

# The Treasury

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

April 2021

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### Cabinet Document Details

Title: **Cabinet Paper DEV-21-SUB-0076: Reserve Bank Act Review - Deposit Takers Bill: Overview (Paper 1 of 4)**

Date: **14 April 2021**

Creator: Office of the Minister of Finance

**No information has been withheld**

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Chair,  
Cabinet Economic Development Committee

## **Reserve Bank Act Review – Deposit Takers Bill: Overview (Paper 1 of 4)**

### **Proposal**

- 1 This paper is one of four papers which seek decisions on a new prudential policy framework for the Reserve Bank of New Zealand. The purpose of this paper is to:
  - 1.1 provide an overview of the package of proposals which relate to the prudential framework for deposit takers, deposit insurance and crisis management;
  - 1.2 outline the role of the Minister of Finance in the new prudential framework, and;
  - 1.3 seek decisions on drafting matters and delegations which are relevant to all policy decisions.

### **Relation to government priorities**

- 2 This package of proposals is part of a broader review of the Reserve Bank of New Zealand Act 1989, which was part of the previous government's coalition agreement between the Labour Party and the New Zealand First Party. Phase 1 of the Review, which was completed in 2018, amended the monetary policy framework, creating the Monetary Policy Committee (MPC) and adding an objective to support maximum sustainable employment. Phase 2 of the Review is a wide-ranging review of the Reserve Bank's governance and financial policy framework, including the development of a new prudential framework for deposit-taking institutions and the introduction of deposit insurance.

### **Executive Summary**

- 3 This paper provides an overview of three detailed decision papers that seek agreement to a set of recommendations that will design a new prudential framework for deposit taking institutions alongside a strengthened crisis management regime, and introduce deposit insurance.

- 4 The proposals in this package are the culmination of three rounds of public consultation on Phase 2 of the Reserve Bank Act Review. The overall objective of the Review is to modernise the Reserve Bank's legislation to support the development of a New Zealand economy that is productive, sustainable and inclusive. This package of proposals will help protect society from the damage to New Zealand's financial system and wider economy that could be caused by excessive risk taking by the deposit taking sector, and the failures of individual deposit takers. Taken together the recommendations that I am proposing will strengthen New Zealand's financial system safety net.
- 5 Given the large number of proposals associated with the new prudential framework and deposit insurance, my recommendations have been organised into three separate decision papers. This paper (**Paper 1**) sets out the background, process, and consultations which underpin the recommendations. It provides an overview of the papers for decision and outlines the role of the Minister of Finance in the new prudential framework. It also seeks decisions on drafting and delegation matters which are relevant to all decisions.
- 6 **Paper 2** provides a set of recommendations around the regulation and supervision of deposit takers: the objectives for the Reserve Bank under new sectoral legislation for deposit takers; the prudential boundary for 'deposit taking'; the licensing framework and how prudential requirements will be imposed; a new accountability framework for directors of deposit takers; the suite of supervisory and enforcement tools available to the Reserve Bank, and; the appeal rights afforded to parties impacted by prudential decisions of the Reserve Bank.
- 7 **Paper 3** details recommendations for the introduction of a formal scheme to protect depositors from loss in the event that a deposit taker fails. New Zealand has been an outlier internationally given the absence of such a scheme in this country. I am recommending that Cabinet revisit its previous in-principle decision on the coverage limit for the scheme in light of stakeholder feedback, so that depositors will be covered up to \$100,000 of their deposits at any single deposit taker.
- 8 **Paper 4** provides a set of recommendations that strengthens New Zealand's crisis management framework. This work has been informed by international experience during and since the global financial crisis, but tailored for New Zealand circumstances. The suite of recommendations will provide a clear mandate for the Reserve Bank as the resolution authority, while enhancing the suite of powers available to manage a deposit taker in distress.
- 9 The Government shares a keen interest in financial stability and the outcomes of prudential policy more generally. It is important however, that the role and responsibilities of the Minister of Finance are clear in the new framework, given the well-understood benefits of prudential policy being undertaken at arms'-length from Government. This Overview paper provides a summary of my role as Minister of Finance in the new framework, and I believe the right balance has been struck between preserving the operational independence of

the Reserve Bank, and the democratic legitimacy afforded by my role in the framework.

