

# The Treasury

## Reserve Bank Act Review - Deposit Takers Bill Information Release

April 2021

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# Cabinet Economic Development Committee

## Minute of Decision

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### Reserve Bank Act Review - Deposit Takers Bill: Crisis Management (Paper 4)

Portfolio                      Finance

On 14 April 2021, the Cabinet Economic Development Committee:

#### Reserve Bank as the resolution authority

- 1        **confirmed** Cabinet's previous in-principle decision that legislation will designate the Reserve Bank as the resolution authority for regulated deposit takers [DEV-19-MIN-0346];
- 2        **noted** that Cabinet has previously agreed in principle that the statutory functions for the Reserve Bank as resolution authority will include the following:
  - 2.1      to prepare and maintain a plan to resolve deposit takers in the event of a possible failure;
  - 2.2      to test the effectiveness of each plan at regular intervals;
  - 2.3      to coordinate with other authorities, both in New Zealand and overseas, as necessary to be prepared for the possible failure of a deposit taker;
  - 2.4      in the event of the failure of a deposit taker, to exercise the powers under the proposed Deposit Takers Act (DTA) consistently with the objectives under that Act;

[DEV-19-MIN-0346]
- 3        **agreed** that the Reserve Bank, as resolution authority, will have statutory duties that capture the matters referred to in paragraph 2 above;
- 4        **agreed** that the Reserve Bank will have the following statutory objectives in performing the resolution function:
  - 4.1      enable all deposit takers to be resolved in an orderly manner;
  - 4.2      avoid significant damage to financial system in the event of the failure of a deposit taker, including by maintaining the continuity of systemically important financial functions and preventing contagion;
  - 4.3      (along the lines of) protect depositors to the extent they are covered by the deposit insurance scheme;

- 4.4 to the extent not inconsistent with the objectives in paragraphs 4.1 to 4.3 above:
- 4.4.1 minimise the cost of resolution and avoid unnecessary destruction of value and interference with property rights,
  - 4.4.2 protect public funds, including by minimising the need to apply public funds to resolve the failure of a deposit taker;
- 5 **noted** that the objective in paragraph 4.3 above is additional to the objectives agreed in principle by Cabinet in December 2019 [DEV-19-MIN-0346], and will be finalised under delegated authority;

### **Direction powers and triggers for early intervention**

- 6 **agreed** that the Reserve Bank have a power to direct a licensed deposit taker, the policy intent being that the power can be used where it has reasonable grounds to believe that:
- 6.1 there is a contravention, or a likely contravention, by a licensed deposit taker of its prudential requirements or obligations (including, without limitation, if the licensed entity is insolvent or likely to become insolvent, or is about to suspend payment or is unable to meet their obligations as they fall due); or
  - 6.2 the business of the licensed deposit taker is not being conducted in a ‘prudent manner’; or
  - 6.3 the circumstances of the licensed deposit taker are such as to be prejudicial to the soundness of the licensed deposit taker or the financial system;
- 7 **agreed** that the terms of the direction would be whatever the Reserve Bank believes is necessary or desirable to remedy the situation that has given rise to the grounds for the direction (the ‘event’), avoid or mitigate the harm or potential harm arising out of the event, potential event, or risks to the ongoing viability of the entity;
- 8 **agreed** that the scope of the direction power include all of the powers currently contained within section 113A of the current Reserve Bank of New Zealand Act 1989, as well as process requirements in section 113 of that Act, and the following additional new powers, to give the Reserve Bank the ability to direct a licensed deposit taker to:
- 8.1 implement its recovery plan; or
  - 8.2 issue additional shares;
- 9 **agreed** that non-compliance by any person (including the licensed deposit taker itself, directors and senior management) with a direction be a criminal offence, and potentially subject to other penalties determined under delegated authority;
- 10 **agreed** that the Reserve Bank be able to issue directions to an associated person where it has reasonable grounds to believe that this is necessary or desirable in order to manage the difficulties faced by a licensed deposit taker, because the affairs of the associated person and the licensed deposit taker are so closely connected, or are impacting on the solvency of the licensed deposit taker;
- 11 **agreed** that the full scope of direction powers be available to the Reserve Bank in the context of associated persons, provided that the triggers for directions to that associated person set out in paragraph 10 above have been met;

- 12 **agreed** that the Reserve Bank have the power to remove, replace, or appoint directors of a licensed entity, where any of the triggers for intervention set out in paragraph 6 above are satisfied, and the Reserve Bank believes it is necessary or desirable to remove, replace or appoint directors of the entity;
- 13 **agreed** that, consistent with Cabinet’s previous in-principle decision to remove Ministerial consent [DEV-19-MIN-0346], Ministerial consent would no longer be required where the Reserve Bank removes, replaces or appoints directors of a licensed entity;

