



Safeguarding the future of our financial system

Update on the Reserve Bank Act Review

Phase 2 of the Reserve Bank Act Review

December 2019



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About this document

This document provides an update on Phase 2 of the Reserve Bank Act Review. It sets out Cabinet's:

- key decisions on the Reserve Bank's governance and accountability framework, and
- in-principle decisions on the regulation of deposit takers and the deposit insurance scheme.

In addition to this report, you can find:

- the [Cabinet papers](#) on the Review
- the [Terms of Reference](#) for Phase 2 of the Review
- information on [Previous Consultations](#) on Phase 2, and
- information about [Phase 1 of the Review](#).

We welcome questions and feedback about this paper, which can be provided to: rbnzactreview@treasury.govt.nz.

Foreword from the Minister



It is now thirty years since the last major review of the Reserve Bank Act. At that time, New Zealand's key macro-economic challenge was reducing high inflation. While maintaining price stability remains important, the world has since changed and we face other challenges. In particular, we face a global financial system that is larger, more interconnected, and more complex than it was in 1989. We have also learnt from the Global Financial Crisis and the failure of finance companies in the 2000s.

In addition to the changes in the economic context, there have been a number of changes in both the Reserve Bank's functions and its approach to regulation since the Act was passed in 1989. The Reserve Bank now regulates banks, insurers and non-bank deposit takers and has responsibilities in regards to anti-money laundering. The Reserve Bank's tool-kit has also evolved since 1989, from a largely disclosure-based regime to a much more extensive prudential tool-kit.

Given this evolution in the environment, the Coalition Government initiated a broad review of the Reserve Bank Act in 2017. The Review will ensure that the legislation that the Reserve Bank operates under remains robust and fit for purpose for the range of functions it now undertakes. The Review has been undertaken in two phases. Phase 1 modernised the monetary policy framework, and was completed in 2018. Phase 2, the topic of this document, covers the Reserve Bank's governance and accountability arrangements, and the Reserve Bank's financial regulatory powers. As part of Phase 2, the Government announced in June this year the intention to implement a deposit insurance scheme.

Cabinet has now made decisions on the governance and accountability arrangements for the Reserve Bank and intends to introduce legislation covering these matters next year. Key decisions include:

- A governance board will be established that will be responsible for the functions of the Reserve Bank, except those undertaken by the Monetary Policy Committee.
- The Reserve Bank will have an overarching financial stability objective, in addition to the economic objectives. The Reserve Bank's main objectives will be:
 - achieving and maintaining stability in the general level of prices over the medium term and supporting maximum sustainable employment, and
 - protecting and promoting the stability of New Zealand's financial system.
- The Minister of Finance will be required to issue a Financial Policy Remit, providing matters that the Reserve Bank Board must have regard to when pursuing the financial stability objective.
- Accountability will be enhanced through greater alignment of reporting and monitoring requirements with state sector practice.
- Coordination and cooperation among regulatory agencies will be reinforced through mandating the role of the Council of Financial Regulators.

Cabinet has also made additional in-principle decisions on the regulation of deposit takers and the introduction of a deposit insurance scheme. Key decisions include the following:

- Non-bank deposit takers and banks will be subject to a single prudential regime, which will allow tailoring of requirements to different entities as appropriate.
- Standards set by the Reserve Bank will be the primary tool for imposing regulatory requirements on deposit takers.
- Accountability requirements on directors of deposit takers will be significantly strengthened.
- The Reserve Bank's supervision and enforcement tools will be strengthened, including an on-site inspection power and a more graduated enforcement and penalty framework.
- The crisis resolution framework will be strengthened and clarified.
- Deposits at licensed deposit takers will be insured up to a limit of \$50,000 per depositor, per institution.

The Government will consult further on the regime for the regulation of deposit takers and the design of the deposit insurance scheme early next year.

I look forward to further progress on this Review in the coming months.



Hon Grant Robertson
Minister of Finance

Chapter 1: Introduction

Background to the Review

In 2017 the Coalition Government initiated a broad review of the Reserve Bank of New Zealand Act 1989 (the Reserve Bank Act) to ensure the Reserve Bank's legislative framework remains robust, modern, and fit for purpose. This Review is being undertaken in two phases.

Phase 1, completed in 2018, focused on modernising the Reserve Bank's monetary policy framework. This introduced the Monetary Policy Committee (MPC), responsible for monetary policy decisions. It also replaced the single price stability objective for monetary policy with dual objectives of: achieving and maintaining stability in the general level of prices over the medium term and supporting maximum sustainable employment. The monetary policy framework will not be changed in Phase 2.

Phase 2 is a broad review of the Reserve Bank's governance and accountability framework and its financial regulatory powers. The [Terms of Reference](#) for Phase 2 include the review of the Reserve Bank's institutional arrangements and accountability framework, the objectives of financial policy, as well as the statutory basis for prudential regulation and supervision. To date, two rounds of public consultation have been undertaken on Phase 2.

