The Treasury

Reserve Bank Act Review Phase 2 Consultation 3 Submission Information Release

February 2021

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Submissions by the Non-bank Mutuals on the third consultation paper to Phase 2 of the Reserve Bank Act review.

23 October 2020

The submitters

This submission is made on behalf of the credit unions and building societies set out in the table below ("**Mutuals**") currently regulated under the Non-bank Deposit Takers Act 2013 ("**NBDT Act**"). For context we also set out the assets, liabilities and capital of each Mutual as at 30 June 2020.[1]

Building Societies				
Entity		**Total Assets**	**Total Liabilities**	**Total Equity**
Nelson Building Society		$882,924,330	$807,014,197	$75,564,036
Wairarapa Building Society		$170,598,000	$148,431,000	$21,943,000
Heretaunga Building Society		$39,843,647	$34,531,030	$5,312,617
	Subtotal:	$1,093,365,977	$989,976,227	$102,819,653

Credit Unions				
Entity		**Total Assets**	**Total Liabilities**	**Total Equity**
Credit Union Baywide		$514,000,000	$456,000,000	$46,200,000
First Credit Union		$400,334,000	$339,972,000	$49,005,000
Police and Families Credit Union		$144,325,332	$117,948,177	$25,987,489
Steelsands Credit Union		$30,969,904	$27,428,538	$3,392,905
Credit Union Auckland		$21,801,166	$18,539,921	$3,261,245
Westforce Credit Union		$13,244,399	$12,400,475	$2,798,617
New Zealand Firefighters Credit Union		$14,723,000	$13,437,000	$1,286,000
New Zealand Employees Credit Union		$4,928,429	$4,494,449	$370,006
Fisher & Paykel Credit Union		$5,160,995	$4,057,369	$1,050,734
	Subtotal:	$1,149,487,225	$994,277,929	$133,351,996

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[1] Many of the Mutuals have grown even since June 2020.

Structure of this submission

This submission is structured in the following way:	
Part 1: About the Mutuals	Sets out the benefit that the Mutuals provide for New Zealand and argues regulatory settings need to encourage greater participation.
Part 2: Key Messages	Summaries the key submissions we want to make.
Part 3: Regulatory Perimeter	Argues that our inclusion in the perimeter should be coupled with certain benefits, including those currently afforded to banks.
Part 4: Purposes of the Deposit Takers Act	Discusses the importance of proportionality of regulation and suggests an additional purpose of promoting access to and growth of a diverse financial sector and particularly promoting mutual ownership.
Part 5: Standards and Licensing	Discusses the approach to standards and supports different standards for small deposit takers. Also discusses why we should have the same access to liquidity support as banks under a single regime and how this would benefit the New Zealand economy.
Part 6: Supervision	Acknowledges the RBNZ's approach to supervision may change and discusses how this approach must not increase the burden on Mutuals.
Part 7: Resolutions and Crisis Management	Discusses how the resolution and crisis management tools in the Consultation Paper were created with companies in mind and sets out complexities and alternative options for the resolution of Mutuals.
Part 8: Deposit Insurance	Generally, supports deposit insurance but argues if an ex ante scheme is introduced the same percentage fee should apply to all (other than domestically systemically important banks ("**DSIBs**") that should pay a premium). Argues that the $50,000 cap on insured deposits will not have the desired effect for Government and will be detrimental for Mutuals.

PART 1: ABOUT THE MUTUALS

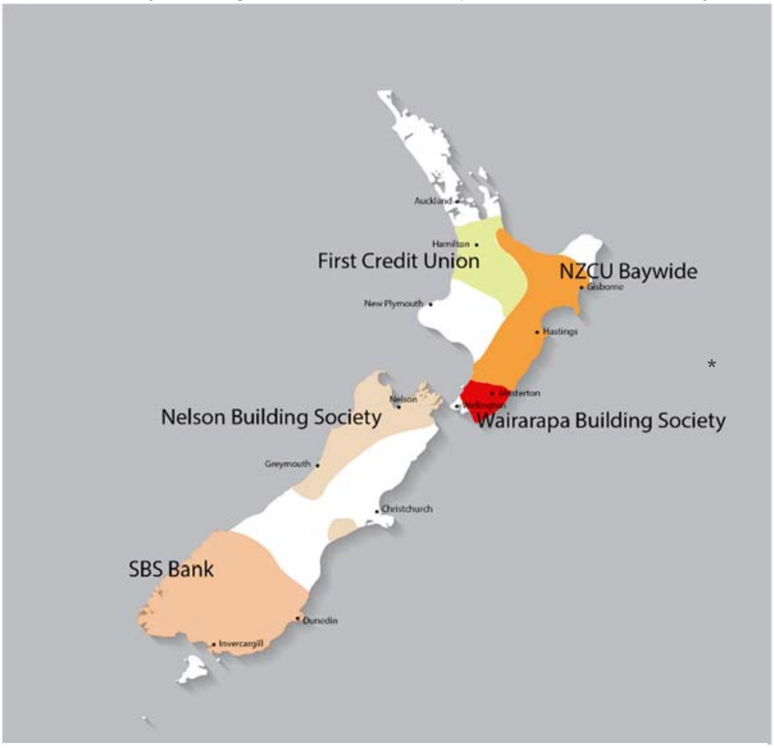
Key points:

1. *Mutuals support key parts of the financial system not typically well supported by banks such as unprofitable customers and provincial New Zealand.*
2. *The New Zealand mutual banking sector is seriously underweight relative to both other important parts of the New Zealand economy and closely comparable economies. New Zealand is worse off for that.*
3. *Prudential regulation and the way it has been applied in New Zealand is potentially a cause of the under-representation of the mutual sector in the banking system. The Deposit Takers Act is an opportunity to remedy that.*

Why support Mutuals?

While we recognise that you are aware of our sector and its important role, we would like to expand on it here for the public record. Mutuals in New Zealand are owned by and operated for the benefit of our members. We take a "profit making" not a "profit maximising" approach as well as a long-term view of doing the right thing for our members who are effectively both our shareholders and customers.

For this reason, we play an important role in financial inclusion in New Zealand. We provide financial services to a disproportionate number of low-income individuals who struggle to get accounts with banks because they don't generate sufficient profit or because they feel uncomfortable or intimidated in bank branches. Unlike the big banks, we have a strong presence in the regions, which without us would have less access to banking services. We serve over 250,000 New Zealanders, primarily in the regions.



* Baywide also has a presence in Nelson, Canterbury, Otago and Southland.
** SBS is a mutual, but not a party to this submission.

We also offer significant support to our local communities through our sponsorship programmes, which cover things like local events, schools, rescue helicopters, community organisations and sports clubs. We do this because our mutual structure, which doesn't require us to pay dividends to shareholders, enables people to help people.

Internationally, mutuals membership is on the rise, particularly since the beginning of the COVID-19 crisis. The President of the World Council of Credit Unions (**WOCCU**) recently commented on this rise by saying "Our movement continues to grow because we respond to the needs of members by expanding services, providing more access through digital channels and putting their economic empowerment ahead of corporate profits".[2]

We note that the banking and financial service mutuals sector is considerably underweight in New Zealand compared to comparable overseas jurisdictions such as Canada, the United Kingdom and Australia. Total Mutual Assets in banking and finance (including SBS Bank and Co-operative Bank) are around only $10 billion in a banking sector with approximately $600 billion of assets. This is in spite of the fact that the New Zealand co-operative and mutuals sector is world-leading in other industries (particularly in agriculture and retail) and a significant contributor to gross domestic product (about 19%). The top 30 co-operatives and mutuals in New Zealand have 1.4 million members and employ 48,500 people.[3]

Percentage of Co-operative Economy[4]		
	Globally	*New Zealand*
Agriculture and food industries	30%	65.2%
Wholesale and retail trade	19%	30.3%
Insurance	41%	1.8%
Banking and financial services	**6%**	**1.6%**
Other services	4%	3%

New Zealand is an outlier in that it has a relatively small proportion of mutuals in the financial sector. While it is difficult to know the exact cause of this we believe the regulatory regime and the way it has been administered by the Reserve Bank of New Zealand (**RBNZ**) (particularly in the 1980s and 1990s) has contributed. Now is an opportunity to correct and redress that position.[5]

In New Zealand, Mutuals operate like simple banks, providing transactional and savings products as well as home loans and personal loans that are important for basic participation in society. We see the new Deposit Takers Act as an opportunity to develop the identity of the sector and support its growth in New Zealand. This submission highlights the key issues and opportunities for Mutuals and, therefore, does not follow directly the format of the paper entitled *"Safeguarding the future of our financial system: Further consultation of the prudential framework for deposit takers and depositor protection"*, *March 2020* (**Consultation Paper**) or the questions raised.