### **Triggers for placing a deposit taker into resolution and exercising resolution powers**

- 14 **agreed** that the criteria to place a licensed deposit taker into resolution require the Reserve Bank to be satisfied on reasonable grounds that both a non-viability test and a necessity test have been met;
- 15 **agreed** that the policy intent is for non-viability to occur when one or more of the following applies to the licensed deposit taker:
- 15.1 the value of the deposit taker’s assets is or is likely to become less than the value of its liabilities;
  - 15.2 the deposit taker is unable or likely to become unable to pay its debts as they fall due;
  - 15.3 the deposit taker has persistently or seriously failed to comply with any direction, condition or other requirement that it must comply with to be a licensed deposit-taker;
  - 15.4 the deposit taker is failing or has failed to maintain a minimum amount (or ratio) of capital as required under an applicable standard or licence condition;
- 16 **agreed** that the policy intent is for the necessity condition to be met when there is no reasonable prospect of the difficulties of the non-viable licensed deposit taker being remedied outside resolution to the satisfaction of the Reserve Bank;
- 17 **noted** that further work is being done on a possible additional resolution trigger that deals with the situation where an overseas authority has taken, or is taking, resolution action against the licensed deposit taker or a member of the licensed deposit taker’s group, and that a decision on this trigger will be taken under delegated authority;
- 18 **agreed** that the Reserve Bank may put an associated person into resolution and exercise resolution powers on that associated person;
- 19 **noted** that the triggers for placing an associated person into resolution will be determined under delegated authority;

### **Empowering the Reserve Bank as resolution authority**

- 20 **noted** that Cabinet has previously agreed in principle that, where practicable, existing resolution powers currently available to a statutory manager be available directly to the Reserve Bank as resolution authority [DEV-19-MIN-0346];
- 21 **agreed** that the DTA will include other significant powers and technical provisions for the resolution of licensed deposit takers based on the statutory management provisions in the Reserve Bank of New Zealand Act 1989 as reviewed, adapted and appropriately modified for the resolution of licensed deposit takers under delegated authority;

- 22 **noted** that the significant resolution powers referred to in the above paragraph include the Reserve Bank (or resolution manager appointed by the Reserve Bank) having the power to assume full powers of management of the deposit taker in resolution, sell or transfer all or part of the business of the deposit taker in resolution, and having the power to suspend payments of the deposit taker in resolution;
- 23 **agreed** that the Reserve Bank have the power to appoint directly one or more persons (acting jointly or individually) as resolution manager of an entity that is in resolution;
- 24 **agreed** that the resolution manager may be a Reserve Bank official or another person determined by the Reserve Bank;
- 25 **agreed** that the Reserve Bank be responsible for the performance of the resolution manager, and that person would be:
- 25.1 subject to oversight by the Reserve Bank;
  - 25.2 subject to and required to comply with instructions and directions by the Reserve Bank;
  - 25.3 accountable to the Reserve Bank;
  - 25.4 subject to removal and replacement by the Reserve Bank;
- 26 **agreed** that a resolution manager be able to take actions to give effect to any of the Reserve Bank's powers in respect of a deposit taker in resolution, but only as the Reserve Bank's delegate and in accordance with direction by the Reserve Bank;
- 27 **agreed** that powers currently vested in a statutory manager under section 127 of the Reserve Bank of New Zealand Act 1989 to suspend payments or to cancel an obligation to provide funding be carried over to the DTA and vested with the Reserve Bank directly in respect of an entity that is in resolution, and that the existing exclusions from that power be updated to include payments and transfers to central counterparties and designated settlement systems;
- 28 **agreed** that, subject to further work on technical supporting provisions, the power to transfer or sell assets, liabilities, legal rights, and obligations, including deposit liabilities and ownership in shares (including the power of assignment and novation) of an entity in resolution, be vested directly with the Reserve Bank;
- 29 **agreed** that section 142 of the Reserve Bank of New Zealand Act 1989 dealing with applications by a statutory manager to the High Court for directions be carried over into the DTA in respect of a deposit taker that is in resolution, with necessary or desirable updates to reflect that the Reserve Bank will be the resolution authority;
- 30 **agreed** that the Reserve Bank may incorporate a new entity to receive assets and liabilities of a failed deposit taker;
- 31 **agreed** that a new entity referred to in paragraph 30 above may itself be placed into resolution as part of the resolution of the failed deposit taker's affairs;
- 32 **agreed** the powers available in respect of a deposit taker that is in resolution also be available in respect of an associated person that is in resolution;
- 33 **agreed** that the DTA include a moratorium based on section 122 of the Reserve Bank of New Zealand Act 1989, with further decisions on the nature of the moratorium (such as duration and process) to be made under delegated authority;

