The Treasury

Reserve Bank Act Review Phase 2 Consultation 3 Submission Information Release

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Submission

to the

Treasury and Reserve Bank of New Zealand

on

Consultation Document 3 of the Phase 2 Reserve Bank Review

28 October 2020

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About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following seventeen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - China Construction Bank
   - Citibank N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
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   - TSB Bank Limited
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Introduction

3. NZBA welcomes the opportunity to provide feedback to the Treasury and Reserve Bank of New Zealand (**Reserve Bank**, together **Review Team**) on *Consultation Document 3: Safeguarding the Future of our Financial System – Further consultation on the prudential framework for deposit takers and depositor protection* (**Consultation Document**). NZBA once again commends the high standard of work that has gone into developing this, and the previous, consultation documents during the Phase 2 Review.

Contact details

4. If you would like to discuss any aspect of this submission, please contact:

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Key themes underlying our submissions

5. Phase 2 of the Reserve Bank review recognises that prudential regulations and financial policy are critical to economic and social outcomes. This reform has rightly been given a high priority and we commend the approach brought to it by the Reserve Bank and Treasury teams.

6. Phase 1 of the review gave statutory expression to this through a new over-arching objective, in s 1A of the Reserve Bank of New Zealand Act 1989 (**RBNZ Act**) to "*promote the prosperity and well-being of New Zealanders, and contribute to a sustainable and productive economy*". NZBA supports that objective. It must provide the yardstick by which all aspects of the regime are measured.

7. Clearly, this begins with safety – banks owe this duty first and foremost to their depositors. But it also needs to be dynamic and effective, to enable banks and their governors the agility to anticipate and respond to continuous change and to support their customers and the economy in all states of the world. This reflects the meaning given by the IMF to "financial stability" (refer pg 12), and therefore is consistent with the in-principle decision made about the objectives of the Deposit Takers Act (**DTA**).

8. The Phase 2 policy proposals that have been further framed in Consultation Document 3 are a big step forward in this regard, providing a far more rigorous and transparent basis for the Reserve Bank's prudential mandate and to banks' responsibilities in helping to give that effect. In our submission there remain a number of aspects that need some refining in order to meet the ambitions of section 1A:

   (a) **Purpose**: The component sub-purposes that are employed to define "financial stability" must incorporate factors in addition to safety that relate to the effectiveness of the financial system in promoting prosperity and well-being and contributing to a sustainable and productive economy. That is, they should promote *efficiency*, both as a central principle underlying the regime (i.e. as a purpose), and beyond the narrow regulatory cost-benefit concept in the decision-making principles.

   (b) **Coordination**: It is the nature of regulatory measures that they are enacted piecemeal but must be given effect in totality and, ideally, holistically to contribute towards the Government's overall goals of prosperity and wellbeing. In addition, there is a layering of existing and proposed regulation covering similar activities, each requiring a tailored regulatory structure to be built. This approach increases complexity and cost. It is crucial, therefore, that regulatory measures are streamlined and coordinated, to avoid a paradigm that is merely compliance-driven and risk-averse, and detracts from dynamism, innovation and customer-focus.

   (c) **Duties and liabilities**: The enforcement and liability regime is proposed to be remodelled on a similar basis to that contained in the Financial Markets Conduct Act 2013 (**FMCA**). We support this direction, which is consistent with the coordination principle just mentioned. It is also proposed to feature new, broad-ranging positive duties on banks' directors and senior managers. The formulation of those duties should be closely considered in their context, refined and clarified. They apply at the governance level and should observe both governance principles and the purposes of the Act. This is the reason why, for example, fiduciary duties enshrined in the

Companies Act 1993 are not subject themselves to civil and criminal sanctions. This load should be carried by the enforcement provisions, which themselves are framed by due diligence defences designed to promote a positive compliance culture.

(d) **Crisis management**: We support the proposal to provide for a modernised, Key Attribute-compliant crisis management framework. In the short run, this provides the Reserve Bank with a superior toolkit to respond to bank failure. But it is important to recognise that any such framework requires enormous resource commitment to be developed and operationalised – as has been the case over the past decade with the current framework premised on statutory management and open bank resolution. As the supervisor, other government agencies and the banks plan for and undertake the investments required in this respect, including by way of new and revised Standards, it is crucial that the end-point is a single, coherent framework, and that work done on open bank resolution (**OBR**) prepositioning or outsourcing is efficiently transitioned to support and contribute to it.

9. These are significant and complex reforms with wide-ranging impacts. We welcome the review and look forward to continuing to engage with the Phase 2 team in developing the new policy framework and moving toward the Exposure Draft.

Brief summary of our responses, by Chapter

10. We set out below a brief overview of the key submissions we have made on the topics set out in those papers.

Chapter 2: Purposes of the Deposit Takers Act

11. We submit that a further DTA purpose should be added, to "promote the efficiency of the financial system". Absence of an efficiency purpose would:

    (a) Contradict a key component of the concept of "financial stability" accepted in prudential regulation internationally.

    (b) Undermine the intent and effectiveness of the new decision-making structure (including for Standards, which now includes a requirement for a formal RIS) and accountability provisions.

    (c) Create a disjunction between the over-arching goal (promoting prosperity and well-being and contributing to a sustainable and productive economy) and the decision-making principles.

12. As such, the exclusion of an efficiency purpose creates an incoherence and skew at the heart of the new regime.

Chapter 3: The regulatory perimeter

13. We support the general approach taken in chapter 3 for the definition of the regulatory perimeter. The regulatory perimeter should be designed in a manner to support the financial stability objective and to discourage regulatory arbitrage and moral hazard.

Chapter 4: Standards and licensing

14. We broadly support the approach taken in chapter 4, and the focus on providing a clear and transparent basis for Standards. We note the importance of the upcoming work programme to create revised/new standards. We would welcome an opportunity to provide input on that programme, in particular regarding the split between Standards and Reserve Bank guidance and the continuity with existing workstreams that should be replicated in the new regime.

15. We also support setting the basis for macro-prudential interventions by the Reserve Bank in Standards (with appropriate inter-agency coordination). They should be applied on a basis that is competition-neutral.

Chapters 5 and 6: Liability, accountability and enforcement powers

16. The Consultation Paper proposes a new liability regime together with a wide range of powers of enforcement. Key to the success of this regime will be consistency and alignment with other overlapping regulation.

17. We agree with the modernisation of these provisions and strongly support an approach to liability and accountability that aligns with the FMCA (and that is coordinated with other key accountability regimes), particularly in relation to the distinction between civil and criminal liability, personal liability, and availability of 'due diligence' and other defences.

18. The proposed enforcement powers provide a wide range of tools to the regulator to respond proportionately to breaches. It will be important to ensure that the new range of powers available to the regulator is implemented in a manner that provides

for consistent approaches (both with different regulated entities and across different regulatory regimes) and proportionate responses. Given the large degree of overlap and flexibility between the new enforcement powers that have been proposed, it is important that there be clear guidelines on what enforcement powers should be used when, and protections to ensure that regulator responses are reasonable in the circumstances.

Chapter 7: Resolution and crisis management

19. We support the approach taken in the consultation paper to make the New Zealand crisis management regime compliant with the Key Attributes for Effective Resolution Regimes for Financial Institutions prepared by the Financial Stability Board (**Key Attributes**). We note the importance of creating a single, coherent framework, which takes into account any pre-existing workstreams (e.g., related to OBR prepositioning or outsourcing).

20. Given the limited scope of the questions in chapter 7 on which feedback is sought we would welcome an opportunity to be further involved in the future implementation of the crisis management framework.

21. We are largely indifferent whether the scope of bail-inable liabilities is defined through a positive or negative list but note the importance of clear communication of the scope of bail-inable liabilities and of alignment of the scope with the NCWO principle.

22. We strongly support unifying the statutory management and resolution regime of the RBNZ Act and Corporations (investigation and Management) Act 1989 (**CIMA**) into a single regime.

Chapters 8: Depositor protection

23. We broadly support the approach taken in chapter 8 regarding introduction of depositor protection but oppose the introduction of depositor preference, in particular given the impact on banks' funding costs.

Submissions on Consultation Paper 3

24. **It is important that our specific submissions are read in conjunction with the key themes set out at the start of this submission, as the key themes outline important inter-relationships between various specific submissions.**

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?

Summary of our key submission on this part

25. We agree with the overall structure of the purposes, including the way that the sole primary objective of the Deposit Takers Act (DTA) interacts with the recently enacted over-arching objective of the RBNZ Act "*to promote the prosperity and well-being of New Zealanders, and contribute to a sustainable and productive economy*".

26. We focus in our submissions on this part on the proposal to add three subsidiary purposes to clarify the term "financial stability". Our submissions are that those subsidiary purposes as drafted:

    (a) would alter the meaning given to "financial stability" in prudential literature and practice; and

    (b) could create significant ambiguity about the way that financial stability, and prudential policy, is intended to contribute to the over-arching purpose of the regime.

27. We also submit that the subsidiary purposes themselves could create unintended implications as a consequence of their current formulation and, for that reason, could create more problems than are thought to be solved by the exclusion of "efficiency" objective. This is addressed under question 2.B.

28. In summary, we submit that efficiency – a measure of how well the financial system performs its functions, thereby contributing to a sustainable and productive economy – or some formulation reflecting efficiency in that sense, should be an objective in itself, and not merely an analytical consideration.

Background – structure and interpretation of the proposed purposes

29. The proposed purposes, as noted, are designed to clarify the meaning of the sole objective for prudential policy, financial stability. Part of the rationale for this is that the term "financial stability", although a very widely used concept in prudential analysis and practice, does not have any single, precise definition.

30. However, such precision is neither necessary, nor particularly common, in the drafting of statutory objectives, which are high level by design. For example, the FMCA calls for development in New Zealand of financial markets which are "*fair, efficient, and transparent*", without any further definition of those terms. In a prudential context, the term "financial stability" is expressed as a cornerstone of the

Australian Banking Act, and no attempt is made to give a more precise statutory expression of its meaning.[1]

31. The term "financial stability" is conventionally understood as encompassing the performance of the financial system in respects beyond mere safety, but extend to delivering outputs that contribute to a sustainable economy, prosperity and well-being.[2] That meaning gels with the regime's over-arching objective, which the financial stability objective is intended to support.

32. This is not the direction taken in the purposes proposed for the DTA, which seeks to clarify the meaning of financial stability by reference to factors which accord no clear recognition to the effectiveness of the financial system in delivering outputs to customers or facilitating a productive economy.

33. The shorthand for this broader yardstick previously employed was "efficiency". Yet this term has been excluded from the DTA's purposes, while a variety of formulations revolving around safety and risk have been retained or reinstated. While a decision-making principle has been included relating to the benefits and costs of prudential decisions, this does not expressly address factors relating to how the financial system performs to support the productive economy, and nor is it expressed as a goal for the prudential mandate. The net result is a set of objectives for prudential policy which appear at odds with the objectives for the regime as a whole.

34. We submit that a further DTA purpose should be added, to "promote the efficiency of the financial system". Given some of the difficulties with the secondary purposes as formulated, an alternative may be to leave the financial stability objective to its ordinary meaning in a prudential context (the approach taken in Australia), and amend the "regulatory efficiency" decision-making principle to include efficiency in its ordinarily understood sense. We expand below on the reasoning underlying our submission.

The centrality and importance of the prudential objectives

35. We agree with the amount of attention that has been given to formulating a coherent set of objectives and decision-making principles for the DTA. As noted in New Zealand's legislative guidance, the "*objective of a bill is its backbone*".[3] It has a crucial role in underpinning interpretation of the statute[4] and guiding the direction of policy making under it.

36. Within the structure of the prudential legislation replacing the existing Act, the prudential objective of financial stability will sit beneath the over-arching objective for the regime, formulated under Phase 1 of the Review, "*to promote the prosperity and well-being of New Zealanders, and contribute to a sustainable and productive economy*". This is an innovative and challenging goal, which recognises – correctly

[1] Banking Act 1959 (*Cth*), section: "(1) The main objects of this Act are: … (b) to promote financial system stability in Australia."

[2] Consultation Document 2a, pg 16, for example, notes that "'Financial stability' captures the aspects of soundness and efficiency".

[3] LDAC Legislation Guidelines: 2018 edition, pg 14.

[4] Section 5(1) of the Interpretation Act 1999 provides that "The meaning of an enactment must be ascertained from its text and in the light of its purpose". See also *Commerce Commission v Fonterra Co-operative Dairy Group* [2007] 3 NZLR 767.

– the importance of the financial system in delivering positive economic and social outcomes for New Zealanders.

37. The key in-principle decision has been taken that "financial stability" should be the sole 'primary' goal for the prudential framework that is encapsulated in the DTA, in support of the over-arching objective just noted above. That decision is a well-reasoned one – financial stability is the touchstone of evolved prudential regimes across the globe.

Assessment of the proposed secondary objectives

38. The main proposals put forward in the third Consultation Document are:

(a) To separate out the purposes of the DTA from decision-making principles for prudential actions taken under it. As noted under question 2.B, we support this approach.

