

# The Treasury

## Reserve Bank Act Review Phase 2 Consultation 3 Submission Information Release

February 2021

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# SAFEGUARDING THE FUTURE OF OUR FINANCIAL SYSTEM

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

### *Submission form*

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

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

#### Chapter 2

#### Purposes of the Deposit Takers Act

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

2a. Partly agree. 'Mitigate the risks that arise from the financial system' along with the 'overarching statutory purpose to "promote the prosperity and well-being of New Zealanders and contribute to a productive economy"' needs some stronger language.

The Reserve Bank has acted in a way which assumes that what is good for the financial sector is good for the economy (and wider well-being). The proposed wording will make no difference to this RBNZ behaviour. It has led to a very hands-off approach to credit creation and allocation by the banking sector. The result is that banks' self-interest has favoured dramatic expansion of mortgage lending over productive business lending, inflating land prices with it. Mortgage debt has increased four-fold as a percentage of GDP, productive business borrowing as a share of GDP has been flat. The proposed objectives do little to explicitly discourage the RBNZ from this banking-led, laissez-faire approach and the social and economic harm from excessive property inflation it leads to.

2b. Add the following principle:

Guiding the allocation of credit to ensure it serves the economy's need for productive investment and the wider social need for access to affordable housing.

The reason for having a principle that specifically references land-based lending is (1) scale -- this category represents about 80% of all lending, (2) social impact on life-chances and well-being when credit misallocation affects housing, (3) economic impact by allocating too much capital to unproductive parts of the economy, (4) prudential -- when asset bubbles increases system risk.

**Defining the overall regulatory perimeter**

- 3.A Do you agree with the proposed approach to defining the overall regulatory perimeter? If not, what approach would you suggest?
- 3.B Do you support the proposed exclusion for wholesale-only funded lenders? If not, what approach would you suggest?
- 3.C Do you support a maximum size threshold for the wholesale exclusion? If so, what would be an appropriate measure of size?
- 3.D Do you agree with the proposed territorial scope of the legislation? If not, what approach would you suggest?
- 3.E Do you have any comments on the application of the Deposit Takers Act to associated persons?
- 3.F Do you agree with retaining the restriction on the use of the words 'bank', 'banker' and 'banking', but limiting it to persons providing 'financial services'? If not, what approach would you suggest?
- 3.G Do you agree that the use of the words 'deposit', 'deposit taker' and 'deposit-taking' should be restricted? What restrictions would you suggest?
- 3.H Do you support the proposed approach to foreign bank branches? If not, what approach would you suggest?

Partly agree. However, the system appears to be based solely on prudential/risk objectives. This approach is inadequate if the RBNZ's objectives extend to ensuring that lending activity meets the wider economic and well-being objectives noted in Section 2 above (ie if the RBNZ is to move on from its apparent belief that "what's good for banks for good for the economy/well-being". Suppose that a LTI ratio is introduced in order to rebalance credit allocation away from land and towards productive lending. Under the proposed perimeter, it would appear that some foreign and wholesale-funded lenders could escape this and potentially compete unfairly with (and undermine) the RBNZ's economic/well-being/prudential goals. Therefore, the perimeter must include lending into NZ, not just deposit-taking from NZ.

**Regulation of finance companies that do not take insured deposits**

- 3.I Do you agree that prudential regulation should be retained for finance companies funded via retail debt securities?
- 3.J Would you support the approach of creating a restricted licence category for finance companies funded via retail debt securities (option 1)? What do you think would be the benefits and costs of this approach?
- 3.K Under option 1, what restrictions should be placed on the services that a licensed finance company could offer without becoming a full licensed deposit taker?
- 3.L Should licensed financial market supervisors undertake the frontline supervision of finance companies under this model? If not, what approach would you suggest?

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

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### Approach to small deposit takers

- 3.N Do you support the proposed approach to small deposit takers, under which the Reserve Bank would be expected to calibrate its regulatory approach in light of the proposed purposes, the decision-making principles, and the contents of the Remit? If not, what changes would you suggest?
- 3.O Alternatively, would you support creating a separate tier in legislation for small deposit takers? If so, how would you suggest drawing this distinction?
- 3.P Do you agree with retaining the restriction on the use of the words 'bank', 'banker' and 'banking', but limiting it to persons providing 'financial services'? If not, what approach would you suggest?
- 3.Q Should current NBDTs have the same supervision, governance and disclosure exemptions from the FMC Act as banks? If not, what approach would you suggest?
- 3.R Should current NBDTs be subject to a disclosure regime that is similar to that for banks? If not, what approach would you suggest?

