize the laws that the public are expected to understand and comply with. The purposes and objectives of the suggested draft Deposit Takers Act proposed can be readily combined without compromise in the revised Reserve Bank Act.

2. **Make Facilitating Competition an explicit objective**: An essential objective for financial system efficiency is (B2 on page 22: Facilitating effective competition in the financial sector.) As regulation and its associated costs (including AML/CFT and KYC client on-boarding rules and proposals for increased capital for risk protection – not offset sufficiently by technical innovation because of lack of competition or regulatory barriers to entry) drive consolidation in the financial sector, we are seeing fewer. not more financial intermediaries.

As for Australia, the banking sector in new Zealand is highly concentrated, as is the capital market sector. That allows a degree of complacency amongst participants - seen by the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Sector"[2].

Both the FMA and the RBNZ need to take competition policy into account in setting policy and rules, making operational licencing and registration decisions, monitoring and enforcing good conduct, and in approving exemptions or making rulings.

The Australian 2014 Murray Commission report on its Financial System Inquiry[3] recommended: "*Rebalance the regulatory focus towards competition by including an explicit requirement to consider competition in ASIC's mandate and conduct three-yearly external reviews of the state of competition."*

While the Australian Government accepted the recommendation it has taken some time (including having the Royal Commission) before implementation. Unfortunately this requirement has not been made explicit for the FMA in the FMCA for but should be included in the revised Reserve Bank Act for the RBNZ.

3. **Social Policy objectives (including climate change) are not appropriate for the RBNZ**: The RBNZ is expected to act independently to maintain its primary objective of financial stability. All social matters on which the Government may formulate policy have the potential to present financial risk to the economy. The financial implications of these policies are expected to be matters for Government and its fiscal policies. Monetary policy of the RBNZ may be directed in response to threats in order to maintain financial stability, but should not be used as a substitute for fiscal policy or to support Government policy on social initiatives of any kind, including protection of any particular groups in society.

   Directing monetary policy to support social initiatives or affect any particular group in society would compromise the primary objective of the RBNZ, and confuse transparency and accountability. As the paper notes (p26) ".. government objectives could compromise the Reserve Bank's independence or divert attention away from the Reserve Bank's core functions."

[2] https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf
[3] http://fsi.gov.au/publications/final-report/

Chapter 3: How should the Reserve Bank be governed?

COHERENCE

In an ideal world starting from scratch, one might question the need for two regulators of financial markets (the RBNZ and the FMA). The paper discusses the Option of a NZFSA. Since the different entities in the financial markets are all involved in creating, supplying, advising on and managing financial products, an integrated approach to regulation would seem efficient and consistent.

However, the two regulators have developed separately historically with the Banking regulation coming well before capital market regulation; the paper notes transition costs would be significant; and there does not appear to be any enthusiasm for integration of the RBNZ and FMA regulatory roles, so that Option has been ruled out by the Minister in the first round of consultation.

Nonetheless it is important to take a consistent approach to the governance frameworks of both entities.

The topic of coordination with other Agencies (in Consultation document 2B) includes the working relationship between the RBNZ and FMA as joint regulators of the financial markets. It is important that design of the governance framework for the RBNZ should have regard to, and be consistent with, the framework for the FMA, and provide a consistent and coherent structure for the dual operation of these regulators – recognizing they have areas of conceptual and actual overlapping of responsibility - for the same reason the Consultation Document 2A looks for coherence of regulation of the same conduct carried out by different (Bank and NBDT) entities.

Chapter 4: How should the regulatory perimeter be set?

Section 1: Regulatory Perimiter: Coherence

The paper seeks a perimeter that “empowers best-practice regulation” (p72); notes that the current parallel regimes are entity based, and asserts that good regulatory practice is “activities based” (p75).

Best practice is not activity regulation but conduct regulation. It’s just that the difficulties of definition and thus enforcement of conduct regulation mean that activity or entity regulation is often chosen instead. Activities and entities are easier to define and make rules around (thereby also avoiding the need for regulatory judgement and possible consequential accountability). e.g. it’s easy to say what taking deposits is, and to define entities that take them, but harder to say what is the bad conduct to be prohibited in taking money in response to an offer of something.

The FMCA made a good attempt to address that by prohibiting bad conduct – like manipulation, misleading conduct, failure to make true and proper disclosure, and insider trading (as extensions of common law fraud, negligence and misrepresentation torts), but banking law and regulation is more established and traditional and has always been more rule based around defined entities and their activities.

