The Treasury

Reserve Bank Act Review Phase 2 Consultation 3 Submission Information Release

February 2021

This document has been proactively released by the Treasury on the Treasury website at

https://www.treasury.govt.nz/publications/information-release/reserve-bank-act-review-phase-2-consultation-3-submission-proactive-release

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[26] 9(2)(ba)(i) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [23] appearing where information has been withheld in a release document refers to section 9(2)(a).

Copyright and Licensing

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

TE TAI ŌHANGA
THE TREASURY

RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

SAFEGUARDING THE FUTURE OF OUR FINANCIAL SYSTEM

Further consultation on the prudential framework for deposit takers *and depositor protection*

Submission form

To have your say on these important issues, please answer the questions below and send this form by email to rbnzactreview@treasury.govt.nz by 5pm on 23 April 2020.

To get more information on these topics and the wider Reserve Bank Act Review, see the full consultation document at treasury.govt.nz/rbnz-act-review.

Chapter 2

Purposes of the Deposit Takers Act

2.A Do you agree with the proposed purposes? If not, what changes would you propose to the purposes? Are there any other purposes that we should be considering?

2.B Do you agree with the proposed decision-making principles? If not, what changes would you propose to the principles? Are there other principles that should be considered?

2A In my opinion, the purposes of the and objectives are appropriate and do not require modification. However, I would recommend that the Regulator to be required to encourage diversity of choice in terms of business model and operational activities, to ensure that the financial system is not adjusted for the convenience of the regulator, but that the regulator adjusts its approach for the system.

2B I agree with the overarching principles and the approach, but would like to make the following suggestions, observations, and recommendations.

- ***In respect of principle two – the requirement should be broadened to ensure that there is a level and fair playing field for all participants in the financial system regulated by the RBNZ, no matter their systemic importance, and that the consideration of impact and cost is solely considered against the regulated entity, and not used as an approach for the RBNZ not to completely, reasonably and effectively engage and provide resourcing for the supervision, oversight and consideration of the smaller end of the financial system sector.***
- ***In respect of principle five, broaden the requirement from a consideration to not only consider actions, and guidance of foreign regulators, but also include domestic regulators that have requirements to impose similar standards and requirements, such as the FMA, AML regulators, Commerce Commission, Privacy Commissioner, and the such like. Again, to ensure costs are minimised for regulated entities in a manner similar to those considered by the RBNZ for international regulators.***

Finally, in respect of the of the policy remit process of the Minister of Finance, although questions are not specifically requested of submitters in this area, this is a new area of focus that is giving political control of prudential regulation, something that has not existed in New Zealand for the last 30 years. I would submit that this political oversight should be removed, or at the very least this oversight should be subject to parliamentary discussion and treasury costing prior to being exercised to ensure that political oversight of prudential regulation is not abused in any manner

Chapter 3

Regulatory perimeter

Defining the overall regulatory perimeter

3.A Do you agree with the proposed approach to defining the overall regulatory perimeter? If not, what approach would you suggest?

3.B Do you support the proposed exclusion for wholesale-only funded lenders? If not, what approach would you suggest?

3.C Do you support a maximum size threshold for the wholesale exclusion? If so, what would be an appropriate measure of size?

3.D Do you agree with the proposed territorial scope of the legislation? If not, what approach would you suggest?

3.E Do you have any comments on the application of the Deposit Takers Act to associated persons?

3.F Do you agree with retaining the restriction on the use of the words 'bank', 'banker' and 'banking', but limiting it to persons providing 'financial services'? If not, what approach would you suggest?

3.G Do you agree that the use of the words 'deposit', 'deposit taker' and 'deposit-taking' should be restricted? What restrictions would you suggest?

3.H Do you support the proposed approach to foreign bank branches? If not, what approach would you suggest?

3A ***I submit that it would be inappropriate for credit unions and other smaller mutual non-bank deposit takers to be excluded from the regime and operate under a separate regime. This would not only defeat the purpose of the legislation, but would create a playing field that would give rise to inappropriate outcomes for all concerned.***

Failure of these smaller institutions can, in a manner similar to that which occurred in the GFC, lead to contagion at the smaller end of the regulated deposit taker market, which then would result in systemic responses having to be put in place where it normally would be inappropriate to do so.

Furthermore, these smaller participants have a significant number of individual depositors that need the same level of protection and prudential oversight as the larger banks, which may have fewer depositors and customers, but larger balance sheets.

In addition, smaller participants can be dealt with through alternative flexible regulatory responses in respect of the standards and rules and oversight intensity.

Finally, such treatment would be inconsistent with international practices.

However, the Reserve Bank should have principles imposed on it – as indicated earlier – that ensure that it does not impose a one size fits all solution on these smaller mutual players, but be required to adapt its approach to suit the market, not the market to suit its approach.

In addition, if the credit unions and mutual entities were to be removed from Reserve Bank oversight, then protections such as deposit insurance, depositor preference and the like

should be removed, and protections that were already in place such as limitation on lending and deposit taking to individuals, maximum deposit taking size, and very close and tight common bonds should be re-imposed.

3B ***I support the exclusion on the basis of international standards and norms, and also on the basis on allowing the NZ economy to grow; but only on the basis of a requirement for enhanced reporting for all participants; and that the exemption from the regime cuts off at a reasonable level. This is because such participants can be significant influencers in the financial system, both in the area of risk mitigation and pricing; and also, in driving competition at a reasonable price.***

3C ***I submit that there that there should be two thresholds - one for entities that are providing lending to non-wholesale customers; and one for entities who are providing lending to wholesale customers.***

Focus of the regulations in this proposal is not just on systemic stability but also trust and confidence in the system. Therefore, any proposals to oversee these institutions should not be solely driven by size – but also on the potential impact such institutions would have on trust and confidence.
I believe, that for non-wholesale lenders, the cut off should be either the one proposed in this discussion document around the financial reporting thresholds, given that detailed information is already expected from these entities at that level; or as a midway, the $1 billion threshold already in place for Open Banking Resolution, as the Reserve Bank already believes that entities of such a size are important to manage effectively.

Furthermore, I believe that the cut off of $15 billion is too high - especially if the wholesale sector grows rapidly, or there are multiple entities that are just below this threshold, or even significantly below it, but together are above it. However, if a higher threshold is to be adopted, and it is not the $1 billion already intimated, then a threshold of $5 billion should be used as a compromise – to ensure that focus on trust and confidence is maintained.