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### Perimeter flexibility

- 3.S Do you support the proposed approach to perimeter monitoring? If not, what approach would you suggest?
- 3.T Do you support the proposed designation power? If not, what approach would you suggest?
- 3.U Do you support the proposed exemption power? If not, what changes or alternative approaches would you suggest?
- 3.V What should the criteria be for the Reserve Bank granting an exemption? What other limitations or safeguards should be placed on the power?

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**Scope of standards**

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

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**Macro-prudential policy**

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

I agree with the RBNZ having power to set lending standards such as LVRs, LTIs in relation to mortgage lending, along with a requirement that it consult widely and publicly, and be subject to some form of parliamentary oversight. In particular, where distributional impacts are material, it needs to work in a coordinated way with fiscal and well-being strategies.

This speaks to a wider issue, viz that the extreme level of Reserve Bank independence needs to be moderated. It has led to a situation where monetary and fiscal policy have been uncoordinated instead of working together to manage the economy and well-being. For instance, the over-reliance on monetary policy to stimulate the economy has led to asset (esp. housing) inflation where more direct fiscal stimulus could have been more efficient with fewer negative impacts.

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**Flexibility of standards**

- 4.C Do you agree that the Reserve Bank should be able to issue differing standards for different entity classes? If not, what approach would you suggest?
- 4.D Do you agree that the Reserve Bank should be able to make standards that enable it to exercise supervisory discretion on matters and within ranges specified in the standards? If not, what approach would you suggest?
- 4.E What procedural requirements and protections should apply to the Reserve Bank's use of supervisory adjustment?
- 4.F Do you support the proposed approach to allowing the Reserve Bank to set reporting standards and lending standards in relation to categories of non-deposit-taking lenders that have been prescribed via regulations? Why or why not?

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**Procedural requirements for standards**

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

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## Licensing

- 4.H Do you support the proposed licensing test for deposit takers? If not, what approach would you suggest?
- 4.I Are the proposed procedural requirements for licensing appropriate? If not, why not? Should any other requirements be considered?
- 4.J What scope of appeal rights should be provided for in relation to licensing decisions and why?
- 4.K Do you agree with the proposed approach to de-licensing? If not, what changes would you suggest?

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## Transparency requirements

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

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**Civil and criminal liability**

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

No. It is essential that penalties reflect the size of financial entities and the scale of potential gains from bad behaviour. The proposal to lower criminal penalties with jail sentences in favour of civil penalties with fines is a move in the wrong direction. The claim that fear of criminal prosecution will dampen legitimate risk-taking behaviour is greatly overstated and financial penalties in an industry with such high earnings provides limited disincentives. If we can jail beneficiaries for a few dollars of ill-gotten benefits, it's frankly hypocritical that bankers and financiers should avoid such sanctions in order that we not discourage risk-taking behaviour. Someone's moral compass needs resetting.

What it does point to, however, is the problem of a regulator being too close to the regulated. It is inevitable in such a tight-knit industry that personal relationships will intervene, or the regulated groups will believe that they can influence the outcome of any proposed penalty decision. I therefore propose that:

1. Penalties be strengthened, eg for corporates up to 10% of revenue, and individuals a maximum of 5-year prison sentences and \$500,000 fines, and
2. That the RBNZ only be involved in determining that there has been a regulatory breach, with all decisions on penalties being moved to an independent agency, thus adding a greater deterrent by making the outcome less predictable.

**Director accountability**

- 5.B Do you agree with the specification of the new positive duties for directors of deposit takers? If not, why not?
- 5.C Do you agree that directors should not be indemnified or insured against loss in the performance of their duties?
- 5.D Do you see any specific issues with the relationship between the existing director duties in the Companies Act, and the new duties being proposed here?

