

# The Treasury

## Reserve Bank Act Review Phase 2 Submission Information Release

October 2019

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**Submission to Treasury**

**ON**

**Consultation Document 2A  
'Chapter 4: How should the regulatory perimeter be set?'**

16 August 2019

## Introduction

1. This Submission is from Trustee Corporations Association of New Zealand Inc ("TCA" or "the Association") in response to the Treasury Consultation Document: Safeguarding the future of our financial system: In-principle decisions and follow up questions on the role of the Reserve Bank and how it should be governed (**Consultation Document**).
2. TCA supports the Treasury's initiative to undertake the Review, and considers it is particularly important in light of the evolving nature of the financial markets and the Reserve Bank of New Zealand's (**RBNZ**) corresponding prudential role since the enactment of the Reserve Bank of New Zealand Act 1989 (**RBNZ Act**) nearly 30 years ago. TCA considers it is good practice to review all regulatory frameworks from time to time to ensure they remain fit for purpose.
3. TCA would be very happy to meet with Treasury to discuss any aspect of this submission. We can be contacted at:

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Level 6  
191 Queen Street  
Auckland

PO Box 10 133  
Wellington 6143

Attention: David Brown Douglas  
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## About TCA

4. TCA is a long-established association representing licenced Supervisors which supervise Non-Bank Deposit Takers (**NBDTs**). The Members of the TCA are: Public Trust, Trustees Executors Limited, The New Zealand Guardian Trust Company Limited and Covenant Trustee Services Limited, and Anchorage Trustee Services Limited is an associate Member of TCA (**TCA Members**).
5. TCA maintains relationships with government ministries, regulatory bodies and financial sector groups.
6. TCA Members also provide prudential supervision for a wide range of investment products and financial arrangements through various legal structures appropriate for the particular product offered. In certain instances, Managed Investment Schemes and Debt Issuers (including NBDTs) must appoint a supervisor to meet regulatory requirements before an offer of a financial product can be made to the market. As at 30 June 2019, TCA Members supervised funds in excess of \$452.9 billion.

7. All TCA Members are licensed under section 16(1) of the Financial Markets Supervisors Act 2011 to provide prudential supervision of a wide range of investment products and financial arrangements. Not all licence holders are Members of TCA.

## **Part A: Proposed licensed deposit taker framework**

8. We understand that an in-principle decision has been made to bring the bank and non-bank deposit takers (**NBDT**) regulatory regimes together into a single 'licensed deposit-taker' framework. As noted in our earlier submission of 25 January 2019, in our view Licensed Supervisors are best placed to continue to supervise NBDTs, for the reasons set out in this Part.

### **Conduct vs prudential regulation**

9. RBNZ is traditionally a prudential regulator as opposed to a conduct regulator. Prudential regulation aims to ensure that institutions adequately manage both their own financial risks and the risks they collectively pose to the financial system. Conduct regulation focuses on behaviours and outcomes in financial markets and aims to ensure that consumers are adequately informed and that regulated entities act fairly, transparently and with integrity.
10. We submit that Licensed Supervisors are experienced frontline conduct regulators. They have the capacity, industry knowledge and expertise to supervise the conduct of NBDTs. TCA members have developed a very close understanding of how those financial institutions operate and what processes, procedures and controls they have in place to comply with their duties and requirements.