- 10 Decisions made on this package will be implemented through a new Deposit Takers Act (DTA) that the Reserve Bank will administer. I am anticipating that a Bill will be introduced into the House towards the end of this year.

## **Background**

- 11 In 2017, the Government announced a review of the Reserve Bank of New Zealand Act 1989. Phase 1 of the Review dealt with monetary policy arrangements, resulting in the introduction of the MPC and the introduction of an economic objective of supporting maximum sustainable employment. Phase 2 of the Review, which began in June 2018, focusses on the institutional structure of the Reserve Bank, and the Reserve Bank's prudential powers and arrangements for depositor protection.
- 12 A joint Review team comprising members from both the Treasury and Reserve Bank is carrying out the Review, supported by an Independent Expert Advisory Panel (the 'Panel'). The Panel is chaired by Suzanne Snively and provides independent advice to me on the recommendations put forward by the joint agencies.

## *Objectives of the Review*

- 13 The overall objective of the Review is to modernise the Reserve Bank's legislation to support the development of a New Zealand economy that is productive, sustainable and inclusive. A modern and fit for purpose prudential regime will contribute to this overarching objective if it provides a credible pre-commitment to the long run goal of financial stability and protects the Reserve Bank's operational independence. This regulatory autonomy is complemented and supported by a robust accountability and transparency architecture that supports quality decision-making and builds public confidence in the legitimacy of the Reserve Bank as an institution.
- 14 The terms of reference for Phase 2 of the Review, which I released in June 2018, outlined the characteristics that I believe help define a successful regulatory regime:
  - 14.1 The purpose of the legislation and the Reserve Bank's objectives are clear;
  - 14.2 The powers available to the Reserve Bank are sufficient to achieve its objectives;
  - 14.3 The roles and responsibilities of key participants, including the Minister, the board and the Governor are defined in statute, and are clear and coherent;
  - 14.4 The regime engenders trust and confidence in New Zealand's financial markets and in the decision-making processes of the Reserve Bank;

- 14.5 The regime is enduring;
  - 14.6 The regime provides sufficient flexibility to adapt and evolve in response to market developments;
  - 14.7 There is clarity as to how the regime interacts with other regulatory regimes and government policy as a whole;
  - 14.8 The regime is clear about the role of government and the scope of the Reserve Bank's operational independence.
- 15 The Phase 2 Review has involved three substantive public consultations and will culminate with two separate pieces of legislation. The Reserve Bank of New Zealand Bill (RBNZ Bill) has been introduced into Parliament and is currently before the Finance and Expenditure Committee. The second piece of legislation – the DTA – will set out the Reserve Bank's powers and functions in relation to deposit taking institutions and will introduce a deposit insurance scheme.

#### *The Reserve Bank of New Zealand Bill*

- 16 The RBNZ Bill changes the governance arrangements of the Bank and will establish a new governance Board. Amongst other changes, this Bill also contains features that directly support and complement the proposed prudential regime for deposit takers. These features include:
- 16.1 a new primary financial policy objective to protect and promote the stability of New Zealand's financial system;
  - 16.2 a requirement for the Minister of Finance to issue a *Financial Policy Remit* which the (new) decision-making board must have regard to when making significant policy decisions about how to achieve its strategic prudential intentions and contributing to the financial stability objective;
  - 16.3 specific process requirements around the development of prudential policy, such as the publication of regulatory impact assessments (carried across from the existing Reserve Bank Act 1989), and that these must include how the *Remit* has been considered, and;
  - 16.4 provisions to strengthen cooperation and coordination across the financial regulatory sector, including statutory recognition of the Council of Financial Regulators, and a statutory cooperation function for the Reserve Bank.
- 17 Taken together, the RBNZ Bill and the proposals I am recommending in the accompanying papers for deposit takers will make a significant contribution to the features defining a successful regulatory regime I outlined above.