3D ***I support this proposal, but with the caveat that entities that offer such services outside of New Zealand should be forbidden from having offices or companies registered in New Zealand for the provision of such services to avoid NZ's good name being abused in a manner similar to that which has already occurred in relation to building societies, credit unions and entities registered on the financial service providers register – and the difficulties that have ensued in attempting to control these entities.***

3E ***I believe that the capture of associated person, as already envisaged by the Reserve Bank Act is a significant impost of regulatory power – and was appropriate where the concerns were systemic, and the controls and penalties criminal and extreme in their application. However, with the change in focus of regulatory powers, and the rights to the Reserve Bank to conduct onsite inspections, I submit that the expansion of associated person should be carefully reviewed to ensure that its use is appropriate and not be seen as a way to discourage investment and prevent growth. Higher thresholds for the use of the powers of the regulatory body against associated persons should be seriously considered, especially where such powers could result in the removal of property rights.***

3F ***I submit that the word bank and its derivatives should be limited to those deposit takers who are also providing access into the payment system. Most people refer to their bank as the institution with whom which they are able to make payments to other parties without cash. This also links back to the historical source of banking and banking activity.***

Credit unions, building societies and finance companies were originally put in place to provide solutions for access to credit and not to provide payment system solutions. However, if such entities now do provide NZD payment solutions, they should be permitted to use the word bank if they are licenced deposit taker, and can meet other requirements outlined later.

3G ***I submit that the use of the term deposit taker or licenced deposit taker should definitely be restricted. Entities that are subject to such licencing should be able to call themselves "XYZ Bank (Licenced Deposit Taker) or XYZ Building Society (Licenced Deposit Taker) or XYZ Credit Union (Licenced Deposit Taker) or XYZ Limited/Inc/Partnership (Licenced Deposit taker). The concern around the use of insured deposits and confusion around their use could be restricted through limiting access to the insured deposits regime as is discussed later in my submission.***

3H ***I have one substantive comment to make on the conditions to be imposed on the operation of branches of offshore banks in New Zealand. This is to recommend that the Reserve Bank providing clarity on some of the definitions it uses in its conditions of registration.***

Definitions such as the definition of retail – to ensure it is consistent with other legislation; and the definition of doing business in New Zealand.

Furthermore, branches should not be permitted to operate in New Zealand as a convenient location – rather these branches should be required to undertake business in New Zealand that supports the New Zealand economy and financial system – a core objective of the current proposed legislation.

A proposed definition of in New Zealand would be the location where cash flows are generated to support the debt being provided if lending; and the location where taxation is levied for interest paid on funding. The use the location of decision making is unhelpful given the movement of people and decisioning systems, and the application of delegations and governance policies.

Decisions of the courts around such matters have already been made, but are inconsistent and based on specific circumstances, and therefore direct regulatory guidance would be helpful.

Regulation of finance companies that do not take insured deposits

3.I Do you agree that prudential regulation should be retained for finance companies funded via retail debt securities?

3.J Would you support the approach of creating a restricted licence category for finance companies funded via retail debt securities (option 1)? What do you think would be the benefits and costs of this approach?

3.K Under option 1, what restrictions should be placed on the services that a licensed finance company could offer without becoming a full licensed deposit taker?

3.L Should licensed financial market supervisors undertake the frontline supervision of finance companies under this model? If not, what approach would you suggest?

3.M Alternatively, would you support requiring finance companies to have full deposit taking licences to issue retail debt securities (option 2)? What do you think the benefits and costs of this approach would be?

3I ***As a person who has had dealings with this part of the sector for at least a decade, and has seen first-hand some of the issues that separate prudential regimes have created, would strongly recommend that Prudential Regulation through the RBNZ be retained for finance companies funded via retail term debt securities (i.e. option two).***

This approach would ensure consistency of treatment, minimise the risk of regulatory arbitrage, and ensure simplicity of focus.

Furthermore, one of the objectives of the proposed regime is that it is to be long lived; and while NZ currently does not have many finance companies at present, this is no indication of what the need may be in the future – in fact it may be a function of the current regime which is recognised as being suboptimal in outcome.

In addition, the Reserve Bank's assumptions about the riskiness of finance companies is not always correct and finance companies are merely seeking to fill credit risk gaps in the market that other players do not see as appropriate. Banks can and do undertake all of the of the activities done by the finance companies.

Moreover, the failures around the finance company sector in the past were in my opinion more around the failure of a regime, rather than the fact that all finance companies are themselves an inherently risky proposal prone to failure – some are, and some are not.

3J ***I strongly oppose the adoption of option one for the same reasons as outlined earlier. The Reserve Bank will already have the power and is expected to right size the regime and its approach, as necessary.***

In response to the sub question, I believe that the costs of this approach are significant and have already been discussed and were one of the main drivers for a unified regime in the first place and in the second place, the small number of players would make this an extremely costly regime, and therefore restrict access to the market by newer players – again a criticism of the current regime.

3K ***I do not agree with this approach. However, if adopted, restrictions should be placed on the offering of debenture securities with maturities less than six months; depositor preference; access to the transaction system; and on the use of the terms licenced deposit taker and bank.***

3L ***I do not agree with the approach, but if it were adopted, I would strongly recommend that licenced financial market supervisors should not be the frontline supervisors of finance companies. In my experience both as regulator, banker, and consultant, I have found that, in my opinion, licenced market supervisors (especially those that are not part of governmental entities) are unable to focus their attention on what is best for depositors rather focusing on risk minimization for their shareholders and directors; leading to sub optimal prudential and regulatory outcomes. Having the Reserve Bank as supervisor would remove this fundamental flaw in regulation.***

3M ***I submit that finance companies be treated in no different a manner to any other company or entity providing lending or taking deposits from the public. While they are few in number at this stage - offering limited debenture securities; it is unreasonable not to expect the number to increase overtime and demand for more boutique credit and investment solutions grow in New Zealand; and therefore a single approach would be far more suitable for New Zealand in the future.***

I believe that the benefits of this approach are significant - in the long term allowing less legislative complexity; better prudential oversight and regulatory requirements; better risk management; and while moral hazard risks do exist around deposit insurance, these challenges are no means unique to finance companies but could be also applied to any of the financial institutions including banks.

Furthermore, concerns around public confusion around insured deposits could be minimised by tightening the definition and coverage of insured deposits to those that are only call deposits or from which access to the NZD payment system is achieved. This will be discussed more fully later in my submission.

Finally, I believe that concerns around resolution options is overstated and can be dealt with as proposed later in this submission – and in fact would be simpler and easier to operate.

Approach to small deposit takers

3.N Do you support the proposed approach to small deposit takers, under which the Reserve Bank would be expected to calibrate its regulatory approach in light of the proposed purposes, the decision-making principles, and the contents of the Remit? If not, what changes would you suggest?

3.O Alternatively, would you support creating a separate tier in legislation for small deposit takers? If so, how would you suggest drawing this distinction?

3.P Do you agree with retaining the restriction on the use of the words 'bank', 'banker' and 'banking', but limiting it to persons providing 'financial services'? If not, what approach would you suggest?

3.Q Should current NBDTs have the same supervision, governance and disclosure exemptions from the FMC Act as banks? If not, what approach would you suggest?

3.R Should current NBDTs be subject to a disclosure regime that is similar to that for banks? If not, what approach would you suggest?