(b) To add three purposes specifically for the DTA (i.e. for the prudential aspects of the Reserve Bank's mandate).

39. These specific purposes lie beneath the sole financial stability objective, making them secondary to that objective, and tertiary to the over-arching objective of the regime as a whole, creating a cascade of statutory purposes.

40. The way the subsidiary purposes are drafted makes it clear that they are intended to clarify the meaning of the term "financial stability".[5] The reason for this approach is evidently the recognition in the 2a Consultation Document that there is no single accepted definition of "financial stability".

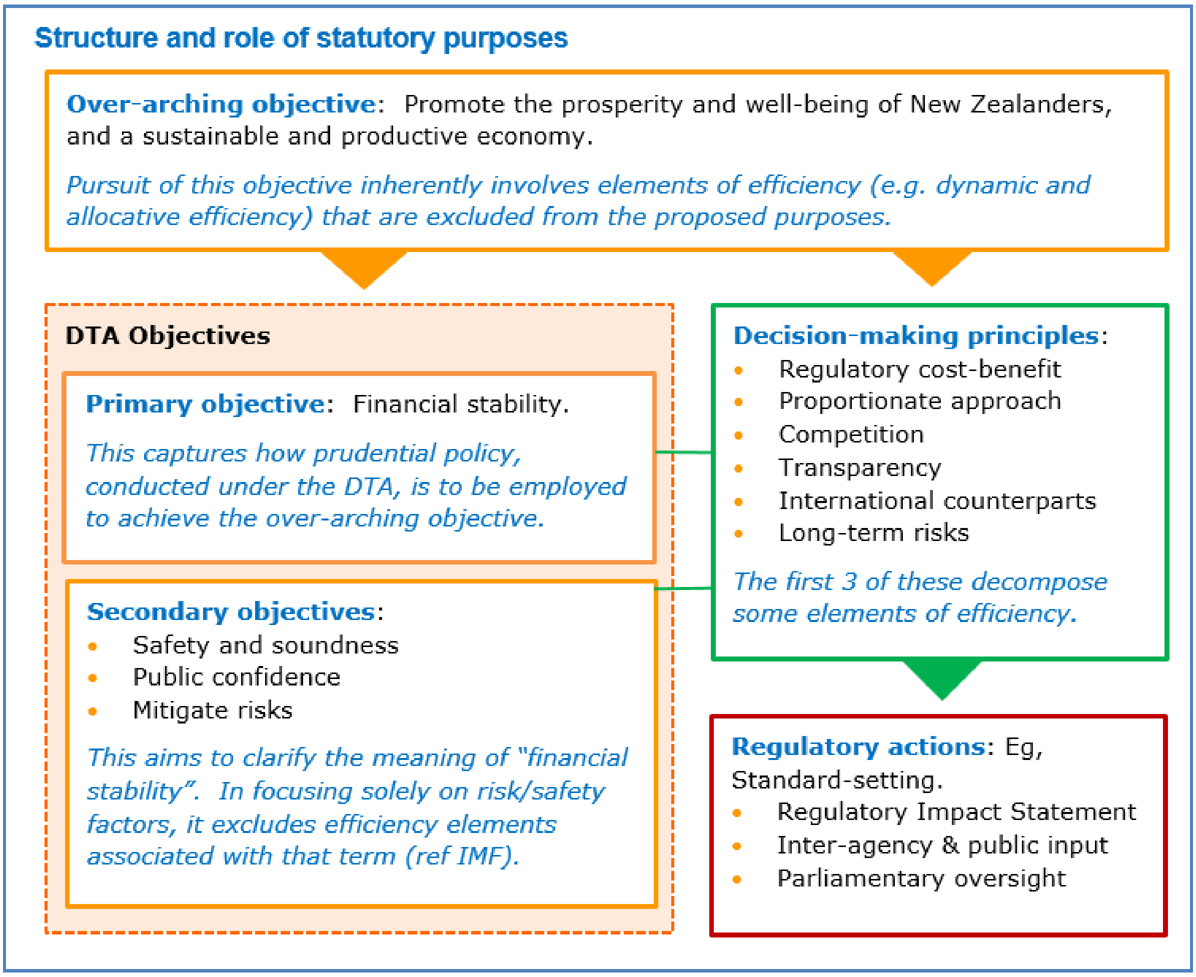
41. An extensive range of potential purposes were put forward for consultation in the C2 document. NZBA, among others, submitted that this would result in confusion, and recommended a manageable list of objectives, clearly organised in priority. We also argued that a clear distinction must be made between purposes (the "*why*") and decision-making principles (the "*how*").

42. We consider that the structure now proposed by the Phase 2 team sets the basis for a rational and clear regime, but we submit that the approach taken to the secondary purposes falls short of officials' expressed regulatory design objectives, for the reasons outlined in more detail below.

Statutory scheme in which the purposes sit

43. To give some context to our submissions, we set out in diagrammatic form the structure proposed for the DTA's purposes and decision-making principles, and how these relate to the functional parts of the regime – most relevantly, the new processes for formulating and implementing prudential Standards, and the new institutional accountability framework more generally.

5 This intent is evident in the drafting, in which each of the subsidiary purposes is to "contribute to protecting and promoting the stability of New Zealand's financial system".



44. This is a reasonably elaborate structure, although much simplified from the proposals in the 2a Consultation Document. From a positive perspective:

(a) there is now a clear distinction made between the "*why*" – the purposes – and the "*how*" – the decision-making principles; and

(b) the list of objectives is now a manageable one, subject to our comments under Question 2.B.

Outcome of this structure from a statutory interpretation perspective

45. As noted above, the subsidiary purposes are intended to clarify the "financial stability" objective. In the way they are formulated, we consider that they function similarly to a definition of that term.[6]

46. Statutory interpretation is directed to discerning the intention which a Court should reasonably impute to Parliament in respect of the language used.[7] This begins with

6 There is precedent for this approach, for example in the amplification of the objective of "sustainable management" in the Resource Management Act 1991.

7 *R v Secretary of State for the Environment, Transport and Regions ex p Spath Holme Ltd* [2001] 2 AC 349 at 396 per Lord Nicholls.

the ordinary meaning of the words used, is coloured by the context and statutory scheme,[8] and may also be informed by the legislative history of the provision.

47. The core provisions leave little room for ambiguity, since they have been carefully drafted to exclude broader notions of efficiency – and in particular, dynamic and allocative efficiency – from both the purposes and from the decision-making principles.

48. The statutory scheme in which these provisions are set is also significant in that the secondary purposes will influence the interpretation of the decision-making principles and – through them – the approach that should be undertaken to the formulation and evaluation of prudential policy.

49. Taking the regulatory efficiency principle as an example, in the cost-benefit calculus forming part of the Regulatory Impact Statement, the **benefits** according to this interpretation would be the contribution to soundness, public confidence and risk mitigation, and the **costs** would involve an evaluation of whether the amount of the regulatory impost exceeds what is necessary to achieve those purposes. Other than in circumstances where competition is impacted (the subject of a separate decision-making principle), there appears to be little room in the statutory scheme to take into account any likely impacts (favourable or adverse) on how well the financial system performs its functions.[9]

50. This is the most natural interpretation because neither the purposes nor the decision-making principles incorporate any criteria, beyond safety, relating to the performance of deposit-takers or the financial system as a whole in supporting a productive economy (whether via the term “efficiency” or otherwise). To put this another way, it is not clear how impacts on performance of key functions of the financial system would be relevant as a matter of statutory interpretation in the absence of any clear recognition of such factors in the purposes.

51. Returning to the statutory scheme, all the purposes and decision-making principles in this DTA are subsidiary to, and are intended to support, the over-arching purpose to promote prosperity and well-being and contribute to a sustainable and productive economy. Achieving the overarching purposes inherently involves factors relating to the performance of the financial system in delivering its core functions (that is, financial system efficiency), which are not reflected in the scope of the purposes for the prudential part of the regime that is addressed in the DTA. This approach would create a substantial ambiguity at the heart of the new law, and arguably would make the objectives of the DTA discordant with those of the regime as a whole.

Achieving the regulatory design objectives

52. The officials’ regulatory design objectives are set out on pg 8 of the C3 paper:

> “However, they [deposit-takers] *can also impact on the efficiency of the financial system, including the range of financial products available to investors and their financial returns*. The objectives, purposes and principles the Reserve Bank is directed to use in decision-making need to balance stability against encouraging efficiency and growth. *It should be clear to the Reserve Bank that financial stability should not be*

[8] *Commerce Commission v Fonterra Co-operative Dairy Group* [2007] NZSC 36, [2007] 3 NZLR 767; Burrows and Carter *Statute Law in New Zealand* (5th ed, 2015, LexisNexis, Wellington) at 259.

[9] Compare Bloor and Hunt “Understanding financial system efficiency in New Zealand” (Reserve Bank of New Zealand Bulletin, Volume 74(2), June 2011), at pg 28: “Efficiency, broadly speaking, is how well the financial system performs these various functions.”

pursued without a consideration of the impacts of regulation on wider economic activity and the efficient provision of financial services." (Emphasis added.)

53. We agree that those matters should be clear, but submit that the promotion of financial stability does not inherently involve a conflict between the soundness and performance of the financial system – rather, these factors are inextricably linked in the pursuit of financial stability, and in a well-functioning (efficient) financial system they should be complementary. This perspective is evident in the IMF's definition of financial stability:[10]

Broadly, financial stability can be thought of in terms of the financial system's ability:

(a) to facilitate both an efficient allocation of economic resources – both spatially and especially intertemporally – and the effectiveness of other economic processes (such as wealth accumulation, economic growth, and ultimately social prosperity);

(b) to assess, price, allocate, and manage financial risks; and

(c) to maintain its ability to perform these key functions – even when affected by external shocks or by a build-up of imbalances – primarily through self-corrective mechanisms.

54. It is clear from this that efficiency is regarded as integral to stability, and that dynamic and allocative aspects of efficiency are key factors in achieving the over-arching goals of contributing to a sustainable and productive economy.

55. The approach taken by the IMF is very similar to the Reserve Bank's own analysis of, and approach to, its existing regulatory mandate.[11] In discussing what financial system efficiency means, the Reserve Bank notes:[12]

The primary function of the financial system is to facilitate the allocation of society's scarce resources, both across the economic system and over time, in an environment of inherent uncertainty. If the financial system performs this role well, then it will be contributing to economic growth and prosperity in a positive way.

56. Yet the concept of financial stability constituted by the three secondary objectives proposed contains no trace of any such factors, or that promotion of a financial system that has those characteristics is a worthy or feasible aim for prudential policy. Such factors – commonly encapsulated within the word "efficiency" – are in our view essential in pursuing the regime's over-arching purpose, to "*promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy*".

57. Excluding efficiency-related concepts from the DTA's purposes would also render the prudential regime anomalous with wider financial policy, where – as noted on pg 3 of the C3 paper – the "Financial Markets Authority (FMA) is responsible for promoting fair, *efficient* and transparent financial markets". Notably, in the FMCA this 'main purpose' of efficiency as a desired nature of the financial markets is

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10 Refer Garry J Schinasi "Defining Financial Stability" (IMF Working Paper WP/04/187, October 2004), at pg 8. See also Asli Demirgüç-Kunt and Ross Levine "Finance, Financial Sector Policies, and Long Run Growth" (Commission on Growth and Development Working Paper No. 11, 2008); and James R Barth, Gerard Caprio Jr, and Ross Levine "Financial Regulation and Performance: Cross-Country Evidence" (unpublished working paper, 1998).

11 An express purpose of "efficiency" is currently contained in sections 1A, 10, 53, 68, 156B, 156K, 162AA and 165 of the RBNZ Act.

12 Refer Bloor and Hunt, footnote 9, at pg 26.

separate from the ‘additional purpose’ of regulatory efficiency (refer sections 3(b) and 4(c)). This makes it clear that efficiency is both a desired characteristic of the financial markets and a key decision-making principle. A consistent approach in this regard is particularly important given that the RBNZ Act and FMCA each address the core component parts of New Zealand’s overall financial system.

58. The issue here is not so much the omission of the term “efficiency” per se, but the absence of any concepts about the characteristics of the financial system, beyond safety, that would contribute to the over-arching goal. This omission is ameliorated, but not resolved, by the careful formulation of the regulatory cost-benefit decision-making principle, which:

(a) is not a purpose, and therefore plays no role in describing the desired characteristics for the financial system (i.e., it is a “how”, rather than a “why”, provision); and

(b) leaves no room for “efficiency” in the sense meant above (including, for example, elements of allocative and dynamic efficiency, where relevant).

59. As a result, the purposes omit considerations that are central both to high quality prudential policy-making and to achievement of the regime’s over-arching objective.

Other issues with the formulation of secondary objectives

60. It was acknowledged in Consultation Paper 2a that there is no settled meaning of the term “financial stability”, with the consequences that “*having a financial stability objective is not enough on its own to guide the Reserve Bank*” (pg 18). A series of secondary objectives has therefore been employed to shape the meaning of the term as used in the DTA.