This document reports back on progress on Phase 2, in particular Cabinet's:

- decisions on the Reserve Bank's governance and accountability framework, and
- in-principle decisions on the regulation of deposit takers and the establishment of a deposit insurance scheme.

Key decisions

The following key decisions have been made:

- Responsibility for prudential regulation will remain with the Reserve Bank. This will: maximise synergies between the prudential functions and the Reserve Bank's other functions; avoid the transition costs of establishing a new agency; and will be cost-effective given New Zealand's size.
- The Reserve Bank will have a high level objective to protect and promote the stability of New Zealand's financial system.
- A governance board (the Board) will be established for the Reserve Bank. This will have statutory responsibility for all the Reserve Bank's functions, except those reserved for the MPC. There will not be a statutory Financial Policy Committee.
- The two separate regulatory regimes for banks and non-bank deposit takers (NBDTs) will be united into a single 'licensed deposit taker' framework.
- A deposit insurance scheme will be established. The scheme will insure deposits up to a limit of \$50,000 per individual, per institution.

Legislative timeframes

The changes to the legislative framework will be made through enacting two separate Acts to replace the Reserve Bank Act – an ‘Institutional Act’ and a ‘Deposit Takers Act’. Chapter 2 explains the Institutional Act, Chapter 3 explains the Deposit Takers Act, and Chapter 4 explains Deposit Insurance.

The Institutional Act will set out the overall governance and accountability framework for the Reserve Bank across all its functions. It will also provide for the Reserve Bank’s central banking functions, including the framework for monetary policy. The Deposit Takers Act will integrate the two different legislative frameworks for deposit taking institutions (banks and qualifying non-bank deposit takers) and establish the deposit insurance scheme. This will be a flexible framework to allow for the regulation and supervision of different types of deposit takers in a way that is proportionate to the risks entities pose to the financial system.

It is intended that a Bill for the Institutional Act be introduced into Parliament in the middle of next year. A further round of public consultation will be undertaken on the Deposit Takers Act and the deposit insurance scheme in the first quarter of 2020. Cabinet plans to make final policy decisions on the Deposit Takers Act and deposit insurance scheme in mid-2020, and to progress legislation after that.

Chapter 2: The Institutional Act

The Institutional Act will set out the Reserve Bank’s governance and accountability framework and provide for its central banking functions, including the monetary policy framework as enacted in Phase 1. This chapter sets out decisions relating to the following matters to be included in the Institutional Act:

- purposes, objectives and financial policy decision-making principles
- the governance framework
- the Financial Policy Remit
- funding
- accountability, and
- coordination of financial sector regulators.

The aim is that the legislation is flexible and empowering to enable the Reserve Bank to achieve its responsibilities, while also maintaining the operational independence of the Reserve Bank across its monetary and financial policy functions.

Purposes, objectives and financial policy decision-making principles

Purposes and objectives

Objectives and purposes are a guide to the interpretation of the Act and the exercise of statutory discretions. Phase 1 of the Review introduced a new purpose for the Reserve Bank Act, which will be retained as the purpose of the Institutional Act:

“The purpose of this Act is to promote the prosperity and wellbeing of New Zealanders and contribute to a sustainable and productive economy.”

This purpose explains the high level reasons behind the Reserve Bank’s pursuit of its objectives. It makes clear that the monetary and financial policy objectives are not ends in themselves, but rather are a means to support wider prosperity and wellbeing. All of the Reserve Bank’s functions will be undertaken in the light of this overarching purpose.

The Institutional Act will also set out the Reserve Bank’s main objectives. These will be:

- The monetary policy objective as enacted in Phase 1: achieving and maintaining stability in the general level of prices over the medium term, and supporting maximum sustainable employment.
- A high level financial stability objective: Protecting and promoting the stability of New Zealand’s financial system.

This high level financial stability objective recognises the Reserve Bank’s role in mitigating risks to the financial system, and provides direction for sector specific regulation. It also recognises the role of functions, such as the lender of last resort function, in stabilising the financial system during times of stress.

The financial stability objective will be incorporated into, and expanded upon (for example with sub-objectives), in the other sector specific pieces of legislation. We will consult on the purposes of the Deposit Takers Act in early 2020. Changes to the Insurance (Prudential Supervision) Act (IPSA) are not part of this Review and will be considered when that Act is reviewed.

Financial policy decision-making principles

Submitters to the public consultation were supportive of financial stability being a main objective of the Reserve Bank, although several submitters considered it was necessary to include the concept of efficiency in the Reserve Bank's decision-making considerations to ensure financial stability is not pursued at all costs. Further, some submitters suggested other potential objectives – such as mitigating the financial risks of climate change. These points have been reflected in the formulation of financial policy decision-making principles that will supplement the Reserve Bank's main financial stability objective.