So addressing conceptual coherence with the FMCA in the review of the Reserve Bank Act is highly desirable and should be a guiding policy and drafting objective.

The paper says an activities based definition of a deposit taker is yet to be developed (p 72). For consistency, all deposit takers should be subject to the same regulatory oversight and set of capital adequacy requirements in relation to their deposit activity (since in fairness they will all get the same level of depositor protection under the new scheme and neither Banks nor NBDT's should receive any relative regulatory advantage as deposit takers. (see P74 – there is a strong case for alignment) .

The purpose for which deposits are used e.g. whether or not NBDTs are allowed to create money or restricted to just making investments or loans fully backed by their deposits, should not affect the definition of deposit taker. How funding is applied by entities, and the potential risks created, should simply be recognised in the capital adequacy definitions designed for protection against those risks, and the prescribed supervisory and monitoring arrangements covering them (Banks and NBDTs in this case).

Coherence is needed because it is efficient and fair, and aids transparency. Entity categorisation is not consistent with an activity based regulatory approach. A standards based approach can be.

Section 2: How should the boundary be set?

WHAT IS A DEPOSIT, AND THUS WHAT IS A DEPOSIT TAKER?

Of course the definition of a deposit taker first requires a definition of what a deposit is.

A DEPOSIT IS A LOAN

The definition of a debt security (under the FMC Act - as noted (p 75)) includes deposits, so all bank deposits accepted by Banks are subscriptions to an offer of debt securities (these are covered under current law and regulation by a PDS issued by the offering Bank and publicly available to customers).

The essential feature of a deposit currently is that it is "lent to" the Bank or NBDT, against an obligation to repay – this may be either with or without any interest obligation or any time restriction on repayment. The Bank takes ownership of a deposit, so a deposit is just a loan from the customer.

[Note here that Transaction accounts can be treated differently if the depositor keeps ownership of the money (if treated as proposed in this submission). In this framework transaction deposits are not a liability of the Bank or NBDT which takes transaction monies on trust and provides a financial safekeeping and transaction service. The terminology of deposit is then used in its traditional sense of “placing” - for safekeeping or to make payments - rather than lending. That usage would however appear to conflict with the way it has become accepted to regard loans to banks as “deposits” (and as including “savings”). If the idea of Sovereign Transaction accounts is adopted, endeavours to provide separate words for monies placed in Transaction Accounts would help improve customer understanding (the report notes that few people really understand how the system of money works) and remove the conflict with the terminology of deposits which are loans to Banks (or NBDTs)].

P76 says there are challenges in differentiating deposits from other debt securities, but these challenges are not specified and so it is not clear why they are challenges? I argue that definitions need not be complex and should provide consistency and clarity in the distinction.

The FMCA grappled with these issues in trying to define types of financial products in a consistent way across Banks and other financial product issuers, having to accommodate the traditional and separately regulated role of banks as financial product issuers.

In principle, all regulated securities must be offered under a PDS appropriately describing the offer, (also allowing for a less comprehensive term sheet to be provided for subsequent or continuous offers where updated information must be disclosed during the currency of a PDS). Deposits are really just subscriptions to, and redemptions from, accounts for which there is a public PDS and generally understood terms and conditions and protections, so that the issuer is free from requiring the lender to acknowledge sighting and agreeing to the PDS terms. This is accepted because the issuer is suitably licensed and regulated to make the offer as part of its ordinary course of business. Standardisation to lower information costs is a common practice in offers of financial products (common shares being an example in the case of an equity financial product).

So the distinction between deposits and other types of offers is based on the regulation of disclosure requirements and lender acknowledgment, which differ between these types of financial products.

WHO MAKES THE DEPOSIT IS NOT RELEVANT

For deposits, there is no different disclosure made depending on the person or nature of the lender. The activity is the same and whether the conduct involved is good or bad does not change because of the person of the lender.

That means it is not relevant to distinguish between different type of depositors (e.g. retail or wholesale) because they are all subject to (or free from) the same (publicly available and understood) terms and conditions when providing money, and the deposit takers are all licensed and subject to the aforementioned consistent and coherent regulatory and capital adequacy supervisory framework.

A distinction between wholesale and retail investors is typically made in securities offerings and markets because of concerns about protecting less informed investors – so offers may be made to wholesale investors with less information required. But this does not apply in the case of deposits, where the terms of the offer are publicly known and accepted to be understood by the public.