*Public consultation on proposals for the new prudential regime*

- 18 The detailed design elements of this suite of papers were the focus of the third and final public consultation undertaken from March 2020 ('C3').
- 19 The proposals and options in C3 were informed by stakeholder feedback on the previous two consultations, additional policy analysis from the joint Review team, and framed within the context of a number of in-principle decisions taken by Cabinet [DEV-19-MIN-0346 and DEV-19-MIN-0161 refers]. These Cabinet decisions include:
  - 19.1 regulating and supervising banks and non-bank deposit takers under a single prudential regime;
  - 19.2 using 'standards' as the primary legislative mechanism for imposing prudential requirements;
  - 19.3 enhancing the accountability and liability of directors of deposit takers;
  - 19.4 giving the Reserve Bank an on-site inspection power and a more graduated enforcement and penalty framework with a broader range of potential sanctions;
  - 19.5 establishing a deposit insurance scheme, and;
  - 19.6 designating the Reserve Bank as the resolution authority with a broader range of powers.
- 20 The joint Review team undertook a programme of stakeholder engagement on C3 following the COVID-19 lockdown. This involved bilateral meetings with interested stakeholders and workshops with industry. The Review team received 45 written submissions from a range of stakeholders including a number of joint submissions on behalf of the banking and non-bank deposit taking sector.
- 21 Submitters were broadly comfortable with a number of the proposals laid out in C3 including the approach to the regulatory perimeter, the standards and licensing framework, a liability regime more focussed on civil pecuniary penalties, a broader supervisory and enforcement tool kit, and the coverage of transactional and savings accounts by the deposit insurance scheme. Some common concerns were also raised including:
  - 21.1 Purposes and principles – although some submitters were supportive of the objectives proposed for the Reserve Bank under the DTA, many suggested that concepts of efficiency and the overarching statutory purpose need more prominence;
  - 21.2 Macro-prudential standards – several submitters suggested the decision-making framework for lending standards should be more

explicitly linked to the overarching purpose of promoting prosperity and well-being of New Zealanders contained in the RBNZ Bill;

- 21.3 Clarity and coherency – a few submitters emphasised the need for a clear and coherent framework across all parts of the new prudential framework, particularly for the liability, director accountability and crisis management frameworks;
- 21.4 Deposit insurance – some submitters expressed concern that the in-principle decision to set the coverage limit at \$50,000 limit is too low, supporting a higher coverage limit.

## **Overview of the suite of papers**

22 This section provides an overview of the proposals in the suite of papers.

### *Paper 2: The framework for the regulation and supervision of deposit takers*

- 23 In Paper 2 I am recommending a suite of proposals that will set the foundations for the regulation and supervision of deposit takers. Paper 2 includes recommendations that:
  - 23.1 define the legislative purposes of the DTA and the decision-making principles that will help guide the exercise of powers under the Act;
  - 23.2 define which financial institutions will be regulated and supervised as ‘deposit takers’ and the flexibility afforded to the Reserve Bank to manage entities that sit close to the boundary of the prudential perimeter (i.e. exemption and designation powers);
  - 23.3 empower the Reserve Bank to set prudential requirements on deposit takers via standards within a permitted scope, with a high degree of flexibility to tailor requirements given the diversity of the sector;
  - 23.4 empower the Reserve Bank to license and de-license deposit takers, subject to criteria specified in the DTA, and in consultation with the Financial Markets Authority (FMA) which will be licensing the same set of financial institutions from a market conduct perspective;
  - 23.5 empower the Reserve Bank to set ‘fit and proper’ requirements on directors and senior managers in line with those requirements in the Insurance (Prudential Supervision) Act 2010;
  - 23.6 provide greater assurance that directors of deposit takers are prudently managing risks to their institution, via the imposition of an on-going duty to ensure that there are adequate systems, processes and policies in place so that the entity complies with its prudential obligations;

- 23.7 provide for an on-site inspection power and a more graduated enforcement and penalty framework with a broader range of potential sanctions;
  - 23.8 calibrate the scope of the Reserve Bank's regulatory and supervisory powers for 'associated persons' of deposit takers as appropriate – i.e. entities that have a relationship with the deposit taker and whose activities may pose a risk to the soundness of the deposit taker and/or the stability of the financial system;
  - 23.9 provide for a well calibrated framework for appeal rights in the prudential framework – i.e. the ability of affected parties to challenge decisions of the Reserve Bank, in a way that strikes the right balance between protecting the rights of affected parties while enabling the Reserve Bank to pursue its statutory mandate effectively and efficiently.
- 24 Following the conclusion of C3 my officials and I discussed a specific policy issue raised by stakeholders that is tied to paragraph 23.2 above and the prudential boundary. This was the role of 'finance companies' in the proposed prudential framework. C3 proposed two options:
- 24.1 Option 1: finance companies should be treated as a separate class of prudentially regulated entities.
  - 24.2 Option 2: finance companies should be licensed as deposit takers and able to offer insured deposit products.