3N ***I strongly support the proposed approach for small deposit takers as outlined.***
However, the regulator could consider increasing the exemption for credit ratings from the current low amount to a much higher amount, given the supervisory oversight of the Reserve Bank.
In addition, for the very small credit unions that wish to take advantage of a much simpler prudential framework, as can be adopted by the Reserve Bank; a condition of adoption of that simpler framework should be the re-imposition of the restrictions that the Credit Union Act initially had imposed on them via licence conditions, as the reason for their removal was given as the increased regulatory oversight of these entities. These restrictions relate to maximum lending and deposit size and term, limitation of interaction to individuals, a strong

common bond, and a recognition that the credit union deposit account is actually not a transaction account but a thirty day notice account.
It should not be expected that persons who do not have access to the normal banking system and have to access it through institutions such as credit unions do not need the same sort of prudential protections as people who can easily access the system.

3O ***I do not support this proposal and it would lead to suboptimal outcomes for New Zealand and those persons less able to access the banking system will be given less prudential protection as someone who has better access. If this were to be adopted, then restrictions on activity and purpose, which were put into place to protect less sophisticated participants in the financial system, should be reinstated, and in some instances tightened further.***

3P ***I submit that the use of the term bank should be restricted and that the criteria for that restriction should be based on meeting at least two of the following three criteria.***

- ***Firstly, the entity offers an account which allows its customers access to the NZD transactional payment system;***
- ***Secondly, the entity has an issuer credit rating from an approved ratings agency of at least BB+; and finally;***
- ***The tier one capital of such institutions should be greater than $30 million and have a tier one capital ratio of 15% (or such amount as set in prudential standards).***

This approach ensures that the term bank is retained for entities that access the payment system and are of sufficient size and scale to be reasonably stable and sound.

3Q and R – I support the approach that all licensed deposit takers have the same supervision governance and disclosure exemptions from the FMC Act as banks currently have and that they be subject to the same disclosure regime as banks, taking into account the principles of proportionality that need to be applied and the objective changes of Deposit Takers legislation.

Perimeter flexibility

3.S Do you support the proposed approach to perimeter monitoring? If not, what approach would you suggest?

3.T Do you support the proposed designation power? If not, what approach would you suggest?

3.U Do you support the proposed exemption power? If not, what changes or alternative approaches would you suggest?

3.V What should the criteria be for the Reserve Bank granting an exemption? What other limitations or safeguards should be placed on the power?

3S ***I support the approach which is around information gathering powers.***

3T ***I support the approach which is around using designation powers as secondary legislation and therefore subject to parliamentary oversight and review.***

3U ***I submit that if the Reserve Bank were given the power to provide exemptions, the safeguards proposed should be supported by an additional safeguard, which would require approvals of applications for exemptions to be publicly notified prior to execution; and that interested parties be able to provide feedback on such a proposals for consideration to ensure that the***

RBNZ is not creating a unlevel playing field. This is similar to any other legislative requirements and would be a reasonable safeguard given that exemptions could impact competition and operations of the financial system.

3V ***I submit that exemptions must not be given permanently, but be subject to a substantive and not a simple administrative review at least every five years – with other parties being given the opportunity to comment on such exemptions.***

Chapter 4

Standards and licensing

Scope of standards

4.A Do you agree that the proposed scope of standards is appropriate? If not, what changes would you suggest?

4A ***I support the proposals and scope. However, I believe that the standard setting powers of the Reserve Bank be specifically worded to require the Reserve Bank to construct its standards in such a manner to be corporate form agnostic in all matters.***

Macro-prudential policy

4.B Do you agree with the proposed power for the Reserve Bank to set lending standards (such as LVRs and DTIs) in relation to mortgages? If not, what changes to the scope or additional safeguards would you suggest?

4B ***I believe that the safeguards proposed are reasonable, however in respect of DTI's it could be argued that such a standard is fraught with difficulty in respect of definitional arrangements around debt and income; and that such decisions are core to differing risk appetites of institutions; and as such would remove a significant component of competition in the financial system and the benefits from such a removal would not outweigh its costs.***

Furthermore, the focus is purely on mortgage lending, and given the overarching purpose of the legislation, perhaps the focus should be broadened to encourage more credit differentiation based on income rather than security – the more traditional role of banks and a focus on business credit provision rather than personal. Therefore, macro prudential tools that impact business activities are more of a concern that those that are there to safeguard retail lending activities.

In addition, I submit that it would be valuable for the Reserve Bank to consider other agencies formally rather than the more informal manner as is proposed; and that the agencies include all of the arms of government that have a Minister assigned to them. The responses by the agencies and the issues raised by them should be disclosed and formally responded to when macroprudential powers are exercised by the Reserve Bank. This would ensure a formal and complete consideration of other matters and impacts that proposed interventions by the Reserve Bank may influence and therefore better decisioning being made.

Flexibility of standards

4.C Do you agree that the Reserve Bank should be able to issue differing standards for different entity classes? If not, what approach would you suggest?

4.D Do you agree that the Reserve Bank should be able to make standards that enable it to exercise supervisory discretion on matters and within ranges specified in the standards? If not, what approach would you suggest?

4.E What procedural requirements and protections should apply to the Reserve Bank's use of supervisory adjustment?

4.F Do you support the proposed approach to allowing the Reserve Bank to set reporting standards and lending standards in relation to categories of non-deposit-taking lenders that have been prescribed via regulations? Why or why not?

4C ***I submit that the process should ensure that the Reserve Bank focus on the materiality of issues that impact the deposit taker itself and not just on the systemic impact of the deposit taker or the class.***

This approach should be such that the Reserve Bank has to consider the impact on the entity and its operations rather than just risk to the financial system. It is important that the Reserve Bank change its focus from size matters and focus on only systemic issues to focusing on depositor and deposit taking issues; and to be able to understand that there are alternative business models and corporate forms that have equally valid reasons for existence and should not be precluded from operation because they have not been observed by the Reserve Bank in the past.

4D ***I agree with the proposal to allow the Reserve Bank to adjust standard metrics; but that these adjustments should be allowed to both relax or tighten standards based on the risk of the institution and its unique characteristics.***

4E ***I support the thresholds and standards for regulatory protection; and in addition, the would like to propose that the standard setting powers should be able to be challenged not just in terms of a judicial review of the process, but also in terms of the assumptions made around the risks and the efficacy of its responses before implementation.***

4F ***I support the proposal to impose the standards on non-deposit taker credit institutions. However given that the regulatory approach needs to be forward-looking and consider the possibility of the growth of material players in this area; and the fact that's such participants could have material impacts on the soundness of the financial system if they failed, I submit that the Reserve Bank should also have the power to require standards in respect of at least prudent risk management and especially around operational risks such as BCP and crisis management. Furthermore, it should also have the ability to intervene in these institutions in crisis – perhaps with ministerial oversight as a safeguard.***

Procedural requirements for standards

4.G Do you agree that the proposed procedural requirements for standards are appropriate? If not, why not? Should any other requirements be considered?