- 34 **agreed** that the DTA will clarify the legal status of payment instructions on a licensed deposit taker's entry into resolution, with further decisions on how to achieve this to be made under delegated authority;
- 35 **noted** that a legal stay on early termination rights for certain financial contracts is considered internationally to be an essential element of a bank resolution regime, but further technical design work is required, and that decisions will either be made under delegated authority or subject to a further report to Cabinet;

### Statutory bail-in

- 36 **confirmed** Cabinet's previous in-principle decision that the Reserve Bank have a statutory bail-in power to write down or convert to equity certain unsecured liabilities of an entity that is in resolution [DEV-19-MIN-0346];
- 37 **agreed** that the statutory bail-in power include the power to write down share capital and to cancel shares;
- 38 **agreed** that the following liabilities be excluded from the scope of statutory bail-in:
- 38.1 secured liabilities, including those related to covered bonds;
  - 38.2 client assets held by a deposit taker in trust or in a custodial capacity;
  - 38.3 liabilities owed to an employee or former employee of the deposit take arising out of the employment relationship;
  - 38.4 tax liabilities owed by the deposit taker to Inland Revenue;
  - 38.5 employer contributions to retirement savings schemes (e.g., KiwiSaver) owed by the deposit taker;
  - 38.6 liabilities owed by the deposit taker to its creditors arising from the provision to the deposit taker of goods or services (other than financial services) that are critical to the deposit taker's operations;
  - 38.7 liabilities owed by the deposit taker to the DTA deposit insurance scheme (e.g. unpaid levies);
  - 38.8 liabilities owed by the deposit taker under derivatives (but this exclusion does not apply to unsecured net amounts owed by a deposit taker to a counterparty after the application of New Zealand's netting legislation);
  - 38.9 other liabilities that are substantially similar in character to those listed in paragraphs 38.1 to 38.8 above;
- 39 **noted** that the above exclusions are expected to leave the following unsecured liabilities as eligible for statutory bail-in:
- 39.1 subordinated capital and debt instruments;
  - 39.2 any structurally subordinated debt issued to a holding company or a parent;
  - 39.3 other unsecured debt (such as wholesale debt and uninsured deposits) that is not excluded under paragraph 38 above;

- 40 **noted** that further work on the eligibility of insured deposits for statutory bail-in is required, and that a decision will be made under delegated authority, noting that they will in any case be protected by the insurance scheme;
- 41 **agreed** that eligibility of liabilities for statutory bail-in will be set out in the DTA, and that the Governor-General may make Regulations by Order in Council on the advice of the Minister of Finance that specify additional unsecured liabilities as ineligible for statutory bail-in;
- 42 **agreed** that eligibility of debt instruments for statutory bail-in would only apply to instruments issued or renewed (including through updated terms and conditions) from or after the date that the eligibility provisions of the DTA enters into force;
- 43 **noted** that eligibility of deposit accounts for statutory bail-in would only apply once statutory bail-in is appropriately recognised in the terms and conditions for those accounts;
- 44 **agreed** that the Reserve Bank will have a power to require licensed deposit takers to maintain minimum amounts of specified, subordinated bail-inable instruments for the purposes of resolution planning;
- 45 **agreed** that the terms and conditions for liabilities that are to be included in minimum requirements of bail-inable liabilities will be set out by the Reserve Bank in prudential standards;
- 46 **agreed** that requirements for contractual recognition of statutory bail-in and subordination requirements for bail-inable instruments will be set out by the Reserve Bank in prudential standards;
- 47 **agreed** that consequential amendments to the Financial Markets Conduct Act 2013 and Regulations, including disclosure requirements, be developed (under delegated authority or subsequently) where required as a consequence of the introduction of statutory bail-in;
- 48 **noted** that a targeted amendment of tax legislation may be required to address the timing of potential tax liabilities in the event that statutory bail-in powers were used;

### Statement of approach to resolution

- 49 **agreed** that the Reserve Bank be required to publish a statement of approach to resolution;
- 50 **agreed** that the Reserve Bank's statement of approach to resolution be required to include matters, along the following lines:
- 50.1 the expected resolution strategy or strategies for different types of licensed deposit taker;
  - 50.2 the approach to collaborating with other agencies (e.g. the Treasury) in resolution planning;
  - 50.3 how the Reserve Bank will engage with the Minister of Finance and other agencies on the use of early intervention powers (such as directions and removing/appointing directors) and resolution powers prior to an entity being put into resolution;
- 51 **agreed** that the Reserve Bank be required to consult the Minister of Finance in preparing the statement of approach to resolution, and have regard to the Minister of Finance's views before finalising the statement;