A key theme of this submission is that the Deposit Takers Act should be used not just as an opportunity to level the playing field for Mutuals (who have been regarded as "second class" entities in the current regime) but to actually tilt the regime in our favour because of the economic benefits we provide to New Zealand.

[2] Credit union assets increased by more than 26% worldwide in 2019. Oceania saw the largest per capita increase in membership, with a 24% increase from 2018.
[3] New Zealand Co-operative Economy Report 2017.
[4] Ibid.
[5] See further discussion on the RBNZ's approach to regulation can be found on pages 7 and 8.

In the words of a recent submission we made on the funding for lending scheme:

"Tane Mahuta's role should be to encourage all trees in the forest to flourish, including New Zealand's smaller native trees and not just the imported exotics."

It is also entirely consistent with the goal of the Government (which the review of the RBNZ Act was to contribute to) of "growing and sharing New Zealand's prosperity more fairly" and developing a productive, sustainable and **inclusive** economy (emphasis added). There is no better way to create an inclusive economy than by fostering the Mutuals sector.

PART 2: KEY MESSAGES

The key submissions which the Mutuals want to make are:

Supporting the Mutuals Sector to Thrive

The Mutuals play an important role in financial inclusion and the importance of promoting our sector should be expressly recognised in the Deposit Takers Act. Regulation and supervision need to be tailored to our size and co-operative model to help the sector thrive rather than contract. It is the best way to share prosperity in the financial sector and create a more inclusive economy, a key objective of Government policy.

Regulatory Perimeter

Mutuals should have the same benefits as larger banks as part of being regulated under the same regime, in particular:

(a) the ability to call ourselves a bank or mutual bank;

(b) access to central bank liquidity and, in particular, the funding for lending programme; and

(c) access to deposit insurance.

Deposit Insurance

We agree deposit insurance should be available to all deposit takers. We do not have a clear view on whether a scheme should be funded on an ex ante or ex post basis but if it is funded on an ex ante basis:

(a) all entities (other than DSIBs) should pay some percentage fee;

(b) DSIB's should pay an additional premium reflecting the systemic risk they pose (similar to what occurred after the GFC); but

(c) if premiums are to be risk-based they should not use credit ratings which unfairly favour the Australian owned banks (because of the implicit support incorporated into them).

Credit ratings are not a good proxy for risk and should be dispensed with as a requirement for Mutuals and other small deposit takers in the legislation (or standards).

Most of us[6] strongly oppose the $50,000 cap on insured deposits and support $250,000 as a level of coverage to ensure consistency with Australia.

Adapting Prudential Standards

The transition to the new regime should be as easy as possible for the Mutuals, including transitioning across existing standards that are working well. The opportunity should be taken now to create consistency of prudential standards across the Mutuals sector (currently inconsistently applied mostly for historic reasons relating to different trustees' preferences).

[6] First Credit Union is comfortable with the $50,000 cap.

Flexibility and a directive to calibrate these standards to the size and model of the Mutuals will be an essential element of promoting the sector, as will a proportionate approach to supervision which we believe should be proportionate to market size.

We agree with the concept of small depositors being recognised and having less onerous prudential rules applied to them. We believe the cut-off should be based on a percentage of the banking system and potentially included in regulations (we suggest between 0.25% and 0.5% of assets which on current metrics would be between $1.5 billion and $3 billion of assets).

Recovery and Resolution

We believe there is scope to improve recovery and resolutions options for Mutuals but that changes to underlying legislation may be required to streamline existing bail-out options (still likely the best option) or to allow for demutualisation at the point of non-viability to improve recovery options.

The RBNZ should also preserve the power to appoint a receiver (currently in trust deeds) as probably the best insolvency option on failure of a Mutual.

PART 3: PURPOSE OF THE DEPOSIT TAKERS ACT

Key points:

1. *Mutuals support the overarching stability objective but seek acknowledgement that it is consistent with this objective to exercise tolerance for failure particularly for smaller institutions and therefore lessen the regulatory burden on smaller less systemically important deposit takers.*
2. *Over-regulation of small deposit takers will likely cause a contraction of the non-bank deposit taker sector which will undermine stability and economic growth.*
3. *The RBNZ's decision-making principles should include the principle of having regard to the legal structure of a regulated institution and the desirability of expanding participation at all levels of the financial system (particularly through mutual ownership).*
4. *To support growth, regulated institutions should have a period of time over which they can transition between different categories as they grow.*

Overarching financial stability objective

In general, the Mutuals support an overarching stability objective. We acknowledge that a necessary micro objective is therefore to ensure the stability of individual deposit taking entities and that this objective is missing from our current regime.

Mitigating the risks in the financial system

The RBNZ has acknowledged that its remit is not to run a zero-failure regime, which we accept. However, clearly the consequences of the failure of a domestically systemically important bank are far more severe than a small credit union, for example. This means that it is consistent with the overarching stability objective to exercise greater tolerance for smaller less systemically important deposit taking entities to fail in order to promote diversity and growth. Therefore, it is consistent to lessen the regulatory burden on these smaller deposit taking institutions.

Growing the Mutuals finance sector objective

We note that the RBNZ's emphasis on individual stability since the GFC potentially has caused the non-bank sector to contract which has a negative impact on competition, innovation, inclusion and domestic capability – all of which ultimately undermine systemic stability and economic growth.

In light of the fact that there have been no new non-bank deposit takers since the NBDT Act was introduced, and the fact that the Mutuals sector is heavily underweight relative to international comparisons, we believe the proposed objectives of the Deposit Takers Act could, and should, go further and actually require the RBNZ to promote access to, and the growth of, a diverse financial system as a core objective (in much the same way as the Financial Markets Conduct Act 2013 (**FMCA**) also includes positive objectives for the Financial Markets Authority (**FMA**) to promote the development of financial markets). We note that competition objectives are increasingly common in other jurisdictions.

The Mutuals believe that there is an opportunity for the Deposit Takers Act to provide the RBNZ with the mandate to support and facilitate the growth of smaller and, in particular, mutually owned financial institutions. The Mutuals believe that there are a number of benefits to growing smaller, New Zealand-owned financial institutions, including:

(d) the benefits of increased competition;

(e) diversity within the financial system;

(f) promotion of financial inclusion to sectors currently under-served;

(g) minimisation of concentration risk that exists when a few banks enjoy approximately an 82% market share;

(h) improving domestic capability; and

(i) the assurance that New Zealand owned financial institutions will focus their efforts on supporting an economic recovery in New Zealand (rather than offshore) during financial crises.

Decision-making principles

The Mutuals agree with the broad decision-making principles for the Deposit Takers Act set out in proposed approach 2.2 of the Consultation Paper, in particular the principles of minimising unnecessary costs of regulation and taking a proportionate approach. We further believe that additional decision-making principles should be included to support an inclusive and diverse financial system.