4G ***I support the proposal but wish to make the following submissions for consideration:***

- ***Firstly, the regulatory impact analysis should be required to be completed before consultation on the final regulatory standard that it refers to is being proposed. This is to ensure a full cost/benefit assessment is being considered at the final decision point.***
- ***Secondly the Reserve Bank should be required to consult with other agencies and to disclose those agency responses and how those responses have been incorporated into the standards***

– if at all. This is to ensure regulatory efficiency and reduce duplication or confusion where there is supervisory oversight across agencies

- *Thirdly, the Reserve Bank should be required to disclose what adjustments it has made to its standards in respect of home/host regulatory oversight and expectations. This is to ensure that its obligations in respect of maintaining and growing the New Zealand economy have not been compromised in any way whatsoever.*
- *Fourthly, the definition of material or minor should be clearly laid out and its use disclosed. This is to ensure certainty and reduce confusion.*

However, I strongly object to the proposal to limiting appeals on standards to judicial review only. While issues around courts having the capability to assess the standards are valid; I believe this risk is being overstated and the courts have a long history of utilising expert witnesses in assessing their decisions. Therefore, challenge should be allowed, but only to request the courts to refer the standard back to the Regulatory Review Committee and thereby through parliamentary oversight either disallowed or changed through mechanisms such as select committees.

Licensing

4.H Do you support the proposed licensing test for deposit takers? If not, what approach would you suggest?

4.I Are the proposed procedural requirements for licensing appropriate? If not, why not? Should any other requirements be considered?

4.J What scope of appeal rights should be provided for in relation to licensing decisions and why?

4.K Do you agree with the proposed approach to de-licensing? If not, what changes would you suggest?

4H ***I support this approach in general. However, I would submit that the Reserve Bank should be explicitly required to consider the overarching purpose of the act and it's enabling legislation when deciding whether an entity is able to be licenced, and that this should not act as a disincentive for licencing, and document its decision against that requirement.***

4I ***I support the approach in general, but would submit that the Reserve Bank be held to account in terms of time frames for addressing licencing applications, and applications should not be unnecessarily or unreasonably delayed – and never should be delayed due to resourcing issues at the Reserve Bank.***

In addition, in terms of other agencies to be consulted, I would submit that this consultation should be broader than just with the FMA; and should also take into account other agencies of government such as Treasury, the IRD, and the Department of internal affairs, as well as considering general government policy.

Furthermore, I submit that any licencing conditions imposed should be proportional to the risks that a deposit taker brings to the financial system and should not be driven by systemic stability concerns alone.

4J ***I submit that any applications for licencing, any conditions imposed, and fitness and proper assessments should be subject to review and challenge through the courts, and not just on process, but on substance as well.***

4K ***I support this approach, but would submit that the Reserve bank be also given the power to consider delicensing if the activities of the deposit taker will lead to material damage to the community in which its operates; failed to comply with the law generally in a material respect; or has brought the New Zealand financial system into disrepute.***

Transparency requirements

4.L Do you agree with the proposed use of the register to record and apply standards and other requirements on deposit takers? If not, what approach would you suggest?

4L ***I support this proposal enthusiastically, but would submit that it be taken further and that a single register or disclosure area maintained for all licencing, regulatory, prudential, conduct and AML conditions, standards or other matters which may have been imposed on the deposit taker or its associated persons by the various regulators and supervisors so that there is one place for interested parties to identify and understand all of the obligations that have been imposed on the entity, or its owners, directors, senior managers, or associated persons; and whether there are any other issues associated with supervision, regulation or licencing that may impact the entity, including issues of non-compliance or rectification plans.***

Chapter 5

Liability and accountability

Civil and criminal liability

5.A Do you agree with the general categorisation of the contraventions that should give rise to criminal and civil liability in the Deposit Takers Act?

5A ***Yes.***

Director accountability

5.B Do you agree with the specification of the new positive duties for directors of deposit takers? If not, why not?

5.C Do you agree that directors should not be indemnified or insured against loss in the performance of their duties?

5.D Do you see any specific issues with the relationship between the existing director duties in the Companies Act, and the new duties being proposed here?

5B ***I am generally supportive of the proposals but would like to make the following submissions in respect of director duties:***

- ***I submit that the powers of independent directors of deposit takers that are controlled from offshore should be significantly enhanced. This is especially important in respect of the actions of senior management and the oversight of the operations of the business by the directors, and also around the duties of the NZ manager of branches of offshore banks where these operate in conjunction with the subsidiary, using combined and integrated risk management processes. While there has been some focus on this issue with respect to systemically important institutions, this issue may also be a concern with smaller institutions who are controlled from offshore. I believe that this could be approached in a manner similar to the control portion of the UK regime.***
- ***I further submit that the director obligations should be expanded to ensure that directors deal not only with the Reserve Bank in an open and honest manner; but that this obligation be expanded to include all NZ regulators, supervisors and government agencies, including the IRD, WorkSafe and the like. Again, this would be similar to the UK regime.***
- ***Finally, I would submit that directors should be required to explicitly indicate how they are managing conflicts between what is required by the host regulator of the Bank, and the requirements of the home regulator – especially in respect of issues such as capital availability and the like.***

5C ***I support the proposals – but would like to submit that if directors agree to their indemnification, they should be required to indemnify senior management as well.***

5D ***I have no basis for raising issues in this area.***

Director penalties for disclosure breaches

5.E Do you agree that deemed liability should be retained for false and misleading disclosure? If not, what approach would you suggest?

5E ***I support this proposal, but would submit that this be limited to public disclosures and not private disclosure to the regulators, and that deemed liability in the case of private disclosure to the regulators been limited to the CEO and senior management. This would avoid directors being forced in some instances to become directly involved in the operations of the entity, and lead to suboptimal outcomes. It also allocates liability to those who most control the issues.***

Penalty levels

5.F Do you agree with the proposed approach to maximum civil penalties on bodies corporate, including the use of maximum penalties based on the size of the institution or any benefit gained (or loss avoided)? If so, what specific metrics or amounts should be considered for these penalties?

5.G Should a lower tier of civil penalties be established for some contraventions, for example, those that do not adversely affect the deposit taker's prudential standing?

5.H What maximum level of individual civil penalty should be provided for and why?

5.I Should criminal offences relating to the obstruction of routine supervisory powers be subject to monetary penalties, but not imprisonment terms for an individual? If so, what level of maximum penalty would be appropriate and why?

5.J What monetary and imprisonment penalties should be considered for more serious criminal offences and why?

