The Treasury

Reserve Bank Act Review Phase 2 Consultation 3 Submission Information Release

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[25]

Appendix

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

We agree with the proposed approach 3.3 and consider that a clear standardised set of license conditions (in much the way that locally incorporated banks currently operate) would ensure a level playing field and a clear standard and expectations. Currently it appears that branches operate under a variety of restrictions and impositions, which creates an inequal playing field.

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

Historically this segment experienced a large number of bankruptcies, therefore we support the retention of prudential regulation for finance companies funded by retail debt securities. Although as explained further in this submission we believe a correct balance has to be struck when developing the regulatory perimeter.

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?

We believe when deciding on the restricted licence category it has to be assessed what is the intent of the retail deposit insurance scheme. On the basis that the insurance scheme's main focus is to protect ordinary retail depositors' transactional and term deposits we believe there is merit in creating a restricted licence category for finance companies funded via debt securities offered to retail investors.

We however highlight, the strong need to adequately define the term 'deposit' as well as correctly educate the public in relation to the differences between avenues and corresponding financial products to provide funding to an entity. This is to ensure there is sufficient clarity on what is insured and what is not, as the public makes their investment decisions.

We believe the public would benefit from additional work to improve the understanding that funds provided by retail investors to these restricted finance companies are not 'deposits', and hence are uninsured. While we agree these entities should be restricted from the use of terms like 'deposit' or 'term deposit', however further work is required to educate the public on the range of associated terms such as 'secured debenture'.

We think it is appropriate for the continuation of provision of higher risk vs return products to retail investors who are willing to take the necessary risks. Under this option this reduces the risks that the system inadequately prices the premium for deposit insurance.

With regards to costs, we believe this will include regulatory supervision that any publicly available documents of these restricted finance companies correctly states that any funding provided is not insured. Additional compliance cost ensure that offer documents and product disclosure statements do not use the restricted term 'deposit'. We don't believe those costs would be materially different from today. However, there could be additional costs in a sense of providing educational costs promoting individual investors' understanding the non-insured nature of funding provided to these entities. We believe this would need to be borne by someone within the market.

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?

We believe fund raising from retail investors should be limited to FMCA regulated products with required prospectus, that clearly articulates the nature, structure, risks and rewards of the product. We strongly believe that restricted finance companies should not be allowed to offer, or allowed to engineer financial products, that mimics the transactional nature of deposits, whilst lacking the corresponding protection.

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

We believe that it would create a system efficiency if supervision was concentrated into the RBNZ to hold a consistent and high bar to the industry, whether they are banks, insurers, NBDTs, or Finance Companies. Therefore, we would advocate a position where the role of the FMS's would be limited to FMC Act compliance (or totally removed), and the RBNZ would take over front line supervision for this industry.

The failures of the finance company industry from 2009 to 2012 point to the fact that when left insufficiently regulated the industry will push the bar and potentially expose the country to unacceptable risks. As such we support a rationalisation of the supervision of entities and a bolstering of the capabilities and skills within the RBNZ to undertake these roles. We believe that there is an overarching challenge to ensure the quality, consistency and efficiency of the regulatory environment, and that this could be better achieved through a concentration of the regulation into fewer entities with more potential therefore to lift the overall standards.

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?

We disagree with Option 2 which we believe would be challenging to manage this industry, within the remit of a retail debt security and potentially covered by the deposit insurance scheme. We believe that this is unnecessary and that it is unlikely the regulators could appropriately price the risk creating a risk of market inefficiencies. We prefer option 1 as articulated. We believe that with adequate safeguards there is no need to require full deposit taking licenses from finance companies. We further believe establishment of a mandatory licencing system for finance companies could be detrimental to this segment of the NZ financial markets and create a substantial cost burden that would ultimately be worn by the investing public, either as increased pricing of lending or reduced yields on funding provided to these entities without a corresponding benefit.

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?

