The Treasury

Reserve Bank Act Review Phase 2 Consultation 3 Submission Information Release

February 2021

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INTRODUCTION

1. This submission is made on behalf of the following New Zealand-owned finance companies ("**RBNZ Regulated Fincos**", "**we**", "**us**", each of which are currently regulated under the Non-bank Deposit Takers Act 2013 ("**NBDT Act**"):[1]

   (a) Mutual Credit Finance Limited;

   (b) Gold Band Finance Limited;

   (c) General Finance Limited;

   (d) Finance Direct Limited; and

   (e) Asset Finance Limited.

2. The RBNZ Regulated Fincos applaud the efforts of the RBNZ Act Review Team ("**Review Team**") to date – and, in particular, the efforts they have made to engage with them and understand their issues. This submission, in particular, follows on from a meeting with the Review Team of 9 September expanding on, and adding to, points made in those discussions.

3. This submission highlights the key issues for the RBNZ Regulated Fincos 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.

[1] Christian Savings Limited regards itself as more akin to a mutual and is making submissions, we understand, separately (Liberty Finance is owned by an Australian parent company and is not party to these submissions).

KEY MESSAGES

Objectives of the Review

We understand that the impetus for this review of the Reserve Bank of New Zealand Act 1989 ("**RBNZ Act**") is to modernise the Reserve Bank of New Zealand ("**RBNZ**"). We accept this is likely to result in the RBNZ becoming a more "orthodox regulator" whose regulatory activities align more closely with international best practice.

However, the review is also part of government initiatives to "grow and share New Zealand's prosperity more fairly" and to develop a more inclusive economy. That must include supporting the responsible New Zealand-owned finance sector.

Purposes of Deposit Takers Act

We broadly agree with the proposed purposes but stress that:

(a) the benefits of prudential regulation should outweigh the costs for smaller deposit takers;

(b) in order to recognise licensed deposit takers as distinct from the rest of the finance market, RBNZ Regulated Fincos should be permitted to us the term "bank", deposit insurance and access to central bank liquidity;

(c) it would be wrong for the Deposit Takers Act to require a "de-risking" of finance companies to comply with prudential standards as these risks are already dealt with through:

i. capital adequacy rules based on risk adjusted assets; and

ii. fit and proper rules for directors;

(d) retail funded lenders have a key place in the financial system because their funding is inherently less volatile than wholesale funding; and

(e) licensed deposit takers provide retail investors with a credible, prudentially regulated investment option in order to enhance their household income.

Regulatory perimeter

We agree with the Review Team's proposed regulatory perimeter articulated in figure 3.1. Finance companies that raise money from the public should be covered by the proposed Deposit Takers Act.

We agree with the creation of a category of "**Small Deposit Takers**" that hold assets of less than $1 billion (with more light handed regulation) but believe this can be further segregated to a mandatory "**Restricted Deposit Takers**" category for new entrants, to give new entrants an opportunity to establish a track record before receiving the full benefits of prudential regulation. The mandatory Restricted Deposit Takers category should be required for any deposit taker who:

(a) has less than $50 million in assets or deposits;

(b) has been a licensed deposit taker for less than three years; and

(c) is not a branch or subsidiary of a foreign registered bank.

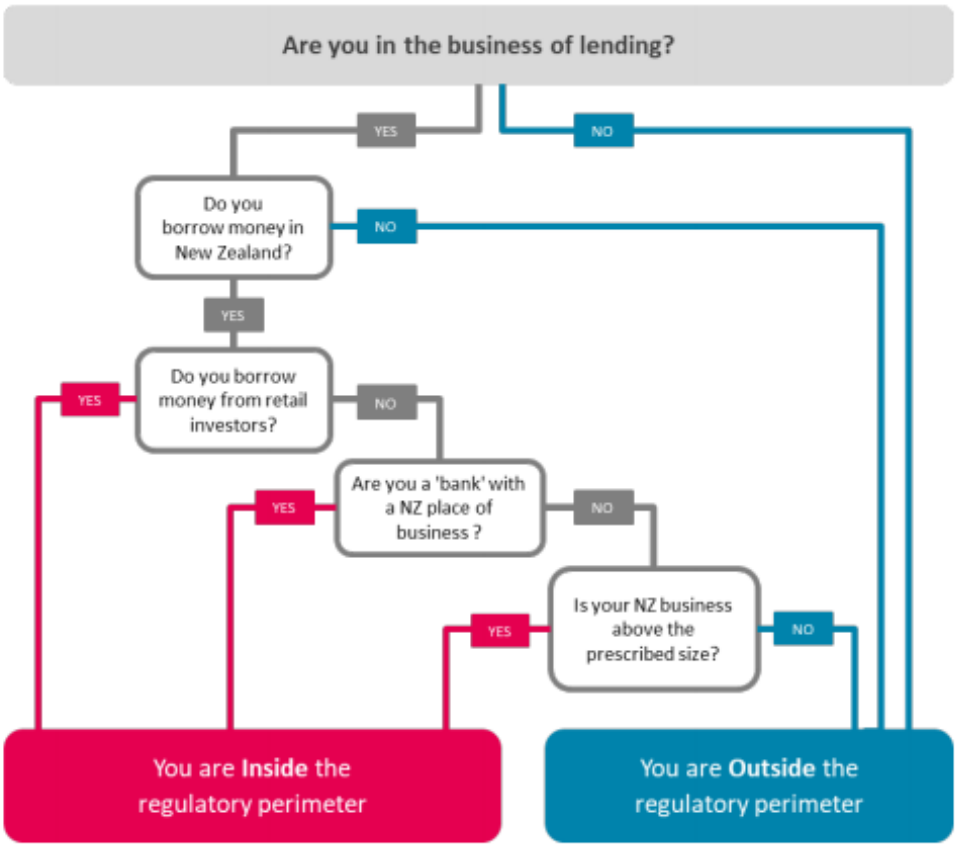
Standards and licensing	We agree with the use of standards. We believe this is an opportunity for a more consistent approach to our regulation by removing historic inconsistencies in trust deeds. We do not believe macro-prudential policies should apply to Small Deposit Takers. We believe that existing rules on capital (especially simple risk weighting), liquidity and connected lending should be carried into the new regime and are more appropriate to us than bank equivalents.
Liability and accountability	The RBNZ Regulated Fincos believe that the director liability and accountability provisions that apply to non-bank deposit takers ("**NBDTs**") should be more considered and targeted. We welcome the review, particularly in circumstances where loss has occurred as a result of national or global market events, rather than the actions of an individual deposit taker. We agree with minimum standards of a director's fitness should apply to all deposit takers within the regulatory perimeter and would welcome a targeted approach to governance requirements for Small Deposit Takers. We would like to see Restricted Deposit Takers meeting director fitness requirements before becoming fully prudentially regulated.
Supervision and enforcement powers	If trustees are dispensed with then there should be some transparency as to the timing of decisions by the RBNZ. If there are no trustees, the cost of supervision should not be passed on to Small Deposit Takers. The extent of supervision should be proportionate to market share.
Depositor protection	All entities regulated under a Deposit Takers Act (except Restricted Deposit Takers) should be entitled to deposit insurance if products issued meet the criteria (effectively products that have the features of transactional accounts or savings accounts) but not compelled to have deposit insurance. Deposit insurance should be funded on the same percentage basis for all depositors. The $50,000 deposit insurance cap is too low.
Crisis management	The RBNZ Regulated Fincos believe existing rights of trustees to appoint receivers and take action on events of review should be transferred to the RBNZ. The RBNZ Regulated Fincos also believe it should be clear that the RBNZ has a greater tolerance for failure of Small Deposit Takers and, therefore, less need to require prepositioning.

REGULATORY PERIMETER

Defining the perimeter

4. The RBNZ Regulated Fincos agree with the view expressed by the Minister of Finance in the December 2019 Cabinet Paper – namely that finance companies[2] that raise money from the public should continue to be prudentially regulated. The RBNZ Regulated Fincos therefore prefer Option 2 which requires a finance company that raises money from the public to be a licensed under the same regime as other regulated deposit takers. We note that the RBNZ Regulated Fincos would be inside the regulatory perimeter based on the questions posed in Figure 3.1 of the Consultation Paper. We agree with the formulation of the regulatory perimeter as expressed by the questions posed in Figure 3.1.

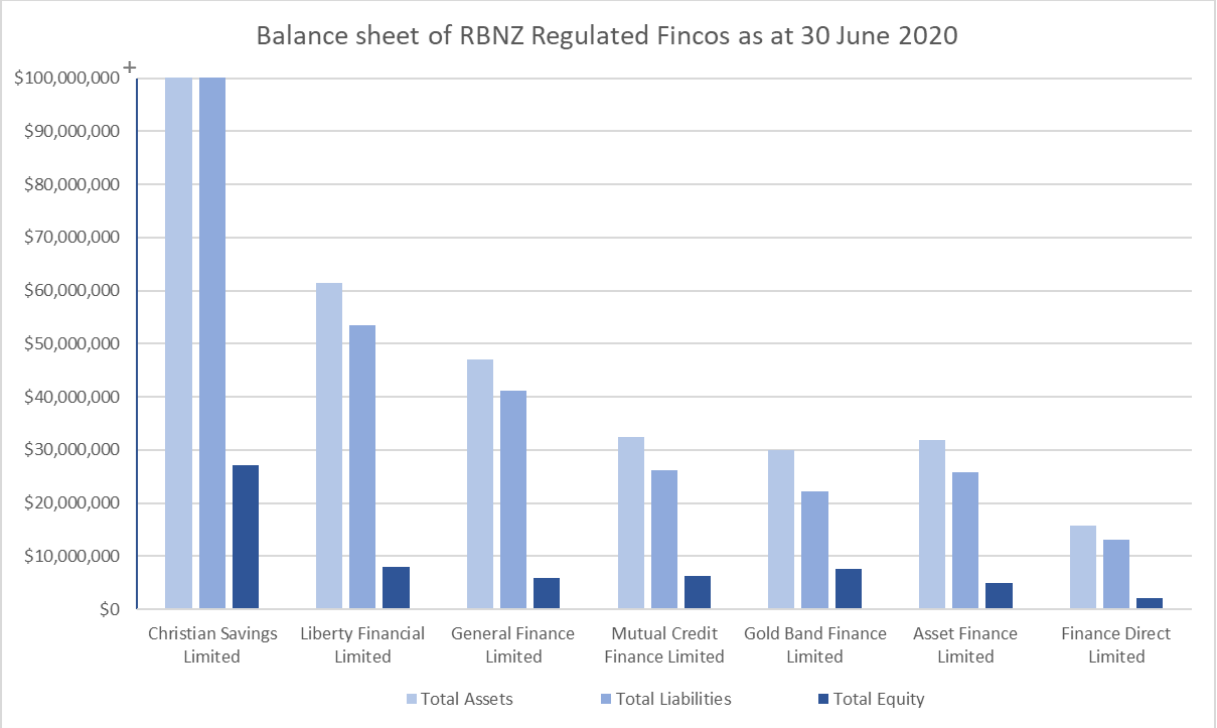
Figure 3.1: Proposed regulatory perimeter