5F ***While I support the proposals in general, there are a number of issues that need to considered by the regulator when seeking penalty thresholds. Civil penalties on body corporates often tend to punish the innocent (other creditors, shareholders of widely held institutions or in the case of mutual entities, the customers) rather than those that have specifically driven the behaviours - which are either the directors or senior management. It would be more preferable that if a body corporate is to be fined a penalty, that penalty should be assigned to the senior management and directors of that body corporate individually if the body corporate is a widely held institution, or a mutual entity. And if not widely held, the fine directly imposed on the shareholder.***

5G ***I agree with this approach – but submit that this should not just be for non-impact on prudential standing – any contravention that does not in and of itself result in harm to the financial system directly or indirectly.***

5H ***I have no comment on this on the maximum level, but would submit that***

- ***any funds received from civil penalties should not be made available to the regulator as operating funds as it could incentivise inappropriate behaviour by the regulator level; and***
- ***the regulator should be concerned that civil penalties at the extreme end could actually be punishing deposit takers and make such institutions more liable for failure. Civil penalties in respect of body corporates should be minimal to reduce this risk.***
- ***Civil penalties imposed on individuals should be higher than against the corporation as they are the mind of the corporation and should be linked to the short and long term benefits that could theoretically accrue to any individual or have been paid to that individual or group; and finally***
- ***Civil penalties should also consider payments over a period of time, restrictions on dividends and limitations on financial rewards to senior management.***

5I ***I support the proposals but would submit that***

- ***Criminal penalties for minor offences should be limited to pecuniary penalties for first or second offences but not beyond that; and***
- ***Criminal penalties should also include actions such as permanent banning or revocation of a fit and proper status for a period of time, or a requirement for retraining and education.***

5J ***While I agree with the approach generally, I believe and submit that criminal penalties for major offences should again be limited to individuals generally, unless the shareholders closely hold the institution. Pecuniary penalties should not place the financial institution at risk of failure.***

Finally, I would submit that agreement should be obtained from home regulators of offshore entities that operate in New Zealand, that the prudential home regulator will seek to enforce penalties imposed on management of the entity that controls the local institution rather than place the penalties on the institution itself, and also uphold fit and proper and other such bans of the host regulator.

Chapter 6

Supervision and enforcement powers

On-site powers

6.A Do you agree that the on-site power for the AML/CFT regime is an appropriate comparator for a similar power for the Reserve Bank's prudential functions?

6.B Should this power be a generic power in the new Institutional Act, or specified in the Deposit Takers Act?

6.C Do you think any additional safeguards are necessary for the on-site power?

6.D Do you think the FMA's on-site inspection power should be expanded in the same way that is proposed for the Reserve Bank?

6.E Should an expanded FMA on-site inspection power apply in all circumstances and to all FMA-regulated entities or only some (e.g. in high-risk circumstances or for dual prudential-conduct regulated entities)?

I submit that the onsite inspection powers should be carefully considered before implementation and that substantial protections be provided before implementation as they infringe directly on personal and institutional freedom from state surveillance.

6A ***I strongly disagree with the proposal the use of the AML legislation as a direct comparator for onsite inspections given my own and my client experiences with AML on-site inspections. The process is intimidating for junior individuals that participate in such meetings – and in smaller institutions this is more likely than in larger ones. In some instances, the behaviour and stance of the inspectors could be construed as bullying behaviour. Reminders to people that they don't have to be present; they don't have to incriminate themselves; and that they are entitled to have a lawyer present is a very adversarial approach. Furthermore, such an environment could be construed as being contrary to the requirements of the Health and Safety legislation and therefore requiring staff to be present at such meetings could create issues for directors and management. I submit that there is a less adversarial third way. This recognises the fact that in most situations, on-site inspections would merely be business as usual activities, and would be information gathering exercises rather than exercises seeking information around enforcement. I would recommend that the Reserve Bank have two on-site inspection powers – the first being used in normal situations where the regulator is invited on to the premises and information is provided and questions answered, but the institution has the right not to provide information or answer questions – such as a normal audit type engagement. While such information can be used for enforcement action, the way it is obtained is through willing agreement rather than through coercion. This onsite review process should be a risk based approach driven by the underlying assumption that unless there is evidence to the contrary, compliance is been undertaken. These reviews should be scheduled and be given with notice to allow information to be gathered. The review should be seen as an audit function, rather than as an evidence gathering exercise for enforcement action.***

However, if the Reserve Bank has reason to believe that there may be non-compliance, or there is activity being undertaken which may give rise to prudential concerns, it should then be able to invoke its enforcement information inspection powers. These powers could be modelled on the AML onsite powers and as the purpose of the onsite is essential to obtain information to support an enforcement action, the approach is appropriate.

Furthermore, I would strongly recommend that such an approach be undertaken for AML inspections as well, or that the AML inspections be clearly noted that they are for use when the regulator believes that there is non-compliance and is seeking information to support an enforcement action.

6B ***I believe that this power should be in the institutional act and not in the deposit takers act as information gathering for enforcement action is broader than just for deposit takers. Furthermore, if the suggestion above is adopted; there is again stronger argument for the enforcement information gathering powers should be in the main act, and the audit type powers in the deposit takers act. Alternatively, if the audit type powers are seen to be a first line of review for multiple regulatory actions – for example for AML as well as deposit taking and the like, perhaps both should be in the institutional act.***

6C ***I am of the belief that especially when the smaller institutions are being reviewed and more junior staff are involved, protection should be provided to ensure that bullying behaviour by Reserve Bank staff is minimised in order to ensure a safe working environment for all staff. Furthermore, when the enforcement information gathering powers are being used, the Reserve Bank should be required to indemnify any deposit taker against actions arising from the Health and Safety legislation caused by or involving any Reserve Bank staff and their contractors while on site.***

Furthermore, I am concerned around the privacy of client and staff information obtained by inspections being used for purposes other than for which it was obtained. This is contrary to the privacy principles and if the Reserve Bank or any other regulator wishes to undertake this, it should apply for an exemption from the Privacy Act or ensure that information shared is anonymised and provide assurance of that anonymisation. Obviously, if the Reserve Bank believes a crime has been committed, then it is entitled to act in accordance with the principles

6D-E ***As indicated above, I have serious concerns and reservations about the on-site inspection powers as proposed and therefore would not be supportive of these being extended to the FMA unless similar protections were offered as proposed above. However, if the powers are to be extended to the FMA then they should be applied to all entities who are regulated by the FMA.***

Other supervisory powers

6.F Do you have any comment on the appropriate legislative location of supervisory powers such as information gathering and sharing, on-site inspections, and other related powers? Do you see merit in consolidating similar powers from sectoral Acts into the Institutional Act?

6F ***I support the proposal in respect to locate all supervisory powers in a single place and further submit that that these powers should be consolidated from other sectorial acts as well. In addition, given that the Reserve Bank is also the AML regulator, perhaps the inspection powers under that regime should also be consolidated in the institutional act as indicated earlier as well.***

Breach reporting

6.G Should a breach-reporting requirement be directly provided for in legislation? Should this be provided for in the Deposit Takers Act, or located in the Institutional Act as a requirement for all entities regulated by the Reserve Bank?