In particular, the Reserve Bank will be required to take account of the decision-making principles when exercising financial regulatory powers. While the precise specification of the principles may change as the Bill is drafted, these principles will aim to recognise the following:

- the desirability of minimising unnecessary costs from regulatory actions, taking into account the value of outcomes to be delivered
- the desirability of taking a proportionate approach to regulation and supervision and ensuring consistency of treatment of similar institutions
- the desirability that sectors regulated by the Reserve Bank are competitive
- the value of transparency and public understanding of the Reserve Bank's objectives and how the Reserve Bank's functions are exercised
- practice by international counterparts carrying out similar functions, as well as guidance from international bodies and standards, and
- the desirability of taking into account long term risks to financial stability.

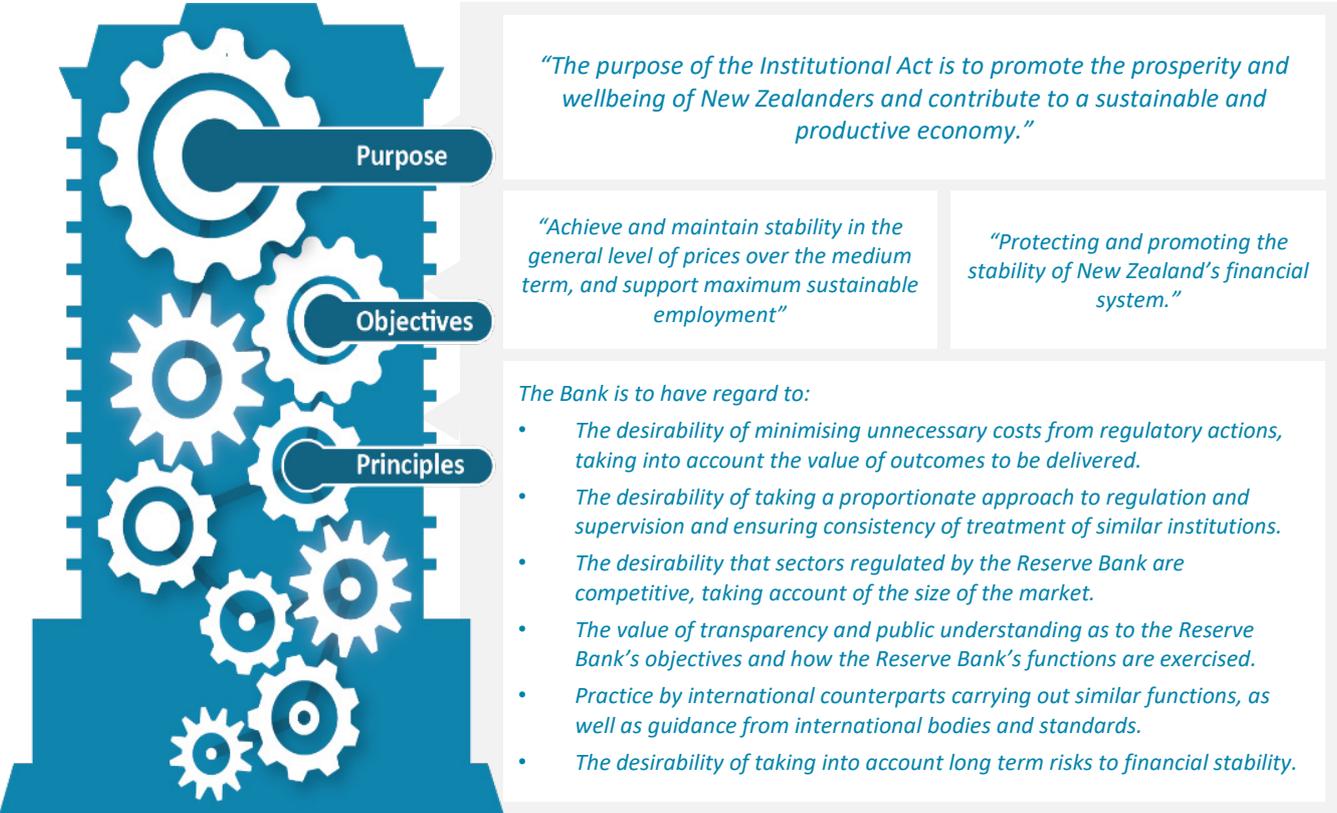
These principles provide guidance as to how the Reserve Bank should undertake its financial regulatory role. They recognise, for example, that greater financial stability is only beneficial when it generates net benefits and that requirements need to be proportionate.

The principles also recognise the need to consider longer term risks, such as those arising from climate change.¹ The Reserve Bank has already identified climate change as an emerging risk to New Zealand's financial system, and has released a [Climate Change Strategy](#). The strategy is focussed on collaborating with stakeholders so that the transition to a low-carbon economy does not impair financial stability, as well as managing the Reserve Bank's own impacts on the climate.

¹ Shorter term risks from the impacts of climate change, such as those arising to insurers from impacts such as flooding, are also relevant to the Bank's financial stability mandate.