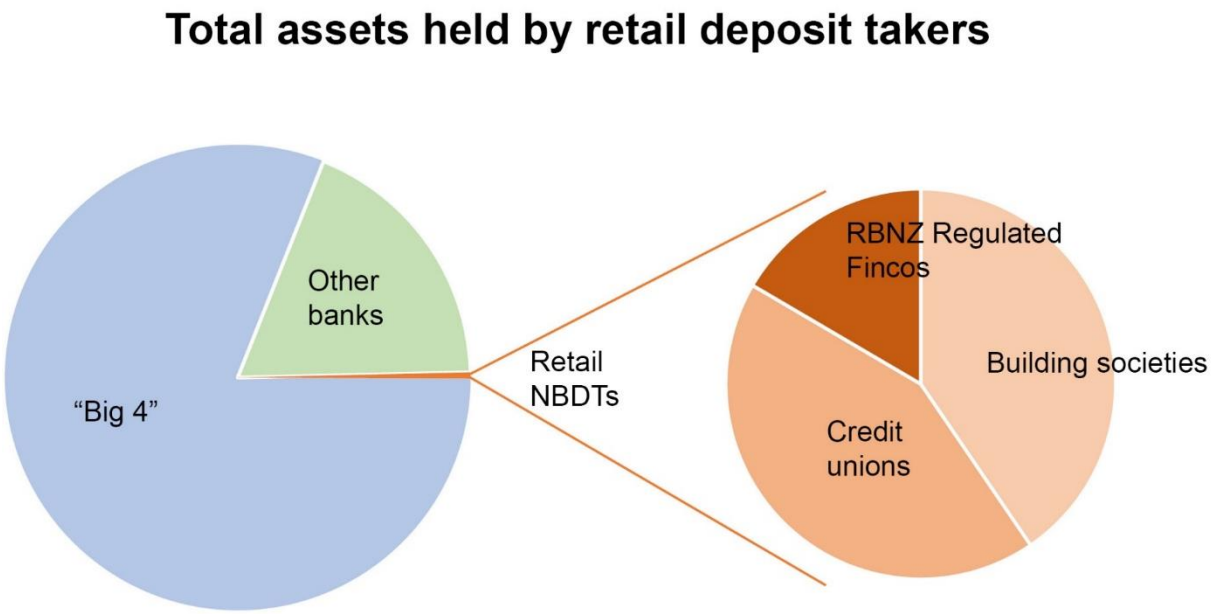
5. The RBNZ Regulated Fincos all made an election in 2014 to register under the NBDT Act because we saw potential value in being prudentially regulated. However, to date, there have been few, if any, benefits arising from being prudentially regulated – and certainly the costs have significantly outweighed the benefit. The Deposit Takers Act is an opportunity to redress this in a manner which would enhance the New Zealand financial system by encouraging more New Zealand-owned and diverse lending services and investment opportunities, hence growing New Zealand's prosperity more fairly and in a more inclusive manner.

[2] The Minister referred to finance companies rather than finance companies currently regulated by the NBDT Act. We note that the Consultation Paper did not distinguish between these types of finance companies either. These are very different models, and this highlights the need to rebrand finance companies that raise money from the public and are therefore subject to prudential regulation and supervision.

6. Since the NBDT Act was introduced there have been no new NBDTs registered and a number that have left voluntarily.[3] Most finance companies have chosen to fund themselves on the wholesale markets – often through securitisation structures. While these finance companies also provide a valuable role in the financial system, the result has been that in the non-bank finance sector there is an overreliance on wholesale markets. As was observed in 2008 in the global financial crisis ("**GFC**"), the first funding markets to disappear are the wholesale markets. The New Zealand finance company sector is therefore vulnerable to this risk with the corresponding risk there could be a sharp retraction in specialist lending sectors of the New Zealand economy – which would then be transmitted to the real economy. In terms of retail funded NBDTs and finance companies, the New Zealand NBDT sector is limited to 19 entities (seven of which are finance companies) and has assets of less than $3 billion against close to $600 billion in total).



[3] Only FE Investments has failed and that, fortunately, has caused little market disruption because it was largely expected.



7. In the same way that the RBNZ required New Zealand banks in 2011 to change their funding mix to a greater percentage of retail funding, we believe any new regulatory regime such as that proposed by the Deposit Takers Act needs to facilitate greater opportunities for retail depositor participation in non-bank lending markets. This could be particularly important where interest rates are zero or negative for retail investors. Access to a credible regulated market, albeit with a moderate risk profile compared to banks, may be increasingly important for a range of depositors.

8. Accordingly, we believe that one of the criteria that should be considered by the RBNZ in regulating RBNZ Regulated Fincos should be to promote access and growth of NBDTs through a regime where the benefits of being regulated outweigh the costs. This is discussed further in comments on the Purpose of a Deposit Takers Act.

9. A key to providing benefit to the RBNZ Regulated Fincos is likely to be the branding of entities regulated under the Deposit Takers Act. The RBNZ Regulated Fincos still suffer from the legacy of the finance company collapses in New Zealand at the beginning of the GFC.[4] This legacy exists at both a political and consumer level. This is in spite of the fact that the RBNZ Regulated Fincos have dramatically different operating models (in large part to comply with legislative requirements imposed on them) than did the finance companies that collapsed at the beginning of the GFC who were effectively unregulated (at least at a prudential level). Political and public perception does not appreciate the changes to how finance companies offering retail deposits are regulated and how that has mitigated the risks of making deposits – indeed, Sir John Key described non-bank finance companies as "mezzanine finance providers for property developers" and suggested the industry is vulnerable to the same issues he dealt with as Prime Minister in an article on interest.co.nz on 21 October 2020.

[4] As noted above, there seems to be no recognition of the significant differences between finance companies that raise money on the wholesale market and those who raise money from the public that are subject to prudential regulation and supervision and all suffer from the legacy created by the finance companies during the GFC. The RBNZ Regulated Fincos are characterised by significantly more stability than the finance companies during the GFC and are subject to the same regulation and supervision as other NBDTs.

10. The simplest way to change this perception may be to entitle those finance companies regulated under the Deposit Takers Act to call themselves a category of bank. The RBNZ Regulated Fincos would like to maintain a level of distinction from traditional banks, but are still interested in using the phrase "bank" in their branding or being able to describe their business activities as "banking activities" in order to improve customer understanding of their business activities with customers. [25,26]

11. We also believe that the Deposit Takers Act should introduce a mandatory "Restricted Deposit Takers" category for new entrants. This category could be modelled in part on the Australian Restricted ADI regime, which was introduced in 2018 and designed to facilitate the principles of competition, inclusion and supporting new entrants. However, unlike the Australian regime, we recommend that it should be mandatory for deposit takers to apply for a Restricted Deposit Takers license before being permitted to apply for a "full" deposit takers licence if the deposit taker meets **all three** of the following criteria:

    (a) it has less than $50 million in assets; and

    (b) it has been a licensed deposit taker (either under the new Restricted Deposit Taker regime, or under the NBDT Act regime or as a registered bank) for less than three years; and

    (c) it is not a branch or subsidiary of a foreign registered bank,

    once a Restricted Deposit Taker no longer meets one of the above criteria, it can apply to become a fully prudentially regulated deposit taker.

12. We think that it is important for the integrity of the new Deposit Takers Act that all deposit takers who are fully prudentially regulated and have a well established track record of compliance with prudential standards through prudent financial management be afforded the same benefits of prudential regulation. However, a Restricted Deposit Taker category would enable the RBNZ to facilitate new entrants by adopting a lighter-handed regulatory approach and a higher risk appetite for failure for Restricted Deposit Takers without creating undue risk to the financial system or the integrity of prudential standards on the basis that Restricted Deposit Takers would not have access to some key benefits of being a regulated deposit taker, including:

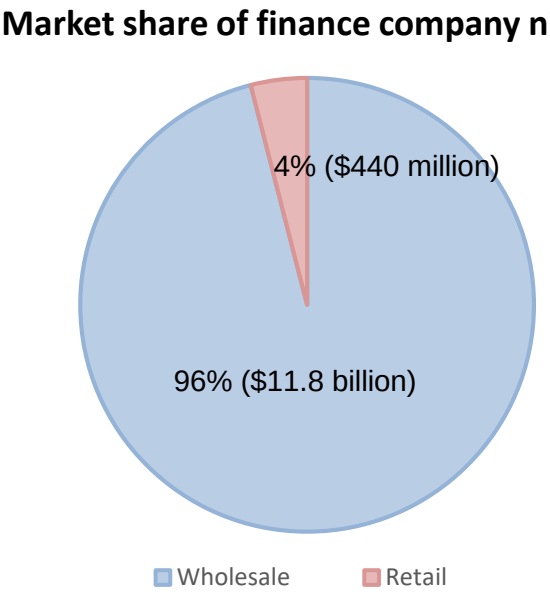
    (a) the ability to call itself a bank and describe its activities as banking;

    (b) access to deposit insurance; and

    (c) access to RBNZ liquidity.