61. The result, in our submission, is a concept of financial stability that would not conform to the internationally recognised meaning of the term “financial stability”, and includes a reversion to previous formulations of the statutory purpose which have been rejected in making the in-principle decision to adopt the single objective of financial stability. It would also, as we have noted, diverge from the over-arching purpose of the regime and to the Reserve Bank’s own approach to carrying out its mandate, consistently with that purpose.

62. The component objectives put forward in C3 to bring greater clarity to the financial stability objective are set out below, with our comments:

DTA Purpose	Comments
Promote the safety and soundness of deposit takers	This brings significantly more attention to the micro-prudential dimension than is currently the case (all existing references are to a sound *financial system*) or would ordinarily be associated with the term “financial stability”. It is unclear why the superseded term “soundness” has been preserved while its counterpart “efficiency” has not – particularly because this would result in a fundamental shift in policy balance that does not have any evident basis in the in-principle decision and for which no rationale has been articulated. Nor is it clear why “safety” has been added, or what significance it is meant to have, over and above soundness or stability.

DTA Purpose	Comments
Promote public confidence in the financial system	This would involve revival of a term that was superseded prior to the enactment of the current Act.[13] Presumably this term was rejected because it has no clear meaning and because a "sound and efficient" financial system should produce that effect. As such, it is best regarded in a prudential context as an outcome of sound prudential policies rather than as a contributor in its own right to financial stability.[14] If, on the other hand, it relates to the efficacy of the financial system in delivering appropriate financial products, growth or prosperity, then it has nothing to adhere to in the existing formulation of the statutory purposes, which do not refer to the efficiency of the financial system in the sense of its outputs to customers and other users at all.
Mitigating the risks that arise from the financial system	It is not clear what this adds to the concept of stability which is not inherently contained within the term itself or how it is intended to interact with the separate consideration of risks as part of the decision-making principles. As things stand, it further reinforces of a tilt toward purposes solely related to safety and risk and not to any other performance parameters for a well-functioning financial system.

63. As noted, the biggest gap in the proposed formulation is that there is no reference to the performance of the financial system in any respect other than its safety (as was previously encompassed, for example, within the term "efficiency"). In addition to that being surprising in its own right, it creates difficulties in the interpretation of other purposes put forward to amplify or clarify "financial stability". For example, if public confidence is meant to encompass the broader performance of the financial system, then it is ineffective without some purpose directed to that performance and not just to safety and risk. In this sense, too, efficiency is a key concept – a financial system that is sound and efficient should inspire public confidence, but it is very doubtful that one that is sound but inefficient would.

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?

64. Subject to the submissions made in response to Question 2.A about the lack of a link to an efficiency criterion, the proposed decision-making principles seem to be sound and will likely prove important in underlying, among other things, the new decision-making structures discussed in chapter 4.

13 Refer section 38J Reserve Bank of New Zealand Amendment Act 1986.

14 As noted in the Consultation Document, depositor protection contributes to public confidence and – through reducing the likelihood of bank runs – to financial stability, but at a theoretical level it does so at the expense of increasing moral hazard, making it an ambiguous contributor to "financial stability", or to prudential policy, in its own right. If the objective is to create a more clear meaning of the term financial stability, such ambiguities become serious – for example, the mitigation of risks which is referred to in the next purpose could be seen as deriving from an *excess* of confidence.

65. In relation to the first point, the analysis notes: "financial stability is not pursued at all costs – so principles should include efficiency-related considerations, **such as** the need to consider net benefits in undertaking regulatory actions" (pg 23) (emphasis-added). Such considerations will need to be addressed in Regulatory Impact Statements that will be required to accompany most policy proposals (including in relation to Standards).[15]

66. Although the statement about net benefits is important, it highlights a significant flaw in the proposed purposes and decision-making principles taken as a whole. As things stand, "minimising of unnecessary costs of regulatory actions" is the **only** efficiency-related consideration that is given statutory recognition (other than to the extent that sectoral competition may be relevant). As a result, there would be no statutory anchor for stakeholders responding to a regulatory proposal (including those from outside the banking sector) to suggest that it falls short on some broader efficiency measure – for example, that it would contribute to a misallocation of resources in the economy. While the weighing of such considerations is a matter for the decision-maker, it is important to recognise the value of such debates in contributing to high quality policy making – particularly in light of the overarching purpose of the regime.

67. It is clear from the Reserve Bank's approach that efficiency in its broader sense is relevant to both prudential policy and to achievement of the regime's overarching purposes. For example, in its May 2014 Financial Stability Report, the Reserve Bank noted:

> *An efficient financial system is one that enables economic resources to be allocated to their best use across time and space without imposing unnecessary costs (or 'rents') on households and businesses. … [A]n inefficient financial system can hamper economic prosperity by imposing unnecessary costs on households and businesses … and misallocating resources.*

68. Deputy Governor Geoff Bascand recently gave the following interpretation, to similar effect:[16]

> *The efficiency goal means different things in different contexts: we minimise compliance costs; we support innovation and operate a regime that is open to new entrants; we avoid creating unnecessary frictions in the supply of credit to the economy; and we ensure that financial resources are allocated in a productive (and not harmful) way to maximise long term economic growth.*

69. As such, in addition to recognition within the purposes of the DTA, we submit that the relevant decision-making principle should be amended as follows:

> "**promoting efficiency, including through** the desirability of minimising unnecessary costs of regulatory actions, taking into account the benefits of the outcomes to be delivered"

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15 This clarifies existing requirements under section 162AB of the RBNZ Act.

16 From a speech entitled "Financial stability – risky, safe, or just right?" delivered to the UBS Australasia Conference in Sydney (13 November 2018).

Chapter 3: Regulatory Perimeter

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

70. Yes, subject to the comments under specific questions below, we think Proposed Approach 3.1 is a reasonable basis for setting the regulatory perimeter.

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 not, what would be an appropriate measure of size?

71. The key question raised by this section is the ability of the Reserve Bank to respond to changes within the overall financial system, both within and outside the defined regulatory perimeter. At a minimum, it is imperative that the Reserve Bank has the information necessary to discharge its prudential function across the financial system, and tools to act where it deems that a threat to stability is emerging. As such, we support the creation of an RFC-style regime applying to significant wholesale-funded non-bank lenders.

72. In relation to the proposal for a size threshold, we agree this is a relevant factor to system stability, but note that a lesson from the GFC is that business model and controls can be just as important.

73. We do not have any comments about the proposals with respect to territorial application, addressed in Question 3.D.

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

74. We submit that, as a starting point, the definition of "associated person" in s 10 of the Insurance (Prudential Supervision) Act 2010 is most consistent with best practice in prudential supervision of groups. It is important that provisions along the lines of s 117(3) RBNZ Act are retained again to reflect best (and current Reserve Bank) practice.

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.P: Do you think the use of the word "bank", "banker" and "banking" should be restricted to a subset of deposit takers? If so, what criteria would be appropriate for their use?

75. We agree with the proposed approach of placing restrictions on both the terms "bank" and "deposit taker". It is consistent with the existing Act and with Basel Core Principles for Effective Banking Supervision (**BCPs**), and it conveys crucial information to customers about the nature of investments they are considering – not only about whether that investment will be in-scope for deposit protection, but also whether the relevant entity is prudentially supervised.

76. In principle, we support restricting the word "bank" to entities of a certain size or characteristics. It is a familiar terminology for customers, at least until the new concept of a "licensed deposit taker" takes hold, and expresses difference of substance as well as form (not limited to scale) – particularly in view of the tailored and proportionate approach proposed to the formulation of Standards and to application of the prudential regime more generally. Detailed criteria should be developed focusing on such differences of substance and should include scale at least as a factor to be considered, but ultimately this designation should be a matter for the supervisor to determine (subject to customary rights of affected parties to be heard).

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

77. In principle, we do not consider that there is an issue with a proposal to enable the Reserve Bank to treat branches of foreign banks as a class of deposit taker for the purposes of the Standards – to some extent, this represents the existing approach taken under Conditions of Registration and the Handbook. More detail would be required to make a fuller assessment of this proposal.

3.I to 3.V – Questions relating to small deposit takers and other NBDTs

78. We have no comments about the proposals under Questions 3.I to 3.V as far as they relate to small deposit takers and other NBDTs, other than as set out below:

    (a) **Question 3.S (perimeter monitoring)**: An important part of the Reserve Bank's prudential mandate is to monitor the whole financial system in order to be in a position to determine if there are any emerging threats to stability, including from sectors or entities outside the regulatory perimeter. As such, we support the proposal to create a category along the lines of the Australian Registered Financial Corporations, at a minimum for the purpose of reporting.

    (b) **Question 3.T (designation)**: We agree that the Reserve Bank should have the power to designate a person as a licensed deposit taker (**LDT**) where, in substance, they are offering deposits to the public. This is an important anti-avoidance measure to protect the integrity of the regime.

(c) **Questions 3.U and 3.V (exemptions)**: Exemptions are a part of the NBDT regime and in principle provision could be made for them within the DTA, in accordance with the decision-making principle of proportionality. However, given that the approach proposed to Standards already contemplates tailoring the prudential regime to the circumstances of particular deposit takers, this may be of less significance in the future.

Chapter 4: Standards and licensing

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

Overview

79. Broadly, we agree with the approach taken in the Consultation Document to the scope of the Standards and with the indicative list set out in Table 4.1.

80. We agree with officials that it is important to provide a transparent and robust foundation for both Standards and the broader prudential toolkit – the current legislation falls short in these respects, owing to the comparative lack of attention given to prudential matters at the time it was enacted. We also agree that there should be rigorous processes for the promulgation of Standards, ideally of a nature that encourages engagement by broader stakeholders.

81. In the latter regard, the Consultation Document correctly notes the significant links between the new checks and balances for Standard-setting and the proposed purposes and decision-making principles that are the subject of Chapter 2. For the reasons given in our submissions on that chapter, it is important that the purposes contain components aligning with the over-arching objective for the regime.

Scoping of new/revised Standards

82. We support the proposal for prudential policy to be made consistently through a single instrument, a Standard, taking effect as secondary legislation, and subject to common processes of consultation and review. This is clearly superior to the status quo, in which a range of instruments and processes currently govern these matters, including prudential standards applied through conditions of registration; disclosure requirements governed by Orders-in-Council; macro-prudential policies which also are grounded in conditions but are governed by additional requirements under an MOU; and important elements that apply indirectly through those powers but do not otherwise have specific statutory recognition (notably in relation to internal risk management systems, controls and policies, where the requirements are given effect through the director attestations required in Disclosure Statements).

83. By way of further comment on the analysis set out in chapter 4:

    (a) We support with the approach of setting the parameters for the Standards on a 'subject area' basis, by reference to the contents of the existing Handbook and also more generally by reference to the BCPs. It would be useful in this regard to undertake a similar process of making reference to relevant BCPs in the list contained in Table 4.1 as it evolves, noting that in many cases the BCPs are high level, so may be suitable only in setting general directions. This would help ensure alignment at the design level with international best practice, comply with the new decision-making principle relating to international coordination, and inform an assessment of BCP compliance and the response to the IMF FSAP findings.

(b) Similarly, we agree that, in legislating the scope of the Standards, it is crucial to define that scope with precision sufficient to comply with LDAC's Legislation Guidelines, and that flexibility to cater for future developments should be provided via a regulation-making power (consistent with s 78(2) of the existing Act). In addition to the concern with legitimacy of the law, this is also important in promoting key purposes and decision-making principles under the new regime – including regulatory efficiency and transparency – and connecting to its over-arching objective.

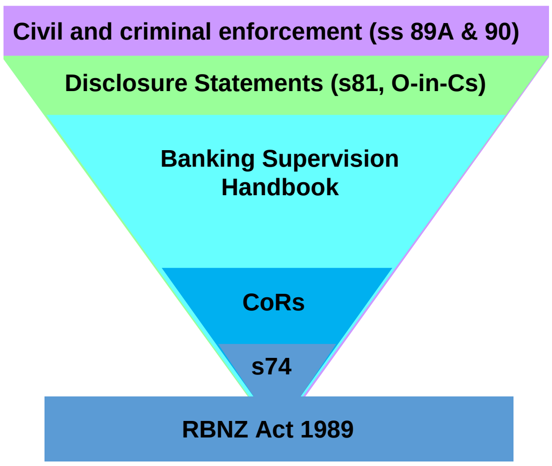
(c) In relation to the new decision-making principles, a particular question in relation to Standards relates to the new requirement for the Reserve Bank to consider practice by international counterparts and guidance and standards from international bodies. In this respect, for New Zealand banks operating under home/host arrangements, consistency in the impact of home jurisdiction prudential standards should also a factor taken into account when formulating Standards.

Legislative coordination of overlapping tools and powers

84. It is important to view the Standards in context. A key objective of the reform is to provide the Reserve Bank with "a flexible and empowering regulatory framework", enabling the Reserve Bank to calibrate its supervisory responses to the particular circumstances.