The principles will apply to the Deposit Takers Act when it is enacted and to other sector specific legislation when the other Acts are amended. The principles will be considered for inclusion in the IPSA when it is reviewed.

Figure 1: Objectives and decision-making principles



The governance framework

The Reserve Bank is not a government department or Crown entity – its governance structure is unique. Prior to the implementation of Phase 1 of the Review, all the powers of a conventional board and chief executive were placed in the Governor, who acted at arm’s length from Ministers. This design was instrumental in reducing New Zealand’s high inflation rate at the time, as it ensured operational independence for monetary policy.

However, there are many benefits of group decision-making which become more important the broader the range of functions an entity undertakes. Group decision-making allows for diverse perspectives to be considered. It draws on a greater breadth of expertise and guards against individual biases. For this reason, Phase 1 established group decision-making in regards to the formulation of monetary policy through the establishment of the MPC. The MPC is independent from government in the formulation of monetary policy.

Following Phase 1, the Governor continues to be the sole decision-maker for the Reserve Bank’s other functions, including its financial regulatory functions. The Reserve Bank, however, now undertakes a broad range of complex functions and makes significant policy decisions on financial policy. For the reasons above, it is considered that group decision-making is more appropriate for

the Reserve Bank. Group decision-making would also be consistent with state sector practice for regulatory agencies.

The governance board

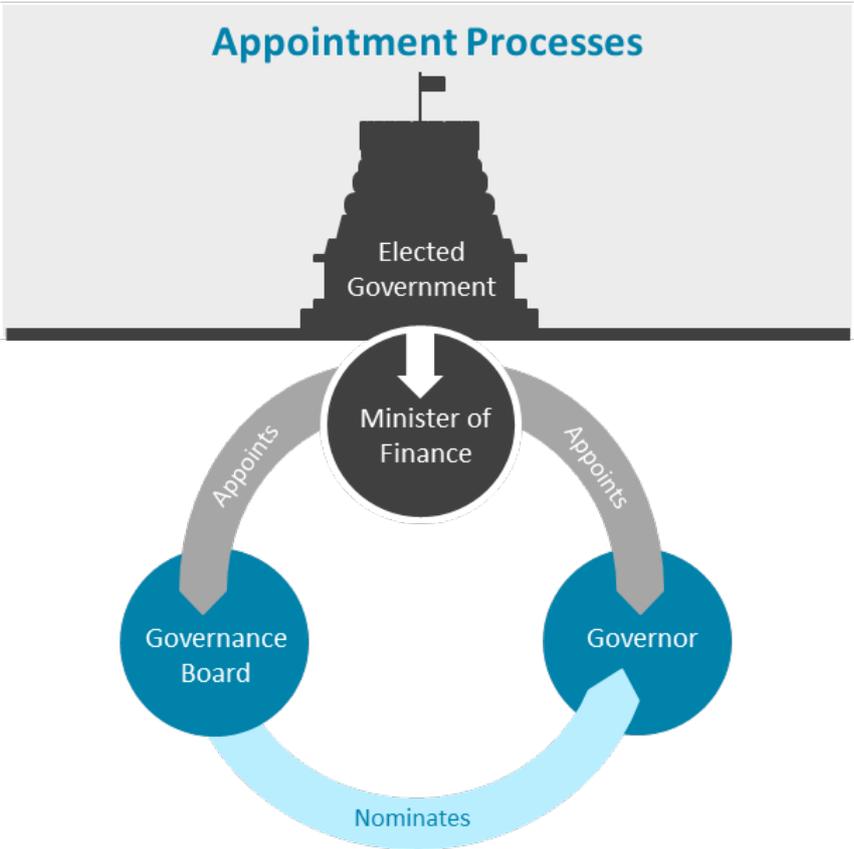
Cabinet has decided that a governance board (the Board) will be established for the Reserve Bank with responsibility for all matters, except those reserved for the MPC. The Board will be fully non-executive and will comprise between five and nine members. The Board’s responsibilities and procedures will be similar to those of a Crown entity board. Submitters were supportive of the Reserve Bank having a governance board.

The current process for the appointment of Board members by the Minister will continue to apply, with the processes to be reviewed after three years. In addition, the Minister will be required to consult with other political parties in Parliament prior to recommending the appointment of a Board member.

Board members may only be removed from office by the Governor-General, following advice from the Minister, for just cause. The high-bar for removal will protect the independence of the Reserve Bank. Appointments will be focused on the specific skills and experience required by the Board.

The Governor

The Governor will be the Reserve Bank’s chief executive. This is a significant role; the Governor will continue to have statutory duties as Chair of the MPC. For this reason, appointment of the Governor will continue to be by the Minister of Finance, on the recommendation of the Board. Requiring the Board to nominate the Governor guards against purely political appointments and ensures the Governor has the requisite skills and expertise. Consistent with arrangements for the board, the Governor will only be able to be removed from office by the Governor-General on the advice of the Minister for just cause.