13. The RBNZ Regulated Fincos agree that minimum prudential standards are necessary and that deposit takers should be required to establish a track record of sound financial management before obtaining certain regulatory benefits. We believe that the RBNZ Regulated Fincos have more than proven our sound financial management since becoming prudentially regulated, especially during this current counter-cycle. A Restricted Deposit Takers category would enable an appropriate balance between ensuring that deposit takers have a proven record while also recognising that those deposit takers who already have a demonstrated record of sound financial management should be entitled to receive the same benefits of prudential regulation as banks.

14. We note that the Review Team has suggested that the necessary corollary of the RBNZ Regulated Fincos being fully prudentially regulated and, in particular, enabling them to access deposit insurance, is that the RBNZ may require the RBNZ Regulated Fincos to de-risk their portfolios and therefore squeeze the niche that they currently operate in. The RBNZ Regulated Fincos disagree that de-risking is a necessary element of being fully prudentially regulated. Indeed, the RBNZ Regulated Fincos consider that this would be a mistake that would further concentrate this segment of the financial system to become wholesale funded, which creates systemic risk during counter-cycles because the niche that we operate in inevitably expands during counter-cycles (as the banks tend to become more conservative lenders in lockstep), at the exact time that wholesale funding experiences "sudden stops" and "dry-ups".



15. It is important to note that the RBNZ Regulated Fincos do not operate in "high risk" niches such as, for example, pay-day lending or mobile traders. Further, it is important to note that while banks may be conservative lenders at times, they also engage in high risk financial activities such as currency trading and credit cards. In contrast, our simpler business models mean we are in many cases less exposed to some of the riskier financial products that banks take on. Although our lending tends to be less conservative than large banks, we take a carefully researched and balanced approach to risk and have demonstrated our ability to manage our risk profiles and act with prudence at all times – for example during this current economic crisis. The RBNZ Regulated Fincos should be regulated within a prudential regime that recognises and facilitates the market segment we operate in – we should not be forced to change our business activities and become unduly conservative in a way that would no longer meet the needs of our borrowers and the expectations of our depositors, nor placed in the same category as much higher risk lenders. To force RBNZ Regulated Fincos into "high risk" or "low risk" with no space for "moderate risk" for retail funded deposit takers would result in a financial system that is unduly concentrated, vulnerable to counter-cycles and does not meet the varying needs in the New Zealand economy and, in particular, innovative and entrepreneurial sectors of the economy that are vital to economic growth or depositors who are interested in taking a moderate amount of risk.

16. The RBNZ Regulated Fincos believe that prudential requirements such as capital adequacy ratios based on risk adjusted assets are the appropriate way to manage portfolio risk – this supports our submissions that the RBNZ Regulated Fincos *should* be prudentially regulated (and therefore be subject to capital adequacy requirements to manage the risk in their portfolio) *and* that, provided the RBNZ Regulated Fincos meet capital adequacy requirements, they should be empowered to operate in different segments and niches of the financial markets that are essential to financial inclusion, innovation, growth and ultimately the stability of the financial system as a whole. Accordingly, we think that there should be space within the prudential regime for a range of niches and a range of risk appetites. This is supported by the report of the Auditor-General relating to the Crown Retail Deposit Guarantee Scheme ("**Auditor-General's Report**), which concluded that the risks of including the finance companies in that scheme could have been effectively managed if the Crown had interacted with finance companies to moderate behaviours before failure, rather than relying too heavily on the presumption of minimal intervention.[5] A prudential regime achieves the outcome of interacting with deposit takers to influence events before a failure occurs.

17. If the RBNZ felt that certain business activities operated with higher risk portfolios, the RBNZ could increase capital requirements in respect of those risker portfolios without directing what sort of business activities a deposit taker can undertake or forcing them out of the regime. We understand that we may be required to increase our capital to perhaps 14% (consistent with smaller banks under the new bank capital regime announced in December 2019). Provided we are given a transition period to meet new, higher requirement, we believe that this would be sufficient to manage our moderate risk profile.

Concerns raised by Review Team	Our comments
Prudentially regulated deposit takers may need to de-risk which could squeeze the niche that RBNZ Regulated Fincos operate in	• Higher risk profiles can be managed provided there are appropriate capital adequacy requirements that are being complied with. • 14% capital requirement (mirroring the requirements of smaller banks) should manage any risks in our portfolio without the need to change the nature of our lending. • The niche filled by RBNZ Regulated Fincos is vital to many sectors of the New Zealand economy and there would be negative outcomes of regulating it out of existence (in the retail funded space). • A requirement to de-risk will force our niche to solely rely on wholesale funding, which is more susceptible to "sudden stops" and "dry ups" during counter-cycles – the sudden contraction of our niche during counter-cycles (where demand for our niche tends to expand as banks tend to lend more conservatively, often in lockstep) could compromise financial stability.

[5] Controller and Auditor-General *The Treasury: Implementing and managing the Crown Retail Deposit Guarantee Scheme* (Office of the Auditor-General, 29 September 2011) at [5.29] – [5.36].

RBNZ Regulated Fincos operate within the margins of what justifiably fits within the purposes of prudential regulation	• It is not clear to the RBNZ Regulated Fincos why prudential regulation inherently requires regulated entities to adopt only the most conservative risk profiles. • There is no need for regulators to dictate the business activities of deposit takers that they prudentially regulate – only the need to set and monitor prudential requirements. • The niche that RBNZ Regulated Fincos operate in is valid and a necessary part of the financial system and should be supported by appropriate regulation – our niche should not be forced to compete with higher risk, less credible deposit takers, nor forced to adopt unduly conservative lending policies which mirror the policies of banks.
High risk deposit takers are less financially stable	• RBNZ Regulated Fincos operate as specialists in "moderate" risk profile lending, not a "high" risk profile, which means they do have greater financial stability. • Entities of any risk profile can be financially stable provided they take a prudent approach to managing risks within their portfolio – this should be the purpose of prudential requirements. • The current prudential regulation of RBNZ Regulated Fincos appears to be effective, as none of the RBNZ Regulated Fincos failed during the GFC nor during the current counter-cycle.[6] • Systemic financial stability should be given greater weight than individual financial stability – although some deposit takers may fail, a diverse financial system with some failures is more systemically stable than a concentrated financial system with no failures.
Prudential regulation of higher risk deposit takers can create moral hazard	• The Auditor-General's Report noted that the moral hazard element of the finance companies' failures during the GFC could have been managed if the finance companies were regulated at the time and the regulators sought to supervise and manage unduly risky behaviour before failure. • If RBNZ Regulated Fincos are prudentially regulated and consistently meeting their prudential requirements (which is what this submission proposes), there is no reason to suspect that there is any moral hazard risk. • In any event, RBNZ does not operate a zero-failure regime and any policy should make it clear that the RBNZ has a higher tolerance for failure of Small Deposit Takers because they have a much lower impact on the overall financial system. Indeed, in relation to the recent collapse of FE Investments, there was no suggestion of moral hazard to the RBNZ.

[6] Noting that the RBNZ acknowledges that FE Investments' failure was not related to the current counter-cycle.

	• Capital adequacy requirements act as an effective brake on RBNZ Regulated Fincos taking on too many depositors in a short space of time in any case.

Perimeter flexibility

18. The RBNZ Regulated Fincos believe that the RBNZ should have the power to designate either individual institutions or categories of institutions as entities that are required to register under the Deposit Takers Act.

19. In particular, it should be clear that the RBNZ has not just the power, but the obligation to designate institutions that are in substance operating as deposit takers. This could, for example, include:

    (a) peer to peer lenders; and

    (b) finance companies using securitisation programmes or wholesale direct programmes that offer securities to the public (because in substance these finance companies are funding themselves using retail investors but just using an intermediary to do so).

20. The RBNZ Regulated Fincos believe it is important for the credibility of the Deposit Takers Act that there is sufficient flexibility to prevent regulatory arbitrage undermining the value of registration for those who have taken the time and incurred the cost of being regulated.

21. In addition, the RBNZ should have the power to exempt deposit takers from compliance with the Deposit Takers Act or parts of it) where compliance is deemed to be unduly onerous or burdensome and an exemption would not be inconsistent with the maintenance of financial stability. Such exemptions are possible under the NBDT Act, for example, the RBNZ has granted a class exemption from the requirement to have a mandatory credit rating to all NBDTs that have just commenced business or that have consolidated liabilities of less than $40 million.

PURPOSES OF THE DEPOSIT TAKERS ACT

Overarching stability objective

22. In general, the RBNZ Regulated Fincos support an overarching stability objective.

23. However, in light of the fact that there have been no new NBDTs since NBDT Act was introduced, and the fact that the non-bank finance company 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, the financial system as a core objective. This could be achieved 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.

Decision-making principles

24. We note that the RBNZ does not run a zero-failure regime, and we consider that the decision-making principles need to allow a diverse range of business models within the prudential regime that can provide for the borrowing and lending needs of all New Zealanders.

25. The RBNZ Regulated Fincos mostly agree with the purposes of the Deposit Takers Act and believe the decision-making principles are broad enough to allow for such diversity within the prudential regime. It will be important to ensure that the RBNZ is prepared to apply the principles in a manner that helps expand, not retract, the diversity of regulated deposit takers.