85. NZBA supports this initiative, which responds to a central flaw with the current prudential framework that the majority of the prudential and supervisory powers currently flow from the narrow base of the statutory mandate to license banks and to set conditions of registration:

Current basis for prudential powers



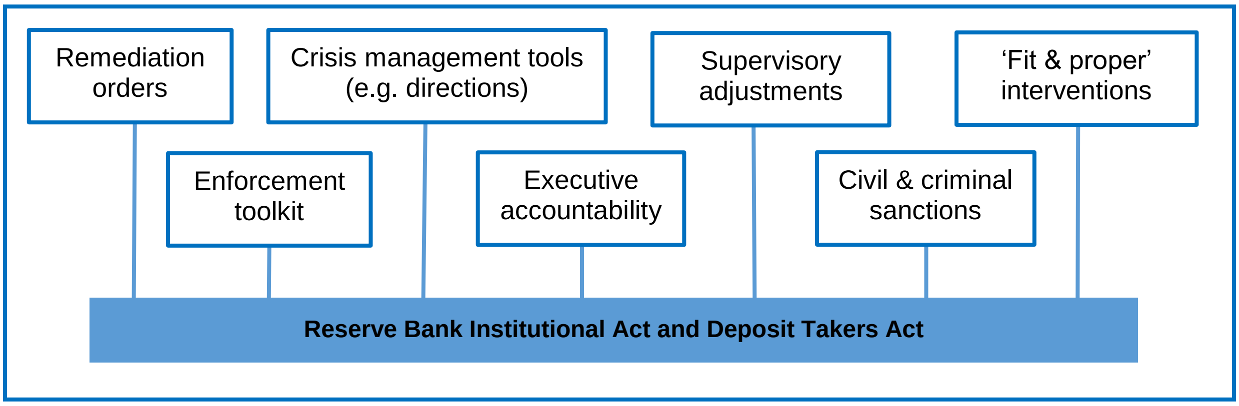
Explanation

- The prudential regime rests on the power in s 74 to impose conditions of registration by reference to the factors in ss 73 & 78
- Banking standards in the Handbook apply through standard Conditions of Registration
- Orders-in-Council governing Disclosure Statements require each director and the CEO to attest that the bank has complied with all CoRs (and thus all Standards) & has adequate control and risk management systems
- Criminal & civil sanctions for false/misleading DS disclosure – indirectly picking up both CoR breach & controls via the attestation

86. This is not a suitable basis for a highly evolved prudential regime. In addition to the absence of transparency, accountability and safeguards, it means that civil and

criminal liability can be imposed on an ill-defined basis without reference to materiality or fault.

87. The new regime proposed following the Phase 2 review will look dramatically different, likely including the following elements (subject to consultation and final decisions):



88. While the direction of this set of reforms is appropriate, it gives rise to significant legislative design challenges. In particular, it creates risks of overlaps and duplication, and corresponding requirements for harmonisation at the level of regulatory design and coordination at the level of implementation.

89. As we move from consultation about particular elements of the reform toward the Exposure Draft of the DTA, it will be important to avoid losing sight of the shape of the regime overall – particularly given the mutually reinforcing nature of the various components of the prudential toolkit – and to ensure that the various available tools and interventions are subject to procedures, consequences and safeguards that are coherent and fair.

Process for promulgating Standards

90. In principle, we support the more rigorous procedures that are proposed to apply to the formulation of Standards. We have the following comments on the procedural requirements set out in Ch 4.4:

(a) We agree that a Regulatory Impact Statement should be prepared at an early stage in the process and submit that the draft RIS should be required to be provided when Standards are put forward for consultation. This is consistent with Government guidance on best practice for policy-making[17] and, in better describing impacts, is also important in encouraging the participation of a broader range of stakeholders, since prudential regulation is a technical subject which tends to create high barriers to engagement.

(b) There should be a clear expectation in the analytical framework applying to Standards-setting, including in Regulatory Impact Statements, of the contributions made by complementary Standards and other elements of

[17] Refer https://treasury.govt.nz/publications/guide/guide-cabinets-impact-analysis-requirements-html.

the prudential toolkit.[18] The prudential tools interact and it is important not to analyse them in isolation. In many cases, particularly for more significant Standards, the RIS would benefit from a Multi-Criteria Analysis.

(c) The statutory objectives fundamentally underpin engagement on Standards. One rationale for the additional procedures and safeguards is that, in addition to their consequences for regulated entities, prudential rules "*may also have broader economic and social impacts (for example on the capital markets, or consumers)*".[19] As such, it is vital that the statutory purposes contain reference to matters relevant to those broader impacts and to the performance of the financial system (refer our comments on Chapter 2).

(d) In relation to consultation with other agencies, it is important that this is undertaken in a manner consistent with regulatory efficiency.

91. As was noted in Consultation Document 2a (pg 33), one of the most commonly identified issues with the existing approach to prudential standards is that they can be hard to navigate and the distinction between binding requirements, definitions, and guidance is not always clear. The new structure provides the opportunity to make a clear delineation in the instrument cascade, particularly in distinguishing 'hard rules' (as appropriate to Standards) from guidance, which is non-binding and principles-based – an approach commonly employed by the FMA. Questions of design in this regard will be an important facet of the Standard resetting project.

Brief comments on the content of the proposed Standards

92. We note that this is a consultation about the relevant principles, including as to the appropriate scope of the Standards that will be contemplated in the legislation. Consistent with that, the wording in the "Intended scope" column of Table 4.1 does not currently purport to be in a final statutory form that would comply with LDAC guidelines or PCO requirements. Accordingly, we will approach our submissions on the basis of high level principles.

93. As noted above, clear design will be important in giving effect to LDAC legislative guidelines and in achieving efficiency for all stakeholders in the project to re-formulate the banking standards in light of the new regime. We would welcome the opportunity to engage on the detail with officials, but there are a number of matters which it would be useful to clarify at this stage:

(a) It is suggested that "fit and proper" standards will apply on an ongoing basis, and not only on registration or appointment as currently under BS10. We would like to see more details about this policy and its interaction with other tools that will be available in the DTA, including as to the procedures, safeguards, and consequences.

(b) The "Ownership, incorporation and governance requirements" standard includes "the standing and regulatory framework of any parent entity". Again, it would be useful to know more about what is proposed here.

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18 Refer for example Bank of England (Martin Brooks et al) "Measuring the Macroeconomic Costs and Benefits of Higher UK Bank Capital Requirements" (Financial Stability Paper No. 35, December 2015).

19 Consultation Document 2a, pg 28.

(c) In relation to internal risk management systems and controls, we note that these are currently incorporated through the statements required to be made in periodic disclosure statements, and therefore are regulated primarily under the disclosure framework in section 81 of the RBNZ Act. We welcome the move to a positive statement of these principles by way of Standards. It will also be important to align the policies in this regard with the new accountability provisions and defences.

(d) In relation to public disclosure, we acknowledge the comments made in the Consultation Document about the difficult questions this raises for non-bank deposit takers which will come within the LDT framework, and note that this issue will be of more general concern when there is a combined bank and NBDT market for insured deposits, having both financial stability and financial markets conduct dimensions.

94. In relation to the indicative scope of prudential standards set out in Table 4.1, we also note that the following current Handbook documents are not covered in the table:

(a) **BS1 Statement of principles – bank registration and supervision**: The high level portions of this may be covered through the purposes and decision-making principles, but it also has some quite granular details that may need to be covered off in various Standards or guidance, including the elements related to overseas banks.

(b) **BS3 Application for status as a registered bank: Material to be provided to the Reserve Bank**: This is mainly a checklist so may not need to be a Standard in its own right (particularly if more details about licensing are included in other parts of the legislative framework). Nonetheless, it is a very useful document, providing transparency to potential applicants for bank registration, and thus contributing to regulatory efficiency, transparency and competition.

(c) **BS 18 Registration of Covered Bonds: process and information requirements**: This should be relatively easy to turn into a Standard.

95. These also give rise to the design question noted above concerning where matters provided for in existing Standards should fit within the legislative cascade – for example in achieving a more clear division between primary legislation, Standards, and guidance.

Transitional matters, planning

96. As noted in the Consultation Document, the undertaking to prepare new Standards required by new elements of the Phase 2 reforms – such as the Deposit Protection Scheme (**DPS**) and crisis management regime – and to re-write existing banking standards under the new procedures noted above, will be a "*very significant policy project*". This work will be on top of consultation on the draft Institutional Act and the Exposure Draft of the DTA and 'business as usual' requirements – including the re-activation of projects such as Outsourcing which were the subject of temporary extensions as a result of the Covid 19 pandemic.

97. These workstreams individually and collectively will require substantial resource commitments from the Reserve Bank, agencies required to be consulted under the new procedures, the industry, and any other stakeholders who wish to engage. The

timeframes for this work may also be compressed, noting the suggestion in the Consultation Document that the Standards reformulation project will start during the legislative process for the DTA – a factor exacerbated somewhat by the impact that Covid 19 has had on the original timetable. These matters will require substantial planning for all concerned.

98. As yet, there has been relatively little consultation on the transitional arrangements that will apply as the existing legislation is phased out and replaced by the DTA and the Institutional Act. The order in which components come into effect, in particular the DPS, may have broader impacts that will require careful sequencing.

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?

99. Since the Reserve Bank already has power to undertake macro-prudential interventions, and has employed it previously with high LVR lending restrictions, we interpret this question as relating to whether it is appropriate to have that set out in a *Standard* (and therefore subject to the proposed procedures applying generally to promulgating Standards), as opposed to procedures contained in the current MOU.

100. In short, we agree that is the right approach, under the same principles applying to prudential Standards more generally. In this regard, it is important that application of macroprudential tools is competition-neutral and not, as a matter of general principle, subject to the sort of flexibility that is contemplated in Proposed Approach 4.3 (pg 60). In addition, macroprudential interventions are not unique in generating “distributional consequences”, so it is important that the process for Standards generally takes into account the broader economic and social impacts of rules, as noted in Consultation Document 2a, pg 28.

101. The Consultation Document also suggests that macroprudential interventions may be expanded into novel areas, such as rural and commercial property lending. While any such proposal could be tested under the new procedures for creating Standards, we submit that caution should be exercised in applying granular lending controls through this channel, particularly in areas in which loans are more complex and bespoke.

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?

102. Yes, we think this is a necessary counterpart to the in-principle decision to combine banks and NBDTs into a single licensed deposit-takers regime, and in any event is an efficient way to address the range of business models even within the existing registered bank set (for example, branches and locally incorporated entities).

103. Where Standards are applied on a tiered or class basis, it will be important to do so in a way that is consistent with the proposed decision-making principles, including that like entities should be treated alike to preserve competitive neutrality. The starting point therefore should be that there is a single, transparent rule set. Ideally,

any material deviations from that starting point should take place through the Standards procedure rather than administrative action, both from the perspective of rigour and because of potential impacts on other LDTs and more broadly.

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 adjustments and protections should apply to the Reserve Bank's use of supervisory adjustment?

104. The new regime is proposed to provide significantly greater latitude for the Reserve Bank to apply a range of prudential interventions to only one or a small group of deposit takers. In addition to tailored Standards and supervisory adjustments, this would include a variety of early intervention resolution tools under the crisis management regime, such as resolution planning responses and directions, and new supervisory and enforcement tools akin to the FMA's wide-ranging toolkit.

105. Significant questions that will arise under this new framework include:

(a) Whether it is most consistent with the purposes and decision-making principles for this to be achieved through the Standards channel or through one or more of the other tools available to the supervisor.

(b) What are the implications of those policy choices for relevant stakeholders, given that the different channels will involve different procedural elements, safeguards, appeal rights, consequences, and in some cases specific statutory objectives (crisis management powers are an example).

106. In the case of Standards, these are to be subject to rigorous procedures and safeguards, in part in recognition of the impact they can have beyond the particular licensed institutions to which they apply. We submit that it is important to maintain the integrity of those processes. Under the new regime, there will be greatly expanded range of channels available to the supervisor to respond to the issues of a particular institution. It is probable that the procedures for those will be more appropriate to respond to the matters which it is suggested would be addressed by a supervisory adjustment (for example any 'natural justice' requirements, which generally focus on the impact on the subject institution).

Chapter 5: Liability and accountability

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?

107. The Consultation Paper proposes that:

(a) "Criminal liability for breaches of the Act should generally be limited to undertaking deposit-taking activity without a licence, purporting to be a deposit taker or otherwise using restricted words, non-compliance with the Reserve Bank's supervision and resolution powers (such as a failure to comply with directions), and knowing or reckless breaches of other provisions." (proposed approach 5.1)

(b) "Breaches of standards should generally give rise to civil liability, including a monetary penalty, with criminal liability generally limited to knowing or reckless breaches." (proposed approach 5.2)

108. At a high level, the NZBA strongly supports the proposal to place a greater emphasis on civil liability in the DTA when compared to the RBNZ Act.