The Financial Policy Remit

The Institutional Act will require the Minister of Finance to issue a Financial Policy Remit to the Board. The Remit will provide matters the Board should have regard to when pursuing the financial stability objective. It will be issued five yearly and will be published.

The Remit may set out matters such as:

- expectations that the prudential framework is broadly aligned with international standards
- that the Bank has regard to guidance issued under the Climate Change Response (Zero Carbon) Act, and
- information in relation to emerging risks to the financial sector that may be relevant to the Bank's financial stability monitoring.

The Remit will act as a mechanism for dialogue between the government and the Reserve Bank, allowing the Minister to express expectations about the significant policy powers that have been delegated to the Reserve Bank. The Remit will relate to the Reserve Bank's objectives, rather than its operations, and set out the matters the Board must consider, thereby protecting the Reserve Bank's operational independence.

Many submitters expressed support for the Minister issuing a Financial Policy Remit.

Funding

The Reserve Bank's funding will continue to be set through a funding agreement. However, a portion of the costs of its regulatory functions will be able to be collected through levies charged to regulated entities. The levy rate will be set in regulation, on the advice of the Minister, following consultation with the Reserve Bank and the sector. A levy allows the costs of the regulatory function to be borne by those who benefit from the carrying out of that function. It is common for the costs of regulatory activities to be recouped through a levy.

While submitters were generally supportive of regulated entities paying a levy, several smaller entities noted the need for levies to be proportionate and reasonable. There have been no decisions on whether levies will be introduced, or the rates which will be charged. The levy would need to be calibrated to reflect legislative changes flowing from the Deposit Takers Act, which is likely to take several years. It would also need to take account of costs imposed by the deposit insurance scheme. Any levies would be consulted on and would be consistent with the Guidelines for Setting Charges in the Public Sector.

Accountability

Operational independence, that is the ability to make decisions insulated from political pressure, is important for the Reserve Bank's monetary and financial regulatory functions. It guards against 'time-inconsistency bias', whereby governments focus on short-term political interests instead of delivering long-term goals such as financial and monetary stability. However, operational independence needs to be matched with robust accountability arrangements to ensure that the entity is run effectively and that public money is being spent efficiently.

To ensure effective accountability, a number of changes to the accountability framework applying to the Reserve Bank will be made. The Reserve Bank's reporting requirements will be aligned with those of a Crown entity. In particular:

- The Reserve Bank will continue to publish a Statement of Intent (SOI). Consistent with the Crown entities framework, this will be required at least every three years. The SOI will set out the Reserve Bank's strategic intentions and performance expectations.
- The Reserve Bank will also produce a Statement of Performance Expectations annually. This will provide a base against which actual performance can be assessed.

Like the board of a Crown entity, the Board will owe collective duties to the responsible Minister. These will include duties to ensure that the Reserve Bank:

- acts in a manner consistent with its objectives, functions, current SOI and current Statement of Performance Expectations
- performs its functions efficiently and effectively, and
- operates in a financially responsible manner.

The Institutional Act will also strengthen the Reserve Bank's Regulatory Impact Analysis requirements. Assessing the regulatory impacts of policy proposals is standard practice for policy and legislative development in New Zealand. Before making regulatory changes, the Reserve Bank will be required to outline the policy problem, set out the objectives of the proposal, evaluate the costs and benefits of the proposal, evaluate the alternative means of achieving the objectives, and demonstrate that it has considered stakeholder views. Consultation requirements in respect of the application of individual policies will be considered as part of the creation of the Deposit Takers Act.

To increase transparency, the Reserve Bank will be required to publish a Statement of Approach in regards to its regulatory functions and the framework for its balance sheet management. These will be living documents and updated as appropriate.

The Reserve Bank is one of the few agencies not currently subject to the Public Audit Act 2001. The Auditor-General will be legislatively enabled to conduct performance audits and inquiries into the Reserve Bank's activities – something which received support during the public consultation. This will allow the Auditor-General to examine the extent to which the Reserve Bank is carrying out its activities effectively and efficiently, and inquire into any matter concerning the Reserve Bank's use of its own resources.

The Reserve Bank will also be subject to the Ombudsmen Act which allows the Office of the Ombudsman to investigate administrative conduct by government agencies that affects a person or a group of persons. The Ombudsman may make recommendations for improvements to an agency.

The Treasury will be formally established as the 'monitor' for the Reserve Bank. The role of the monitor is to assist the Minister in carrying out his or her role, including keeping under review the operations and performance of the monitored entity.

Coordination of financial sector regulators

The regulation of the financial sector is undertaken through several regimes. Within this system different agencies have different roles with frequent interaction and overlap. The Reserve Bank is the prudential regulator, the Financial Markets Authority (FMA) regulates conduct, and the Commerce Commission regulates consumer credit. The Treasury, the Reserve Bank, and the Ministry of Business, Innovation and Employment (MBIE) have policy responsibility for different parts of the financial regulatory system.