We are not inclined to support the Remit as we believe it creates ambiguity. As highlighted by the consultation document, by nature the sector in question is small in comparison to the entire sector. In addition, we believe risk appetite statements are generally broad documents that whilst provides guidance of the overall intent, does not focuses on auxiliary risks. Therefore, we see little room that the Finance Minister's risk appetite statement would provide sufficient clarity to the Reserve Bank on how to design and implement the restrictions and requirements to the sector. We believe this will prohibit transparency and potentially create misunderstanding between the Minister and the RBNZ. In addition, we believe without a lack of rule-based system the transparency of the sector in question would be impaired. And this may inhibit future entities from entering the sector limiting development and growth.

Further while the RBNZ could make a risk-based assessment, the benefit of a tiered system would be the public consultation and discussion on the tiers and the respective requirements. This could enable industry and community involvement in the level (and cost) of the requirements being created, and perhaps promote a discussion on whether these requirements are efficient and cost-effective.

Finally, it ensures a consistent approach over time, vs the risk that the RBNZ could be reactionary, or change its requirements based on personnel changes or changes in Governors. This consistency over time is good for the industry (and supervisors).

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?

We support the idea of licencing tiers. As seen across various areas of the NZ legislative requirements, including financial reporting, with sufficient clarity on the requirements and standards against each Tier, a well-balanced risk management approach can be established with limited cost burden.

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?

For a range of reasons, we would not advocate for a move to grant NBDTs the same exemptions as banks from the FMC Act. While the banking sector is not totally homogeneous, we believe that there is a higher correlation of entity type/products and risks than that within the broader NBDTs. Accordingly, our assessment is being made from considering the banking sector who hold a level of scale, substance, historical maturity and capabilities, and potentially this experience being applied against a broader group (NBDT) who range from significant entities with size and strength through to other entities with less robust characteristics. We consider this creates a significant risk to the proposed approach.

A second factor is the nature of the products being marketed. While there are clearly variations in products across the banking sector, given the broader controls, capital and liquidity requirements, these provide a level of protection that may not existing across the broader NBDTs even after the imposition of new requirements under the amended regulations. While the proposed deposit insurance scheme will provide some financial protection, we believe the existing requirement for the preparation and disclosure of product disclosure statements provides a range of other protections for customers in terms of understanding, conduct and vulnerability.

As such we would advocate for the retention of many of the underlying requirements of the existing FMC Act around the requirements to prepare and disclose product disclosure statements, but with a range of enhanced supervision and operating requirements which might more closely mirror those imposed on banks (the Conditions of Registration).

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

We welcome the proposed scope of standards; however, we would encourage a review of the breadth and scope of existing standards, which may see a broadening of the scope by including standards governing for example:

- the private reporting of the licensed deposit takers to the RBNZ. The completeness and accuracy, and hence the reliability, of these datasets are fundamental for the RBNZ, as well as users of the statistical information published on the RBNZ's website.

- on Risk Management, including key elements of the risk domains such as Cyber risks, and data security. The absence of these standards, as seen in other jurisdictions results in a more arbitrary and varied quality of risk management across the industry.

Compared to Australian equivalents (or the Basel guidance), the New Zealand standard set is relatively light.

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?

Yes, we believe these key macro-prudential instruments require a deep understanding of the financial markets and that knowledge sits with the RBNZ. In addition, we believe that sometimes financial markets and economic conditions change rapidly as such they require prompt responses. We believe granting the proposed power to the RBNZ the promptness of actions are not at jeopardy. This gives the Reserve Bank a deeper toolkit from which to operate to regulate the market and achieve the RBNZ's broader mandate and outcomes.

This said, the imposition of such requirements, needs careful consideration and discussion as while the overall objective might be appropriate (e.g. to regulate an overheated property market), it does risk creating distortions and inefficiencies in the market which mean that not all market participants are equal. As an example, the imposition of low equity LVR requirements, meant that some first home buyers may have struggled to enter the market creating a bias to existing property holders. This is more a social risk and could be countered by early and public consultation on when and how such measures would be applied. This is particularly relevant given the risk of the imposition of both LVR and DTI measures which have seldom been used in other overseas markets together.

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?

We support the principles that the Reserve Bank should be able to adjust standards to reflect supervisory discretion, however, we question whether further safeguards could be applied to protect the supervised entities. The consultation document discusses a scenario where such adjustments could need to be made under urgency, and that appeals would be limited to judicial review. We believe that this protection is difficult for an entity to practically use, as to undertake a judicial appeal could create a difficult supervisory relationship.