THE ACCEPTANCE OF TERMS IS A SIGNIFICANT DISTINCTION

Bonds, notes and debentures are offered, or securitisation is done, through explicit recognition of the contractual arrangement between borrower and lender. Any form of "investment' for which a Bank or NBDT customer must make explicit acknowledgement of the terms should be held to be outside the definition of "deposit" since there is a clear acknowledgement that the money is to be put at risk for a defined purpose. Fund investments (like Kiwisaver) fall into that category. These accounts require an initial acknowledgement of terms when a customer signs up, but regular or subsequent "deposits" to the account may be made under the current acknowledgement until and if the terms change. Accounts into which these monies are placed are investments and should not be thought of as deposit accounts.

SO WHEN CUSTOMERS ACCEPT PARTICULAR TERMS IS A GOOD BOUNDARY CRITERIA FOR THE DEFINITION

Customers accept the terms of "standard" transaction and savings "deposit" accounts when they sign up as customers.

However, while term deposits are generally thought of as deposits, as a minimum they require specific acknowledgement or acceptance of terms by the customer before the money is placed, and thus in principle should be held to be outside the definition of a deposit. Only accounts that depositors may freely transfer funds between without any separate explicit acknowledgement of terms (those being publicly available) should be thought of as a "deposit" account.

I would therefore regard savings accounts, and call accounts as deposits, but exclude term deposits. Clearly securitised products (bonds, notes, debentures, term deposits etc.) that are obligations of the borrower which a depositor cannot convert back to a deposit immediately without the borrower's approval, (or through sale to a third party if permitted), are investments, not deposits.

SO TERM DEPOSITS ARE DIFFERENT FROM CALL DEPOSITS

In the current definition of Broad money, term deposits are included. There is no reason to change that definition. It would however, be better if term deposits were instead referred to as term investments.

IT MAKES A BIG DIFFERENCE FOR DEPOSIT PROTECTION

Term deposits make up currently make up around 52% of Broad Money. Savings deposits make up 25% and Transaction deposits 20%. Excluding term deposits from depositor protection would halve the potential cost, or reduce it by 2/3rds if Transaction balances are excluded as I propose below.

Of course the Government may draw the line on insurance protection where it likes, but if term deposits are protected, not only will that be more costly (when it has been well argued by many that any additional deposit protection is not even needed) but will also increase the cost of raising money by other equivalent security types such as bonds – extending a special privilege only to Banks and NBDTs who offer term deposits.

DESCRIPTIONS MATTER

I agree that however these definitions are decided, clarifying the terminology of "deposits" and "deposit takers" restricting the use of the word to products that meet these requirements, and providing appropriate labelling or warning statements is appropriate (re P 77).

DIFFERENT RULES FOR DIFFERENT FIRMS?

Deposit takers should not be categorised by size. The activity is the same, only the scale changes. The standard rulebook should allow for (or allow for exceptions to be made to cover) any operational differences related to size or activity. Any differences in risk between different deposit takers should be taken into account in the capital adequacy standards.

The RBNZ, as regulator should have the ability to extend the regime to designate an entity or class of entity as deposit takers. As noted, this aligns with FMA's powers under the FMCA and avoids regulatory arbitrage.

Chapter 5: Deposit Protection

Section 1: In-principle decision

DEPOSIT INSURANCE PROPOSAL

The Minister's in-principle decision assumes that all customer deposits (as that becomes defined) will be covered by the Insurance Scheme.

Treating Transaction deposits separately removes $60B from the ~$312B of deposits that need to be covered (if term deposits are included).

While this is only 20% it should materially reduce the cost and extent of the Insurance proposed and the negative effects of the cost of the scheme.

Insurance costs are further reduced if term investments (currently thought of as deposits and making up ~50% of Broad money) are excluded as I recommend.

NOT NARROW BANKING

The summary of first round consultation responses refers to my submission (and similar others if there were any) as proposing a Narrow Banking solution. That is a mischaracterisation (if understandable) of what is proposed.

Ever since the Chicago Plan, there has been much discussion of narrow banking, full reserve banking and sovereign money proposals. Many alternatives have been proposed and, so far, none implemented. Mostly these are for extensive reform of the Banking system, based on the ideas of 100% reserve banking or a single circuit sovereign money model.