## Placing a deposit taker into resolution

- 52 **agreed** that the Reserve Bank be able to place a licensed deposit taker into resolution without authorisation from the Minister of Finance where:
- 52.1 the deposit taker is to be resolved in an open state; and
- 52.2 the use of statutory bail-in is limited to specified subordinated bail-inable instruments that have been prepositioned for statutory bail-in in line with requirements under prudential standards issued by the Reserve Bank;
- 53 **agreed** that, in all other cases, authorisation from the Minister of Finance, on the recommendation of the Reserve Bank, will be required to place a deposit taker into resolution;
- 54 **noted** that the legal instruments that the DTA would require to be transmitted at the point of placing a deposit taker into resolution will be determined under delegated authority;

## Managing fiscal risk to public funds

- 55 **agreed** that the Minister of Finance will have the ability to direct the Reserve Bank on the management of risks to public funds in a resolution;
- 56 **agreed** that the Minister of Finance's direction power is intended as a residual lever only in order to enable the Minister to manage risks to public funds, and not used for day-to-day intervention in a resolution;
- 57 **agreed** that, for the purposes of the Minister of Finance's direction power, 'risk to public funds' covers the Crown's financial liabilities or commitments in respect of the entity in resolution (such as government guarantees, loans, indemnities, share purchases and underwriting, and equity injections), but excludes the Reserve Bank's use of its own funds or use of the deposit insurance scheme funds or the government fiscal backstop for the deposit insurance scheme (the use of which would be governed under separate provisions);
- 58 **agreed** that the Minister of Finance will have a statutory test for exercising the powers that the Minister will have under the DTA resolution regime;
- 59 **noted** that further work is being undertaken on the statutory test, the process to be followed in exercising the Minister of Finance's direction power, and on the Reserve Bank's accountability for its statutory objectives where it considers a Ministerial direction to be in conflict with its objectives, and that decisions on these matters will be taken under delegated authority;

## No creditor worse off

- 60 **confirmed** Cabinet's previous in-principle decision that resolutions be required to be conducted in a manner that respects the creditor hierarchy that would normally apply in a liquidation unless departure from the hierarchy is necessary to maintain the stability of the financial system, including maintaining critical financial functions [DEV-19-MIN-0346];
- 61 **confirmed** Cabinet's previous in-principle decision that an after-the-event compensation mechanism be established to compensate creditors if a resolution left some creditors worse off than they would have been in an ordinary liquidation (the 'no creditor worse off' principle) deposit takers [DEV-19-MIN-0346];



62 **noted** that decisions on the ‘no creditor worse off’ compensation mechanism will be taken under delegated authority;

**Public Finance Act 1989 amendment to provide authority to incur expenditure without an appropriation in a financial crisis**

63 **agreed** to amend the Public Finance Act 1989 to provide authority (similar to the existing section 25 of the Public Finance Act), whether or not there is an appropriation in place, for the Minister of Finance to approve expenses or capital expenditure to be incurred in respect of a financial entity regulated by the Reserve Bank where conditions along the following lines have been met:

63.1 the Reserve Bank has advised the Minister of Finance that the financial entity is insolvent, or would soon be insolvent, or otherwise considered to be failing financially;

63.2 the Minister is satisfied that the expenditure is:

63.2.1 necessary or desirable in the public interest; and

63.2.2 necessary or desirable to maintain the stability of the financial system and the continuity of critical financial services;

63.3 the Minister is satisfied that all other options consistent with the public interest to resolve the entity without using public funds had either been exhausted, were unlikely to succeed on their own, or were not in the public interest under the circumstances;

63.4 the Minister is satisfied that adequate arrangements will be in place to prudently manage fiscal risks to the government arising from the expenditure.

Janine Harvey  
Committee Secretary

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**Present:**

Hon Grant Robertson (Chair)  
Hon Dr Megan Woods  
Hon David Parker  
Hon Nanaia Mahuta  
Hon Poto Williams  
Hon Damien O’Connor  
Hon Stuart Nash  
Hon Willie Jackson  
Hon Michael Wood  
Hon Dr David Clark  
Hon Phil Twyford  
Rino Tirikatene, MP  
Dr Deborah Russell, MP

**Officials present from:**

Office of the Prime Minister  
Officials Committee for DEV

**Hard-copy distribution:**

Minister of Finance