I am recommending Option 2.

- 25 The new framework should promote cooperation and coordination between New Zealand's two key financial system regulators – the Reserve Bank and the FMA. The RBNZ Bill provides for the statutory recognition of the Council of Financial Regulators (CoFR) and a statutory cooperation function for the Reserve Bank to work with relevant domestic and international counterparts. The recommendations I am putting forward underscore the importance of cross-agency cooperation, particularly the Reserve Bank and the FMA working together (e.g. on (de)licensing decisions).
- 26 Related to this, the Ministry of Business, Innovation and Employment (MBIE) is undertaking targeted consultation on the merits of an on-site inspection power for the FMA that aligns with the one I am recommending for the Reserve Bank. Alignment of on-site powers is appropriate since the Reserve Bank and the FMA often regulate the same entities, and increasingly carry out joint or coordinated supervisory and monitoring activities. Depending on the outcome of this work, any further changes could be included in a second tranche of policy decisions (see timeline in the Next Steps section).



### *Paper 3: Deposit insurance*

- 27 Deposit insurance is a key feature of almost every financial system safety net in other developed countries. In the absence of a formal scheme, there is greater potential hardship for depositors in the event a deposit taker fails, and a further undermining of financial stability if depositors lost confidence in their deposit taker and decided to rapidly shift their funding (i.e. perpetuate a 'bank run').
- 28 Deposit insurance schemes aim to promptly reimburse protected depositors in a failed deposit-taking institution(s), rather than leaving depositors to rely on an insolvency process, which can involve significant delays and uncertainty in recovery of funds.
- 29 In Paper 3, I am recommending that Cabinet agree to a set of foundational proposals that pave the way to establish a deposit insurance scheme (DIS) for New Zealand.
- 30 My first proposal is that Cabinet agree and confirm its previous in-principle decisions [DEV-19-MIN-0161 and DEV-19-MIN-3046 refers] that the DIS would be compulsory for all licensed deposit-taking institutions, would be fully funded by levies on member institutions, and would be supported by a government funded backstop that will enhance the credibility of the DIS. I also recommend a reframing of the objective of the deposit insurance scheme along the lines of "protecting depositors to the extent they are covered by the deposit insurance scheme and thereby contributing to financial stability".
- 31 My second proposal is that Cabinet agree to increase the coverage limit for deposit insurance from the previous in-principle decision of \$50,000, to \$100,000. The \$100,000 limit would apply on a per depositor, per institution basis. Based on the current balance sheets of deposit takers, the scheme would fully cover more than 93 percent of depositors in New Zealand.
- 32 Over the latest two rounds of public consultation in 2019 and 2020, the Review received numerous submissions from stakeholders raising concerns that the proposed \$50,000 limit is too low. During the 2020 consultation, small banks, credit unions and building societies, and finance companies (collectively 'small deposit takers') submitted that the introduction of deposit insurance with a \$50,000 limit poses a threat to their stability and liquidity. During previous rounds of consultation, the majority of stakeholders supported a higher limit more in line with international norms.
- 33 I believe that a \$100,000 limit would mitigate the risks to stability and liquidity highlighted by small deposit takers, respond to the broader concerns raised by stakeholders, increase public confidence in the safety of deposits, and strengthen the commitment of future Governments to use resolution tools.
- 34 In addition, I am asking Cabinet to agree to a number of recommendations associated with the design of New Zealand's DIS:

- 34.1 Governance and mandate of the deposit insurer – these recommendations define the role of the deposit insurer, which I am recommending would be fairly narrow and tied to promptly reimbursing depositors, collecting and managing levies and raising public awareness. I am also recommending that the DIS is located within the Reserve Bank;
- 34.2 Funding framework – these are a set of recommendations to ensure funding is available to promptly reimburse depositors in the event of failure and are designed to support public confidence, be cost effective, and provide a predictable and well-understood framework for both deposit takers and the wider public. The centrepiece for this set of recommendations is the Funding Strategy for the DIS, which the Minister of Finance would be required to publish at least every five years. This will set out guidance for levies and how the DIS will have adequate funding over time;
- 34.3 Boundary for eligible products and depositors – a well-designed scheme needs to clearly set out the rules for defining the level and scope of coverage, so depositors understand which products are (and are not) covered by the DIS. I am recommending that the limit and scope of coverage be set out in primary legislation and that the scheme covers transactional, savings and term deposits. I recommend that the scheme should exclude some more sophisticated groups, such as large non-financial corporates and financial institutions, in order to strengthen their incentive to monitor the risk-taking of their deposit taker.

#### *Paper 4: Crisis management and resolution*

- 35 Crisis management is another key part of the regulatory system's financial safety net, along with prudential regulation and supervision (Paper 2) and depositor protection (Paper 3).
- 36 New Zealand's legislative framework for bank crisis management, being largely based on statutory management, has not been comprehensively reviewed since the late 1980s. Under this framework, the Reserve Bank developed the Open Bank Resolution (OBR) policy to manage the failure of a large bank. Since then, bank resolution regimes have been fundamentally overhauled internationally, particularly in the wake of the 2007-08 global financial crisis (GFC). It is therefore timely to consider possible enhancements to New Zealand's framework. The Review's work has been informed by the international experience and the subsequent post-GFC global reform programme. A key theme in the stakeholder feedback – which the Review seeks to deliver – is that the regime should be aligned with international best practice and guidance.
- 37 The Review's work on reforming the crisis management framework for all entities that will come under the single integrated framework for deposit takers will take place across two tranches of advice. The first are my recommendations contained in Paper 4, and the second through supporting

framework decisions that will follow at a later date (see Annex 1). In Paper 4 I am recommending decisions on the following aspects of the crisis management framework:

- 37.1 Early intervention powers – these recommendations provide for the Reserve Bank to direct a licensed entity to give effect to corrective action and ensure compliance with prudential requirements, including instructions to implement a recovery plan or to issue additional capital. These powers are designed to enable the Reserve Bank to act proactively and well in advance of needing to action any formal resolution powers;
- 37.2 Criteria for placing an entity into resolution and exercising resolution powers – these are a set of recommendations providing a clear set of triggers for placing a licensed deposit taker into resolution and are tied to a non-viability and necessity test;
- 37.3 Empowering the Reserve Bank as the resolution authority – these recommendations provide the Reserve Bank with key resolution powers when acting in its capacity as the resolution authority. These powers are significant, can override property rights, and therefore need to be balanced by appropriate creditor safeguards such as the ‘no creditor worse off than in liquidation’ (NCWO) safeguard;
- 37.4 Bail-in – I am recommending that Cabinet confirms its December 2019 in-principle decision to introduce the statutory bail-in power to write down or convert unsecured liabilities of a deposit taker in resolution. I am also recommending decisions that set out which liabilities would be eligible for statutory bail-in. Statutory bail-in will be an important addition to the resolution toolkit, particularly in terms of resolving deposit takers quickly without recourse to public funds – i.e. shifting the costs from taxpayers to creditors and investors via bailing-in a deposit taker’s liabilities;
- 37.5 The role of the Minister in the framework – as Minister of Finance I have a legitimate interest in how the Reserve Bank undertakes its crisis management and resolution functions, given the wider economic and social impact of deposit takers’ failure and the potential for public funds to be put at risk in managing such failure. The recommendations I am putting forward here strike the appropriate balance between this interest and the operational independence of the Reserve Bank;
- 37.6 Amendments to the Public Finance Act 1989 (the PFA) – I am recommending an amendment to the PFA in order to address a gap in the current framework which is the ability of the Government to act quickly and use public funds in a financial crisis. Similar to the existing power to incur expenditure in a civil defence or health emergency, the amendment would be for an authority to incur expenditure without an appropriation under limited circumstances and where it is impracticable to use other options (including using Imprest Supply or having

Parliament authorise specific spending through an Appropriation Act or additional Imprest Supply) and it is in the public interest.