Purposes	Current	Our comments
	Promote the safety and soundness of deposit takers	Although we agree that this will be a key purpose of the Deposit Takers Act, putting undue emphasis on individual soundness is not consistent with the RBNZ's mandate that it does not run a "zero failure regime" and the Deposit Takers Act should explicitly require that this purpose always be counterbalanced against other purposes and principles.
	Promote a diverse, innovative and competitive domestic financial system that meets the needs of all New Zealanders	We think that the new Deposit Takers Act is an opportunity to actively promote segments of the financial system that contribute towards financial inclusion and build domestic capability. The existing regime has failed to deliver this and so it is useful the Deposit Takers Act changes that.
	Promote public confidence in the financial system	We agree with this principle and note that financial inclusion (facilitated through diversity, competition and innovation) and fostering domestic capability and minimising concentration risk are likely to be key principles in promoting public confidence in the financial system.
	Mitigate the risks that arise from the financial system	We agree with this principle and note that the individual stability of each deposit taker (especially Small Deposit Takers) is unlikely to be a key source of risk that arises in the financial system. We consider that concentration risk (both due to the dominance of banks and also the concentration of our niche to the wholesale funded space) and associated lack of domestic capability are key risks to the financial system.
Principles	The desirability of minimising unnecessary costs of regulatory actions, taking into account the benefits of the outcomes to be delivered	We agree with this decision-making principle and would like to see some more guidance on this – ideally being that compliance costs should be broadly relative to market share.
	The desirability of taking a proportionate approach to regulation and supervision and ensuring that similar institutions are treated consistently	We agree with this principle and recommend that specific factors be included that should be taken into account when designing a proportionate approach, where we suggest that: • Small Deposit Takers be defined as those with less than $1 billion of deposits; and

		• Within the Small Deposit Taker segment, there be a mandatory Restricted Deposit Taker Category for deposit takers with: (a) less than $50 million of assets or deposits; (b) licensed as a deposit taker for less than three years; and (c) not a branch or subsidiary of a foreign registered bank.
	The desirability of sectors regulated by the RBNZ being competitive, taking account of the size of the market	We strongly agree with this principle and suggest it can elaborate further.
	The value of transparency and public understanding of the Reserve Bank's objectives and how the RBNZ's functions are exercised	We agree with this principle.
	Consideration of the practice by relevant international counterparts carrying out similar functions, as well as guidance and standards from international bodies	We agree with this principle and suggest that the Deposit Takers Act specifically signal to the regulator to duly consider the Basel III standards which specifically note that it is not desirable to impose the highest standard of prudential regulation of financial institutions that do not pose systemic risk.
	The desirability of taking into account long-term risks to financial stability.	We agree with this principle and believe that it should focus on both long term and systemic risk and ensure that concentration risk is duly considered as both a long term and a systemic risk to the financial system.

Financial Policy Remit

27. In addition, the RBNZ Regulated Fincos also support the ability of the Minister of Finance through the Financial Policy Remit to give guidance to the RBNZ on matters that it needs to take into account in pursuing its financial stability objectives. We presume this will be similar to the power in the NBDT Act for the Government to issue a government policy statement (but would be interested to know how technically or legally a Financial Policy Remit would differ from a government policy statement).

28. The RBNZ Regulated Fincos believe it will be important that the Minister of Finance does take advantage of this power – particularly in relation to the importance of developing the New Zealand-owned finance sector as a way of reducing New Zealand's dependence on large

foreign banks and ensuring that as all parts of the New Zealand economy have access to finance on reasonable terms – and not just those that meet what are often strict bank credit criteria – which often exclude (almost by definition) the more innovative sections of the economy that New Zealand will increasingly need to rely upon for business growth.

Macro-prudential policy

29. The RBNZ Regulated Fincos recommend that the new Deposit Takers Act restrict the RBNZ from imposing macro-prudential requirements on Small Deposit Takers. Small Deposit Takers do not have any macro-economic impact and imposing macro-economic requirements would only serve to unnecessarily restrict business activities and which would have undesirable consequences. In particular, it would have the effect of limiting financial products available to New Zealanders in a way that is unlikely to meet the needs of many of New Zealand's small businesses and most innovative people who could have the greatest impact on New Zealand's economy. It makes sense that macro-prudential requirements should only be imposed on large institutions whose activities could conceivably have macro-economic impacts.

STANDARDS AND LICENSING

Flexibility of standards

30. The RBNZ Regulated Fincos support the use of standards to impose the more detailed elements of prudential regulation on regulated entities.

31. For the RBNZ Regulated Fincos, standards seem to be a reasonable midpoint between:

    (a) regulation which is used now to impose core standards on the RBNZ Regulated Fincos and which are legislative instruments often with penalties attached; and

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

32. The RBNZ Regulated Fincos 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 are drafted consistently with statutory regulations so as to give maximum legal certainty.

33. The RBNZ Regulated Fincos understand that it may be contemplated that trustees are no longer required and that the RBNZ would instead supervise the RBNZ Regulated Fincos directly, as it does with banks. The RBNZ Regulated Fincos do not have a clear view on whether to retain or remove trustees from the supervisory framework, but note that in either case, it would be preferable for prudential requirements to be removed from trust deeds and instead be translated across to standards (as well as translating across any prudential requirements from the current Deposit Takers (Credit Ratings, Capital Rations and Related Party Exposures) Regulations 2010 ("**NBDT Regulations**") to the same standards). We think that it makes sense for all prudential requirements to be located in one place and applied consistently to all deposit takers within a category.

34. We do note that, if the new Deposit Takers Act discontinues the use of trustees, we would appreciate if the RBNZ could engage with us on how certain matters would be operationalised in practice (for example, whether we should need an exemption from having a trustee approve our product disclosure statements ("**PDS's**") under the FMCA, and whether it would complicate the

charge our depositors currently have) and that there be some memorandum of understanding (or similar) setting out, at least, the indicative timeframes for decisions (as other regulators do).

35. The RBNZ Regulated Fincos also believe it is critical that the way in which standards are set enable the RBNZ to take a risk-based approach having regard to the size and activities of a particular deposit taker 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 depending on the size, characteristics and complexity of business activities. For example, Canada is currently consulting on proposed changes to the Bank Act 1991 to segment deposit takers based on their size, nature and complexity of the business activities and take a more selective approach to capital and liquidity requirements for smaller or less complex segments. This would result in a progressively more "light handed approach" to prudential standards imposed on the smaller segments to ensure the requirements are fit for purpose and do not impose standards that new entrants could never meet on the one hand, and that do not properly moderate the behaviour of systemically important banks on the other hand.

36. As a starting point, we recommend that the Deposit Takers Act specifically create at least segments of deposit takers based on the total retail deposits of the entity (i.e. broadly consistent with the current approach adopted by the RBNZ for banks), or potentially assets, with the following categories:

    (a) Restricted Deposit Taker:

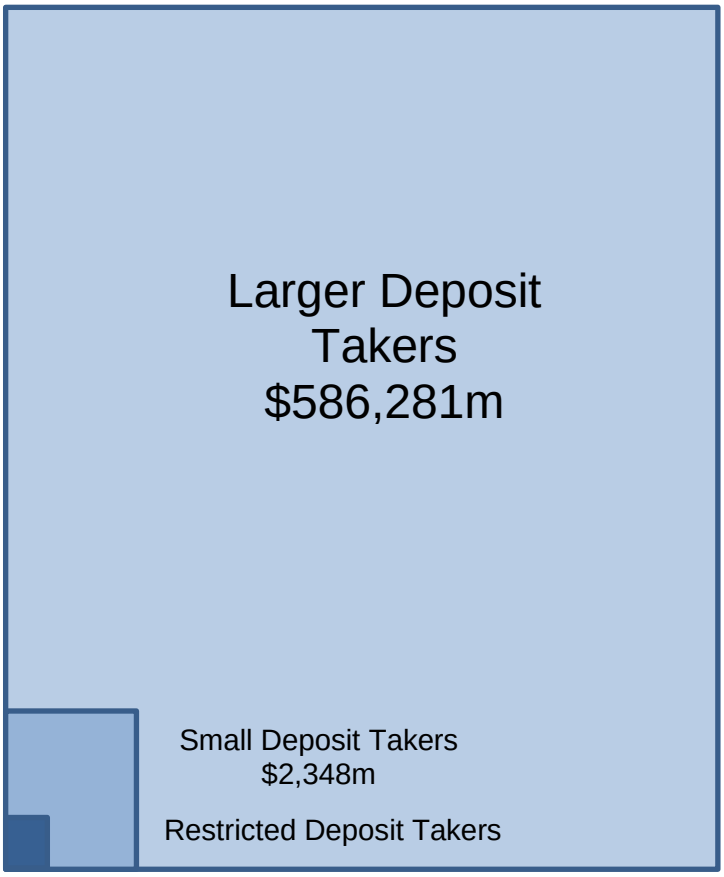
        (i) under $50 million of assets or deposits;

        (ii) licensed as a deposit taker (either under the new Restricted Deposit Taker regime or under the existing NBDT Act or registered bank regime) for less than three years; and