109. In general, the approach to liability should be aligned with the FMCA as far as possible, particularly given the high degree of overlap in both regulated persons and product coverage (including both approach to civil/criminal liability, and availability of clear defences including the taking of reasonable steps to prevent breach – i.e. 'due diligence' defences). The FMCA liability framework was enacted after considerable review of international best practice and New Zealand-specific factors, and provides a clear and generally consistent position on matters of civil and criminal liability, as well as corporate and personal liability. It is a regime that banks and their directors are familiar with and a consistent approach minimises the risk of regulatory arbitrage or inconsistent enforcement requirements between regulators.

110. In particular for this question, we submit that criminal liability should be limited to knowing or reckless breaches of key DTA provisions only. We expect the DTA and associated standards to contain a wide range of requirements, including those that are fundamental to the system and those that are more procedural or technical. Reserving criminal liability for key provisions ensures that resources are adequately focused on those provisions, with civil liability being adequate to ensure compliance for more technical and procedural matters. In particular:

(a) It is important that key matters such as undertaking deposit-taking activity without a licence or improper use of restricted words should attract criminal liability only if there was knowledge or recklessness. By comparison, defective disclosure under the FMCA may attract criminal liability where there is knowledge or recklessness (s 510 of the FMCA), but otherwise civil liability is imposed (subpart 3 of Part 8 of the FMCA). While this knowledge/recklessness threshold for key provisions is implied in the

Consultation Paper, we mention it here as it is not explicitly included in proposed approach 5.1.

(b) Knowing or reckless failure to comply with Reserve Bank directions may be treated in a similar manner to other key matters as described above. However, this should also take into account any conflicting obligations on the bank that may otherwise give rise to a "knowing" breach. For instance, if the Reserve Bank seeks to direct a bank to maintain confidentiality, such a direction may conflict with the bank's obligations to its shareholders under New Zealand or foreign law, including disclosure obligations under a parent entity's prudential framework. Clear guidance on the expectations for compliance in such situations should be set out and clearly taken into account when determining potential liability.

(c) Knowing or reckless breaches of other provisions of the DTA should only attract criminal liability where those provisions are identified as key provisions, equivalent in scale to defective disclosure in the FMCA. We expect that the matters prescribed by standards should generally not reach this threshold.

(d) For completeness, we note that the FMCA contains a range of different penalties and remedies for breach. This includes infringement offences for some technical breaches (which provide a fine of no more than $20,000, compared to defective disclosure offences which may include 10 years' imprisonment and a fine of up to $1 million for an individual). Such an approach may also be appropriate in some limited circumstances in the DTA, depending on context.

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

111. As stated in previous submissions and set out in the above submissions on Question 5.A, it is extremely important to ensure that director accountability – for reasons of both workability from the perspective of banks and efficiency from the perspective of regulators – is coordinated with other executive accountability regimes, including under the FMCA, the proposed laws regarding conduct of financial institutions, and expanded director obligations on directors to ensure that creditors comply with their obligations under the Credit Contracts and Consumer Finance Act 2003 (s 59B). Our comments below are made subject to this point.

112. The NZBA has no objection to the proposal to impose some positive duties on deposit takers, in line with the approach taken in other jurisdictions. However, we strongly submit that the proposed requirement to take reasonable steps, as currently drafted, is too broad and would leave considerable uncertainty as to compliance. In particular:

(a) there is a risk that after any bank failure, a hindsight test may be the basis for imposing personal liability on directors for not adequately ensuring that "the deposit taker is being run in a prudent manner", merely because of such failure;

(b) the exact scope of a requirement to ensure that operations always occur in "a prudent manner" is unclear and open to interpretation, and leaves considerable uncertainty for directors when addressing these duties;

(c) the above uncertainties are compounded by the lack of guidance, within the primary legislation, of the scope of the obligation to comply (including substantive guidance on the meaning of the obligations, and clear direction as to what would constitute "reasonable steps"); and

(d) a number of directors and senior managers of New Zealand banks are or will become subject to the requirements of dual or multiple executive accountability regimes, whether as being part of an international banking group, or under requirements of other New Zealand regimes.

113. For those reasons, there are three key matters that ought to be addressed in the design of an appropriate set of positive duties:

(a) The precise formulation used should be closely considered, with input from governance specialists, specifically including a detailed review against formulations in other regimes, most notably the Australian BEAR regime.[20]

(b) The regime must fit coherently within other domestic laws that are, or amount to, executive accountability regimes, in a way that best supports overall regulatory objectives and outcomes.

(c) These duties apply at the governance level and should observe both governance principles and seek to drive behaviours and outcomes that conform to the purposes of the Act. This is the reason why, for example, fiduciary duties enshrined in the Companies Act 1993 are not subject themselves to civil and criminal sanctions. This load should be carried by the enforcement provisions, which themselves are framed by due diligence defences designed to promote a positive compliance culture.

114. As such, it will be important to clearly demarcate the positive directors' duties from more specific duties that attract civil or criminal sanctions, not only because of their governance setting but because there is an inherent conflict between the nature and intent of these duties to relate to matters that, by design, are high-level and conceptual in nature, as against the need in the drafting of liability provisions to avoid any vagueness or ambiguity. Further, the combination of uncertain personal liability and (as discussed below) associated carve outs from indemnification or insurance create a real risk that capable individuals would be deterred from accepting bank directorships in New Zealand or that those who take up such board positions will feel compelled to take an excessively risk-averse approach.

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[20] For example the Australian regime has a different formulation of the core prudential duty, which is for directors to take reasonable steps in conducting their responsibilities to prevent matters from arising that would adversely affect the prudential standing or prudential reputation of the entity.

115. In addition, the NZBA submits that:

(a) As a more general (but fundamental) point, the proposals in the DTA function to shift the director liability 'trigger' away from six-monthly attestations to an ongoing compliance requirement. The current director attestation regime is outdated (and out of step with other international regimes) and can encourage a focus on 'point in time' compliance. Completing such attestations can also significantly increase compliance costs and, with the modernisation of the DTA, should be removed as it is redundant and undermines the purposes as per Chapter 2.

(b) While guidance issued from the Reserve Bank on what is expected of directors is welcomed, it should be clear that it serves as a guide to compliance, but should not itself have the force of law (except as a 'safe harbour'). That is, it should be clear that the duties are imposed by primary legislation and such guidance cannot be used to impose additional duties. Deposit takers should also be provided reasonable opportunity to engage on draft guidance.

(c) The Consultation Paper refers to potential regular use of Reserve Bank powers to require directors to privately report the minutes of board meetings. We submit that such a power would not generally be appropriate (particularly as an ongoing/regular monitoring tool), as it would inhibit open discussion in Board meetings (such as discussion of interpretation of requirements, and how to comply with Reserve Bank requests).

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

116. The NZBA supports an approach to director indemnification and insurance that aligns with the Companies Act and FMCA.

117. We disagree with the proposed carve-out that prevents director indemnification of personal financial losses from unsuccessfully defending any proceedings relating to the new positive duties. The three new director duties go much further than to "mirror" section 131 of the Companies Act (the duty to act in good faith and in the best interests of the company) – for instance, duties relating to prudential running of the business go well beyond a "best interests" analysis and may be subject to interpretation. Preventing indemnification for such matters may leave directors personally exposed for decisions that, at the time, were made in good faith but (with the benefit of hindsight) were found not to meet the required standard.

118. If, despite our submissions above, a carve-out in relation to the new positive director duties is considered necessary, it should only extend to honesty based obligations – that is, the duty to act with honesty and integrity.

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?

119. We have not identified any particular concerns regarding the relationship between the Companies Act duties and the new duties proposed in the Consultation Paper. However, as discussed elsewhere, it is vital that director accountability regimes are coordinated between all different proposed regimes.

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

120. The NZBA supports aligning the deemed director liability regime with the FMCA. In particular, this would mean deemed director liability for misleading disclosure, but with clear defences including a defence for taking reasonable steps to ensure that the disclosure was not misleading. This would effectively provide a clear acknowledgement that the directors' obligations would be satisfied through the establishment, staffing and monitoring of appropriate due diligence or assurance procedures, rather than implying that directors must personally verify every statement in disclosure.

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?

121. The NZBA supports a maximum civil penalty based on a specified dollar amount, potentially with a smaller cap for entities below a certain asset size.

122. Penalties based on a multiple of any gain or loss avoided are unlikely to be generally appropriate here given the focus of the DTA requirements (which may only rarely relate to specific transactions).

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?

123. The NZBA supports a lower tier of penalties for formal or technical breaches. Given the extent and complexity of obligations placed on banks, both through primary legislation and separate Standards, there is likely to be a range of procedural and technical requirements. Imposing a lower tier of civil penalties acknowledges this complexity, and supports a measured director and organisational focus on key provisions required to maintain prudential standing.

5.H - 5.J: Civil and criminal penalties

124. The NZBA has no comment on questions 5H to 5J.

Chapter 6: Supervision and enforcement 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?

125. The NZBA agrees that the AML/CFT Act provides a generally useful base for inspection powers. However there are some important differences between the scope and intention of the AML/CFT Act requirements compared to the DTA, particularly where it comes to inspection without notice. The AML/CFT Act is designed with a primary focus on detection of criminal activities (money laundering), where 'tipping off' is a key concern. In such circumstances the power to inspect without notice has been determined to be a key power.

126. By contrast, the DTA regulates commercial banking activities and compliance with regulation and prudential standards. Inspection of such matters can be adequately served with a reasonable notice requirement, particularly where inspections are likely to relate to specific matters and records may be held at different locations. Providing notice will generally allow the relevant deposit taker to gather records and other details as needed.

127. Further, for larger institutions, matters relating to prudential regulation will largely be managed at corporate offices rather than retail branches. Powers of inspection should therefore include a clear requirement to consider the appropriateness of the inspection location.

128. Lastly, we submit that the purposes for which inspections may be carried out, and the use of information collected, should be clearly prescribed. The combination of broad inspection powers and the ability to share information with other regulators, particularly where FMA and Reserve Bank are expected to jointly regulate activities, may otherwise lead to a concern that inspection powers could be used (or overused) as broad information-gathering exercise without a defined purpose.

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

129. As described in our submission on question 6.B above, it will be important to place clear limits and safeguards on both the power to inspect and the usage of collected information:

    (a) There should be limits on entry without notice (similar to those highlighted for food safety) and notice should be required unless such notice would clearly defeat the purpose (e.g. there is reasonable suspicion of fraud).

(b) Strict limits should be placed on the use of gathered information for other purposes, including sharing with other regulators.

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?

130. The NZBA strongly disagrees with the proposal to expand the FMA's on-site inspection power as part of this review.

131. We are not aware of any particular practical issues or concerns that have arisen with the FMA's inspection powers under the FMCA, and that Act is broadly viewed as functioning well. The FMCA also applies to a potentially extremely broad range of issuers and other entities in the market. Any proposal to change the FMA's powers should be subject to separate consultation in the context of the FMCA.

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?

132. The NZBA supports the inclusion of a breach reporting requirement in the legislation, with Standards setting out breach materiality thresholds (relating to when breaches may be disclosed on the Reserve Bank's website). Those materiality thresholds should:

(a) generally align with the requirements for disclosure in other contexts (such as under listing rules and in FMCA disclosure); and

(b) provide for the relevant bank to assess the materiality of the breach against those Standards for disclosure purposes (similar again to the position under listing rules and in FMCA disclosure).

133. We further submit that:

(a) any breach reporting requirement should be included in the DTA, to centralise compliance requirements in one piece of legislation; and

(b) liability for failure to comply should be a civil matter only, and limited to cases of actual knowledge or recklessness (including where a bank has identified a breach as immaterial rather than material, and reports it as such). Liability in such cases should generally arise under the actual breach rather than a failure to promptly report it.

6.H: Do you agree 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 a 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?

134. As a general matter, the NZBA agrees with the implementation of a broader scale of potential regulatory responses, however it is critically important that such responses be exercised consistently, and proportionate to the circumstances.

135. We submit that considerable further clarity must be provided as to when various enforcement powers are to be exercised, what they are intended to achieve when exercised, and requirements to minimise duplication of enforcement via different tools.

136. This includes, for instance:

(a) **Undertakings** (6.H): clarification (via, for instance, written public guidance) should be provided as to:

(i) when enforceable undertakings might include payment of 'compensation or an amount in lieu of a monetary penalty'. It is not clear when such monetary payments would be needed in enforceable undertakings, particularly given other more explicit abilities to impose fines and penalties; and

(ii) what would be the consequences if a bank refused (or was unable) to give an enforceable undertaking;

(b) **Public notices** (6.I): The NZBA does not see significant value in adding a statutory basis for public notices, however we do not have a strong view on this. If they are included, then further clarity on their use and scope should be provided – for instance, in what circumstances might public notice require disclosure in advertising.

(c) **Infringement notices** (6.J): The NZBA is comfortable with the inclusion of infringement notices in principle (similar to the FMCA), provided these are limited to fines of a similar limit to the FMCA and are appropriately limited. If included, they should be applied only in situations where the consequences of non-compliance are material enough to warrant such a fine, and it is clear whether compliance has or has not occurred (for instance, non-delivery of key notices).