6G ***I believe that breach reporting requirements should be directly incorporated in legislation, again to ensure certainty. However, in addition, I submit that a requirement to self-report a breach is a***

draconian obligation if the self-reporting results in criminal or civil prosecution. No law should require anyone to incriminate themselves, rather, the legislation that requires self-reporting should provide indemnity from prosecution if the breach being reported is rectified within an agreed period; and that the breach that is being reported was not the result of deliberate actions by the deposit taker or its staff.

Enforcement powers

6.H Do you agree that the Deposit Takers Act should provide for the Reserve Bank to accept a voluntary undertaking from a deposit taker that is enforceable in court?

6.I Should the Deposit Takers Act provide a statutory basis for the Reserve Bank to issue a formal notice to a deposit taker?

6.J Do you see any role for infringement notices in the Deposit Takers Act?

6.K Do you see a useful role for remedial notices and/or action plans in the Deposit Takers Act?

6H ***I believe that a voluntary undertaking is a very useful tool to have and it allows a deposit taker to focus on the necessary requirements to achieve compliance and give certainty to that deposit taker that it if it has done at the things it said it was going to do no further actions will be taken.***

6I ***I would strongly submit that the formal notices be provided in the act to provide standardisation of approach and certainty of outcome.***

6J ***I agree that infringement notices are also useful tool and can be seen as an early indicator are problems within deposit takers and as such should be used within the deposit takers act in a manner being proposed. This will allow certainty without the cost of court action and will encourage the Reserve Bank to focus it's more extreme actions on those covered by the courts.***

6K ***I note that that remedial notices and action plans are an especially useful tool providing certainty to boards and depositors and ensuring that if the actions taken are in accordance with the plan acceptable compliance will be achieved, especially where remediation may take a number of years or require a significant investment of time and money. I would strongly support these tools being included in the arsenal of the Reserve Bank.***

Chapter 7

Resolution and crisis management

Conditions for placing a deposit taker into resolution

7.A What are your views on the proposed triggers for placing a deposit taker into resolution and exercising resolution powers?

7A ***I note that the powers that are proposed for the Reserve Bank are draconian but not unusual, but would submit that the necessity condition needs some modification.***

I submit that where the Reserve Bank has come to a decision about the inability of other solutions to solve the issue at hand; it should be required to publicly declare why it has rejected those options – and especially those options that may have preserved existing shareholder and depositor rights. Furthermore, in rejecting other options the Reserve Bank should have clear criteria for reasons for rejecting such options - for example lack of committed funding, extended timeframes, or other commitments.

Liabilities that would be subject to statutory bail-in

7.B What should be the scope of statutory bail-in in New Zealand? What liabilities should be expressly included or expressly excluded? How should deposits be treated?

7.C Should statutory bail-in have retrospective application?

7B ***I submit that the relative merits of the broader scope of liabilities as per the UK approach is more preferable to the narrow scope of the Canadian approach. The broader approach is more appropriate in that all liabilities of a firm apart from those on the negative list are available for utilisation – and is therefore consistent with preserving creditor obligations and rights. The narrow approach would also mean that in most instances smaller institutions would not have access to bail in solutions as they would be unlikely to have any significant liabilities that would meet the definition. This weakness is explicitly recognised in the Canadian approach which is only available for large banks.***

In respect of sub-question one, I strongly support the negative list approach and support the exclusion of insured deposits; secured liabilities where they are in a separate vehicle such as covered bonds; liabilities arising from holding client assets; short term interbank liabilities; liabilities arising from participation in the payment system; liabilities owed to employees and pension schemes and KiwiSaver; liabilities arising and relating to the provision of critical services in a manner similar to what is required for OBR; and finally derivatives but only to the extent that these are used to hedge interest rates and FX risk arising from the banking book. Derivatives in the trading book should be removed from this exclusion.

In respect of a sub question 2, deposits that are not insured deposits, but which are held by retail creditors who are natural persons should be given priority over deposits held by retail deposit creditors who are not natural persons and wholesale deposit creditors. However, these deposits should still be subject to statutory bail in provisions, but in accordance with their priority. I submit that the bail in priority should be as follows (lowest to highest):

- ***ordinary shareholders;***
- ***preference shareholders;***
- ***debt that is convertible to equity under capital rules;***
- ***debt that is funded by wholesale counterparties;***

- ***trade creditors and creditors with general priority on cashflows rather than on assets, or on all the assets of the firm.***
- ***debt funded by non-natural person retail counterparties;***
- ***debt funded by retail counterparties who are natural persons***
- ***creditors with priority on specific assets of the firm;***
- ***Preferential creditors of the firm, including staff, but excluding senior management and directors.***

7C ***I submit that the case for inclusion of all creditors is strong and given that there is a reasonably long time frame for the implementation of this regime and the short term nature of most credit arrangement, creditors who are captured will be able to price in any risk appropriately prior to the introduction of the regime.***

The statutory management advisory committee

7.D Is there still a role for a ministerially-appointed advisory committee to a statutory manager? If so, should legislation be more specific about the purpose and the composition of that committee?

7D ***I submit that, given the amount of power that a statutory manager would have, including the power for liabilities undertaken by the manager to be guaranteed by the Crown; and given that the Reserve Bank is proposing to reserve some of those powers for itself and act as statutory manager in some instances, there should be some checks and balances on the exercise of these powers. A committee would be a useful tool in this regard.***

In respect of the second part of the question, I submit that legislation provide guidance about the purpose of the committee – ensuring that that actions taken by the Reserve Bank are independently assessed to warrant that they are consistent with the objectives of the act and the overarching act. When the committee is being used to advise the statutory manager of a larger bank – this purpose could be expanded to ensure that value is not destroyed due to lack of understanding of the operations of these banks. In this instance, the committee would be expected to advise the statutory manager as if it were a company advisory board similar to that envisaged by the Institute of Directors.

I submit that the composition of the committee should include a senior member of the legal profession with background in banking and insolvency management , an experienced banker, a senior advisor from the FMA, and if the entity is impacted by home/host regulations there is a case for a senior advisor from the home regulator being invited to participate or observe. Furthermore, depending on the institution, but definitely in the case of systemically important banks, consideration should also be given for a consumer representative and an IWI representative to be on the committee.

Resolving credit unions and building societies

7.E Should the Reserve Bank have the power to demutualise a building society or credit union that meets the criteria for being placed into resolution?

7E ***I strongly oppose this recommendation. The proposal displays a singular lack of understanding of the role of co-operatives and mutuals in the financial system globally – and especially in Europe and North America.***

I note that the paper indicates that the purpose of the regime is to be agnostic as to corporate form and to ensure that multiple choices are available to the New Zealand public in respect of how deposit taking can be undertaken.

The paper fails to recognise that there are numerous regulatory environments that operate with mutual institutions ranging from large credit unions in Europe and North America as well as building societies and credit unions in Australia.