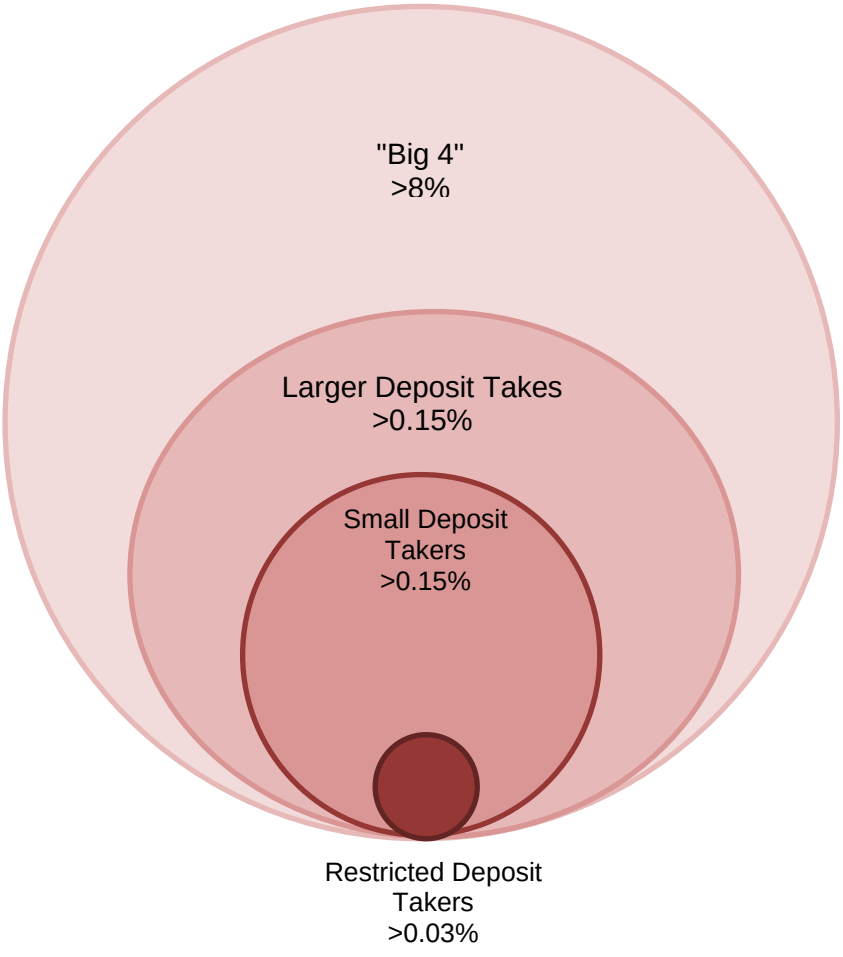
        (iii) not a branch or subsidiary of a foreign registered bank;

    (b) Small Deposit Taker: less than $1 billion in assets or deposits; and

    (c) Larger Deposit Takers: over $1 billion in assets or deposits.



Market share of an individual deposit taker in each segment



37. This is broadly consistent with the thresholds applying to the Open Bank Resolution policy, with another category created for Restricted Deposit Takers to support growth, facilitate new entrants and ensure a deposit taker can demonstrate a minimum track record of prudent financial management.

38. The RBNZ Regulated Fincos 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. However, the RBNZ Regulated Fincos would like to see this more clearly articulated either in the Deposit Takers Act or through regulation and believe a mandated segmentation approach would assist the RBNZ with its task of creating proportional standards.

39. 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. Although we do not go into detail (as we understand the specifics of the standards will be set by the RBNZ at a later date), we set out **below** some general comments regarding things that should be taken into consideration in how the Deposit Takers Act sets the decision-making mandate for the RBNZ:

Subject matter	Bank standards	Comments on applicability to Small Deposit Takers
Capital requirements	BS2A	It is critical for Small Deposit Takers that capital requirements minimise complexity. The preference of RBNZ Regulated Fincos 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 to a new standard at least on a transition basis while it is compared with BS2A. The RBNZ Regulated Fincos accept minimum capital ratios may need to change in a consolidated regime to be more consistent with the new bank minimum capital requirements. However, we also note contrary to popular belief, the NBDT Act capital regime has been tougher than the bank capital regime because 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 RBNZ Regulated Fincos than banks in respect of the same assets. Like the banks, RBNZ Regulated Fincos should have seven years to comply with higher capital ratios from the point they are imposed.
Liquidity requirements	BS13	The nature of the RBNZ Regulated Fincos' activities tended to mean we have much simpler liquidity requirements than banks (mostly just

Subject matter	Bank standards	Comments on applicability to Small Deposit Takers
	BS13A	for holding of cash). The RBNZ Regulated Fincos do not see the value of imposing seven day and one-month mismatch ratio reporting or core funding ratio requirements on them.
Ownership, incorporation and governance requirements	BS9 BS14 BS15	We expect these policies will not be relevant for the Small Deposit Takers. Imposing such restrictions would seem to create unnecessary bureaucracy and cost.
Internal risk management systems, controls and policies	BCP 17 Liquidity and lending standards	The risk management requirements in the NBDT Act and trust deeds now could also be transitioned – probably instead of imposing internal capital adequacy assessments on Small Deposit Takers.
Crisis management and resolution	BS17	See paragraphs 45-52 of this submission.
Loan concentration and risk exposures		We do not think it is appropriate to apply loan concentration standards on deposit takers whose business activities are simple and do not pose any systemic risk. It is important that the New Zealand financial markets support specialist lenders who have expertise in particular niches, and a degree of concentration risk is an inherent effect of the existence of specialist, niche lenders. We think that the impact of disallowing the existence of specialist lenders from niches they have expertise in carries far greater risk to financial inclusion and overall financial stability than any potential concentration risk that is the inevitable consequence of such specialist lending. The RBNZ should exercise its higher risk tolerance for failure in respect of specialist lenders who do not pose systemic risk. Our trust deeds include concentration limits in respect of our exposure to individual borrowers. We think any concentration standards imposed on specialist lenders should reflect the standards in our existing trust deeds and risk management plans.
Related party transactions	BS8	The credit rating-based approach for banks could unduly penalise the RBNZ Regulated Fincos whereas the related party exposure requirements of the NBDT Regulations have worked well and have been tailored to finance company issues and they should be transitioned.

Subject matter	Bank standards	Comments on applicability to Small Deposit Takers
Public disclosure of information	BS7 BS7A BS4	The RBNZ Regulated Fincos do not yet have a view on the extent to which the disclosure regimes to which we are currently subject under the FMCA should be aligned to the disclosure regime applied to banks. Anecdotally, customers find it much easier to understand the product disclosures made by NBDTs than bank disclosure, which the vast majority of users find dense and almost impossible to understand. In practice, the discipline imposed by bank disclosure is probably exercised only by competitors, academics, and a very few in the financial media. The RBNZ Regulated Fincos believe that the existing product disclosure regime that applies to them not only minimises complexity and facilitates understandability for those writing disclosures, but also for end-user customers. Accordingly, the preference would be to retain a similar disclosure regime for Small Deposit Takers to retain that understandability (with or without the requirement for trustees).
Outsourcing arrangements	BS11	We note that this largely only applies to banks with more than $10 billion of liability and assume it would not apply to Small Deposit Takers.
AML/CFT	BS5	We assume the current AML/CFT supervision will continue unchanged.
Fit and proper standards	BS10	We believe that directors of all prudentially regulated deposit takers should meet a fit and proper standard. In particular, we think that the RBNZ should require this of all Restricted Deposit Takers before they can enter the "full" regime. However, we also believe that some of the corporate governance requirements should be tailored to Small Deposit Takers on the basis of their size and capacity to manage complex internal processes.
Deposit insurance		See Appendix 1 of this submission.
Lending standards in relation to mortgages	BS19	This is macro-prudential policy and accordingly we do not think it should be applied to Small Deposit Takers.
Matters prescribed in regulations		We think that, if the Deposit Takers Act intends to empower the Minister of Finance to create regulations to extend the scope of matters on which the RBNZ can set standards, there should be set criteria which need to be met first in order to maximise certainty that

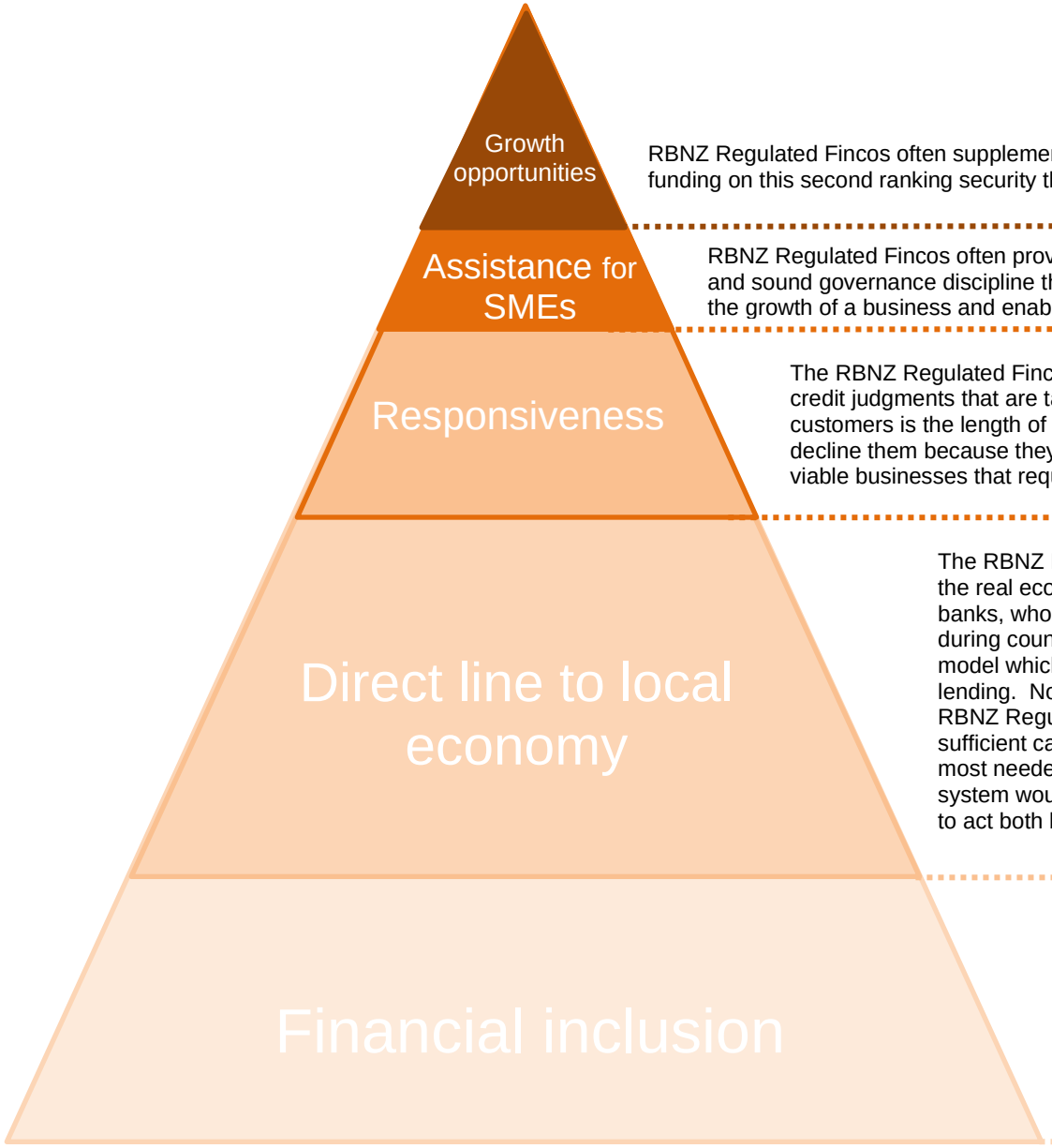
Subject matter	Bank standards	Comments on applicability to Small Deposit Takers
		deposit takers will not consistently have new standards imposed on them. Any new matter which does not meet the standard should be provided for by a change to the legislation so that we have an opportunity to make a submission.