For every proposal there are different interpretations of how to best implement them. Critics of the alternative system approaches (including beneficiaries of the current system) are able to identify and explore concerns about the detail, and the effects on interest rates, inflation and monetary policy in practice - since none of these ideas are in place anywhere to provide guidance.

In contrast, the current international model - fractional reserve dual circuit system banking (where Banks create money and settle between each other using sovereign money) is well tried and understood. This proposal does not change that current system. Interbank retail transactions are currently only a small proportion (around $4B or 13%) of daily ESAS transfers.

BUT IT'S TIME TO ALLOW THE PUBLIC TO HOLD SOVEREIGN MONEY ACCOUNTS.

Fintech is providing challenges to current money and banking systems. Blockchain and DL technologies allow the creation and exchange of crypto-assets between owners. These alternative address the key attractions of digital currencies:

- **Ownership and Disintermediation**
  - A key benefit is that people actually own the currency/token/asset directly and can transfer it at will to whomever they choose, bypassing the need for (and cost and risk of using) an intermediary.
- **Speculation**
  - The lack of stable value (priced against sovereign monies) of a digital token is both a disadvantage (as money) and an attraction (as a risky investment).
- **Privacy**
  - Taking ownership without AML/CFT and KYC checks is a benefit to those who seek anonymity and is a social threat to others (tokens can be used to finance criminal activity).

Central Banks are investigating the idea of introducing or permitting alternative digital currencies without recognizing that they already have one - sovereign money in electronic form - currently used only for settling transfers between banks.

Sovereign money provides all the basic functions of money[4] and also the important day to day need for short term temporal constancy – i.e goods and services have “accepted” and “understood” money values over reasonable periods of time so people don’t have to mentally reevaluate value for their everyday purchases (one of the criticisms of the Facebook Libra is that it will not meet that requirement).

Current digital currency alternatives meet some of money’s functions, but have too much variability to be reliable means of deferred payment, or have enough day to day temporal constancy to be practical for everyday transaction purposes.

Electronic sovereign money should be the Central Banks’ answer. The technology of implementation (encryption, DL, Blockchain, central register etc) is irrelevant and the licensed intermediary model (for KYC, AML/CFT protection and avoidance of criminal conduct) is now well established and accepted.

Logically, facing the introduction of international digital currency alternatives, Government should either abandon client on-boarding checks on owners of current sovereign or accepted bank money, or they should ban digital tokens that are not transferred through licensed intermediaries. To have both is inconsistent policy.

NZ has an advanced electronic banking and money transfer culture and a stable and well-regulated banking and money system.

It has played a leading role in banking internationally, both technically - in developing its electronic banking EFTPOS, ESAS and SBI systems - and in policy (Central Bank single objective (inflation) targeting for monetary policy).

NZ is extremely well placed to make the next move to a digital currency.

The simplest possible solution for that is to make Bank customers’ Transaction accounts into sub accounts of their ESAS accounts, and make them the legal owners of those monies.

HOW TO DO IT?

As with any implementation of a retail sovereign money concept, there are different possible ways in which such a change could be made.

[4] Medium of exchange, store of value, unit of account and means of deferred payment.

My recommendation is to minimise disruption, by transferring the transaction account liabilities of banks to the RB in the transition, without any cost to the bank of funding the transfer (as there would be in say a 100% reserve model for transaction accounts if they had to fund their ESAS accounts by an equivalent amount). The conversion would be one-off, on a chosen Conversion Day.

The balances of depositors in transaction accounts on day zero (0) simply become sovereign money and liabilities of the RBNZ and are removed as liabilities from the balance sheets of the Banks. That would significantly reduce a Bank's potential funding costs for withdrawals from depositors' transaction accounts, so is a significant benefit to the Banks.

On its face that conversion would basically increase each Bank's shareholders' equity and might be seen as an unfair benefit to shareholders, so creation of a reserve in the Bank's accounts for the equivalent liability (and making it unable to be paid out to shareholders) might be publicly more acceptable.

Banks subsequently become transaction service providers for these client transaction funds - custodians of the clients funds in a similar way to holding client funds in trust.

FINANCIAL IMPLICATIONS

If treated as overnight holdings of Banks, depositors transaction balances at the RBNZ would currently earn OCR-1.0% i.e 0.5% (~$300M annually), so separate consideration needs to be given to whether the RBNZ should pay depositors any interest on their transaction accounts, or treat them quite separately from Bank's settlement account overnight funding needs and, perhaps, pay no interest on them, i.e treat them like holdings of notes and coin). That would be my recommendation.