### **Role of the Minister of Finance in the new prudential framework**

- 38 The Terms of Reference for the Phase 2 Review made clear that the “operational independence of the Reserve Bank remains paramount and will be protected”. Delegating the performance of a set of functions and objectives to an agency that sits at arm’s length from government is fundamental to ensuring a credible pre-commitment to, in this case, the long-run goal of financial stability. Without this pre-commitment and the depoliticisation it entails, a government of the day may be tempted to renege and focus on short term goals, or other objectives that ultimately undermine financial stability.
- 39 That said, there is a legitimate interest of government in financial system outcomes given the wider financial and economic impacts arising from prudential policy. In addition, Parliament, via the statutory objectives given to the regulator, is unable to specify with absolute clarity financial policy goals – ‘financial stability’ is not readily amenable to quantification (unlike monetary policy). We, as a Government, may have a different ‘risk appetite’ to that of the prudential regulator for financial system outcomes.
- 40 Situating the role of the Minister of Finance in the prudential framework necessarily involves trade-offs. A greater role for the Minister of Finance potentially:
- 40.1 promotes democratic legitimacy;
  - 40.2 better manages broader distributional trade-offs and societal preferences, and;
  - 40.3 reduces the risk of ad hoc changes to the legislative framework arising from political frustration.
- 41 On the other hand, this greater role needs to be balanced against the risk of:
- 41.1 short-termism and inaction bias which can undermine financial stability;
  - 41.2 reduced confidence in the Reserve Bank and its ability to successfully achieve its statutory mandate;
  - 41.3 blurred accountability for financial policy outcomes, and financial stability in particular, and;
  - 41.4 inconsistency of decision-making and a reduced role for technical expertise.
- 42 Throughout the Phase 2 Review I have been conscious of the need to strike an appropriate balance between the operational independence of the Reserve Bank and managing the Government’s interests in the prudential framework.

- 42.1 In terms of the institutional settings for governance, the RBNZ Bill confers financial stability decision-making rights to a board appointed by me and the board will be required to have regard to the *Financial Policy Remit* that I issue when it is undertaking the following:
- 42.1.1 setting the Reserve Bank's prudential strategic intentions;
  - 42.1.2 making significant policy decisions; monitoring and reporting on the Reserve Bank's performance; and
  - 42.1.3 issuing and reviewing standards.
- 42.2 In terms of the prudential framework for deposit takers, the DTA will include a purpose statement and decision-making principles. This will shape the way in which the Reserve Bank seeks to achieve financial stability through the DTA. The decision-making principles that I am recommending include, for example, taking into account efficiency-related considerations, and longer-term risks to financial stability (such as climate change).
- 43 The proposals that I am recommending across the suite of Cabinet papers provide a number of further touch points for the Minister of Finance in the prudential framework. The nature of these touch points differs across parts of the prudential framework to reflect where a Minister's interest might reasonably expect to lie (e.g. when Crown funds are at risk in the context of crisis management).
- 44 The process for setting prudential requirements through standards provides a role for the Minister of Finance in the following ways:
- 44.1 Regulations – an instrument made by the Governor-General by Order-in-Council on the advice of the Minister of Finance – are required to expand the general areas over which the Reserve Bank can set prudential requirements through standards, beyond those explicitly provided for in primary legislation (in order to keep pace with the rapid pace of financial sector innovation, for example);
  - 44.2 Regulations will also be required to define the permitted scope of 'macro-prudential' lending standards that can be imposed on deposit takers, and separately, to allow the Reserve Bank to impose lending standards on non-deposit taking institutions (i.e. those entities outside the perimeter);
  - 44.3 I am recommending that the Reserve Bank be required to inform the Minister of Finance of key policy changes. This will be buttressed by any additional expectations I set out for engaging with the Reserve Bank in a *Letter of Expectations* I may choose to issue.
- 45 In the context of supervision and enforcement I am proposing to recalibrate and reduce the role of the Minister (relative to the current framework in the Reserve Bank Act 1989) with respect to de-licensing decisions and the ability

of the Reserve Bank to issue directions to a deposit taker. This is in line with best practice internationally and in line with other sectoral legislation such as the Insurance (Prudential Supervision) Act 2010. This removes the ability for the government to influence the regulator's decisions that pertain specifically to individual entities.