(d) **Remedial notices and action plans** (6.K): The use of remedial notices and action plans may be appropriate in some cases, and we agree with their inclusion as potential options, subject to clear limits. For instance, to the extent such remedies are included:

(i) there should be a clear provision that any proposed action plan can only be rejected by the regulator where reasonable to do so; and

(ii) liability for non-compliance should be proportionate to the materiality of the obligation that has been breached.

As noted in our submissions on the proposal to provide for supervisory adjustments, there will be a need to carefully coordinate the various powers that, under the new regime, will be available in respect of the same conduct.

(e) **Civil penalties**: As a general point, it should also be clear where and how civil penalties would be used among these new regulatory powers (noting they are not included in the toolkit in figure 6.1, page 106 of the Consultation Paper).

(f) **Director attestation**: As noted earlier in this submission, given the expanded regime of enforcement and supervision powers proposed, the requirement for director attestation of six-monthly is now outdated. It would no longer serve a useful purpose and increases compliance costs, particularly as it is out-of-step with other international regimes.

Chapter 7: Resolution and Crisis Management

General remarks

137. We agree with the direction of the consultation paper to align the New Zealand crisis management framework with international best practice, in particular the Key Attributes. The changes contemplated in this reform are fundamental in both their nature and their significance in contributing to financial stability, and we commend the rigorous approach being taken to them by the review team.

138. Crisis management is an integral part of the overall prudential toolkit, and it is essential that it is aligned, and interfaces appropriately, with the other elements of the framework, including the DPS, banking standards (**Standards**) and work programmes that address resolution and recovery under the current legislative framework. We discuss the coordination with the DPS in our submission on chapter 8.

139. Crisis management is one of the most complex elements of the Phase 2 reform process and lies at the heart of its goals, not only because it helps to address the consequences of bank failure, mitigating impacts on the financial system and potential fiscal costs for the Crown (the **recovery** part of the equation), but because of the way it shapes incentives and responses at all times up to the point of non-viability and with a view to ensuring that such position is never reached (the **resolution** element). As such, and as noted in the Consultation Document on pg 113, not all the detailed components of the regime could be included in this Consultation Document when it was published in March and that work is, and will continue to be, ongoing.

140. A mitigating factor is that, in implementing Key Attribute-compliant regimes, New Zealand has a 'second mover' advantage, and in particular can draw significant lessons and guidance from the approach taken in the United Kingdom, which is contained in the Banking Act 2009 (as amended in 2013), and in Hong Kong, primarily through its Financial Institutions (Resolution) Order (FIRO). Each of these regimes draws on the sophisticated, but complex, EU Bank Resolution and Recovery Directive. The UK framework also features substantial work on Codes and other guidance, which can provide a useful model or touchpoint both in design and implementation.

141. It is important to note, however, that this is not work that is starting from scratch in New Zealand. Both the supervisor and the New Zealand banks have committed significant resources, particularly over the past decade, to improving and implementing the current resolution frameworks, based on statutory management and the OBR policy. We agree with the thrust of the reforms as they relate to crisis management being aligned with international best practice so that the Reserve Bank has the most highly-evolved tools available – indeed, international coordination is an important attribute in its own right, including because it helps international investors understand our regime and price risk. The key issues this creates, then, are not so much matters of principle, but ensuring that:

    (a) existing/ongoing workstreams can, where possible, be efficiently 'repackaged' into the modernised framework (for example OBR prepositioning becomes a core part of Key Attributes-compliant resolution planning); and

(b) identifying areas where elements of New Zealand's current resolution framework are incompatible with, or require some adjustment to cater for, Key Attributes compliant counterparts.

142. In the latter regard, one of the most substantial matters to be considered is whether statutory management (with its current features such as the moratorium):

(a) should be the primary stabilisation tool through which other options (such as transfer and/or bail-in) are implemented;

(b) becomes just one of several stabilisation options that can be implemented separately; or

(c) ultimately should be replaced as a stabilisation option on the basis that other procedures evolved since the GFC are more fit for purpose and better understood internationally.[21]

143. Although clearly there will need to be a transition period during which these matters can be more thoroughly considered and resolved, they must also be carefully considered at the legislative/design stage to avoid the worst of all worlds, in which New Zealand is running (and paying for) multiple, potentially conflicting, regimes.

144. As noted above, key aspects of the crisis management framework regime remain under development, and will need to be the subject of separate and ongoing engagement as we move toward the Exposure Draft of the legislation. As such, this consultation addresses only a limited number of areas. Some of the key areas omitted, which will have to be the subject of separate discussions, include:

(a) coordination with overseas regulators;

(b) considering further what might happen in practice upon a bank failure *before* the design of the crisis framework;

(c) coordination with all failure and crisis mitigation related policies, including regulatory capital requirements; and

(d) delineation between recovery actions and resolution actions.

145. These additional areas must be kept in mind when designing and implementing the statutory crisis management framework.

Single and cohesive framework

146. Further to the above points, in our submission it is crucial that the crisis management framework is a single, cohesive framework, focused on the objective of the DTA of promoting the stability of the New Zealand financial system. We discuss the "single" element, and the corresponding interplay with the other

21 Particular examples that should be considered in this regard would include the bank insolvency procedure and the bank administration procedure which apply under Parts 2 and 3 of the UK Banking Act 2009 – each of which is specifically designed to align with Key Attribute objectives and tools, and operate on a fundamentally different basis to statutory management. In addition, in the UK and other KA-compliant jurisdictions the five core stabilisation tools are subject to precisely defined triggers but do not rely on the institution of an insolvency style procedure for their implementation – rather, that is a distinct tool. Among other important issues to be considered is the very different approach taken internationally to stays than that contained in the current RBNZ Act moratorium provisions.

resolution frameworks such as the CIMA, in our submission on question 7.G and in the comments below about current resolution-related banking standards and frameworks.

147. It is fundamental to consider how the new crisis management framework is inter-connected with existing Standards relating to BS11 (Outsourcing Policy), separation plans, OBR and the Reserve Bank's Disaster Recovery (DR) and Business Continuity Policy (BCP).

148. We acknowledge that this consultation paper is about putting the future statutory framework in place, and therefore the focus of this aspect of the reform project properly is on design – for example on providing the supervisor with the full range of resolution tools called for by the Key Attributes. Equally, it will be important to give early consideration to the transitional and operational arrangements for the roll-out of the new resolution and recovery regime. To take one key example, the interaction with the DPS will need to be taken into account in further work on the ongoing BS 11 and OBR projects and in the process of re-writing those Standards (e.g. the application of haircuts and the de minimis exemption), particularly given the comment in the Consultation Document that aspects of the related Standards/Regulation formulation process are planned to commence at the same time as the Exposure Draft is introduced. Institutional and resourcing arrangements will need to keep pace in order to fulfil the regime's objectives. We would welcome the opportunity to continue to engage with the review team as the detailed aspects of the ensuing regulatory and implementation workstreams are scoped and designed.

149. We suggest that the Act provide some protection to market participants in respect of a multi-tool and multi regime/regulation approach to manage failure/crisis. Our concerns relate to:

(a) efficiency impact of compliance with multiple regimes;

(b) the uncertainty created as to what will happen at the time of a failure in relation to what tool is used; and

(c) the risk of conflict of the regimes (both at the time of compliance and at the time of failure) given the complexity involved.

150. The Act should provide the opportunity to create quality aligned regulation, rather than providing broad powers to implement key aspects in a largely discretionary manner through Standards and Regulations – the new procedures proposed in chapter 4 should not be a substitute for coordinated design at the level of the primary legislation.

151. From an investor perspective, simplicity of the crisis management regime is key. The market for wholesale debt issuance is highly competitive and banks have small windows of opportunity to explain their product and the regulatory environment in which they are issued. If the resolution and crisis management regulatory regime is too complex for investors to readily understand, they will not invest.

152. Given the structure of the New Zealand banking market, with the majority of large New Zealand banks being owned by Australian parent banks and many other banks also being part of international groups, as previously submitted we support a legal

framework that will strongly encourage the Reserve Bank to coordinate resolution actions with the relevant home regulator. In particular, in resolution scenarios coordination is critical in achieving optimal resolution outcomes. This approach would also be in line with the Key Attributes, which encourage international coordination, and with the existing provisions of section 68A (*Trans-Tasman cooperation*) and the related MOU. For example, for non-D-SIB banks and branches which are part of international banking groups, robust coordination measures will be crucial in achieving positive resolution outcomes, and will be fundamentally dependent on the regulatory approach taken in the bank's home jurisdiction (specifically, whether those operate on a single or multiple point of entry basis). Key Attributes 8 and 9 encourage these arrangements to be formalised and given effect through Crisis Management Groups and/or Cooperation Agreements.[22]

153. In addition, recognising the substantial changes to the framework proposed in this and previous consultation papers, and the expanded role proposed for the Reserve Bank, we note the importance of building up corresponding capacity and capability within the Reserve Bank (or having appropriate contingency plans in place to allow the relevant expertise to be rapidly accessed). Where the Reserve Bank requires particularly specialised knowledge we would also support the creation of specialised advisory committees that would be available to the Reserve Bank at short notice.

154. Finally, given the wide range of powers the Reserve Bank will have, and the wide range of deposit takers such powers may be applied to, we support the inclusion of an explicit obligation on the Reserve Bank to use its powers in a proportionate manner, with the severity of the action taken by the Reserve Bank "matching" the circumstances a deposit taker is in. In this regard, we support the comments under 7.1 (on p. 113) that there should be a clear delineation of the interventions and clarity in the triggers for exercise of the various resolution powers.

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

Early intervention/recovery vs resolution

155. Resolution can substantially affect customers, creditors and shareholders of deposit takers. It is therefore essential that the triggers for resolution are clearly defined and understood. In this context, we support a clear delineation between the pre-resolution **early intervention/recovery** phase where a deposit taker is able to continue providing banking services (potentially with some limited intervention from the Reserve Bank that does not affect creditor rights); and **resolution** where a deposit taker is no longer viable.

156. Each phase should have clear conditions that unlock the Reserve Bank's power to act. At this stage, triggers for formal resolution are suggested at a high level, but no triggers for other early intervention actions by the Reserve Bank have been articulated in the Consultation Document. We understand that these triggers, as well as the specific powers the Reserve Bank will have in that phase, will be consulted on separately, and we would welcome an opportunity to participate in that

22 For a general discussion of the issues and recommendations, refer IMF "Resolution of Cross-Border Banks – A Proposed Framework for Enhanced Coordination" (11 June 2010) and IMF "Cross-Border Bank Resolution: Recent Developments" (2 June 2014).

discussion. As a starting point, we consider that the model offered under the UK Banking Act 2009 has a number of useful features:

(a) The specific objectives for the crisis management regime are very clearly set out and are easy to understand (refer section 4 (*Specific resolution objectives*)).

(b) The procedures include the safeguard that two agencies are required to trigger a stabilisation intervention, on the basis of clearly delineated accountabilities (section 7(1) and (5F-5H) (*General Conditions*).

(c) The threshold conditions are stated transparently and succinctly (section 7 (*General Conditions*)). In the case of the most extreme stabilisation options – bank liquidation and special administration procedures – these are subject to separate, narrower tests (sections 96-97, and 143-144 respectively) and to clear guidance that these are to be used as a "last resort".

(d) These clearly stated thresholds are required by statute to be further clarified by Codes of Practice and Guidance issued by relevant agencies (refer section 5 (*Codes of Practice*)).[23] These note that a bank will only enter into a special resolution regime "*where it is clear that there is no realistic prospect that it will be able to continue as an authorised person*".[24]

157. We also note that the exercise of early intervention powers by the Reserve Bank may lead to a number of further issues. These include the protections that are available to deposit takers, their directors and accountable executives if directions by the Reserve Bank clash with the director's obligations under, e.g., disclosure or company law rules, many of which are subject to different regimes with different regulators. It will be important for these issues to be taken into account when assessing the appropriate triggers for early intervention and to ensure that statutory protection for directors, employees and agents are in place when acting in accordance with directions or otherwise giving effect to Reserve Bank interventions.[25]

Triggers for resolution powers

158. In terms of the trigger for the exercise of resolution powers, while we support the general direction taken by the consultation paper, we submit that:

(a) The triggers are not yet sufficiently clearly defined to give interested parties a clear understanding when resolution action might occur. It will be essential that they are clearly defined, in line with international best

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[23] Refer Her Majesty's Treasury publication "Banking Act 2009: special resolution regime and code of practice" (as revised March 2017) and also in the Bank of England's "Resolvability Assessment Framework" (7 May 2020); and Bank of England's Resolvability Assessment Framework, including Policy Statement, including its publication *The Bank of England's approach to assessing resolvability* (July 2019).

[24] Refer HM Treasury Code of Practice (footnote 23) at 6.23.

[25] These are cornerstone aspects of KA-compliant resolution processes. Refer section 48O Banking Act 2009 (UK) and section 62 of the Hong Kong FIRO.

practice and the Key Attributes (as noted above, those include a statutory requirement for a formal code or further guidance on these matters).