Resolution by demutualization is not the only option available to regulators. In respect of building societies most of its deposits are held in the form of preference shares which while having one person, one vote are able to be haircut to provide additional capital; while still preserving one person; one vote rules. The same can be said for the deposits held by credit unions; which are again instruments of ownership, conferring the rights of one person; one vote and again being able to be haircut.

Furthermore, the Reserve Bank already supervises three institutions that are regulated banks which are mutual or cooperative entities or owned by such and it did not seem necessary for it to change the legislation when these were registered.

I believe that the key issue is that the Reserve Bank appears to be concerned that the mutual entities do not have parents with deep pockets to allow recapitalisation. There is no reason forced demutualization should be the default solution in statutory management. It should be noted that home regulators are now commencing to limit to ability of parent institutions to recapitalise host banks – so this issue is broader than the mutual.

I submit that the Reserve Bank should be required to investigate other arrangements that that do not default immediately to equity funded entities. Given that there are now multiple forms of legal ownership including limited liability partnerships; incorporated societies, partnerships, and other legal forms.

I note that that an aspiration of this legislation is to be intergenerational in focus. If this is so, and the requirement of the legislation is to support growth in New Zealand, the Reserve Bank needs to be required to broaden it's thinking about how crisis management can be actioned outside of its historic bias towards companies owned by large offshore Banks.

The application to deposit takers of CIMA statutory management

7.F Do you agree that deposit takers should only be subject to one statutory management and resolution regime?

7.G Do you favour option 1, option 2, or some other approach (including the status quo)?

7F ***I support the proposal to have one statutory management and resolution regime to ensure simplicity of operation and ease of understanding.***

7G ***I submit that option two is preferable as there is a role for the FMA in the statutory management process; especially in respect of conduct and culture and in the fair and reasonable operation of financial markets.***

Chapter 8

Depositor protection

Depositor preference

8.A What are your views on the benefits and costs of a preference for insured depositors compared to no preference?

8.B If a preference for depositors is introduced, do you agree it should only cover insured deposits (not all deposits)?

8A ***I am strongly supportive of the introduction of depositor preference. I note that there is an argument by the larger banks that depositor preference would negatively impact the cost of wholesale funds for smaller deposit takers. This argument is a red herring given that most smaller deposit takers are almost 100% retail funded and the existence of the preference in Australia has not stopped smaller participants from growing. This argument is more about the costs of wholesale funding going up for the larger banks, rather than protecting the interests of the smaller banks.***

Furthermore, market discipline will definitely be enhanced through depositor preference and given that depositor preference already exists in Australia it would level the playing field between the two countries especially during a systemic crisis.

8B ***I do not agree with the proposal that deposit preference should only cover insured deposits. I believe that that depositor preference should be given to all retail deposits issued by licenced deposit takers, if natural persons hold those retail deposits.***

This approach allows the Deposit Insurance scheme to be closely focused on giving retail depositors access to transactional funds or transactional accounts and supporting the operation of the payment system and NZ economy, rather than purely focussing on deposit protection for wealth retention. Further commentary will be made on this later, and will allow those persons with overdraft facilities continued access to the system as well. I believe that this will reduce the overall cost of the Deposit Insurance scheme.

Scope of coverage

8.C Do you agree with the proposed prescribed product approach for coverage under the new scheme? If not, what approach would you suggest?

8.D Do you agree that both retail and wholesale investors in insured deposit products should be covered up to the $50,000 coverage limit? If not, what approach would you suggest?

8.E Is the list of excluded deposit products appropriate? If not, what approach would you suggest?

8C ***I strongly oppose the prescribed approach given that it artificially excludes products merely because they are issued by non-banks - such as debentures securities which are merely term deposits.***

I am strongly of the view that insured deposit coverage should focus on those products that are used to directly interact with the New Zealand dollar payment system. This would therefore

exclude any term deposit or debenture, PIE deposits and savings or call accounts that do not allow direct payments to be made to third parties.

This approach, when linked to retail depositor profiles would ensure that support would be provided for holders of products where information gaps around risk due to information asymmetry is reasonably high everyday spending is supported; financial stability maintained by ensuring payments can be made; and finally would be easy to identify and measure as the account would be on call and linked to a payment process to a third party in NZ.

In order to ensure claims are still protected, retail investments that require notice or cannot be used to pay third parties would not be covered by the insurance scheme but would be subject to preference if held by individuals. These would also be subject to bail in.

8D ***I am of the view that wholesale investors should not be covered by the Deposit Insurance scheme in any way whatsoever. Furthermore, the argument that the split on wholesale and retail is complex and cannot be easily understood is spurious as the entire financial advice regime of New Zealand is based on the identification and division between wholesale and retail. The FMC Act definition should be used.***

Furthermore, information asymmetries in respect of wholesale depositors will be minimal; and the existence of the enhanced capital regime; OBR arrangements and other schemes to get access to funds easily to preserve financial stability on failure have been the focus of the Reserve Bank over the last 20 years, and the existence of a deposit insurance scheme should not derail the efforts to impose good discipline that has been the focus in respect of this area.

In addition, including wholesale depositors in the scheme will reduce funds available for bail in and increase costs substantially for little benefit. Furthermore, as the OBR or any other statutory management scheme will require government guarantees in any event, reducing the claim on the insurance fund, and increasing the bail in amount available is beneficial to the failure model as well.

Finally, I believe that the scheme should only be available to retail depositors who are natural persons and on accounts that have direct links to payment infrastructure in New Zealand. This ensures that the most vulnerable is protected and that exchange in the NZ economy can continue.

8E ***I note that if the definition is changed as proposed above, then the first and third exclusions are unnecessary and the second would be immaterial if only available to individuals. Therefore, no exemptions would be required, indicating that the enhanced definition is more appropriate***

Mandate, powers and additional objectives

8.F Do you agree with the proposed narrow mandate for the deposit insurer?

8.G Do you agree that the deposit insurer should be able to provide funding for resolutions other than a liquidation?

8.H If yes, do you agree with the limit on the amount of funds that can be used? What are your views on the appropriate safeguards?

8.I What are your views on the appropriate decision authority for the coverage limit?

8.J If a deposit insurance fund is established, should changes to the target size and the levies be made by ministers via regulations or by the deposit insurer itself?

8.K Should there be a legislated requirement to review the deposit insurance scheme? If so, how often should it be reviewed (e.g., every five years)?