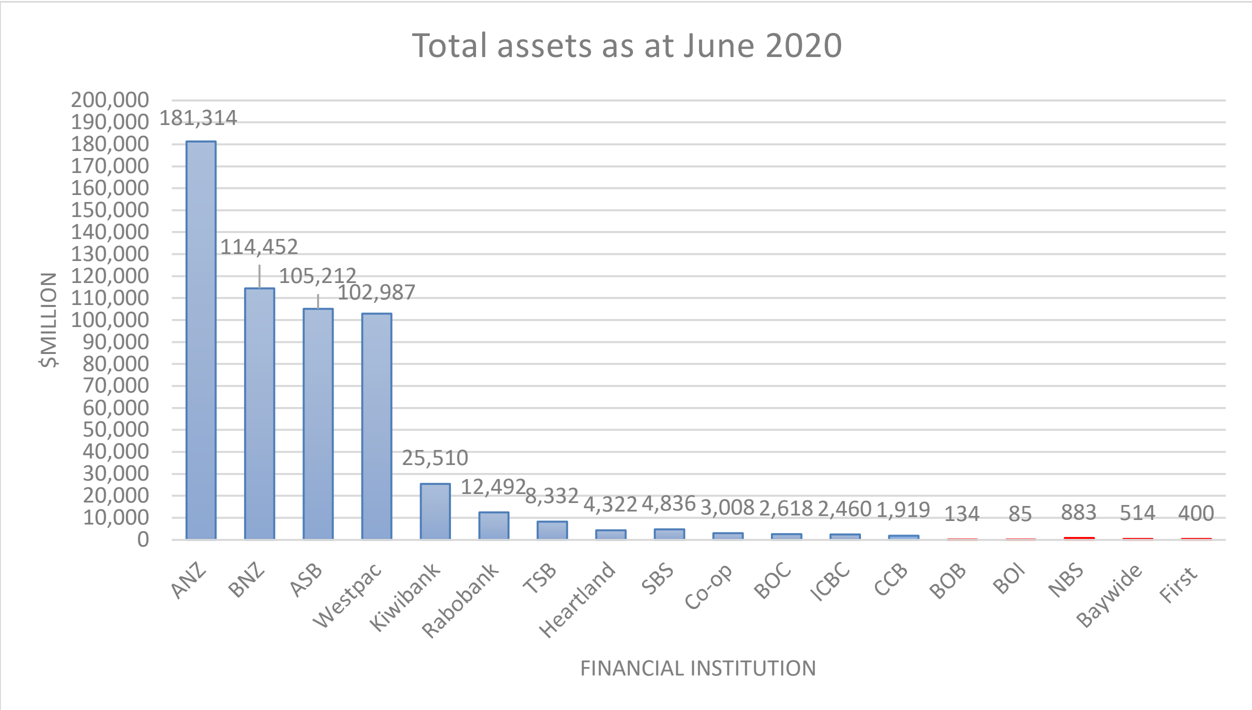
Proportionality and minimising the cost of regulation

The Consultation Paper stresses the importance that any costs are proportionate and do not have an anti-competitive effect. We believe that fostering competition will require going beyond removing barriers to entry for new deposit takers and developing regulation that supports the growth of small deposit takers. This has been and continues to be a major theme for WOCCU, which notes that a tendency to adopt the "gold standard" of regulation designed for globally systemically important banks does not lend itself to a system that promotes institutional diversity and competition in the financial system.

It is essential to the survival (and hopefully growth) of our sector that the new regime does not place a prohibitive burden on Mutuals by making them subject to the same compliance costs as much larger banks. Ultimately, the objectives should be that compliance costs are, at least, approximately the same as a percentage of revenue across entities (noting that the large banks will also have much more complex business models and higher degrees of interconnectedness in the financial system (eg Westpac as Government banker) which actually warrant higher proportionate costs). We would like to see some guidelines either included in the Deposit Takers Act or in regulation to redress the natural propensity for regulatory creep over time.

As well as proportionality, it will be important that the Deposit Takers Act regime has mechanisms that support the growth of small and locally owned deposit takers. We agree with the Review Team's comments on page 27 of the Consultation Paper that aspects of the regime, such as the current supervisory model, may not be conducive to innovative business models. We would add that it does not fit well with some existing business models either, such as the Mutuals model which is designed to support members who in many cases struggle with the impersonal large bank model. To this end we believe that a principle should be added to those suggested requiring regard to be had to the organisational model of a regulated entity and the desirability of expanding participation at all levels of the financial system through, for example, mutual ownership.

Mechanisms to support growth should include transition periods for deposit takers giving them a reasonable period of time to meet the standards of new categories as they grow. We suspect that the simplest approach for determining categories of deposit takers for applying different standards will be using the size of the institution, potentially using the RBNZ's current approach of using total liabilities (although we note the more common metric internationally is assets). Our initial view is that the threshold for differentiating standards for small depositors should be set at between 0.25% and 0.5% of total financial system assets, which would be somewhere between $1.5 billion and $3 billion on current metrics.[7] This threshold would be sufficient to capture most of the existing banks (and the smaller banks like Bank of India could opt in or be grandfathered into the existing regime). The graph below shows the assets of the entities that would fall below the lower end of the threshold in red.



The largest Mutual is Nelson Building Society, with around $890 million of assets. This threshold would give it headroom to transition into the current bank regime; Credit Union Baywide which is the next largest at around $500 million of assets would be a lot further from meeting even the lower end of this threshold. This threshold should be entrenched either in the Deposit Takers Act or Regulations as a percentage of total financial system assets to avoid regulatory creep that may result over time by not adjusting thresholds to the size of the system.

[7] See further discussion on this threshold in Part 5: Standards and Licensing (pp 16 and 18).

Additional decision-making principles

As well as proportionality, the RBNZ should be directed to take the legal structure and business model of the regulated entity into account. This is of particular importance to the Mutuals whose unique model often does not fit well with regulations and standards designed for companies. If we recognise and want to support the social benefit of the mutual model then the RBNZ will need to take into account matters such as our ownership structure and "profit-making" rather than "profit-maximising" approach when setting standards to ensure it meets its supervisory objectives without creating complexity and unnecessary costs for Mutuals, all of which suggest they pose a very low level at prudential risk.

Recognition of international practice and standards should be another key decision-making principle, especially in light of the fact that the Reserve Bank Act Review was initiated in response to the RBNZ's governance and approach to supervision which until recently was based on the strongly free-market views of the mid-80s, which are now largely discredited. Having regard to and incorporating international practice relating to Mutuals will likely be an effective way to support growth in the sector.

WOCCU has requested that the Basel Committee on Banking Supervision (**Committee**) provide more guidance on when less complex regulatory approaches can be warranted. Below we set out WOCCU's suggested (but non-exclusive) list of matters that should be taken into account, along with our assessment of how they apply to the Mutuals:[8]

WOCCU suggested matters	**Assessment of Mutuals**
(a) whether the institution has cross-border operations;	Not relevant.
(b) the complexity of the institution's assets and liabilities;	Low complexity – Low risk.
(c) the asset size of the institution;	Small size – Low risk.
(d) the extent of the institution's leverage;	Low – Low risk.
(e) the institution's connectedness with the financial system;	Low to Moderate – Low to moderate risk.
(f) the degree to which the institution reports to multiple prudential supervisors;	Only RBNZ.
(g) the extent and nature of the institution's off-balance sheet exposures; and	Low – Low risk.
(h) the mix of business activities of the institution, such as whether it engages in community banking, commercial banking and/or investment banking.	Community banking only – Low risk.

[8] World Council of Credit Unions Submission to the Basel Committee on Banking Supervision *Proportionality in Regulation at the Global Level* (3 April 2019).

The Committee has already embedded the principle of proportionality in its Core Principles of Effective Banking Supervision, which includes that "supervisory practices should be commensurate with the risk profile and systemic importance of the banks being supervised".[9] This was noted in its joint statement with the Basel Consultative Group, released in November 2019, supporting the use of proportionality when implementing Basel III.[10] While not yet providing explicit guidance, the Committee has actively begun to take steps towards promoting proportionate approaches to regulating banking activities. In March 2019, the Committee released a report on a survey undertaken of the current practices in proportionality amongst its members.[11] The Committee's position is clear that members are not expected to apply the Basel framework in full to all banks in its jurisdiction and that this approach is, in fact, undesirable. This is in line with our view that New Zealand adopt a policy of supporting competition by supporting the position of smaller deposit takers, particularly mutuals, and attracting new ones.

[9] Basel Committee on Banking Supervision *Core Principles of Effective Banking Supervision* (September 2012).
[10] Basel Committee on Banking Supervision and Basel Consulting Group *Joint BCBS-BCG statement on proportionality* (26 November 2019).
[11] Basel Committee on Banking Supervision *Proportionality in bank regulation and supervision – a survey of current practice* (19 March 2019).

PART 4: REGULATORY PERIMETER

Key points:

1. *The current regime imposes a significant regulatory burden on Mutuals with few corresponding benefits. This should be rectified with the Deposit Takers Act at least levelling the playing field and ideally promoting mutual and New Zealand-owned institutions.*
2. *All deposit takers in a single regime should have the benefit of the same support from regulators, such as liquidity, lender of last resort and term lending facilities (particularly the funding for lending programme), on a relative and proportionate basis. This should be formally recognised in the Deposit Takers Act.*
3. *Mutuals provide banking services and should be able to call themselves "banks" or "mutual banks" and describe their services using the term "banking".*
4. *Proportionality of regulation is of such importance that guidelines should be included in the Deposit Takers Act or Regulations on how to implement regulation proportionately. It should ideally be based on relative market size.*
5. *Small deposit takers should be subject to simplified supervision and regulation and the threshold for a small deposit taker should be set at between 0.25% and 0.5% of total financial system assets.*

Given the overlap with Part 3: Purpose of the Deposit Takers Act, many of the comments contained in that section will apply equally to the regulatory perimeter.