40. All of our observations and comments in respect of considerations to have regard to when setting standards for Small Deposit Takers is based on our understanding that the RBNZ does not operate a "zero failure" regime. We accept that some level of prudential supervision is required to contribute to the protection of depositors (indeed, we advocate for new entrants to establish a track record of sound management as a Restricted Deposit Taker to safeguard the credibility of prudential standards). However, we think it would be appropriate for the RBNZ to adopt a slightly higher risk appetite and have a higher tolerance for failures of Small Deposit Takers than it might for systemically important banks. This is on the basis that these deposit takers are unlikely to pose systemic risk to the stability of the financial system.

Access to liquidity

41. If RBNZ Regulated Fincos 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, the Funding for Lending Programme ("**FLP**") that the RBNZ is currently working to roll out by the end of this year, or similar equivalent programmes that may be implemented in future). The RBNZ Regulated Fincos 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.

42. In addition to the concept of competitive neutrality, the RBNZ Regulated Fincos believe that their inclusion in liquidity support will have a disproportionately positive impact on the real economy, and consequentially, on the RBNZ's monetary policy objectives, in particular, employment. This is because, for example:



RBNZ Regulated Fincos often supplement banking relationships usually by agreeing to rank behind banks' security. It is often funding on this second ranking security that is most critical to business growth.

RBNZ Regulated Fincos often provide a "stepping stone" for small business, so that they can develop a financial record and sound governance discipline that enables them to transition to bank funding in due course, which is a critical step in the growth of a business and enables the business to support economic activity.

The RBNZ Regulated Fincos tend to be much more responsive in providing credit approval and making considered credit judgments that are tailored to a borrower's specific needs (a common complaint of RBNZ Regulated Fincos' customers is the length of time and formulaic method which banks take to process applications – generally to decline them because they are outside strict lending criteria). Access to timely finance for businesses, especially viable businesses that require temporary but immediate support, supports economic activity.

The RBNZ Regulated Fincos believe that liquidity support will assist them to filter more funds into the real economy, especially during counter-cycles (such as the current environment). Unlike banks, who, in the experience of the RBNZ Regulated Fincos, lend even more conservatively during counter-cycles (and often do so in lockstep), RBNZ Regulated Fincos have a business model which allows them to operate within niches and take a more counter-cyclical approach to lending. Notwithstanding this willingness in principle to take a counter-cyclical approach, the RBNZ Regulated Fincos, 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 RBNZ Regulated Fincos believe that the niche that we fill in the financial system would be greatly supported if we had access to backstop liquidity, which could enable us to act both bravely and prudently during counter-cycles, which benefits the real economy.

The RBNZ Regulated Fincos lend to parts of the economy and to important projects that banks simply don't lend to. The fact that the RBNZ Regulated Fincos have higher funding costs means that we lend at higher interest rates. This means we focus on understanding and managing risk in more detail in markets that banks don't tend to operate in because they are outside their inherently conservative standard credit criteria. As a consequence, the type of lending undertaken by RBNZ Regulated Fincos is more likely to result in additional economic activity and/or support more vulnerable businesses back to viability (reducing the impact of the contagion effect of business failure) than bank lending.

43. Although the RBNZ Regulated Fincos 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 Small Deposit Takers to ensure that holding cash is not punitive and that meaningful liquidity is available to us when needed. This might involve changes to the capital requirements relating to the provision of liquidity facilities to Small Deposit Takers 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 Small Deposit Takers. Such a requirement could be modelled on the United Kingdom's Term Funding Scheme with Additional Incentives for SMEs.

Cost of regulation

44. If the RBNZ becomes the sole regulator (i.e. the new regime removes trustees), there should be no costs associated with that prudential supervision (at least for Small Deposit Takers – most of whom to date have had to pay trustees, whereas banks have not had to pay for supervision). Providing supervision at no cost should counterbalance past inequities.

RESOLUTION AND CRISIS MANAGEMENT

45. Most of the commentary in the chapter on Resolution and Crisis Management seems to relate to banks and, to a lesser degree, building societies and credit unions.

46. The RBNZ Regulated Fincos do not have a strong view on any of the content in the Resolution and Crisis Management chapter but broadly agree with the approach – in particular having a single statutory management regime overseen by the RBNZ (i.e. we do not see the value of having competing statutory management regimes under the RBNZ Act and the Corporations (Investigation and Management) Act 1989).

47. The RBNZ Regulated Fincos' primary concern is not with the content of what is proposed but its application.

48. If new resolution and crisis management tools are to be introduced into the Deposit Takers Act, the RBNZ Regulated Fincos believe that it is important that a balanced approach is taken to any prepositioning that may be required – and in particular any compliance costs which could be associated with that prepositioning. The RBNZ Regulated Fincos favour a continuation of the existing approach adopted by the RBNZ where, for example, the Open Bank Resolution policy only applies to entities with more than $1 billion of external liabilities – which we think should be a natural limit for the Small Deposit Takers segments. We would want the RBNZ to continue to commit to a similar approach, for example in relation to any prepositioning that might be required for bail-in. The RBNZ Regulated Fincos believe that bail-in might be an appropriate resolution tool for Small Deposit Takers, but it is unlikely to be practical for the form of the bail-in to mirror exactly – in particular, the requirement that the deposit taker must be in a position to open within 24 hours. We think that, especially in the case of RBNZ Regulated Fincos, who do not operate transactional accounts, this requirements would be unnecessary and burdensome, and would welcome the RBNZ considering alternative bail-in approaches.

49. The RBNZ Regulated Fincos also wish to point out that under our existing trust deeds there is a power for trustees to appoint a receiver. We suggest that it could be useful to retain that power (as opposed to simply having the option of liquidation or statutory management). In this context, we note that there is a precedent for 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 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.

50. If that power is to be retained and 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 also be granted to a receiver appointed by the RBNZ (presumably through amendments to the Receivership Act 1993). Such powers include exercising the right to declare all deposits due and payable, exercising any rights conferred by law in relation to the secured property and doing anything with the secured property that the charging entity could do.

51. In addition, many NBDTs trust deeds also 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. 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 are 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.

52. The RBNZ should consider these crisis management powers for Small 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 RBNZ Regulated Fincos, 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 got comfortable with.

LIABILITY AND ACCOUNTABILITY

53. Again, the RBNZ Regulated Fincos do not have any strong view on what is proposed. However, we do welcome the review and the attempt to ensure that the powers are targeted and appropriate.

54. The RBNZ Regulated Fincos do however note that most of the commentary in the section on Liability and Accountability is directed at banks. The liability for directors under the NBDT Act is significantly more onerous than the liability regime for bank directors. Under section 68 of the NBDT Act, directors are liable for all of the same offences that the NBDT is liable for – with the penalties applied being the same as for the NBDT (as if the NBDT was an individual not a corporate).

55. The RBNZ Regulated Fincos see this provision as a relatively "blunt instrument" and would welcome a much more structured approach, particularly to director liability.

SUPERVISION AND ENFORCEMENT POWERS

56. The RBNZ Regulated Fincos do not have any strong views on the chapter relating to Supervision and Enforcement Powers.

57. We assume, however, that supervision, in particular, will be undertaken on a graduated and risk-based approach. We are not expecting a significantly different approach by the RBNZ to that which has been adopted by our supervisors to date.

58. In particular, the RBNZ Regulated Fincos note that proposed approach 6.3, which relates to a new breach reporting framework, appears to be significantly more burdensome than the breach reporting currently required under our trust deeds. The trustees seem to have made their own materiality assessment and only require the RBNZ Regulated Fincos to report on certain limits under the trust deed being exceeded including total liability limitations, prior security interest limitations, capital ratio limitations and related party exposure limitations. The RBNZ Regulated Fincos believe this is an example of where the RBNZ could take a proportionate approach and adjust its regulation and supervision by taking into account the size and risk posed by a deposit taker.

DEPOSITOR PROTECTION

Deposit insurance

59. As has previously been discussed with the Review Team, the RBNZ Regulated Fincos strongly believe that deposit insurance should be available to all entities regulated under the Deposit Takers Act (except Restricted Deposit Takers).

60. The RBNZ Regulated Fincos set out further reasons for inclusion and the reasons for increasing the cap for deposit insurance in more detail in an appendix to this submission, which follows on from earlier submissions and updates previous correspondence and discussions between the RBNZ Regulated Fincos and the Review Team.

Depositor preference

61. The RBNZ Regulated Fincos all currently have trust deeds giving security over their assets to a trustee on behalf of their depositors.