8F ***I support the narrow approach. Given the proliferation of regulators that are already in place in New Zealand a further Deposit Insurance regulator with broad powers would be of concern even if it were at the Reserve Bank.***

8G ***I support the proposal and would suggest that the deposit insurance scheme's first obligation would be to support the restructure of an entity to minimise disruption to the depositors and the payments system. In addition, I believe that the focus should not merely be on systemic importance, but also on disruption to both the system and the number of depositors or transaction providers in respect of payments.***

8H ***I support the proposal and the limits that are being proposed in the discussion paper and that together with the proposed objective these would be a strong protection of the scheme. However, I would submit that an additional rider could be put in place to indicate that the scheme is also in place to minimise disruption to the payment system.***

8I ***I submit that the decision authority for the coverage limit should be set in legislation and therefore subject to parliamentary oversight for changes. However, in order to take into account inflation, perhaps the legislation should automatically adjust the level every five years based on CPI inflation levels.***

8J ***I submit that if an ex ante insurance fund is established, the deposit insurer should set the target size and levies itself. However, strict guidelines in respect of how it is set; requiring it to consider the prudential regulations; and to ensure that there is sufficient choice of deposit taker in the financial system should be included. Furthermore, these target sizes and levies should be executed as regulations and therefore subject to review by the regulatory oversight committee and therefore disallowance.***

I submit that in no instance should the levies and fund size be set by the minister as this would be valuable ground for political lobbying and intervention.

8K ***I submit that the Deposit Insurance scheme should be subject to review at the same time and concurrent with any reviews of the prudential regulation. The automatic review should however preclude the removal of the scheme in its scope. Normal political processes should drive the removal of the scheme if the political wish to do so is there.***

Institutional arrangements

8.L Has the Review identified the appropriate criteria for assessing the best organisational form of the insurer?

8.M Do you agree that the insurer should be located within the Reserve Bank? If not, what approach would you suggest?

8L ***I submit that the criteria used to assess the organisation form has omitted one significant criterion – the conflict between objectives of the deposit insurer and prudential regulator, and how this is to be managed.***

8M ***I also note that while there is a strong case for the insurer being located within the Reserve Bank , the role of the deposit insurer is to fund failures of the prudential regime and therefore if based at the Reserve Bank and under its control, it could be inappropriately used by the Reserve Bank.***

I believe that the deposit insurer should be located in Treasury and that issues around information sharing and the like are simple issues to be dealt to; or if they are more significant, at the very least Treasury controls the decisions of the deposit insurer at the Reserve Bank.

Funding framework

8.N Do you agree that the insurer should build a deposit insurance fund ahead of a failure? If not, what approach would you suggest?

8.O What are your views on the appropriate size of any deposit insurance fund?

8.P Should the insurer charge higher levies to higher risk deposit takers? What are your views on how risk should be assessed?

8.Q What are your views on how the Government funding backstop should be designed?

8N ***I submit that a prefunded scheme is preferable to an ex post funded scheme, but that the prefunded part of the scheme should only be based on idiosyncratic failures rather than a systemic failure. This is because the deposit takers can manage idiosyncratic failure but not systemic, and that is the responsibility of the Reserve Bank and government.***

8O ***I propose that that the size of the fund be based on greater of insured deposits held for payment (being those linked true transaction accounts that enable payments and which are held by retail individuals); secondly that the fund be sized at a level that could support the pay-out of a large idiosyncratic failure. Furthermore, when considering the size of the failure, especially where there are systemic issues, consideration of the fund size should take into account the ability of the Reserve Bank to act as lender of last resort; and the Crown to guarantee wholesale liabilities to reduce probability of failures in a systemic failure scenario.***

8P ***I note that while there is a strong argument for levies to be based on risk, the Reserve Bank needs to consider what the drivers of risk of pay-out in the fund are.***

In addition, the Reserve Bank must consider its other obligations in this area in respect of promoting choice and competition. Furthermore, risk comprises both the probability of failure and impact of failure or probability of default and loss given default. Smaller higher risk entities may

have a higher probability of default, but loss given default (to the fund) is much lower than that larger systemic entities.

Furthermore the idiosyncratic risks of smaller players if they fail will in most instances not give rise to systemic risks and failures, that the failure of a systemically important institution would have, which if these are to be priced in would be significantly higher than the risk posed by idiosyncratic failure (and is not reflected in the credit rating provided on these institutions).

Therefore, I note that if the fund is purely based on idiosyncratic failures, firstly its size would be much smaller, and secondly the size of the levies much smaller as well, as the loss of one may not give rise to the loss of another. However, if the contagion effect of a large deposit taker failure is measured, and the systemic issues that arise from such a failure considered; while probability of failure may be lower than for smaller players - impact is significantly greater. Furthermore, if the scheme focuses on transactional capability, then the costs of the scheme would be less as well.

I therefore submit that the scheme levy for both ex ante and ex post levies be based on the size of the insured deposits only and the rate of the levy be consistent across all deposit takers.

8Q *I believe that the size of the government backstop and how it should be charged for is causally linked to decisions being made around the size of the upfront levy and the expected size of the fund. The insurance fund should only be required to pay a facility fee to the government for the shortfall between the current fund and the target fund (which should be based on idiosyncratic failure). Any additional contingent liability is a risk on the Crown for having the scheme in place. This will allow creative tension between the insurer and insured who have to pay an upfront levy, the Crown, who has to fund any shortfall and the participants in the scheme after failure.*

Furthermore, I also submit that if the scheme has been invoked due to systemic failures rather than an idiosyncratic failure it would be unreasonable for the Crown to expect the survivors to pay for the cost of the bailout given that the purpose of the Reserve Bank Act was to avoid systemic issues . Furthermore, after a systemic failure such as the GFC, having a drag on the financial system for rebuilding the fund would be an unnecessary drain on participants of the system. However, if there is a shortfall in the case of an idiosyncratic failure then the proposal to charge survivors has merit.

Any other comments?

Deposit insurance should focus on maintaining the ability of retail depositors to interact with the payments system and insured deposits limited to those products that provide such support. Depositor preference for all other retail deposits is an ideal solution to ensure appropriate focus on resolution outcomes that support both the crown and the financial system at minimal cost.

In addition, separate regimes for finance companies, credit unions and the like would be a huge step backwards and would not be appropriate given the proposed objectives of the legislation.

Furthermore, the Reserve Bank should be required to be corporate form agnostic in its approach to prudential supervision. The historical approach of the bank has been extremely damaging to alternative forms of corporate construction and has led to sub optimal outcomes for New Zealand.

Finally, its focus on systemic issues alone and its view that all lending apart from retail housing lending is extremely risky has been unhelpful and given its presupposition that small equals risky, competition has been stifled, choice removed, and asset bubbles created.

The Reserve Bank should have added as a core objective not only consumer price stability and employment, but asset price stability as well, as it has pursued consumer price stability through the creation of an asset price bubble in housing which has impinged on it actions as prudential regulator.

SAFEGUARDING THE FUTURE OF OUR FINANCIAL SYSTEM

Details of submitter

For individuals

Name:	[35]
Contact number:	[23]
Contact email:	[23]
Region/country:	Wellington

For organisations

Name of organisation:	
Contact person*:*	
Contact person's position in organisation:	
Contact number:	
Contact email:	
Region/country:	

Confidentiality request

If you want all or part of your submission to be kept confidential and not uploaded onto the Treasury's website, please mark the applicable box below:

Entire submission confidential	☐
Part of submission confidential[1]	☐
Name only confidential	☒

[1] The text that you do not want published must be clearly marked in the submission