A single regime

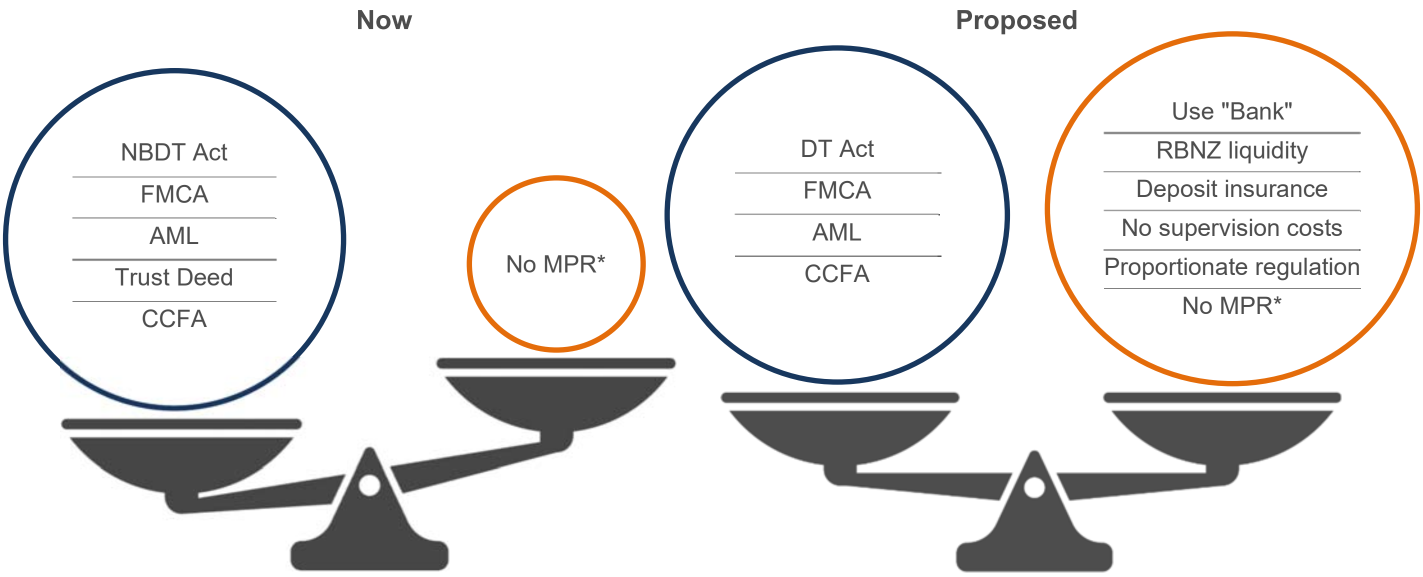
We accept the position under the Consultation Paper that Mutuals should be included in the regulatory perimeter because we essentially provide simple banking services to our customers (including, in most cases, transactional accounts).

However, we strongly believe that the regime created by the NBDT Act has not created a level playing field and has, as you pointed out in the Consultation Paper, created a category of "second class" firms. We would like to see the new Deposit Takers Act address this and not just "level the playing field" but actually promote the expansion of the Mutuals sector in New Zealand as a policy objective.

While the Mutuals have had a significant regulatory burden under the NBDT Act and have had to pay the costs of supervision, we have not received the same benefits as the registered banks. This has been particularly apparent during the COVID-19 crisis which saw the RBNZ providing significant support to registered banks to pass onto their clients, such as liquidity support, access to cheap central bank funding, capital relief, and things like removing tiered pricing for ESAS accounts and allowing mortgages in arrears to be used as collateral. MBIE also gave banks additional waivers from consumer protection legislation which was not extended to non-banks.

If all deposit takers are subject to the same regulatory regime, all entities in the perimeter should have access to the same support that the RBNZ provides to banks on a relative and proportionate basis. The

Deposit Takers Act should not just empower the RBNZ to do this but require it to take steps to do this (subject to balancing the risks of doing so in a proportionate way).



*MPR means macro-prudential regulation.

Mutuals, which provide essentially the same services as banks and are also prudentially regulated, should be able to call themselves banks or mutual banks, as is the case in Australia (subject only to a right by APRA to prevent them doing so in certain circumstances). Many of our customers view us as their banks and our inability to use the word "bank" or its derivatives makes it difficult to describe our services in a simple and understandable way (without including wordy, and in our view unnecessary, disclaimers).

Proportionality in standards

We strongly support proposed approach 3.4 in the Consultation Paper, whereby the RBNZ has the flexibility to calibrate the regulatory approach to small deposit takers, and urge the RBNZ to adopt the position recommended by WOCCU and the Committee. The survey on Committee members' approach to proportionality noted that a common approach is to provide a threshold below which a regulated institution will be subject to reduced regulatory requirements. As noted above, we believe that an appropriate threshold in New Zealand would currently be between $1.5 billion and $3 billion in assets. We also note that comparable jurisdictions such as Canada and the United Kingdom have separate standards of prudential regulation for mutuals to ensure that the standards are proportionate and fit for purpose.

Principles entrenched in the Deposit Takers Act and associated regulations will, of necessity, need to be reasonably high level. However, we note that the RBNZ does not involve itself in Government policy matters and therefore we strongly encourage clear guidance in the Deposit Takers Act on how the RBNZ should implement standards to ensure that it is empowered to support the mutual sector and redress the current regulatory imbalance.

In addition to guidance in the Deposit Takers Act, we urge the Government to actively use the Financial Policy Remit proposed to give the RBNZ guidance on Government policy (which hopefully will be to promote mutual and New Zealand ownership in our financial system). While the current power to do this exists under the NDBT Act, it has not been used to date.

PART 5: STANDARDS AND LICENSING

Key points:

1. *Mutuals support the use of standards for implementing the more detailed elements of prudential regulation and the ability of the RBNZ to calibrate those standards to be fit for purpose for different institutions.*
2. *The standards should still be legislative instruments and subject to review by the Regulatory Review Committee to ensure consistency with the Deposit Takers Act and maximum legal certainty.*
3. *Certain standards contained in the NBDT Act and some trust deeds work well but should be applied consistently to all the Mutuals (effectively substituting different wording from trust deeds into a single set of common standards).*
4. *Different standards should apply to small deposit takers (initially at least), in particular standards relating to capital, liquidity, connected exposures and disclosures.*
5. *Macro-prudential standards should not apply to small deposit takers (ideally they should be limited to domestically systemically important banks only – absent any good reason not to).*
6. *Mutuals should have the same access to liquidity support as banks on a relative and proportionate basis. This access would have a disproportionately positive impact on the real economy, particularly during financial crises.*

Flexibility of standards

The Mutuals support the use of standards to impose the more detailed elements of prudential regulation on regulated entities. For the Mutuals this seems to be a reasonable midpoint between:

(a) Regulation, which is used now to impose core standards on the Mutuals and which are legislative instruments often with penalties attached; and

(b) provisions contained in trust deeds which are contractually binding.

The Mutuals believe it is important that the standards are still legislative instruments, and potentially subject to review by the Regulation Review Committee, to ensure there are adequate checks and balances on standards imposed and that they are drafted consistently with statutory regulations so as to give maximum legal certainty.

The Mutuals also believe it is critical that the way in which standards are set enables the RBNZ to take a risk-based approach having regard to the size, structure and activities of a particular institution and therefore strongly support the proposed approaches 4.3, 4.4 and 4.5 that would enable the RBNZ to calibrate its approach based on class, type or even individual institutions, and set different reporting and lending standards for smaller deposit takers. The Mutuals understand that the current intention is that the Deposit Takers Act will signal to the RBNZ that it can and should take a proportional approach to prudential standards and can apply differing prudential standards to different institutions.

The Mutuals agree that this directive should be incorporated into the Deposit Takers Act and believe that the following are key features which the Deposit Takers Act should direct the RBNZ to explicitly consider in the formulation of standards:

(a) the corporate structure of the institution (eg registered bank, credit union, building society, finance company);

(b) the size of the institution;

(c) the complexity of the institution's business model;

(d) the institution's inter-connectedness with the financial system;

(e) whether the institution has cross-border operations; and

(f) the extent of the institution's leverage and off-balance sheet exposures.

If there is a single consolidated prudential regime to be introduced for all entities (as is proposed by the Deposit Takers Act) which incorporates banks regulated under the RBNZ Act, and finance companies, credit unions and building societies regulated under the NBDT Act, then a differentiator will be required for small deposit takers. As noted above, we suggest a threshold of 0.25% to 0.5% of total financial system assets.