The Council of Financial Regulators (CoFR) is co-chaired by the Reserve Bank and the FMA. It meets quarterly to discuss financial market regulatory issues, risks and priorities. The CoFR coordinates collaborative responses to issues that require cross-agency involvement. This includes system-wide monitoring and operational coordination.

Cabinet has decided to create a legislative mandate for the CoFR. This will underscore the importance of the CoFR and ensure it endures into the future.

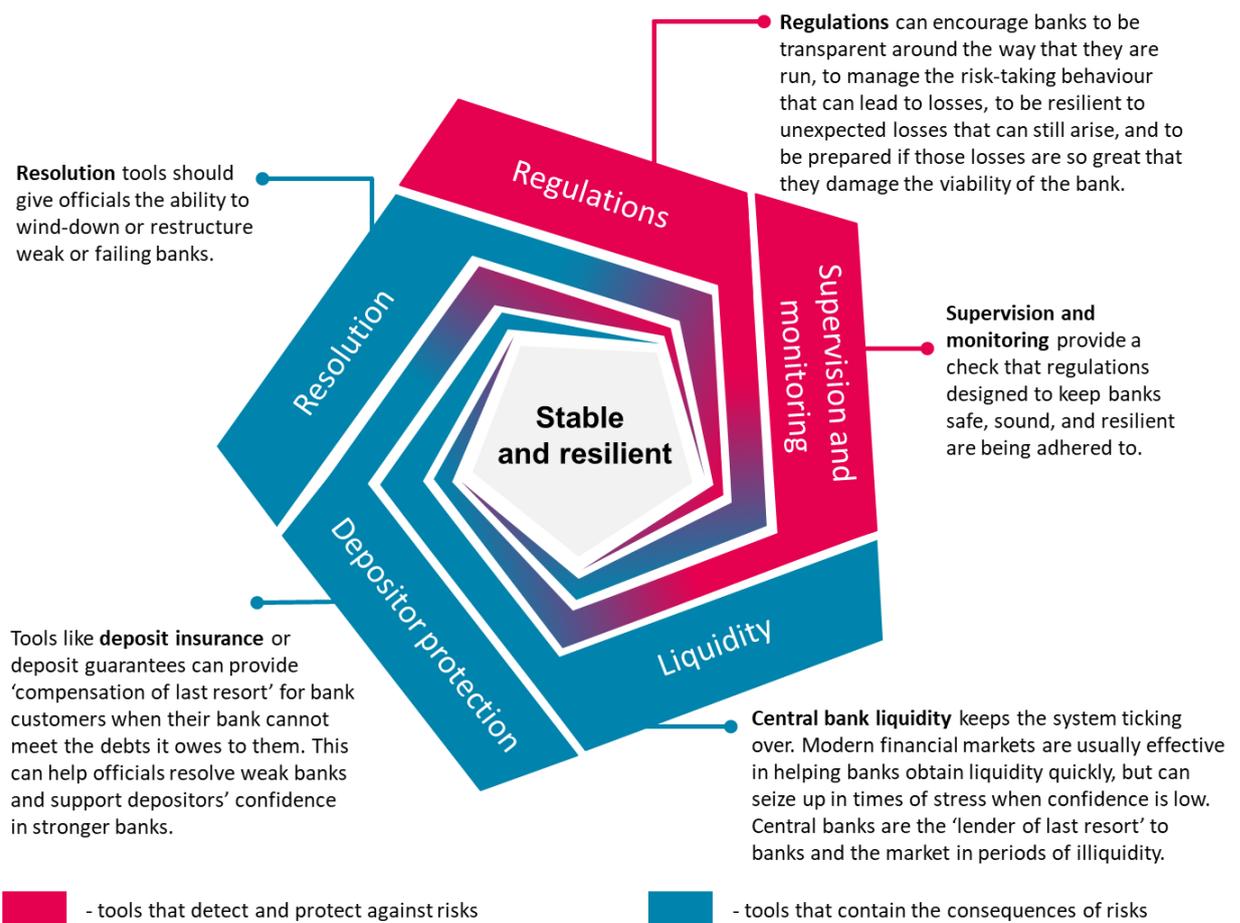
Chapter 3: The Deposit Takers Act

Cabinet has made a number of in-principle decisions on the key features of the deposit takers regime, with the design of the regime to be consulted on in early 2020, and final policy decisions planned for mid-2020.

The Review will strengthen the financial safety net

Deposit takers play a critical role in the economy, enabling both saving and borrowing and transactions between economic agents, and facilitating economic activity more generally. The failure of a bank or other deposit taker can therefore have very significant impacts on the stability of the overall financial system and on the wellbeing of individual depositors.

Prudential regulation seeks to reduce these risks by setting requirements that promote the soundness and resilience of deposit takers, supported by a supervision and enforcement regime that promotes compliance. It is also critical that, in the event of a crisis, there are clear and credible mechanisms to protect depositors (such as a deposit insurance scheme – as discussed in Chapter 4) and for managing the crisis and resolving any deposit taker failures.