### **RBNZ mandate - 'a sound and efficient financial system'**

11. RBNZ's primary functions are to formulate and implement monetary policy and promote the maintenance of a sound and efficient financial system. RBNZ's focus has traditionally been on the health of 'systemically important' institutions such as banks and other large financial institutions.
12. From a regulatory perspective, we agree with the Treasury that there should be equal treatment among different institutional deposit holders and borrowers, but whether RBNZ closely supervises institutions should depend on their size and whether this category of institutions is likely to pose a systemic risk for the financial system. For example, RBNZ currently supervises \$543 billion dollars of assets (of 26 registered banks). In comparison, NBDTs assets comprise of \$2.58 billion dollars. The soundness of the financial system would not be fundamentally affected by the failure of an NBDT.
13. RBNZ's website outlines its current regulatory approach to NBDTs. It notes that "prudential regulation is not aimed at insulating individual NBDTs from failure, nor does it protect depositors from the consequences of their investment choices," and "it is neither possible nor desirable to try to prevent institutional failure. The prudential rules are intended to improve overall standards."
14. TCA's concern is that if supervision of NBDTs were to shift to RBNZ, there is a risk that RBNZ will disregard the smaller entities, to the detriment of individual investors. A shift from a 'hands on' approach could lead to a loss of confidence in NBDTs and would further lesson their ability to compete with larger financial institutions such as banks.

15. In addition, RBNZ's focus has been on larger financial institutions which are well-resourced with robust governance structures to manage risk adequately. In comparison, smaller NDBTs are not typically well-resourced (often they do not have a dedicated person or team committed to regulatory compliance). These entities need concentrated and 'hands-on' supervision, as well as a large amount of guidance on how to comply with their obligations. We consider Licensed Supervisors are better placed to provide this intensive supervision, as opposed to RBNZ whose mandate is to maintain a 'sound and efficient financial system' and is therefore better suited to supervision of larger, more systemic, entities.

#### **Reduction in appetite for smaller entities to compete**

16. Competition between Licensed Supervisors ensures that fees for NDBTs remain low. If the proposed model is funded by issuer levies to RBNZ, fees may increase for NDBTs which would be a further reason for them to exit the market.
17. If NDBTs do leave the market, this will likely reduce diversity, efficiency and competition in the New Zealand financial system. The proposal to subject non-deposit taking lenders to conventional prudential supervision would exacerbate the homogeneity of our financial system, reducing diversity and competition.

#### **Alignment with other regimes**

18. TCA considers it is beneficial to align with other regimes where appropriate. However, the current regulatory regime is working well, and TCA considers that it should not be overhauled simply to align with overseas jurisdictions. New Zealand is a relatively small and less complex market than Australia. It has also not experienced the same systemic conduct issues in its financial services industry, which would indicate that the regulatory framework in New Zealand is appropriate and proportionate with the scale and complexity of the market.

#### **Growth compatibility**

19. The consultation paper notes that the NBDT regime is the likely location for challengers and new entrant NDBTs, given the lower capital requirements. It goes on to note that 'these firms may struggle to build digital models around licensed supervisor oversight.' We tend to disagree with this assertion - Licensed Supervisors act for a very diverse group of entities. The Trust Deed model is very adaptable and can be tailored to suit the needs of a particular entity. Licensed Supervisors are responsible for the supervision of a wide range of entities, from small retirement villages to large managed funds and KiwiSaver schemes. Many of these products are innovative and use various digital technologies. In TCA's view, licensed supervision is an advantage, not a disadvantage, for encouraging new entrants to the market.

#### **Part B: The proposed model**

20. If a decision is made to shift to a single deposit-taking perimeter, TCA will fully support the Treasury and RBNZ to implement a regime that is efficient and best serves the interests of consumers. Our suggestions on how to structure the single deposit-taker model are set out below.

## **Continued role for Licensed Supervisors**

21. TCA submits that Licensed Supervisors would need to continue to play an integral role in the frontline supervision of NBDTs. That is because:
  - 21.1 Licensed Supervisors have a history of regulatory know-how about their clients and a clear and long-established role in such supervision;
  - 21.2 They have specialised knowledge of the business of their clients and risks faced by them; and
  - 21.3 While funded by issuers, Licensed Supervisors have both reputational, legislative and strong fiduciary duties and incentives to act in investors' interests and to protect their interests. This is particularly important in respect of NBDTs as the issuer has no fiduciary duties to investors, nor does the RBNZ or any other regulator.
22. The Trust Deed model ensures that the Supervisor is held responsible for acting on behalf of investors in relation to closely supervising the NBDT's performance and any breach of its obligations. A Trust Deed empowers (along with the FMCA) the Supervisor to do everything in its power to cause any breach to be remedied, including promptly reporting the nature of the breach and any other relevant information to investors. In contrast and as described above, RBNZ is likely to be more focused on systemic risk in the sector, rather than what is in the best interests of individual investors.
23. As such, we consider that Licensed Supervisors are best placed to continue to supervise NBDTs and could continue to provide assurance to RBNZ that NBDTs are functioning well and within agreed limits. In TCA's view, a joint approach whereby RBNZ is focused on systemic risk, and Licensed Supervisors are focused on individual entity risk, would provide a robust approach that would benefit both individual investors and the financial system as a whole.