Consistency of standards between Mutuals

The Mutuals currently comply with prudential standards set through the Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010 (**NBDT Regulations**) and in the terms of their trust deeds (where each trust deed may contain different requirements for each deposit taker, and the basis for differentiation may not always be clear and may indeed be largely historic). We support any proposal which contains all the prudential requirements for the sector in one place, and believe that the use of standards to set prudential requirements (as opposed to conditions of licence, regulations or contractual instruments such as trust deeds) is the appropriate mechanism. The Mutuals believe that standards would provide maximum transparency, consistency and legal certainty, without the formalities required to pass regulations. Any variants to standard conditions could be included in the terms of licence.

We think that the RBNZ should consult with the Mutuals and the trustees to determine the best way to translate prudential requirements that are currently contained in trust deeds and the NBDT Regulations into standards in a way that creates consistency amongst Mutuals without prejudicing the protections that our depositors receive in the trust deeds. We note that the imperative for this review of the RBNZ's governing legislation does not relate to any concerns about the institutions that are prudentially regulated, but instead is intended to address concerns raised by the IMF about how the regulator undertakes its functions. Accordingly, we think that there should be a general principle that our existing prudential requirements should be retained unless there is good reason for change, although we expect that some changes will be required for the sake of consistency with the current bank regime (or more particularly replacement of it). To the extent that any changes are required, we believe that the Mutuals should be afforded a period to transition to new prudential requirements.

Scope of standards

Areas where there could be separate standards for small deposit takers could include (as acknowledged in the Consultation paper):

	Mutuals' comments
Capital requirements	The Mutuals need a simple regime that puts us on a level playing field with larger banks. It is critical for smaller financial institutions that capital requirements minimise complexity. The preference of Mutuals would to be to retain the simplicity of the existing regime in the NBDT Act for calculating risk adjusted assets. A simple and understandable regime such as the existing NBDT regime should be translated into a new standard, at least on a transitional basis while it is compared with BS2A to determine how appropriate it is for Mutuals. The NBDT Act capital regime has been tougher than the bank capital regime because, until recently, it had the same minimum capital ratio but did not allow tier 2 (or other alternative forms of capital) and the simplified risk weighting regime tended to result in higher levels of capital being required by the Mutuals than banks in respect of the same assets. In other jurisdictions, such as Australia, the prudential supervisors have approved special mutual equity instruments under the capital adequacy standards to make it easier for mutuals to comply. These considerations should be front of mind in developing standards going forward, ideally with existing capital instruments formally recognised.
Liquidity requirements	The Mutuals believe that the complexity of this standard would create significant compliance challenges and the substance of the standards would not necessarily be appropriate for much smaller deposit takers.
Ownership, incorporation and governance requirements	Some of these standards should not apply to Mutuals simply because of their different ownership structure and others may need to be differentiated (eg governance).
Internal risk management systems and controls	These standards may need to be differentiated for Mutuals, using their existing requirements for a risk management programme as a starting point.

Crisis management and resolution	These standards will need to be adapted to the structure of and legislation governing the Mutuals, and may require legislative changes to the Mutuals' underlying legislation.
Loan concentration and risk exposure	The Mutuals, by their nature, have concentration of risk in geographical regions or through some other common bond of its members. Standards should recognise this and not penalise Mutuals unduly for their model.
Related party transactions	These standards have been developed to deal with connected lending exposures of corporate groups and the larger banks. Mutuals are in an unusual position in this respect given they don't have controlling shareholders, and differential standards may be appropriate.
Public disclosure of information	Disclosure obligations should take account of Mutuals' relatively simple product offerings and business model, which may justify some exemptions from the FMCA. Certainly, Mutuals should be exempt from the need for a trustee.
Outsourcing arrangements	This standard does not seem relevant to Mutuals.
AML/CFT	We understand the same standards currently apply to Mutuals.
Fit and proper standards	These standards may need to be differentiated for Mutuals.
Deposit insurance	The deposit insurance scheme should be available to all institutions that offer specified insured products.
Lending standards in relation to mortgages	Macro-prudential regulation should not apply to small deposit takers.
Matters prescribed in regulations	Mutuals should be consulted on a case-by-case basis.

Access to liquidity

If Mutuals are to be regulated under the same regime as registered banks, we strongly believe that we should have equal access to any liquidity support provided to banks by the RBNZ (for example, access to support like the backstop liquidity support and open market operations available to banks and the funding for lending programme that the RBNZ is currently working on to be able to roll out by the end of this year). The Mutuals believe that competitive neutrality between institutions that are all prudentially regulated by the RBNZ under the same regime is critical to foster diversity and consequential stability in the overall financial system – but this will need the RBNZ to accept a wider range of security for these facilities than it does now (and it may also potentially be appropriate to cap facilities available to small deposit takers at, for example, 3% of total funding).

In addition to the concept of competitive neutrality, the Mutuals believe that their inclusion in liquidity support will have a disproportionately positive impact on the real economy. This is because, for example:

(a) the Mutuals lend to parts of the economy that banks simply don't lend to. [25]

We focus on the economic empowerment of our members rather than profitability and invest time in supporting those who need it most. Without access to the credit we provide, many of our members would be forced to resort to pay-day lenders; and

(b) the Mutuals are more likely to filter funds into the real economy during counter-cycles (such as the current environment). Unlike banks, who, in the experience of the Mutuals, lend even more conservatively during counter-cycles (and often do so in lockstep), Mutuals continue to focus on the financial wellbeing of their members especially during more difficult times. Notwithstanding this willingness in principle to take a counter-cyclical approach, the Mutuals, as prudentially regulated entities, still need to act prudently and hold sufficient cash reserves, which frustrates our ability to filter money into the real economy when it is most needed. The Mutuals believe that the niche that they fill in the financial system would be greatly supported if they had access to backstop liquidity, which could enable them to act both bravely and prudently during counter-cycles, which benefits the real economy. In a number of cases, even though Mutuals have standby facilities with banks, they are dubious that they would be available in a time of need. There is simply no incentive for banks to support entities that are effectively competitors. The RBNZ should remove this risk, perhaps by at least lending to some of the larger Mutuals who would be more likely to support the sector than banks.

The Mutuals understand that the RBNZ is interested in supporting the Mutuals in facilitating diversity and competition in the financial system, but may be reluctant to provide liquidity support to smaller financial institutions equal to that provided to larger banks on the basis that larger institutions can provide collateral that meets the RBNZ's standards. However, the Mutuals believe that the RBNZ should be willing and empowered to adopt social policy objectives and consider alternative forms of security from smaller institutions (as well as other measures which support smaller financial institutions) if it receives a signal from the Government/Treasury that it has the mandate to do so. This reinforces the need to include in the Deposit Takers Act the principles relating to promoting a diverse and inclusive financial system including by providing the same liquidity support on a tailored (and perhaps capped) basis. The Mutuals believe that confirming the RBNZ's mandate to do this is also consistent with the RBNZ's mandate as the lender-of-last-resort, which implies that it is not necessarily outside the RBNZ's mandate to take a more flexible and proportionate approach to the security it accepts from entities it regulates.

Although the Mutuals prefer an approach which gives them equal access to RBNZ liquidity facilities, it believes that the Deposit Takers Act must, at the very least, provide a requirement for the RBNZ to modify the regulatory settings for the liquidity facilities that banks currently provide to smaller financial institutions to ensure that holding cash is not punitive to smaller institutions and that meaningful liquidity is available to them when needed. This might involve changes to the capital requirements relating to the provision of liquidity facilities to smaller financial institutions to enable banks to provide better liquidity support as well as a requirement to directly pass on a portion of the benefits of any liquidity support they receive from the

RBNZ to smaller financial institutions. Such a requirement could be modelled off the United Kingdom's Term Funding Scheme with Additional Incentives for SMEs.

Product disclosure

We provide simple products and, as such, complex disclosure is not required, it is in fact not in the best interests of our members. Accordingly, the preference would be to retain the FMCA disclosure regime, but:

(a) provide exemptions for very simple products like transaction and savings accounts from the full disclosure regime which is designed for more sophisticated debt products; and

(b) dispense with the requirement for a trust deed and trustee because we would be directly prudentially supervised based on common standards.

Cost of regulation

As a general principle the cost of regulation should be proportionate to the size of an entity in the financial system (acknowledging that there will be a base level fixed cost that can't be avoided). So, an entity which makes up 0.1% of the financial system should incur $1/100^{th}$ of the cost of one that makes up 10% of the system. Proportionately the cost could increase for domestically systemically important banks given the much lower tolerance for failure of those institutions.