Banks would then be able to borrow from depositors (as well as they do from Banks currently) by paying interest and thus encourage depositors to move money into (or keep money in) Savings or Term Investment accounts (thus being held in Bank money not sovereign money and transferring equivalent sovereign money from the transfer into the Bank's settlement account – which would buffer transfers).

Removing depositors transaction balances from other "deposits" still leaves savings and term/call/money market accounts in Bank money. Whatever deposit insurance arrangements are agreed by Government would still apply to those monies.

Transaction balances currently make up only around 20% of broad money so making them sovereign money owned by depositors would not be expected to have a disruptive effect on how banks operate currently. (Only about $4B of retail value is transferred daily between banks). Deposit insurance on $164B of Term deposits, making up ~50% of Broad Money, would likely have a far greater impact on Bank activity.

Since ~80% of monies created by Banks from loans would still be held by the bank in bank money accounts, and customers would receive deposits from other banks and also transfer money from transaction accounts to accounts holding bank money (in order to gain interest), no significant additional funding cost for banks should be expected.

Following transition, Banks making loans would credit a depositor's Bank money accounts at that Bank (savings, term, loan, investment, or however described). Only monies depositors needed to make payments with would be transferred to their transaction accounts. Banks making loans could manage that process as it suited them (recognizing that transfers to transaction accounts would require funding by the Bank and transfers to bank money accounts would provide sovereign funds for Banks). Payment transfers between customers (within or across banks) of customers' money would have no funding implications for banks.

The disincentive for customers to transfer balances from Bank money accounts would be a loss of interest paid on savings or term deposit accounts (and these would be protected to some extent anyway if the proposed deposit insurance regime proceeds). The end result would be a system where Banks would operate much as they do now, except transaction monies might be thought of as treated in funding terms as if, under the current system, they were going to, and coming from, outside the Bank. (i.e. as if all customer transactions had to be carried out now in notes and coin in a separate money exchange system outside the banks). The transaction processing system and ESAS could be streamlined to facilitate Real Time Gross Settlement (RTGS) and On-line Transaction Processing (OLT) of customer transfers (interbank as well as intrabank), initiated on demand by the transferor.

Discussions between the RBNZ and Banks would need to resolve pricing for transaction services - some degree of cross subsidy from the Banks' returns from use of customers bank money balances is already present and could continue.

BANK CAPITAL ADEQUACY AFFECTED

Removing Transaction account balances from Bank liabilities would have a significant impact on bank exposures for capital adequacy (as would a deposit insurance scheme that cover deposits anyway). Proposals to raise Bank capital need to be reconsidered both in the light of this proposal and any deposit protection scheme approved.

CONCLUSION

The advantages of making depositors' transaction account funds sovereign funds owned by them in the manner proposed are that it:

- is a natural extension of the concept behind the current ESAS system;
- capitalises on and enhances New Zealand's lead in efficient electronic clearing and transaction systems;

- provides a genuine digital currency for Bank customers;
- has a one-off effect of reducing bank liabilities by $60B and raising bank reserves, thereby benefitting bank shareholders and customers alike;
- gives depositors protected transaction funds and risk-free payments;
- allows revised OBR procedures addressing non-secured creditors in the event of bank failure;
- provides true safekeeping of money in Transaction accounts;
- provides direct digital money ownership with the benefits (KYC, AML/CFT) of existing intermediary regulation;
- allows a more limited (cheaper) deposit insurance scheme to cover bank monies in savings and call deposit accounts (and perhaps term deposit accounts);
- gives Government a political pat on the back and reputational credit for the initiative;
- allows regulation of banks and NBDTs to be more coherent and focussed (with depositor protection worry for transaction deposits removed);
- keeps banks more focussed and transparent with clarity in separation of transaction and lending businesses;
- in conjunction with deposit insurance protecting public customers means banks can be allowed to fail (improving competition and reducing consolidation pressures);
- ensures lending rates are more competitive; and
- assists improved customer understanding and awareness of the role and functions of money and its uses - risk free (for payments, holding or accumulation) and risky (for interest or other investment returns).

Disadvantages are limited to any transition costs and the current uncertainty of the possible economic impacts (in terms of pricing, asset allocation, lending and subsequent monetary policy) arising from separating transaction banking from lending.