62. The RBNZ Regulated Fincos appreciate that we may no longer have trustees or trust deeds once we are regulated under the Deposit Takers Act. If that is correct, we believe that the charge given for the benefit of our depositors should be replaced either by:

    (a) a regime where there is no charge over our assets, but that key ratios currently monitored by trustees are included in conditions of licence; or

    (b) there is either a statutory charge (like that that exists in respect of banks in Australia) or a statutory priority granted for our deposit holders.

63. The RBNZ Regulated Fincos believe that either option could work. The key principle should be that our depositors will be no worse off as a result of the transition. We believe that given the relatively few general creditors that exist in RBNZ Regulated Fincos and the complexities of introducing a statutory charge over all deposit takers (potentially including large banks) that an option involving a mix of:

(a) statutory preference for depositors of Small Deposit Takers (even if on a transition basis); and

(b) conditions of licence imposing key ratios on Small Deposit Takers to ensure that our depositors are protected,

is probably the best option.

64. Regardless of which option is adopted, the RBNZ Regulated Fincos also believe that it is important to ensure that our existing capacity to give prior security should also be protected. This could be particularly important to enable Small Deposit Takers, such as the RBNZ Regulated Fincos, to access liquidity and funding facilities from the RBNZ on a reasonable basis.

SIGNED)
Asset Finance Limited by)

Daniel McGrath, Chief Executive Officer)

General Finance Limited by)

Brent King, Managing Director)

Gold Band Finance Limited by)

Martin Brennan, Chief Executive)

Finance Direct Limited by)

Wayne Croad, Managing Director)

)

Mutual Credit Finance Limited by)

Clint Barry, Chief Executive Officer)

APPENDIX – DEPOSIT INSURANCE

1. INTRODUCTION

1.1 In this Appendix we advocate:

(a) that the deposit insurance scheme should be available to all prudentially regulated deposit takers, including RBNZ Regulated Fincos;

(b) introducing a deposit insurance scheme with a cap of at least NZ$250,000 on insured deposits per depositor per institution;

(c) using a funding model at inception that is simple and, most importantly, proportionate so that it is not prohibitive for small or new deposit takers; and

(d) housing the deposit insurer with the RBNZ.

1.2 We also include in a Schedule a summary of characteristics of deposit insurance schemes in comparable jurisdictions.

2. SCOPE OF INSURED DEPOSIT TAKERS

Impact of scope on RBNZ Regulated Fincos

2.1 The RBNZ Regulated Fincos believe that there are a number of potential behaviours we expect to see from depositors in response to receiving insured deposits up to particular caps, and accordingly do not express a view on whether we believe that our net deposits will increase or decrease depending on the cap on the basis that any opinion would be highly speculative. Our core consideration in submitting is that we are able to continue to provide both deposit and lending services that create value to our customers and the New Zealand economy.

Impact of scope on the Crown

2.2 We understand that the Crown will be conscious of limiting its liability, especially after its experience with the finance companies in the 2008 deposit guarantee scheme. However, we note that the level of fiscal risk to the Crown of including RBNZ Regulated Fincos in a deposit insurance scheme is significantly lower than it was in 2008 for two main reasons:

(a) First, there are only seven RBNZ Regulated Fincos at present with approximately $360 million of deposits. Compare this with the situation during the GFC in 2008, where the government became liable for approximately $2 billion of liabilities to depositors from nine failing finance companies.

(b) Secondly, we are now subject to robust prudential regulation and supervision, which mean that the likelihood of incurring Crown liability is significantly reduced. As we have previously stated and as supported by the Auditor-General's Report, we believe that appropriate prudential requirements minimise Crown balance sheet risk, even in respect of finance companies. As a backstop, we would be open to discussing with the RBNZ the possibility of setting a cap of the total insured amount per institution (in particular, Small Deposit Takers) based on the level of capital held by that deposit taker to limit any perceived moral hazard that might remain. Any limit per institution should be based on that deposit taker's capital

adequacy and accordingly should be capable of being applied to banks, credit unions and building societies if their capital adequacy levels are of concern.

2.3 We are similarly conscious of the legacy attached to finance companies and are particularly motivated to do everything in our power to maintain stability in our sector. We five submitters (together with Christian Savings) are the few finance companies that committed to a model of funding through retail deposits despite the significantly increased regulatory burden (we understand that Christian Savings is submitting separately as it has features of both a finance company and a mutual not for profit). Each of us has put in place significant measures to decrease risk, including restrictions on related party lending, capital adequacy and liquidity requirements and risk management plans. We all have proven business models. We believe that this is a robust threshold for inclusion in a deposit insurance scheme.

2.4 We agree that there should be certain minimum standards of prudence and conduct before a deposit taker can benefit from deposit insurance (hence, our support for a temporary Restricted Deposit Takers segment that would not be entitled to deposit insurance). However, we believe that the combination of prudential regulations and directors and the requirement that senior managers be confirmed to be fit and proper is sufficient to meet that standard. In the case of the RBNZ Regulated Fincos, we believe that we have more than proven our prudence and sound risk management since the NBDT Act has been in force, especially during the current economic crisis, and therefore meet any and all appropriate minimum criteria for inclusion.

2.5 Given the impact of our exclusion is unclear – [25,26]

In fact, with the robust platform of prudentially regulated NBDTs, we believe that the Crown should carefully consider the potential of the NBDT sector, including RBNZ Regulated Fincos, to contribute to the COVID-19 recovery. At present, we play a role that is disproportionate to our size in serving the SME sector – which is the backbone of the New Zealand economy, particularly outside of the main centres. Our services are often preferred by the SME sector because of our ability to tailor services to customer's needs. We also fill an important gap providing finance to entities with solid businesses who are ignored by banks because of their lack of track record or the innovative nature of their projects and activities.

Consistency across entities with similar activities

2.6 In respect of our deposit services, we are competing with banks, credit unions and building societies for customers and if we are not on a level playing field with like organisations – this has the potential to create a significant amount of extra funding costs. [25,26]

This is at odds with the services we provide and the needs of our customers, whose continued success will be important to New Zealand's economic recovery.

2.7 We also believe that the deposit products provided by RBNZ Regulated Fincos are much closer to bank term deposits than, say, corporate bond issues. Corporate bond issues tend to be issued in single issues and repaid on fixed dates, with much longer maturity periods and are often listed on the NZX debt market. We, however, tend to issue deposits on a continuous basis, with deposits maturing progressively. Like banks and mutuals the deposits are not listed and while theoretically deposits can be transferred this is very rare. In summary our deposits are much more like bank

deposits than corporate bonds and broadly meet the features of products that are described in the section "Financial Products Covered" in the Consultation Paper. The fact they are not issued by "financial co-operatives" should not affect their coverage. It should be the customer expectations and product issued that matters not the issuer of the product.

Products providing a perimeter for the Scheme

2.8 Proposed approach 8.1 in the Third Consultation Paper sets out the limitations on the application of a deposit insurance scheme by way of types of products. We believe that this limitation on the scope of a deposit insurance scheme is sufficient and an appropriate criterion that ensures a scheme meets its policy objectives and is consistent across entities undertaking similar activities.

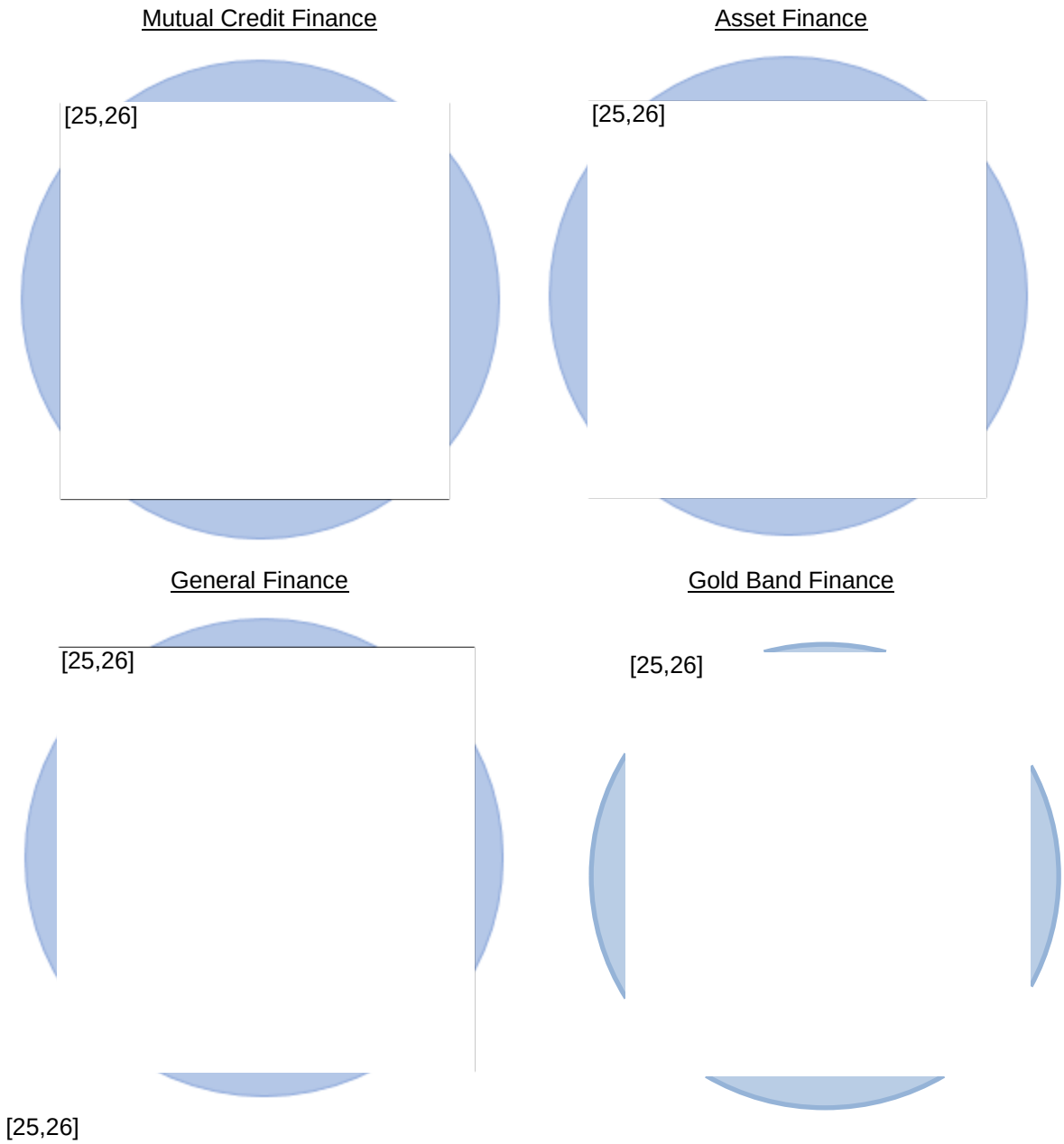
2.9 Jurisdictions that align membership with a deposit insurance scheme with prudential regulation (which is the most common approach) create limitations, in line with their policy objectives, by limiting the types of products that are covered or the type of depositors. Canada draws the line between debt securities that will be covered by their scheme and those that won't in terms of the maturity date of a deposit. A deposit will not be covered where there is no obligation to pay within a five-year period from the date the deposit is made. The United Kingdom scheme insures a much broader range of financial products and limits the scheme by focusing on retail and other depositors that are particularly at risk.