PART 6: SUPERVISION

Key points:

1. *The Mutuals believe that any newly introduced powers of the RBNZ, such as on-site inspection powers, must be exercised proportionately and be no more onerous than current supervision.*
2. *The Mutuals support being supervised by the RBNZ directly and believe they should not incur costs in respect of this supervision.*

Proportionality

The Mutuals believe that any powers introduced to position the RBNZ as a more "orthodox regulator", including on-site inspection powers, should be exercised in a manner that is not more onerous than current supervision – especially in the case of smaller deposit takers. This would reflect a proportionate approach to regulation that does not impose undue costs on smaller deposit takers that pose little to no systemic risk. On that basis, the Mutuals believe that the RBNZ should adopt a risk-based approach and allocate time spent onsite at each deposit taker in a way that reflects the proportionate market share of deposits and the risk posed to the financial system (ie spending more time with large, domestically systemically-important banks.

To avoid regulatory creep and a standardisation approach to supervision being applied across all entities that does not reflect the more present customer interactions at Mutuals and the level of resources available, we believe the proportionality approach to supervision should be specified in the Deposit Takers Act and regulations and potentially reported against by the RBNZ.

Direct supervision

The Mutuals expect that there will be no need for trustees under a new deposit takers regime. Instead, the Mutuals expect that they will be prudentially supervised directly by the RBNZ and would not incur any costs in respect of this, which is consistent with the position of banks in respect of their supervision by the RBNZ. To the extent that the RBNZ intends to charge for its supervision, the Mutuals would hope to receive an exemption (ideally in the form of a "small deposit-takers exemption") to compensate for the past disparity that arose from the requirement of NBDTs to pay trustees costs while banks paid nothing to be supervised.

PART 7: RESOLUTION AND CRISIS MANAGEMENT

Key points:

1. *The existing resolution tools were created with companies in mind and careful consideration will need to be given to how these tools apply to Mutuals and the legislation under which we operate.*
2. *The Mutuals do believe there is value in reviewing their underlying legislation in the context of a bail-out option which could facilitate an easier transfer of engagements process in these circumstances or a demutualisation option without member approval (subject to a reasonably high hurdle before the powers can be activated).*
3. *Mutuals do not believe demutualisation is necessary for a bail-in.*
4. *The RBNZ should also retain certain rights that are currently held by supervising trustees, such as the right to appoint a receiver or the power to give directions to a Mutual under an event of review. The right of the FMA to appoint a liquidator in certain circumstances for building societies at least should be replaced with an equivalent right for the RBNZ to appoint a liquidator for prudentially regulated building societies.*
5. *The Mutuals welcome a codification of the duties of their directors and a review of the current position on director liability under the NBDT Act which is currently unfairly onerous, especially when compared to the liability of bank directors.*

Resolution tools and the Mutuals' structure

The Mutuals believe that the existing resolution tools were created with banks in mind and may not work effectively for mutuals. In particular, it is important to emphasise that Credit Unions and Building Societies operate under different legislation, namely the Friendly Societies and Credit Unions Act 1982 (the **Credit Unions Act**) and the Building Societies Act 1965 (the **Building Societies Act**) respectively. It is therefore important when considering appropriate resolution tools to ensure that such tools can be effectively operationalised in accordance with each piece of legislation.

An example of the complications of applying the existing resolution strategies to Mutuals is how a statutory bail-in would apply to deposits held by Mutuals. Our depositors already receive equity in the institution, which provides rights to influence the direction of the firm and claims on future profits. This is reflected in section 107 of the Credit Unions Act and section 11 of the Building Societies Act. Effectively, a "bail-in" of a Mutual would not involve writing down debt and providing equity as compensation, because the deposits of Mutuals are already equity instruments. In general, the terms we offer to depositors as Mutuals already contain the right to write-down the value of deposits (because they are also effectively shares), rendering statutory bail-in powers unnecessary as they would replicate a process that already exists by virtue of our mutual structure.

On that basis, the Mutuals disagree that demutualisation is likely to be necessary when a statutory bail-in is the preferred resolution strategy (and indeed question whether statutory bail-in would ever be a preferred resolution strategy in the context of Mutuals given the end result of statutory bail-in can already be accomplished by Mutuals).

On the other hand, the Mutuals accept the comments made in the Consultation Paper relating to the need to have a continuing ability to de-mutualise in respect of distressed Mutuals in the context of a potential bail-out, to enable entities other than Mutuals an opportunity to bail out a distressed deposit taker.

We believe there is also an opportunity for the existing regulatory regimes for Mutuals to be considered and possibly aligned as part of a failure to settle regime. There are significant differences in the processes for a transfer of engagements between credit unions and building societies. We have found that the existing processes for transfers of engagement, for credit unions in particular, can be lengthy and complex. In particular, a transfer of engagements to another credit union requires member approval. As a democratic model, we question whether the removal of member approval would be appropriate. However, we note that the process is not ideal if a resolution is required in a short space of time. Either our supervisor and its resolution options will need to take account of this extended timeline, or the process may need to be streamlined in circumstances where the RBNZ requires the Mutuals to merge effectively as a bail-out option. We would welcome the opportunity to discuss this directly with the RBNZ at the time it commences the drafting of prudential standards.

As part of the process of identifying which resolution tools could be effectively operationalised for Mutuals, we also think it would be helpful for the Review Team to carefully consider legislative amendments to unambiguously enable Mutuals to access qualifying tier 1 capital without undermining their mutual status, which would minimise any need for an eventual resolution.

Resolution under the current regime

The Mutuals also wish to point out that under their existing trust deeds there is a power for trustees to appoint a receiver. We suggest that it could be useful for our supervisor to retain that power (as opposed to simply having the option of liquidation or statutory management). There is precedent for a regulator having that power with the FMA, which has the power under the FMCA to apply to the courts for an order to appoint a receiver or manager to an issuer of financial products in certain circumstances, including where it believes the issuer is insolvent or unlikely to be able to pay all the money owing on financial products when it becomes due. We believe that power should vest with the RBNZ as part of its resolution toolbox.

If that power is to be transferred to the RBNZ, it may also be worth considering whether some of the specific powers granted by contract to a receiver through the trust deeds should be granted to a receiver appointed by the RBNZ (presumably through amendments to the Receivership Act).

In addition, many Mutuals' trust deeds include certain powers on the occurrence of an event of review – giving the trustee some flexibility, short of appointing a receiver, in dealing with breaches of the trust deed. Trustees are able to declare an event of review, not only where there has been an event of default, but in other circumstances where the soundness of the debt issuer's business operations or financial condition is in question. Once an event of review has been declared, the trustee has the power to give the issuer directions, including prohibiting certain activities, like borrowing money, lending money or accepting new creditors. This seems similar to existing powers of the RBNZ to give directions to banks, but it would be worthwhile aligning them.

The RBNZ should consider these crisis management powers for small and developing deposit takers. While they could potentially either be introduced through standards or conditions of licence, it is likely that the Deposit Takers Act will at least need to ensure that it is clear that the regulator has powers to do that and there are some constraints on those powers. The Mutuals, however, would expect those powers to be transferred across on a "like for like" basis. They have been well tested over a number of years and, we understand, are powers that trustees have generally become comfortable with.

Director Liability

Unlike companies, the duties of Mutuals' directors are not codified. Although we operate on an assumption that our directors will likely be held to similar standards as company directors (possibly on the basis of the old common law duties, modified by case law relating to the statutory duties of company directors that are based off the old common law duties and are therefore likely relevant), this is not certain. Accordingly, we welcome legislative changes which codify the duties of our directors for the sake of certainty.

Section 68 of the NBDT Act provides that each director of an NBDT is liable for the penalty applicable to an individual for any offence committed by the NBDT, even if the NBDT itself is not charged with the offence. The Mutuals consider that this is a fairly burdensome and blunt way to impose personal liability on their directors, which can at times make it difficult for them to attract talent. The Mutuals would welcome a review of this provisions in favour of a more considered approach to director liability.