## **Flexible framework required**

24. If the proposed model is to be introduced, RBNZ will be responsible for the supervision of a very broad range of entities. Therefore, a 'one size fits all' approach will not be appropriate given the varying size of the entities the regulations will cover. The new framework would need to be 'tiered' to be fit for purpose.
25. TCA's view is that smaller NBDTs should be subject to proportionately fewer compliance requirements relative to larger financial institutions such as banks. Otherwise, the compliance cost may be too high for smaller entities and effectively consolidate the market dominance of the 'big four' Australian owned banks, which would reduce competition and create barriers to entry for new market participants. We also note that a number of previous large and successful NBDTs have exited the NBDT regime in recent years due to rigid "one size fits all" regulatory requirements. These businesses still remain successful but are now solely funded by wholesale investors thereby limiting the number of good risk/reward investment opportunities for retail investors.

## **Definition of 'deposit-taker'**

26. The regulatory perimeter currently consists of lenders who accept deposits from the public. Once that happens, the deposit-taker is subject to prudential regulation under the NBDT Act (unless it is a registered bank).
27. We agree with Treasury that although the simplest option for integrating the banking and NBDT regimes would be to use the existing NBDT definition to set the boundaries of the deposit taking regime, this is unlikely to be the best approach. TCA agrees with Treasury that the definition of 'deposit-takers' should be framed around 'retail deposits' with a focus on firms that provide 'banking-like' services to the public. TCA agrees that these firms face potential market failures that justify the application of prudential regulation and supervision. For example, cheque accounts and ATM facilities provide a critical economic service for customers and when these types of entities fail depositors can face a disruption in their access to funds that they rely on for basic transactions. In addition, depositors are able to access substantial amounts of money 'on call' in a financial crisis. It would make sense for RBNZ to be able to closely supervise this sector to help ensure there is not a 'run' on bank-like entities.
28. TCA considers that credit unions and building societies are closely aligned with banks in that they take deposits and provide critical services to the public such as cheque accounts and ATM facilities. We agree with Treasury that these 'bank-like' entities are more suited to prudential supervision.
29. In contrast, finance companies do not ordinarily offer 'transactional' type services to consumers and are better supervised by Licensed Supervisors, rather than a prudential regulator. In addition, following the finance company crisis in 2008, many finance companies have chosen to exit the market - the few that remain do not pose a systemic risk to the financial system and therefore do not warrant RBNZ supervision.
30. We submit that NBDT's that fall outside the traditional bank-like structures should continue to be licensed under the FMCA and be subject to supervision by Licensed Supervisors and not subject to RBNZ's licensing and regulation. TCA considers that this would provide more flexibility (under a trust deed structure) to this sector. In addition, it would provide an appropriate alternative source of capital for finance companies that currently do not participate in retail capital markets and reduce the risk that further NBDTs exit the regime due to the increased compliance burden.

## **Potential exclusions**

31. TCA agrees that retail issues of longer dated 'capital markets' products such as bonds, debentures or medium-term notes are excluded from the regulatory perimeter for the reasons set out on page 76 of the consultation document.
32. TCA also agrees with the Treasury that wholesale non-deposit taking lending institutions (NDLIs) should be excluded from the licensed deposit taker regime. It is appropriate that these entities are not subject to prudential regulation but continue to be subject to FMCA requirements and applicable responsible lending obligations.