3. CAP ON INSURED DEPOSITS

3.1 Further, the RBNZ Regulated Fincos believe that the cap should be set at $250,000 on the basis that we believe any lower figure would create market distortions (though it is unclear whether those distortions would benefit or harm the RBNZ Regulated Fincos). In the interests of not finding out, we believe that the minimum amount required not to create market distortions is the appropriate cap.

3.2 An example of a market distortion which could be caused by a cap of $50,000 on insured deposits per customer per institution is that it may deter local investment (on the basis that depositors are protected for significantly higher balances in countries like Australia).

3.3 In terms of our liquidity and funding, the image below sets out examples from four RBNZ Regulated Fincos, showing the impact of a $50,000 cap in terms of the number of our depositors with deposits over $50,000 as well as the value of total deposits which are held as deposits over $50,000:



3.4 RBNZ Regulated Fincos do not have the same access to wholesale funding as banks to replace those funds. [25,26]

further concentrating risk in, and dependency on, Australian-owned banks at precisely the time we should be looking to increase diversity and spread risk. Our depositors are not all sophisticated investors and the added complexity of having to consider how best to protect their deposits and dealing with multiple institutions may mean that they simply don't bother investing. With interest rates going so low, putting money into a well-managed and well-regulated finance companies and diverse parts of the economy might be sensible.

3.5 We further note that this cap is significantly lower than what we see in comparable jurisdictions, particularly schemes implemented during times of economic instability. For example, a $50,000 cap is negligible compared to the retail deposit guarantee scheme implemented in New Zealand during the GFC. New Zealand's cap on insured deposits for a depositor at a single deposit taking institution during the GFC was set at $1 million. Australia implemented their deposit insurance scheme in the wake of the GFC. This was originally implemented as an unlimited guarantee over deposits held by deposit takers under the prudential supervision of APRA. It was subsequently adjusted to deposits of AU$1 million being covered automatically and deposit takers having the opportunity to opt-in for coverage of deposits over that threshold. Once the economy stabilised, the cap on coverage was reduced to AU$250,000 per account holder per deposit taker.

3.6 We believe that the cap should be set at $250,000 to align with the position in Australia. We operate in an Australasian market and New Zealand's position should put us on equal footing with our Australian counterparts. This would minimise the risk of flight of funds from New Zealand to Australia where a significant proportion of the New Zealand population with investment funds have access to accounts and more could easily get them.

3.7 We strongly suspect that the fiscal risk of a $50,000 cap has been miscalculated because no modelling has been done on how deposit splitting will impact Crown liability. As people spread their deposits across multiple institutions to increase their coverage, the potential liability to the Crown will increase. As a result, it is likely that there is no significant increase in the fiscal risk to the Crown should it implement a higher cap on insured deposits and there would certainly be decreased risk of distorting the market.

3.8 Some consideration should also be given to the approach taken with joint and trust accounts. In comparable jurisdictions, each joint holder of an account and each beneficiary of a trustee that holds an account are considered to be individual depositors. Provisions should also be considered for protecting a temporary high balance, for example, following the sale of a property. The United Kingdom approach is to cover a balance of up to GB£$1 million in certain circumstances for a period of up to six months.

4. FUNDING

4.1 The key considerations for funding a deposit insurance scheme from the perspective of participants is simplicity and ensuring that the fees are not prohibitive. In other jurisdictions we have seen regulators balancing these considerations at implementation and have subsequently adapted their funding approach over time. For these purposes, we strongly support proposed approach 8.9 in the Consultation Paper which proposes that levies are based on a percentage of the deposit taker's insured deposits. This approach is used widely by international deposit insurers. It is a desirable approach because it is proportionate and reduces the risk of being prohibitive to smaller and newer deposit takers in the market.

4.2 We do not consider a risk-based approach appropriate for the scheme at inception but can see value in it as the scheme matures. We remain willing to support the government to explore this option at a later date. We are interested in how the risk of an entity would be determined for these purposes as we believe there are approaches that would disproportionately advantage the large banks, such as basing risk on credit ratings. For the moment we think it sufficient to note that a

risk-based approach must still be proportionate. We would suggest that any risk-based approach to premiums be calibrated by the level of insured deposits and should reflect market risk in New Zealand – an example of this approach can be found with the Canadian Deposit Insurance Corporation.

4.3 While building up an ex-ante fund, the government will be required to provide a backstop. We suggest a similar approach to that taken in New Zealand during the GFC, whereby institutions with over $5 billion in insured deposits (and who are likely to present a systemic risk) were required to pay an additional premium reflecting the systemic risk they posed.

5. INSURER

5.1 We understand that there would be significant benefits to housing the deposit insurer with the RBNZ – including the synergies with its role as prudential supervisor, which would create efficiencies on both sides. As we have noted at numerous points during this submission, the prudential supervision of deposit takers should be a key consideration in various aspects of scheme design, including who to include in the scheme and how its effect on risk management should inform the setting of caps and levies. We believe that a scheme that applies to all NBDTs should be housed with and administrated by the RBNZ to benefit from its complementary role as supervisor.

5.2 However, where the scheme becomes more complex, we see benefits in the insurer being a stand-alone entity. This would likely make it easier to include arrangements where additional members can opt-in to the scheme or could top up the insurance to a higher threshold on a commercial basis. Where this approach is taken, we would like to see some representation of the RBNZ Regulated Finco sector in the insuring entity to ensure that it is priced fairly for them.

6. CONCLUDING REMARKS

6.1 We strongly support a deposit insurance scheme in New Zealand with the following characteristics:

(a) cover extends to all New Zealand prudentially regulated deposit takers equally (except for Restricted Deposit Takers);

(b) a cap of $250,000 on the level of insured deposits per depositor per institution; and

(c) funding of the scheme is based on market share of insured deposits, potentially with a premium for larger more systemically important deposit takers.

6.2 New Zealand should implement the scheme in line with international best practice and to help manage Crown liability without distorting the market. As well as best practice from the perspective of financial stability, a well-designed deposit insurance scheme could play an important role in New Zealand's economic recovery going forward. We believe the scheme should focus on encouraging investment in New Zealand, which will ultimately deploy more liquidity into the market.

6.3 The characteristics of the scheme could be updated over time, for example, by introducing more complexity in terms of membership and fees. We support the government to continue to explore options as the scheme matures in order to promote diversity and competition amongst deposit takers and ensure our customer base continues to be served and have choices available that will enable them to reach their financial goals.

6.4 Most of the RBNZ Regulated Fincos are keen to be involved in the consultation on deposit insurance as a sector that could be disproportionately affected (both adversely and positively) by the terms of any deposit insurance scheme.

SCHEDULE 1 – SUMMARY OF DEPOSITOR INSURANCE SCHEMES IN OTHER JURISDICTIONS

Financial claims scheme

Institutions covered:
Australian incorporated authorised deposit takers (does not include finance companies that issue retail deposits, but also covers insurers)

Products Covered:
"Protected accounts" as defined in Banking Regulation 2016

Deposit Cap:
AU$250,000 per depositor per institution

Funding:

Now: ex-post, levies based on demand no set form of calculation.

At inception: as above.

Legal entity:
Within bank supervisor – APRA.

Financial services compensation scheme

Institutions covered:
Any authorised firm which holds regulatory permission from the FCA to accept deposits (or to take investments or provide insurance).

Products Covered:
All deposits (as well as investments and insurance).

Deposit Cap:
GB£85,000 per depositor per institution (for deposits and investments)

Funding:
Now: Ex-ante and ex-post
At inception: ex-post, levies based on demand with assessment based on insured deposits.

Legal entity:
Independent – federal crown corporation.

Canada deposit insurance corporation

Institutions covered:
Retail Deposit taking Institutions (which includes banks, credit unions, trust and loan companies)

Products Covered:
All deposits with a maturity of less than 5 years.

Deposit Cap:

CA$700,000 per depositor per institution (up to $100,000 per insured category)

Funding:

Now: Ex-ante fund, supplemented by ex-post (access to government credit line)

Levies = risk-based rate x level of insured deposits.

At inception: ex-ante fund to be established, based on level of insured deposits plus access to government credit line (with ability to levy ex-post).

Legal entity:
Independent – federal crown corporation.