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**Director penalties for disclosure breaches**

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

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## Penalty levels

- 5.F Do you agree with the proposed approach to maximum civil penalties on bodies corporate, including the use of maximum penalties based on the size of the institution or any benefit gained (or loss avoided)? If so, what specific metrics or amounts should be considered for these penalties?
- 5.G Should a lower tier of civil penalties be established for some contraventions, for example, those that do not adversely affect the deposit taker's prudential standing?
- 5.H What maximum level of individual civil penalty should be provided for and why?
- 5.I Should criminal offences relating to the obstruction of routine supervisory powers be subject to monetary penalties, but not imprisonment terms for an individual? If so, what level of maximum penalty would be appropriate and why?
- 5.J What monetary and imprisonment penalties should be considered for more serious criminal offences and why?

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### On-site powers

- 6.A Do you agree that the on-site power for the AML/CFT regime is an appropriate comparator for a similar power for the Reserve Bank's prudential functions?
- 6.B Should this power be a generic power in the new Institutional Act, or specified in the Deposit Takers Act?
- 6.C Do you think any additional safeguards are necessary for the on-site power?
- 6.D Do you think the FMA's on-site inspection power should be expanded in the same way that is proposed for the Reserve Bank?
- 6.E Should an expanded FMA on-site inspection power apply in all circumstances and to all FMA-regulated entities or only some (e.g. in high-risk circumstances or for dual prudential-conduct regulated entities)?

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### Other supervisory powers

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

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### Breach reporting

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

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### Enforcement powers

- 6.H Do you agree that the Deposit Takers Act should provide for the Reserve Bank to accept a voluntary undertaking from a deposit taker that is enforceable in court?
- 6.I Should the Deposit Takers Act provide a statutory basis for the Reserve Bank to issue a formal notice to a deposit taker?
- 6.J Do you see any role for infringement notices in the Deposit Takers Act?
- 6.K Do you see a useful role for remedial notices and/or action plans in the Deposit Takers Act?

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### Conditions for placing a deposit taker into resolution

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

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### Liabilities that would be subject to statutory bail-in

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

Deposits, if confiscated, should be swapped for equity or equivalent in the failed deposit taker.

### The statutory management advisory committee

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

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### Resolving credit unions and building societies

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

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### The application to deposit takers of CIMA statutory management

- 7.F Do you agree that deposit takers should only be subject to one statutory management and resolution regime?
- 7.G Do you favour option 1, option 2, or some other approach (including the status quo)?

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**Depositor preference**

- 8.A What are your views on the benefits and costs of a preference for insured depositors compared to no preference?
- 8.B If a preference for depositors is introduced, do you agree it should only cover insured deposits (not all deposits)?

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**Scope of coverage**

- 8.C Do you agree with the proposed prescribed product approach for coverage under the new scheme? If not, what approach would you suggest?
- 8.D Do you agree that both retail and wholesale investors in insured deposit products should be covered up to the \$50,000 coverage limit? If not, what approach would you suggest?
- 8.E Is the list of excluded deposit products appropriate? If not, what approach would you suggest?

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**Mandate, powers and additional objectives**

- 8.F Do you agree with the proposed narrow mandate for the deposit insurer?
- 8.G Do you agree that the deposit insurer should be able to provide funding for resolutions other than a liquidation?
- 8.H If yes, do you agree with the limit on the amount of funds that can be used? What are your views on the appropriate safeguards?
- 8.I What are your views on the appropriate decision authority for the coverage limit?
- 8.J If a deposit insurance fund is established, should changes to the target size and the levies be made by ministers via regulations or by the deposit insurer itself?
- 8.K Should there be a legislated requirement to review the deposit insurance scheme? If so, how often should it be reviewed (e.g., every five years)?

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### **Institutional arrangements**

- 8.L Has the Review identified the appropriate criteria for assessing the best organisational form of the insurer?
- 8.M Do you agree that the insurer should be located within the Reserve Bank? If not, what approach would you suggest?

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### **Funding framework**

- 8.N Do you agree that the insurer should build a deposit insurance fund ahead of a failure? If not, what approach would you suggest?
- 8.O What are your views on the appropriate size of any deposit insurance fund?
- 8.P Should the insurer charge higher levies to higher risk deposit takers? What are your views on how risk should be assessed?
- 8.Q What are your views on how the Government funding backstop should be designed?

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**Any other comments?**

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# SAFEGUARDING THE FUTURE OF OUR FINANCIAL SYSTEM

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