## **Depositor insurance**

33. For completeness, we note that a deposit protection scheme is proposed to be introduced in New Zealand. TCA considers that given the safety and soundness of New Zealand's financial sector (including existing prudential tools available such as open bank resolution), the benefits of developing formal procedures to protect depositors in a bank failure event do not justify the costs of its introduction.
34. TCA notes that the depositor protection scheme development is still in its early stages. TCA will continue to monitor developments and comment on those where appropriate.

**Mark Jephson**

**Chairman**

**Trustee Corporations Association of New Zealand Inc**

**16 August 2019**

## Part C: Response to consultation questions

No	Questions	Submission
4.A	<p>What is the appropriate definition of 'deposit taker'? Do you agree that the definition should be framed around entities that take retail 'deposits' and lend? If not, what approach do you consider would be preferable?</p>	<p>We agree with Treasury that although the simplest option for integrating the banking and NBDT regimes would be to use the existing NBDT definition to set the boundaries of the deposit taking regime, this is unlikely to be the best approach. TCA agrees with Treasury that the definition of 'deposit-takers' should be framed around 'retail deposits' with a focus on firms that provide 'banking-like' services to the public. TCA agrees that these firms face potential market failures that justify the application of prudential regulation and supervision. For example, cheque accounts and ATM facilities provide a critical economic service for customers and when these types of entities fail depositors can face a disruption in their access to funds that they rely on for basic transactions. In addition, depositors are able to access a substantial amount of money 'on call' and in a financial crisis, it would make sense for RBNZ to closely supervise this sector to ensure there is not a 'run' on bank-like entities.</p> <p>TCA considers that credit unions and building societies are more closely aligned with banks in that they take deposits and provide critical services to the public such as cheque accounts and ATM facilities. We agree with Treasury that these 'bank-like' entities are more suited to prudential supervision. In contrast, finance companies do not ordinarily offer 'transactional' type services to consumers and are better supervised by Licensed Supervisors, rather than a prudential regulator. In addition, following the finance company crisis in 2008, many finance companies have chosen to exit the market - the few that remain do not pose a systemic risk to the financial system and therefore do not warrant RBNZ supervision.</p> <p>We submit that other NBDT's that fall outside the traditional bank-like structures should continue to be licensed under the FMCA and be subject to supervision by Licensed Supervisors. TCA considers that this would enable more flexibility to this sector that, subject to appropriate disclosure, would better protect investors. It would also reduce the risk that further NBDTs exit the regime due to the increased compliance burden.</p>
4.B	<p>Should the Reserve Bank's ability to monitor non-licensed entities be enhanced, for example through</p>	<p>TCA would not be opposed to RBNZ having an ability to monitor non-licensed entities through increased data reporting requirements, however, TCA submits that any data collection and reporting be</p>

No	Questions	Submission
	increased data reporting requirements? What do you consider would be the costs and benefits of such an approach?	proportionate to the size and scale of the reporting entity (such is the case in Australia).
4.C	Should the Reserve Bank be given discretion to extend the perimeter within clearly specified parameters to avoid regulatory arbitrage (such as designating in entities with business models economically similar to deposit takers)? Do you agree that changes that are more significant may be more suited to legislative change, supported by prepositioning?	TCA is supportive of RBNZ having a designation power, similar to the power given to the FMA under the FMC Act. TCA submits there will need to be adequate checks and balances on the designation power, for example, that the RBNZ makes a recommendation and this is subject to approval by the Minister. We agree that more significant changes are better suited to legislative change.
4.D	Should tools that are not linked to licensing have a different perimeter? For example, it is common internationally for non-bank lending institutions to be subject to macroprudential lending tools, even though they do not take deposits.	We think it is appropriate that some non-bank lending institutions be subject to macro-prudential lending tools, however, this should be subject to some parameters. For example, entities that are considered systemic to the financial systems should be within the perimeter. It would be appropriate for smaller entities to be excluded on the rationale that the cost of compliance outweighs the benefit of their inclusion within the perimeter.