(b) The triggers should be tested with relevant deposit takers and in light of the action that creditors and shareholders will likely take when a deposit taker approaches resolution. Actions could include stakeholders, such as investors holding bail-inable debt, pressuring a deposit taker's management to take mitigation actions or altering/activating rights under contracts and instruments, rating downgrades and associated increases in funding costs/loss of access to credit and capital flight from depositors.

(c) We also support the triggers being based on an objective basis for non-viability, e.g. a capital and/or liquidity floor, which would preferably be assessed by an independent party. One possible approach is similar to section 6E of the UK Banking Act which requires the Bank of England to undertake a valuation by an independent valuer prior to exercising any stabilisation option or mandatory write-down.

(d) The last element of the viability test – non-compliance with conditions to a degree that would justify removal of the bank's licence – would constitute a most severe action by the Reserve Bank, in particular in scenarios where the deposit taker is still financially viable and other early intervention options are available. Accordingly:

(i) this trigger will need to be very carefully drafted to avoid being a "hair trigger"; and

(ii) the trigger should only arise in the most egregious of circumstances where the contravention irreparably compromises the deposit taker's social licence to operate. [26]

159. We agree with the comment on p. 114 of the Consultation Document that exercising resolution powers "should also be a last resort intervention by authorities", and submit that this principle should be given clear expression in the statutory framework, which should explicitly state that liquidation in these circumstances constitutes a measure of last resort. The very basis for resolution regimes is that the characteristics of banks, and of the financial system in which they form a part, makes corporate insolvency proceedings inappropriate in most cases.[27]

160. We note the importance of transparency from the Reserve Bank with what its conditions are for putting a deposit taker into resolution, and would strongly recommend that legislation includes a requirement for the Reserve Bank to publish guidelines detailing further how it interprets the conditions for resolution in practice. There is useful precedent for this internationally, for example in the statutory

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[26] Compare s 7 Banking Act 2009 (UK), and s 55B/Schedule 6 Financial Services and Markets Act 2000 (UK).

[27] Refer for example Martin Ćihàk and Erlend W Nier "The Need for Special Resolution Regimes for Financial Institutions - The Case of the European Union" (IMF Working Papers WP/9/200, September 2009); Joesph H Sommer "Why Bail-in? And How?" (FRBNY Economic Policy Review, December 2014); and FDIC "The Orderly Liquidation of Lehman Brothers Holdings under the Dodd-Frank Act" (18 April 2011).

requirement under the UK banking legislation for the issuance, and tabling in Parliament, of a code of practice and guidance on the crisis management procedures, including on how to determine whether the threshold condition to formal resolution is met.[28]

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?

161. Deciding the exact scope of statutory bail-in will be a major project that will need substantial work, including with the relevant banks that will most likely be affected by statutory bail-in. It will also be crucial to align that workstream with the work already done by banks in OBR prepositioning.

162. As to whether a positive or negative list approach is used, in principle this is a matter of indifference so long as whatever route is taken ends in the right place. In practice, however, it is sometimes far more difficult to define key banking concepts and instruments positively without being very imprecise or over-inclusive (the term "deposit" for example, despite being well-understood, is very difficult to define in this manner).[29] It is probably for this reason that the UK banking authorities opted for the 'negative' approach of applying bail-in to other than "excluded liabilities".[30] On balance, then, we think that is the better approach.

163. We note that the more targeted the approach is, the smaller the pool of bail-inable liabilities becomes (irrespective of whether a positive or negative list is used). If the Reserve Bank were to consider requiring banks to hold minimum amounts of bail-inable liabilities we submit that such requirements need to be coordinated with banks' other regulatory capital requirements, in particular the decisions made under the Reserve Bank's capital review.

164. With regard to deposits, we note the general international approach is to exclude protected (if not all) deposits from bail-in. Noting the practical difficulties with bailing-in depositors, and the desirability of reducing unnecessary complexity, we support excluding deposits from bail-in in their entirety.

165. As an overarching point, we note the importance of clear communication to the public and other financial stakeholders – in particular wholesale investors – as to which liabilities are subject to statutory bail-in, to allow investors and creditors to understand/price that risk. Similar considerations apply to suppliers of services which are critical to the functioning of a bank's operations. Clear communication is also important in order to avoid unwelcome surprises and/or political pressure or interference whether before, at or after the point of resolution, in particular if uninsured deposits are subject to statutory bail-in. We also support an approach

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[28] Refer section 7 Banking Act 2009 (UK). This requirement has been given effect in Her Majesty's Treasury publication "Banking Act 2009: special resolution regime and code of practice" (as revised March 2017) and also in the Bank of England's "Resolvability Assessment Framework" (7 May 2020).

[29] Compare Articles 5 to 9 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (UK), which takes a 'negative' approach to that definition.

[30] Section 48B(4) and (8) Banking Act 2009 (UK). Briefly, "excluded liabilities" include protected deposits, secured liabilities, client assets, amounts owed to settlement systems or central counterparties, non-bonus employee remuneration, and liabilities for essential services.

that is in line with international standards, to limit the explanations required for offshore investors.

166. We further note the importance of aligning any differentiation in bail-inable liabilities with the scope of the no creditor worse off (**NCWO**) principle. If certain liabilities are bailed-in first, whether by statute or through contractual acknowledgments, the protections of the NCWO principles will have to be aligned accordingly, to avoid large compensation payments under NCWO.

Relationship between OBR, bail-in, and deposit insurance

167. As noted in the Consultation Document, in practical terms the OBR regime, in combination with statutory management and the transfer power, replicates what could be achieved directly under the bail-in tool. The introduction of the DPS makes a significant difference to this, in the sense that deposits up to the coverage limit will be insured rather than being potentially bailed in, as contemplated in the OBR policy, subject to the detailed requirements about in- and out-of-scope accounts and products, *de minimis*, and so on. This distinction will also have to be reflected in deposit takers' operating systems.

168. We submit that OBR and bail-in cannot operate together, nor can they operate alongside depositor protection. While bail-in initially will be simply an available resolution tool, the DPS we presume will be provided for in the legislation and supported by a new Standard. As such, although some elements of this involve implementation rather than design, at the legislative level there will need to be a very clear hierarchy/waterfall in terms of the tools available for the supervisor and when/to what they will apply. Adding to the difficulties is the fact that statutory management, which is core to the design and operation of OBR, will now be one of a number of available stabilisation options and will not itself necessarily be compatible with resolution conducted in accordance with the Key Attributes (please refer to our further comments under Questions 7.F and 7.G).

169. In a scenario in which the regime simultaneously includes depositor preference, bail-in and OBR, investors (possibly including uninsured depositors) and other stakeholders potentially will be left guessing what option the Reserve Bank will use. This would make New Zealand a much less attractive investment destination as the regime affecting creditors is more complex and there is less certainty about resolution options in the event of a failure. There needs to be a recognition that increased optionality increases complexity and compliance cost, particularly where there are real questions about the compatibility of some of those options.

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

170. We submit that retrospective application for statutory bail-in would be inappropriate. The presumption is against retrospectivity is a fundamental constitutional principle of New Zealand law.[31] Further, legal certainty is crucial for investors, who would not have been able to price in the risk of bail-in when they invested in the relevant bail-

[31] LDAC Legislative Guidelines, 4.7, section 7 of the Interpretation Act 1999 and section 26(1) of the New Zealand Bill of Rights Act 1990.

inable instruments and there could be a general reduction of confidence of investors in New Zealand as a place to invest.

171. We also note that putting in place a statutory bail-in framework will require substantial investments by both the deposit takers and the regulator over a prolonged time period, with a corresponding transition period. This transition period can be used by banks to issue bail-inable instruments that are subject to New Zealand statutory bail-in, with investors in such products being fully aware of the risks they're taking while investing.

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?

172. Given the protections of NCWO and the objectives for crisis management, as well as the other statutory protections, we see limited value in maintaining the ministerially appointed statutory advisory committee in the form currently contemplated, particularly in the absence of statutory direction about its composition and a lack of clarity about its role and function.

173. However, we consider there would be merit in considering the formation of committees with a clearly defined membership and mandate, in the context of some of the particular stabilisation options and/or to enhance the rigour and coordination of approach to resolution regimes. Examples of each are incorporated in the UK resolution regime:

(a) In addition to the five core stabilisation options (which are the same as those proposed under the New Zealand framework), the regime provides for a bank insolvency procedure (designed to address and complement the UK's deposit insurance scheme) and a bank administration procedure (designed to facilitate an open-bank resolution).[32] In the former, a liquidation committee is formed, initially comprising representatives of government prudential and treasury authorities.[33] Once the objective of resolving deposit accounts, through transfer to a solvent institution or payment of deposit insurance, has been concluded, the government members are replaced by creditor representatives.

(b) There is provision for a Banking Liaison Panel, to advise HM Treasury about the effects of the special resolution regime on banks, the persons with whom banks do business, and the financial markets.[34] The panel comprises members from the core government prudential and treasury agencies, together with one or more persons (a) representing the interests of banks, (b) having expertise in law relating to the UK's financial systems, and (c) having experience in insolvency law and practice.

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32 We note that none of these procedures are analogous to statutory management. Rather they are calibrated to complement particular elements of a Key Attributes-compliant resolution regime, for the most part by modifying conventional insolvency arrangements. By contrast, the statutory management regime is a stand-alone procedure.

33 Section 100 Banking Act 2009 (UK).

34 Section 10 Banking Act 2009 (UK).

174. The institution of panels and committees of this nature may be particularly relevant as the new regime is implemented and as institutional capability is built up.

175. A further question is whether a separate advisory committee should be instituted to act as a check and balance of the Reserve Bank's execution of resolution powers, given the breadth of such powers and the discretion of the Reserve Bank in executing them. We believe the phase 2 review team and the Reserve Bank should consider this question carefully.

176. Furthermore, as mentioned in the general remarks, it will be crucial that the Reserve Bank has the capacity and capability in place to perform its crisis management function. To the extent that this requires specialised technical advice we would support the Reserve Bank proactively instituting expert advisory committees to that effect, in combination with having appropriate contingency plans in place to allow the relevant expertise to be rapidly accessed.

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?

177. An open bank resolution scenario for a building society or credit union, such as statutory bail-in, is a very unlikely scenario, given the structure of the current New Zealand banking market and the size of building societies/credit unions in that market.

178. Furthermore, the structure of such entities already allows for various other ways to absorb losses, and any forced demutualisation would also remove their particular mutual character. We are therefore very reluctant to support any such proposal.

179. If the Reserve Bank is given the power to forcibly demutualise a building society or credit union, the statutory framework should also clarify that this resolution tool should only be used as a last resort. In addition, the Reserve Bank would need to very carefully weigh up any perceived benefits of exercising this power against the potentially significant downsides that would accompany the removal of the entity's mutual character.

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)?

180. We strongly support unifying the statutory management and resolution regimes of the RBNZ Act and CIMA into a single regime, for the following reasons:

(a) It would create legal certainty for investors as to what regime is applicable to deposit takers.

(b) A single regime would also make communication to overseas investors substantially easier, increasing the access to and lowering the cost of core term funding in relevant markets.

(c) It avoids the fragmentation risk of having multiple regimes potentially dealing with the same circumstances. Deposit takers already face obstacles in explaining to overseas investors why deposit takers are subject to more than one regime, with different grounds for putting a deposit taker into statutory management.

(d) A single regime would align better with the resolution objectives and Key Attributes.

Other policy impacts of retaining CIMA statutory management

181. The reasons given above indicate some of the practical difficulties with the approach of having two separate statutory management regimes potentially applying to deposit takers. At the level of first principles, we submit that continued application to deposit takers of a separate CIMA regime would also contradict a number of key in-principle decisions and other policy determinations underlying the Phase 2 reforms or otherwise undermine the integrity of the new regime:

(a) The in-principle decision that the Reserve Bank will be designated as the resolution authority for deposit takers would be undermined if a deposit taker could be placed in statutory management either by another authority or under grounds unrelated to financial stability.

(b) The governing objective of crisis management is financial stability, supported by secondary purposes and decision-making principles that are not applicable to CIMA statutory management, which operates under fundamentally different purposes (refer sections 5 and 41 CIMA). In addition, the Reserve Bank in considering resolution options will take into account the impact not only on the financial institution concerned, but on other deposit takers and the financial system as a whole (for example the possibility of contagion or disruption as well as perception by international investors) – considerations which are not relevant under CIMA.

(c) The DTA resolution framework – whether a modified form of statutory management or other insolvency or administration related options – will be designed to be a part of an integrated regime supporting both the formal stabilisation options and the early intervention tools. CIMA is not designed on that basis.

(d) Invoking CIMA statutory management would be likely to have a very significant impact on the value of the relevant deposit taker and could trigger fiscal consequences for the Crown, including for deposit insurance, NCWO compensation, or other Crown support. CIMA does not contemplate such circumstances or provide for the engagement of the deposit insurer, the Minister of Finance, or the Treasury with respect to decisions about or the management of any such effects.