Firms that take deposits will be subject to a single deposit takers regime

In June 2019, the Government made an in-principle decision to bring the bank and NBDT regulatory regimes together into a single 'licensed deposit taker' framework. The decision was based on an assessment that a single licensed deposit taker framework would increase regulatory efficiency, improve regulatory neutrality, and better accommodate new entrant deposit takers. A single licensed deposit taker framework would also better enable the introduction of a competitively neutral depositor protection scheme.

The regulatory regime is expected to capture all lenders that offer transactional, savings and term deposit accounts to the public. This would capture the existing banks, credit unions, and building societies.

Some submitters raised concerns that the costs of compliance under the integrated regime could be prohibitive for smaller deposit-takers, such as credit unions and building societies. The Review will be engaging further with the NBDT sector in the coming months on how the new regulatory regime will balance the soundness of insured deposit takers against competition and financial inclusion.

A key outstanding question is how the regulatory regime will deal with lenders who predominately issue longer-dated secured debt, such as finance companies. Given the risks associated with this business model, as demonstrated by past finance company failures, it is important that there continues to be adequate prudential regulation and supervision of this sector. However, a number of submitters argued these entities should not be categorised as deposit takers as they offer investment products that should be differentiated from deposits and not subject to deposit insurance. The third round of consultation will seek feedback on the regulatory approach to these entities.

The Reserve Bank will set prudential Standards

Cabinet has agreed in-principle that Standards should be the primary instrument for setting regulatory obligations on deposit takers. Standards will be set by the Reserve Bank, independently of Ministers but will be subject to Parliamentary oversight. This provides a greater degree of transparency and accountability in comparison to the current approach of setting requirements through Conditions of Registration. The third round of consultation will seek feedback on procedural requirements for Standard-setting.

The Deposit Takers Act will establish the matters on which the Reserve Bank can set Standards. It will seek to strike a balance between providing clarity around the scope of the Standard-setting power, while maintaining flexibility for the Reserve Bank in terms of managing financial stability risks. There will be further consultation next year on whether to empower the Reserve Bank to set macro-prudential lending Standards (such as Loan to Value Ratios and serviceability requirements like debt-to-income ratios) subject to appropriate consultation with Ministers and other agencies.

The accountability of directors and senior executives will be strengthened

Cabinet has agreed, in-principle, to increase the accountability of the directors of deposit takers. It will do this by imposing positive duties such as the need to ensure that a deposit taker is run in a prudent manner, acting with honesty and integrity, and dealing with the Reserve Bank in an open and transparent manner. These obligations would be enforced largely under a civil liability framework rather than a criminal one, with criminal sanctions reserved for cases of clear 'intent' or recklessness on the part of directors.

These changes represent a strengthening in the accountability of directors, sharpening their incentives to manage risk and improving the ability of the Reserve Bank to hold directors to account. The third consultation planned for February 2020 will test the design and specification of these new duties and the accompanying liability regime.

Cabinet has also agreed that an integrated prudential-conduct 'executive accountability regime' should be developed which extends accountability requirements to certain senior employees of both deposit takers and insurers. This work will take place through a cross-agency process separate from the current Phase 2 Review, with consideration given to policy initiatives in other jurisdictions such as Australia. The terms of reference and timeframes for this policy work will be developed and publicly released in due course.

The Reserve Bank will have a broader range of supervision and enforcement tools

The Reserve Bank has an important supervision and enforcement role. It is able to monitor the financial health of regulated entities, assess compliance with formal regulatory requirements, and to effect corrective action in the event of non-compliance. It can also address emerging risks and concerns.

The Reserve Bank has signalled that it will be strengthening the intensity of its supervisory approach. This is in line with the recommendations from the IMF's 2016/17 Financial Sector Assessment Programme (FSAP) review of New Zealand's financial sector regulatory frameworks. By taking a tougher and more intrusive approach to supervision and enforcement, the Reserve Bank will be better placed to identify and remedy issues before the risks become more significant. The proposed supervisory approach will necessarily require greater resources.

It is critical that the new regulatory framework for deposit takers provides the Reserve Bank with the right tools to effectively support a more robust supervision and enforcement model. Cabinet has, therefore, agreed in-principle to a number of changes to strengthen the Reserve Bank's ability to supervise deposit takers, and take enforcement action in the case of breaches. This includes providing the Reserve Bank with the power to undertake on-site inspections as part of its supervision activities. This is in addition to the introduction of a more graduated enforcement and penalty framework. Providing the Reserve Bank with a broader range of sanctions, such as enforceable undertaking and civil penalties, will support the Reserve Bank in shifting to a more robust supervision and enforcement model.

The framework for managing failed deposit takers will be modernised

The Review has identified the need for a number of improvements to New Zealand's bank resolution and crisis management regime to better align with international best practice, including learning from international experience during and after the Global Financial Crisis.