PART 8: DEPOSIT INSURANCE

Key points:

1. *The Mutuals strongly oppose a $50,000 cap on insured deposits. We believe this cap will result in underfunding the scheme (increasing Crown liability), is not politically realistic, is unlikely to prevent a run on deposit takers, may cause a flight of funds to Australia, and is likely to cause a contraction in the lending activities of Mutuals when our members need them the most.*
2. *Most believe the cap on insured deposits should be $250,000.*
3. *Any approach to depositor preference under the Deposit Takers Act should put the Mutuals' depositors in no worse position than they are currently under the Mutuals' trust deeds. This will require careful consideration due to the different approaches taken by different deposit takers and may lead to some complexities in the application of a depositor preference.*
4. *The Mutuals support the RBNZ taking on the role as insurer to reduce costs and maximise efficiencies in reporting.*
5. *The Mutuals believe that, if there is an ex ante funded scheme, there should be a flat premium for all except DSIBs who should pay an additional premium for systemic risk (as was the case when deposit insurance was introduced after the GFC).*
6. *Credit ratings are not a good proxy for risk and should:*
    (a) *not be used to determine insurance premiums; and*
    (b) *no longer be required for deposit takers.*

Cap

The Mutuals believe that there are substantial benefits to implementing deposit insurance. We agree that it is time to bring New Zealand into line with international best practice. While the Mutuals appreciate that an in-principle decision has been made by Cabinet to limit the depositor insurance cap to $50,000, all but one of us believe that this is insufficient coverage and would like to take this opportunity to express our opposition to such a low cap. First Credit Union is comfortable with a $50,000 cap, although all Mutuals would like more information on the detail of the scheme, and particularly how its costs would be allocated, to develop a fully informed view on the appropriateness of the cap.

The Mutuals recognise that managing Crown liability and public balance sheet risk will be an important factor in setting the cap. However, most believe that a cap of $50,000 will not minimise Crown liability and public balance sheet risk – in fact, we suspect it will increase it. This is because it is inevitable that depositors will split their deposits amongst deposit takers in order to maximise the benefit they receive from the insurance. We believe that deposit splitting will have the following negative outcomes:

(a) We understand that no modelling has been done to assess the risk to the Crown if deposits are split as a result of a low cap. We therefore expect that any ex ante insurance funds built up at the point of a failure will be insufficient to cover the true costs of that failure, which increases the likelihood that a Government backstop will be required. We believe it is preferable for a realistic approach to be taken which accounts for the true cost of a failure.

(b) A cap which keeps [26] of the value of deposited funds exposed is not politically realistic during periods of financial system shock, especially if there are multiple failures. Many depositors with funds over $50,000 are retirees, who rely on the cashflow from their deposits for their livelihood. Accordingly, the Government is likely to need to increase the cap during counter-cycles to protect vulnerable communities, such as the elderly. This reality was observed in the UK during the run on Northern Rock in 2007, when the Government increased the deposit cap from GBP35,000 to GBP50,000 (and subsequently GBP85,000) because it recognised it was politically untenable to have a lower cap during an economic shock and such a low cap had been proven to fail to prevent a bank run. This also increases the risk of the need to use the Government backstop, or worse, the risk of needing to use public funds to bail out a systemically important bank. We understand that the Review Team intends for the deposit insurance regime to decrease the opaque perception that some deposit takers would be bailed out by the Government, while others would not (and the associated moral hazards). Accordingly, a cap which minimises the risk of needing to resort to a publicly funded bail-out is critical not only from a public balance sheet perspective but also to facilitate competitive neutrality (as the Consultation Paper admits, such an option would only be considered if it was necessary to maintain financial stability or critical financial services – that threshold will only ever be met if the deposit taker is a large bank, therefore giving a large bank the benefit of additional relief that would never be provided to a smaller deposit taker).

(c) One of the leading rationales supporting the introduction of a deposit insurance regime is to prevent a "run on funds" during a period of financial system shock. However, a cap which covers only [26] of the value of funds is very unlikely to prevent a run on funds if depositors consider there is a real risk of an entity failing. Accordingly, the low cap fails to address one of the primary benefits of deposit insurance.

(d) Indeed, a low cap is likely to create a run on funds as depositors seek to deposit split as soon as there is any hint of problems in the financial system. Such an event could create distress for a deposit taker that was otherwise sound and stable. The Mutuals are very concerned that this exact scenario will play out in respect of deposits held with them. Unlike banks that operate nationally (and are therefore likely to pick up depositors from other banks to compensate for any losses from their existing depositors and not suffer a change in their net position) and who also have access to wholesale funds to manage any loss of deposits, Mutuals require their depositors to be members and to have a "common bond" – often with a focus on a specific geographic location or occupation. Accordingly, Mutuals are extremely unlikely to pick up new depositors to compensate for lost deposits in the same way banks can, and have no access to wholesale funding to offset the run on funds. [25]

[25]

We set out below a table of the percentage of funds of certain Mutuals that are "at risk" of a flight of funds if a $50,000 limit is applied, compared to the funds at risk if the limit was $250,000.[12]

[25,26]

(e) [25] This reduction in lending would be detrimental for our customer base. We often provide personal loans at levels between $100 and $20,000 for basic lifestyle and day-to-day expenses to customers that banks have no interest in serving because of their limited economic value (for example, because they are unlikely to ever be in a position to purchase a house). These customers will be forced to turn to pay-day lenders or other fringe financiers and/or potentially endure significant hardship. In short, a $50,000 cap will disproportionately adversely affect our ability to service our customers, who often are vulnerable New Zealanders.

(f) A cap that is so out of step with the Australian cap of AUD250,000 creates a risk of a flight of funds to Australia. Many depositors with over $50,000 in funds are likely to have accounts in Australia or brokers that can help them to invest there – so transferring funds if there is a loss of confidence will be easy for them. Any cap that does not create rough parity between the Australian and New Zealand cap creates a risk for Mutuals as they probably have a disproportionately high number of retail customers with balances over that amount who may choose to split funding due to their status as retirees and the conservative fiscal positions that retirees tend to take.

We note that the cap is significantly lower than caps introduced in comparable jurisdictions. The IMF has noted that the rule of thumb commonly used in determining deposit insurance limits is two to three times per capita GDP.[13] This rule of thumb has been followed by our international counterparts as shown in the table below:

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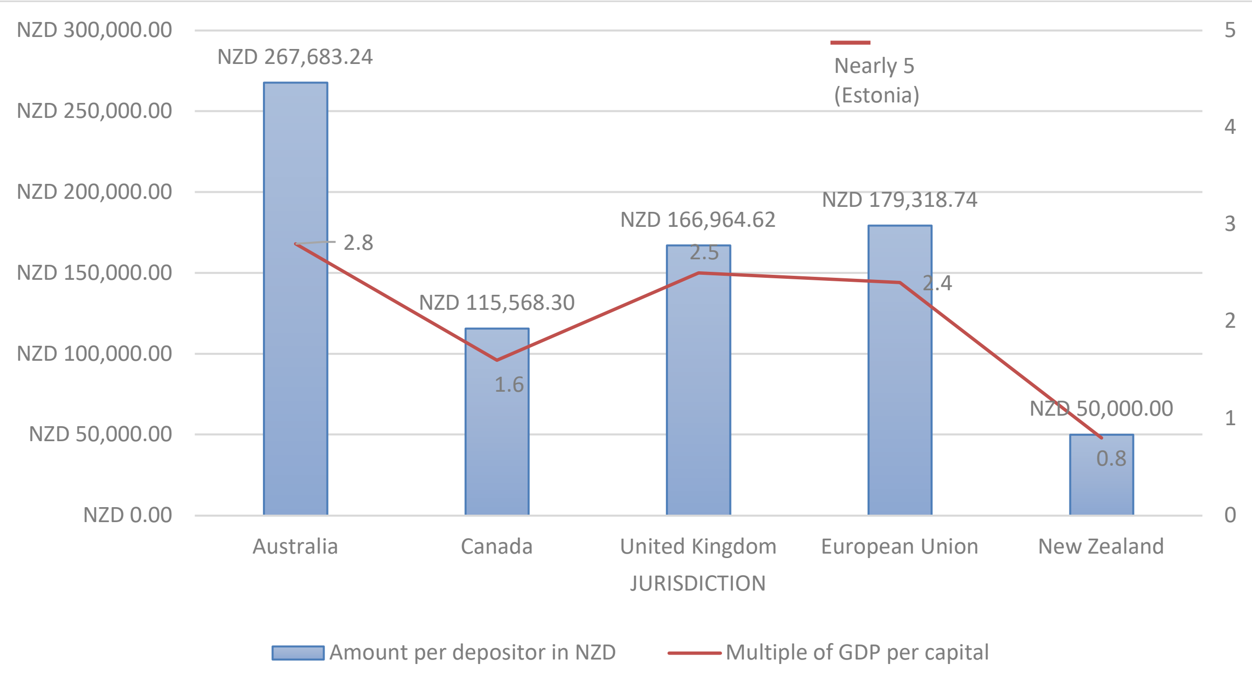
[12] This data was current as at March 2020.