As such we believe there would be value to the industry as a whole, if the RBNZ considered a mechanism to allow for consultation and review, without the need to seek a full judicial review. There are examples in other entities that we believe add equity and fairness to the process without the need to revert to a judicial review. The current process, and process as proposed, appear to have few checks and balances to the overarching power that the RBNZ would hold. This could take a number of forms but would be a constructive step on openness and engagement should there for a forum that allowed for oversight (potentially via a committee) or a 'mediation' function to allow appeal without reverting to a full judicial review.

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

Yes, we believe the proposed procedure is appropriate. Although we encourage the establishment of the boundaries of the consultations to enable cost effective development of standards.

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

We believe that the proposed safeguards are appropriate.

However, the second safeguard (the authorisation or approval of persons carrying out inspections (and these persons being well-trained and having requisite expertise)) should be clarified to require an internal RBNZ/FMA process to go through before the power of inspection without notice is applied - i.e. so that there is a process to provide justification internally before this power was applied.

Additionally, the confidentiality protections for information obtained under inspections should be clarified with reference to the powers to collect information gathered (via Section 25) to then be provided to third parties e.g. ANZ Bank New Zealand Limited vs Financial Markets Authority with regards to information provided by ANZ under Section 25, or to be captured under Official Information Act requests.

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?

We believe that the powers should be expanded. There is a risk given the existing powers, that the FMA relies on firms to give access to premises and documentation without a formal power - in these cases, there is a danger that documents could be omitted or altered prior to sending to the FMA and firms potentially being able to 'prep' staff members who are interviewed. This means that the regulator may not get the 'real' picture. Further powers where there is suspicion or evidence of misconduct would allow for more timely action and a better utilisation of regulator resources.

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

Given the intent of the Deposit Taker Act and the deposit insurance scheme is to better protect the retail depositor, we believe the Reserve Bank should have the power to issue a formal notice and that notice be publicly available.

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

We agree with the triggers provided. However, we add the term "likely soon" to be defined with sufficient specificity to promote clarity of its meaning.

Part C of the non-viability test should be focussed on areas that directly go towards viability as a going concern and pose risks to creditors and the financial system, given the powers potentially being invoked and risks to the stability of the financial system from invoking them. We consider that further detail is required to define when de-licensing would be warranted under part C, with a focus on those conditions that directly impact the solvency of the entity.

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?

We consider the targeted approach is a preferable approach, as it improves the operational effectiveness of the regime, subject to the provision of minimum standards. This provides greater transparency for all parties regarding what liabilities are subject to bail in. We consider an appropriate approach is to treat uninsured deposits as available to be bailed in, but higher in the bail-in hierarchy category for creditors.

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

We are of the view that the bail-in should not be applied retrospectively. As the consultation correctly identifies such features were not considered and priced into their investment. Furthermore, we believe a retrospective bail-in could suddenly trigger a significant sell-off whereby investors try to exit this investment as their risk versus return suddenly become out of balance. This could put pressure on the financial markets and devalue this investment.

However, we note that retrospective application will make bail-in a more difficult option to implement until all investors and creditors have priced this. Given the current economic climate and the risks of different tiered creditors (i.e. existing creditors not subject to bail-in and new creditors subject to bail-in) and would create significant complexity and inequitable results in the event of a bail-in process.

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

Yes, this enables the RBNZ to access a broad range of skill sets and thinking to consider the appropriate solutions for any potential financial institution failure. Legislation should be specific regarding the purpose of the committee, so that committee members understand their role and purpose and the RBNZ understands what role the advisory committee can play.

We do not consider there to be a need to define the composition of the committee.

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?

Yes, this is consistent with overseas jurisdictions and provides an appropriate resolution tool for the RBNZ.

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

No, we consider that certain NBDTs are of a scale and importance and their failure could have a significant impact on their customer base. The RBNZ should have a greater range of tools to help address any failing firm in the NBDT sector.

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

We favour option 2, as this provides a greater level of optionality for addressing any financial stability risks.