My view is that there are already uncertainties surrounding the impact of proposed deposit insurance and increased capital requirements for banks, that implications may be equally readily and thoroughly assessed in advance, and that the proposal offers sufficient merit to be investigated further without delay.

Section 2: Follow-up issues and questions for consultation

PART 1: HOW DOES THE DEPOSITOR PROTECTION SCHEME FIT INTO THE PRUDENTIAL FRAMEWORK

The interactions are reasonably well described and understood. Any form of different treatment of transaction balances and protection of other deposits will have significant implications for the hazards and risks that prudential supervision and capital adequacy address and should be thoroughly considered before implementation.

This includes the dynamics of how any protection scheme takes effect in the event of a solvency or liquidity problem.

Particular attention should be given to the resolution arrangements under any insurance scheme. Insurers (or any fund trustees) will be unlikely to act immediately (same day) and directly to authorize payment to depositors, so OBR procedures should be redesigned to include assurances (not present in the current arrangements) of immediate protection, continued real time transaction processing (ESAS will be a Financial Market Infrastructure (FMI) entity), and no transaction delay or in-flight loss to covered depositors whose funds are immediately needed for payments or withdrawals.

One of the advantages of the sovereign transaction balances proposal is that the transaction banking functions of a bank can be permitted to continue (under administration if necessary) while the resolution of unsecured creditors can proceed more slowly.

This is another argument in support of having term deposit holders not covered by deposit insurance - as the risks of loss to them are addressed (as for other unsecured creditors) through regulatory supervision and capital adequacy requirements, and potential problems should be identified in advance by active RBNZ monitoring. In the event of Bank failure, term depositors, who do not expect their monies to be immediately available, can be expected wait out the resolution of the Banks finances.

If term deposits are also to be covered by insurance, it is practical nonetheless to allow customers transactions of transaction and call deposits to continue, but require term depositors to wait proper resolution of their claims under whatever insurance and bank resolution arrangements are decided on.

PART II THE ECONOMIC IMPLICATIONS OF DEPOSITOR PROTECTION AND PART III WHAT PUBLIC POLICY OBJECTIVES SHOULD DEPOSITOR PROTECTION PROMOTE

OBJECTIVES

The objective of depositor protection is simply to protect depositors from loss in the event of a bank failure. This has become a political necessity as Banks have become "too big to fail". A better[5] policy direction would be to spread and diversify depositor risk through restricting bank size and increasing competition, but that is not a current policy direction.

Making transaction balances sovereign money owned by depositors will help encourage competition and innovation in banking. Deposit insurance will increase costs and barriers to entry, strengthen incumbents and support further bank consolidation.

Depositor protection is a benefit to Banks as it necessarily increases confidence of the public in making bank deposits but that is not an objective.

Depositor protection is not a significant factor in achieving financial stability, which is much more widely affected by other factors – such as the demand for and supply of money and economic conditions.

PART IV: CALIBRATING A DEPOSITOR PROTECTION SCHEME

PROTECTION LIMITS

I do not support placing a limit on the value of protected deposits in accounts or by depositor as that encourages limit arbitrage - the establishment of multiple accounts and holdings, to get around the limits, that are not otherwise needed. Whatever scheme is chosen, Banks would naturally constrain levels of investment in protected call or savings accounts, to manage their liquidity exposure to sudden withdrawals.

I therefore support protecting all transaction account monies (as proposed above) and insurance to cover the full value of other "deposits", but as noted I recommend excluding any term deposits from such protection (for consistency with the treatment of other forms of more obviously securitised term investment).

This exercise and its outcomes both have educational value. Explicit protection schemes and promotion of deposit and investment differences in public discussions can assist people with understanding their financial choices and the role money plays for various purposes.

[5] In the sense of better for customers and the public, not incumbents. Competition may be expected to encourage efficiency (i.e. less waste – despite economies of scale, regulated entities that can exercise monopoly renting power often spend in ways that do not support basic purposes.) Diversifying and spreading risk reduces incentives for Governments to "protect" large affected groups at a cost to other taxpayers.

PREFERENCE ARRANGEMENTS

I would oppose any depositor preference arrangements for insured depositors as unfair - it interferes with unsecured creditor resolution in a discriminatory way - and an unnecessary complication to the administration of any scheme.

Kind Regards

William Foster