[13] International Monetary Fund Monetary and Capital Markets Department *New Zealand Financial Sector Assessment Program, Financial System Stability Assessment* (International Monetary Fund, Country Report 17/110, 8 May 2017) at 37.

Jurisdiction	Amount per depositor	Multiple of GDP per capita
Australia	AUD250,000	2.8
Canada	CAD100,000 (per insured deposit category)[14]	1.6 (or 11.5 for all deposit categories)
United Kingdom	GBP85,000	2.5
European Union	EUR100,000	2.4 (Germany) Nearly 5 (Estonia)



* Each depositor is covered for up to CAD100,000 per insured deposit category up to a maximum of CAD700,000 at each institution.

Accordingly, New Zealand's approach is out of step with international best practice, notwithstanding the fact that the reason a depositor insurance regime is being introduced is to bring New Zealand into line with international best practice.

We therefore recommend in the strongest possible terms that the Review Team advise Cabinet to reconsider their in-principle decision and recommend that the depositor insurance cap be set to at least $150,000. $150,000 represents approximately 2.5x GDP per capita consistent with the IMF's recommendations. Ideally, the cap would achieve rough parity with the Australian limit and therefore be set at $250,000.

[14] Each depositor is covered for up to CAD100,000 per insured deposit category up to a maximum of CAD700,000 at each institution.

Depositor preference

At present, NBDTs are subject to requirements under the FMCA to provide that certain rights of debt security holders are held on trust. Under most of the Mutuals' trust deeds, depositors are already given priority in the event of liquidation by virtue of a change in the trust deed. We want to ensure that our depositors are not put in a worse position by a new regime. Regardless of the approach taken by the Review Team to depositor preference, we would like to work with them to ensure our depositors are no worse off. We are open to exploring various forms of protections for our depositors to achieve this, but strongly believe that the transition will require careful consideration.

Products

The Mutuals support the prescribed product approach for coverage set out in the Consultation Paper. We agree that deposit insurance should be targeted towards transactional and savings accounts, and not include higher risk investment products. In particular, the Mutuals agree that PIE deposits and retail bonds, debentures and capital notes are purchased by investors who likely understand the higher risk/return nature of those products, and agree that it is likely preferable to enable those investors to seek higher risk, higher return products and not have the margins of those products squeezed by regulation. The Mutuals similarly agree that foreign currency deposits, deposits held by related parties and interbank deposits should be excluded.

The Mutuals believe that wholesale deposits should be excluded from any deposit insurance regime for the following reasons:

(a) there is no consumer protection justification for wholesale investors, who are highly sophisticated entities who should be encouraged to continue to exercise market discipline over deposit takers;

(b) there is little to no financial stability justification for their inclusion because whatever cap is placed on the scheme will be an extremely small portion of the deposits held by wholesale depositors and as such will not mitigate the risk of "sudden stops" or "dry-ups"; and

(c) unlike retail deposits which, if frozen due to failure, would significantly impact the daily lives of the public, there is little to no risk that it would be politically unacceptable to allow a wholesale deposit taker to fail, even if their wholesale depositors were not protected.

Accordingly, there is no rationale for their inclusion and therefore no reason to impose higher levies on deposit takers in order to be in a position to cover their deposits.

Insurer

The Mutuals agree that it is appropriate for the RBNZ to take on the role of insurer – the RBNZ has prudential regulation and statutory management powers which means it will already be across the details of a failed deposit taker in respect of which it would subsequently provide insurance.

We also think the RBNZ will be the more cost effective insurer – both because it would reduce the need to duplicate reporting for deposit takers (as we assume any insurer will require information from deposit takers to assess risk), and also because, unlike any private insurer, the RBNZ will not seek profit for undertaking this role.

We think that the insurer should have the power to use the insurance funds as a resolution tool, especially if preventing a failure is achievable and more cost-effective than paying out depositors. We think that this is an important tool that should be at the insurer's disposal to minimise the risk of needing the Government to use public funds to bail out a large bank to maintain financial stability or critical financial infrastructure. Instead, any bail-out that is deemed necessary or appropriate would be funded using funds that the distressed entity has contributed to, and which would be used to repay their depositors in any case. Further, it could be used as a resolution tool for all deposit takers, unlike a publicly funded bail-out, which the Consultation Paper suggests could only realistically be used to bail out a large, domestically systemically important bank and gives those banks an opportunity to recapitalise while other prudentially regulated deposit takers could not. Finally, unlike a publicly funded bail-out, it would not necessarily need to be a last resort – instead, it could be used any time it is determined that preventing a failure is achievable and more cost-effective than paying out depositors. This supports our submission that the RBNZ would be the appropriate insurer because it is also the resolution authority.

We agree that any ability to use the insurance funds to recapitalise a distressed deposit taker requires appropriate safeguards and support embedding the International Association of Deposit Insurers' core principles in any power to use the insurance funds to recapitalise a distressed deposit taker. Further, any recapitalised deposit taker should be required to pay a premium on future levies to recover the costs of using the fund.

Mutuals have in the past operated a stabilisation fund and, in the event of a failing mutual, the funds could be used to facilitate a merger with another mutual and would be paid back over time. We believe that consideration should be given to creating different categories within the fund (a bit like the ACC model which has different funds for different sectors) for, say:

(a) DSIBs;

(b) standard deposit takers (smaller banks);

(c) mutuals; and

(d) finance companies.

Levies

The Mutuals have differing opinions on whether an ex ante or an ex post fund would be preferable, seeing value in both options. However, if the Review Team decides to proceed with an ex ante fund, we believe the Government backstop will be crucial in the coming years as an insurance fund is accumulated during a counter-cycle (where deposit takers are at greatest risk of failure) and especially given our strong belief that the deposit cap is too low and distorts the true cost of the regime.

Most of the Mutuals would prefer Treasury to set the levies for the deposit insurance scheme. We strongly believe that the insurer should charge higher levies to deposit takers of high "systemic risk" instead of focusing on high individual risk. This is because the size of a deposit taker can often be an unfair proxy for their "individual risk". As we have previously stated, it would be counter to principles of competition, inclusion, innovation and building of domestic capability to impose disproportionate costs on smaller deposit takers, especially given those deposit takers are prudentially regulated and therefore the

RBNZ should have sufficient confidence in their individual stability not to require them to pay a premium on their levies.

We recommend that the levies model follows a similar structure to the 2008 guarantee scheme – the same percentage fee for all deposit takers on the total of insured deposits and a premium for deposit takers with more than $5 billion of deposits to reflect their systemic risk (although reflecting on market changes since 2008, it may be better if this systemic risk fee is only paid by the DSIBs).

In the event that our strong insistence that the deposit cap be raised is not accepted, we think that there should be a legal obligation to review the insurance scheme at least every five years, ideally every three years, with an ability to call a special review if there is a financial system shock. This is because we believe that the cap and the fund size will need to be reviewed if it remains at $50,000 once the behaviour of deposit splitting has materialised to account for the increased fiscal risk and the political reality of such a low cap during periods of financial instability. In any event, we recommend that the cap be consistently reviewed to ensure that it remains in step with the IMF's recommendation of two to three times per capita GDP.

Ratings

Finally, we would be concerned if credit ratings were used as a proxy for individual risk. This is because larger, foreign-owned banks benefit from the implicit guarantee of their parent (and in some cases, their parent's Government) and our own Government (especially given the Consultation Paper effectively confirms that a government bail-out is an option, but only on the basis of necessity to maintain financial stability or critical financial services, a criteria which could only be met by larger banks) in receiving their credit rating.

On the other hand, many Mutuals, by their nature, have a specific focus in their region or are limited in size by a "common bond". Such focus on specific geographic locations or other common factors, such as the same occupation can have an unfair adverse impact on their credit ratings on the assumption of concentration risk, notwithstanding the underlying financial soundness of the deposit taker.

In our view ratings in a small country like New Zealand are simply not a valuable or helpful proxy for risk. It takes substantial changes to move credit ratings even slightly and there are numerous examples globally of where ratings have not reflected actual risk (and ended up being dramatically downgraded on default). We believe the mandatory requirement for deposit takers to have a credit rating should be removed in the Deposit Takers Act. It was, we understand, largely introduced as a substitute for onsite supervision and detailed reviews of data by RBNZ (to, ostensibly, mitigate moral hazard).