(e) The trigger conditions for CIMA statutory management are far too vague and discretionary to meet the policy objectives for bank resolution set out in the Consultation Document. For example, p. 114 notes that the criterion in section 113(1)(e) of the RBNZ Act – that the business is not being conducted in a prudent manner – should be placed with a trigger "that is more transparent and grounded in a rationale that warrants a deposit taker being placed in resolution". The grounds under section 39 CIMA include that statutory management "is desirable" on the basis of a number of largely subjective grounds, including "the public interest".

182. Most fundamentally, the continuation of a CIMA statutory management option could bind the hands of the prudential supervisor in the most significant decision it has to make in the context of bank resolution. Where the Reserve Bank has made the determination that statutory management in a given circumstance would not promote financial stability, this should not be able to be counteracted by a decision or recommendation to place a deposit taker in statutory management under a separate regime and for separate grounds (particularly since customarily such recommendation would constitute an event of default under a bank's funding programmes and derivatives contracts).

Submissions regarding Options 1 and 2

183. Of the two options we strongly favour option 1.

184. We presume that option 2 is designed to provide an option to respond to issues of the sort addressed in the trigger conditions under section 39 of the CIMA, including operating in a fraudulent or reckless manner or other substantial conduct issues. However, the institution of CIMA statutory management does not foreclose on the very broad range of options available to respond to issues of that nature:

(a) to the Reserve Bank, under the enhanced supervision and enforcement powers that will be available in the new regime;

(b) to the Financial Markets Authority in its capacity both as conduct regulator and financial markets licensor, using the very broad range of powers available to it under the FMCA, including civil and criminal liability, management banning orders, directions, and information-gathering powers; and

(c) to the Commerce Commission, including under the similarly broad new range of enforcement tools available to it under the Credit Contracts and Consumer Finance Act 2003.

185. It is notable that virtually all those powers have become available (or at least have been significantly expanded) since the CIMA was enacted in 1989. It is very difficult to envisage any realistic circumstances in which those tools and powers would be inadequate to the task of addressing conduct issues, particularly given that statutory management has traditionally been invoked in circumstances of complex groups of companies whose affairs are difficult to unwind because of the way they have been operated.

186. In summary, option 2 is unnecessary, would carry a very high cost, and contradicts a number of core policy drivers for the new regime.

Chapter 8: Depositor protection

187. A deposit protection scheme (i.e. as per the DPS) is one of several key elements of an effective financial safety net, evidenced by its universal deployment in other OECD jurisdictions. It needs to be aligned closely with the other elements of the net. In particular, it needs to be aligned and integrated with the crisis management framework. Properly designed, it can support crisis management in several areas, including by reducing the risk of public money being at risk and by making resolution more predictable and flexible.

188. It is important to note that the whole point of a depositor protection scheme is to reduce the likelihood that it will ever be invoked, by counteracting the conditions that can create self-fulfilling bank runs.[35] This recognises that financial crises can begin as, or evolve into, liquidity and confidence events, as was the case with the GFC.[36] Nevertheless, it is crucial that a depositor protection scheme is carefully designed, and operationally supported, against the eventuality it might need to be invoked, however remote that risk might be.

189. For the stability benefits of depositor protection to come to fruition, it is essential that depositors have the assurance that their deposits will actually be protected in a time of crisis. This will require public confidence in the scheme, including that its scope is known and understood by depositors from the outset, and will also have to be taken into consideration when deciding whether to exclude depositors from bail-in. As with other parts of the financial safety net, international standards (in the form of the IADI Core Principles for Effective Deposit Insurance Systems (**Core Principles**)) can provide useful assistance in the design of the scheme.

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

190. Introducing a depositor preference could lead to a range of issues, including from the different funding models that banks use, and in particular could create significant issues for the banks operating under a mutual model. The Scheme needs to ensure that it treats the different banks and funding models fairly and in a way that avoids distortions or other unintended consequences.

191. A further factor to take into account is that regulatory capital confers a de facto preference on depositors that does not suffer from the complexities or design issues of a formal preference regime – increased capital requirements under the Capital Review not only contribute to financial stability but increase the extent of that preference. This result is achieved to the same extent by bail-in instruments, whether in the form of Alternative Tier 1 or Tier 2 capital or of TLAC-compliant instruments more generally, since these involve an explicit agreement by the

35 Douglas W Diamond and Philip H Dybvig “Bank Runs, Deposit Insurance, and Liquidity” (Journal of Political Economy, Vol 91, No. 3, 1983). Ultimate losses in asset terms are often comparatively small – the economic costs of financial crises arise primarily from disruptions to the flow of credit and from effects on confidence; refer Basel Committee on Banking Supervision Working Paper 37 “The costs and benefits of bank capital – a review of the literature” (June 2019).

36 Gary B. Gorton *Misunderstanding Financial Crises: Why we don’t see them coming* (Oxford University Press, 2012).

noteholders to subordination to all senior debt, including deposits. These factors would have an important impact on the cost-benefit of depositor preference.

192. In addition, depositor preference may also affect the NCWO principle that is to be introduced. As a general matter, introducing a formal depositor preference into the law could:

(a) be difficult to reconcile with widely recognised *pari passu* and anti-deprivation principles (which are also a core part of New Zealand's insolvency regimes); and

(b) give rise to difficult questions about the relationship to existing priorities set out in Schedule 7 to the Companies Act 1993 (including the priority among those claims and the effect of exclusions for 'revolving assets' – which would likely include deposits as "accounts receivable" to the account holder).

193. Also, the Scheme should be focused on maintaining financial stability, by preventing bank runs which would exacerbate a bank's issues. Depositor preference's primary impact is not to promote financial stability but to reorder payments in the liquidation of a bank, after the bank has failed.

194. Advantages of depositor preference include potentially lowering the cost of the Scheme due to lower payouts and increasing the feasibility of bail-ins due to it being highly likely that depositors would not be bailed in. We also note that depositor preference is not unusual internationally, having been introduced both in the European Union and the United States.

195. Despite these advantages, we continue to be of the view that the complexities and other disadvantages of introducing a depositor preference substantially outweigh the benefits, in particular given the risks of increased wholesale funding costs and potentially a distorting effect among different funding models. In any event, it would require specialist insolvency advice as to how preference would take effect to enable a more settled view to be formed.

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

196. For the reasons given above, on balance we oppose the introduction of depositor preference, at least without more detailed guidance on its legal implementation and impact on broader liquidation outcomes and insolvency principles. If one is nevertheless introduced, we submit that it should be limited to insured deposits (as is the case under the UK Banking Act 2009), to lessen the negative impacts of a preference described above.

197. We also submit that if a preference is introduced it should be introduced through formal statutory provisions, given the interaction with broader legislation and other creditors' rights (or in appropriate circumstances as may be supplemented by provisions in the relevant funding instruments).

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

198. We agree with the proposed approach of having a prescribed list of products that will be covered by the Scheme. We also support setting out the covered products in regulations, with the option of further types of products benefitting from the protection of the Scheme, if they have similar functions as the products covered from the outset. The aim should be for the scheme to create minimal distortions to consumers' savings choices.

199. We also agree with the emphasis on clear communication to the public on whether a product benefits from the protections of the Scheme, including in the disclosure regimes applicable to such products.

200. We note the importance of aligning the scope of entities issuing protected products with the regulatory perimeter of the Deposit Takers Act, to avoid scenarios where non-licensed entities issue products protected by the Scheme, or where any impression might be created that that is the case.

201. We generally support the types of products that are to be covered by the Scheme. We note that the consultation paper suggests to exclude Kiwisaver (and other superannuation investments) from the Scheme. Excluding these types of products from the Scheme could disincentive consumers from investing in them, with such consumers instead preferring to invest in protected products (at various institutions). We understand that this goes against the Government's objectives for consumers.

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?

202. We agree with the proposed approach that both retail and wholesale investors should benefit from the protection offered by the Scheme. The complexities of distinguishing between the two types of depositors substantially outweigh any benefit. We also note experiences from the GFC that suggest that non-insured segments of the deposit base can trigger bank runs on the insured ones.

203. Also, while we acknowledge the in-principle decision to introduce a coverage limit of $50,000, we note that, in absolute numbers, New Zealand's proposed protection limit is low when compared to other jurisdictions (e.g., EUR 100,000 (or equivalent) in European Union countries and A$250,000 in Australia), and we would support a higher coverage limit.

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

204. While we agree in principle with the list of excluded deposits, we note that excluding deposits from related parties creates practical difficulties. If these are to be included, we submit that "related parties" should be clearly defined, by reference to how banks group these customers and BS8 (Connected Exposures Policy).

205. Furthermore, we suggest to also exclude Nostro/Vostro balances of offshore banks as well as credit balances on credit cards from the scope of protection.

206. We also note that the exclusion of foreign currency deposits could adversely affect small and medium-sized exporters which require such deposits in their daily operations.

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

207. We agree with the proposed narrow mandate of the Scheme. Supervision and resolution are among the Reserve Bank's core functions, and duplicating such functions in the Scheme would only create uncertainty and could impair financial stability as well as efficiency.

208. We emphasise the importance of coordination between the Scheme and the Reserve Bank in its crisis management function, as further discussed in our introductory remarks.

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

209. We agree that the Scheme, in principle, should be able to provide funding for resolutions other than a liquidation. In particular, if deposit accounts are transferred to other institutions it would be sensible if the Scheme could finance such transfer of deposits.

210. It will be important to put proper safeguards and limitations in place for the use of such funds. These include that the creditor hierarchy is not affected as well as the ones suggested in the Consultation Paper that are based on the Core Principles.

211. A key element in the design of and transition to the Scheme is that it aligns with the broader crisis management framework, including to ensure that the Scheme is compatible with current aspects of the OBR policy such as the application of haircuts and the de minimis exemption.

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?

212. As per the discussion above.

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

213. Given the importance of depositor protection in the broader crisis management sphere we submit that the Reserve Bank (to the extent that the Scheme is located within the Reserve Bank) should be the appropriate entity to instigate any changes

to the coverage limit. However, given the potentially substantial impacts of higher (or lower) coverage limits, we support high procedural requirements for any changes. These should include Ministerial oversight as well as appropriate consultation before any changes are made.

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?

214. A number of important and nuanced factors need to be weighed in designing a levy regime that supports financial stability and other policy goals and decision-making principles. Equally, it is important to maintain some flexibility to enable the regime to be adapted through time. As such, we support the proposal for any changes to the regime to be undertaken by way of regulations, and therefore subject to the associated rigour, safeguards and engagement requirements.

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)?

215. We agree with a regular review of the Scheme in five year intervals. However, given that deposit protection is newly introduced in New Zealand we also support one interim review, e.g., two or three years after the Scheme's inception.

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

216. We agree with the criteria identified, with particular emphasis on rapid payouts and public awareness of the Scheme and the products covered by the Scheme.

217. We also note the importance of coordination between the Scheme and the broader crisis management obligations of the Reserve Bank.

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

218. We agree to locate the Scheme within the Reserve Bank, to make use of the various synergies between those two functions and to enhance coordination, while noting the importance of safeguards that ensure that the Scheme remains focused on its objectives.

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?

219. While we do not object to building the fund up ahead of a potential failure over a reasonable period of time, we note that a number of factors affect both the size and the rate of ex-ante funding. These include alignment with the broader crisis management framework, in particular with the increased regulatory capital requirements coming into force over the coming years. They also include acknowledging that the size of the ex-ante levy, if too high, may inefficiently allocate capital, given the low likelihood of a default that would lead to the fund being used.

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

220. We do not have a conclusive view at this stage but note the importance of alignment with the broader regulatory capital requirements, as both the deposit fund levies and the increased regulatory capital requirements have the potential to substantially increase banks' costs.

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

221. We in principle support a risk-based approach to the setting of levies, as this will help prevent distortions, including as a result of riskier deposit takers from benefitting from the Scheme's protection, which will in its majority be financed by large, less risky deposit takers.

222. Given the numerous factors influencing risk based levy setting, we support holding further consultation on this aspect, and understand that this is the intention.

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

223. We agree with the implementation of a Government funded backstop, both for the phase while the fund is being built up and subsequently if required amounts exceed funds available at the Scheme.

224. We are concerned about the fee arrangements discussed in the Consultation Paper. In our view, the Government should not be entitled to make a profit out of its contribution, and funding should be offered at cost, for the following reasons:

    (a) The fee would have to be financed through levies of the non-failing deposit takers, who likely will already be subject to higher levies through a need to replenish the fund. It would thus put another obligation on deposit takers to cover a cost that they did not cause.

    (b) The resolution of the relevant deposit taker is conducted by a government agency with no input from other deposit takers. It should not be the deposit takers' obligation to cover for any inefficiencies in that process that lead to higher demand on the Scheme's funds.

(c) The Scheme benefits the prosperity and well-being of New Zealanders, which is a key goal of both the Government and the Reserve Bank.

Next steps

225. We would be happy to discuss this submission or provide further information.