Cabinet has, therefore, made a number of in-principle decisions to strengthen the resolution framework for deposit takers, including:

- designating the Reserve Bank as the resolution authority for deposit takers, with statutory functions, including planning for the resolution of deposit takers and exercising resolution powers
- providing for clear resolution objectives, including resolving deposit takers in an orderly manner, avoiding significant damage to the financial system and protecting public funds
- providing the Reserve Bank with the ability to 'bail-in' (that is, write-down or convert to equity) certain unsecured liabilities, as a new mechanism to recapitalise a failing bank, and
- establishing protections for bank creditors, including ensuring that creditors end up no worse off than they would be in an ordinary liquidation.

Crucially, notwithstanding the Reserve Bank's resolution planning function, deposit takers – particularly large banks – will be expected to provide substantial input into developing and maintaining their resolution plans. This reflects the need for resolution plans to closely reflect the nature of their specific business, for assessment by the Reserve Bank and as the main input to inform the Reserve Bank's resolution planning.

While there are a significant number of further details to work through in the development of the new resolution regime, these decisions will underpin an approach that better aligns with international guidelines. The new resolution regime will also provide the Reserve Bank with a wider range of tools to resolve a failing deposit taker without severe disruption to the financial system and without relying on taxpayer funds.

Chapter 4: Deposit Insurance

New Zealanders will be able to insure up to \$50,000 at a single deposit taker

New Zealand does not currently have a deposit insurance scheme (DIS). This means that, in the event that a deposit taking institution failed, depositors would be dependent upon a liquidation or receivership process to try to recover their money, which could take years. An explicit DIS means that depositors will be able to have prompt and certain access to some of their money.

The Government's decision to establish deposit insurance was announced in June 2019, and was strongly supported by stakeholder feedback. Under the scheme, deposits held by New Zealanders will be protected up to a total of \$50,000 at a single deposit taker. More than 90 percent of depositors are likely to be fully covered by the scheme, and many of the others would have most of their deposits insured.

The coverage limit will be reviewed once the scheme is bedded in and better data are available. The number of depositors that are fully covered once the scheme is in place will depend on how many have multiple accounts at their institution (the Review does not currently have complete data on this). It will also depend on how responsive depositors are in splitting their accounts across banks and other deposit takers in order to maximise their coverage.

The scheme will protect depositors and thereby contribute to financial stability

The introduction of the DIS reflects a desire from the Government to protect vulnerable depositors. The failure of a deposit taker could create significant hardship for depositors that rely on deposits to fund day-to-day transactions. Deposit insurance means that protected depositors do not need to invest time to monitor the riskiness of their deposit taking institution, which is a difficult task, even for sophisticated creditors that have large amounts of money at stake.

The protection provided to depositors will also contribute to financial stability. The DIS is expected to enhance public confidence in the financial system, lowering the likelihood that financial stress is magnified by depositors withdrawing their money at the first sign of trouble. As part of the financial safety net, deposit insurance also improves the likelihood that governments will be willing to use the resolution tools being enhanced as part of the Phase 2 Review. This will reduce the fiscal risks associated with implicit guarantees of the financial system, and strengthen incentives for uninsured creditors to monitor their deposit taker.

These goals will be set as objectives for the DIS in legislation, helping to shape the future design and operation of the scheme. The DIS will be expected to:

- ensure that depositors can receive their money within a specified timeframe in the event of a deposit taker failure
- promote public confidence in the financial system during periods of financial stress
- enhance the credibility of resolution tools, thereby reducing the likelihood of taxpayer funds being used to bailout all creditors, and
- be designed to mitigate any negative impact on financial stability resulting from a reduction in the incentives of depositors or deposit taking institutions to monitor their own risks.

Deposit takers will fund the scheme, with a government backstop

The DIS will apply to all institutions that take deposits. As noted above, Cabinet has decided to bring all of these deposit takers under a unified regulatory regime, and there will be further work next year on the precise definition of products covered by the scheme. As a result, there will be a minimum set of supervisory and regulatory standards that are applied as a condition of being able to offer insured deposits. More intensive supervision will help manage the possible growth in riskier institutions that are part of the scheme.

An effective DIS must have sufficient resources available to pay out insured depositors. The funding for the scheme should come from levies collected from licensed deposit takers (i.e. a user-pays model where the costs are borne by institutions and potentially depositors benefitting from the scheme). The government will provide a funding backstop, so that the scheme maintains public confidence even if systemic banks are under threat. Any funding provided by the government will ultimately be paid back by levies on deposit takers.

There will be further public consultation on depositor protection arrangements in early 2020. This will include further scoping of the DIS, such as: the nature of products to be covered; the amount and nature of prefunding for the scheme from industry; the conditions for the government funding backstop; where the scheme will be located; and how it will be governed. There will also be further consultation on the possible role of depositor preference, where preferred depositors' claims are paid out before the claims of other unsecured creditors in the event of a liquidation.