- 46 The risk of public funds being used during periods of financial stress, and the wider economic and social costs from the failure of deposit takers, implies government has a legitimate interest in the crisis management framework at key touch points. I am recommending that the Minister will be consulted by the Reserve Bank in the preparation of a *Statement of Approach to Resolution*. This will be a document required under the DTA that sets out the Reserve Bank's general approach to resolving deposit takers of different types and sizes. It will also set out the nature of information to be provided to the Treasury as part of resolution planning, matters it will inform the Minister of, and the approach to engaging the Minister when the failure of a deposit taker appears imminent.
- 47 Furthermore I am recommending that I, as Minister of Finance, will be responsible for putting a deposit taker into resolution, on the advice of the Reserve Bank as the resolution authority, in all cases except where the resolution is an 'open resolution' whereby stabilisation is achieved through bailing in liabilities that were prepositioned for bail-in as part of 'minimum requirements'. This explicit role in certain resolutions recognises the wider social and economic costs of failure and, in some cases, the potential international relationship impacts.
- 48 Any decision to put public funds at risk in a resolution (outside recourse to the deposit insurance scheme) will be the Minister of Finance's decision as authorised by Parliament (for example, using powers under the PFA). Where public funds have been put at risk in a resolution, the Minister will have a power to direct the Reserve Bank on the management of that fiscal risk to the government (in line with the principles of responsible fiscal management under section 26G(1)(d) of the PFA).
- 49 The DTA will add a new function for the Reserve Bank – deposit insurance. In the model I am recommending that the Minister of Finance is required to publish a *Funding Strategy* and set the levies that will be imposed by the deposit insurer on deposit takers. In addition I will:
- 49.1 be responsible for managing the Crown's liability under the deposit insurance scheme due to the government 'backstop';
  - 49.2 be responsible for detailed regulations defining eligible depositors (e.g. trusts or other complex ownership structures);
  - 49.3 be responsible for adding new products to the scheme that are the same in economic substance as the legislative product boundary.

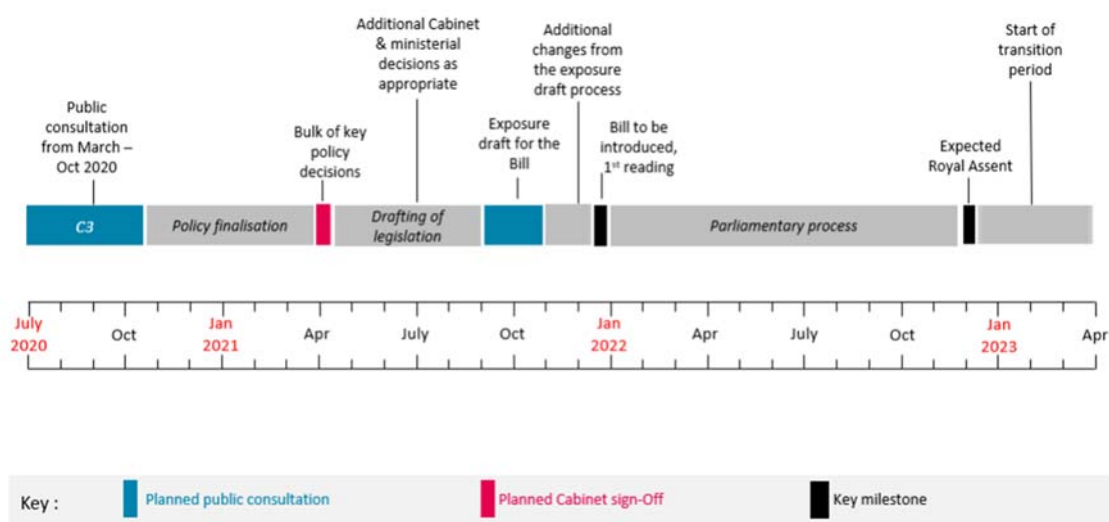
## Drafting and delegation matters relevant to the package of proposals

- 50 I propose Cabinet agrees to several general recommendations that sit across the three substantive decision papers (Papers 2-4):
- 50.1 drafting will consider provisions in the DTA that are desirable to ensure consistency with other prudential legislation, as appropriate;
  - 50.2 drafting will consider the merits of consolidating certain generic powers proposed for the DTA that also appear in other sectoral legislation – such as various supervisory powers – into the RBNZ Bill (or as subsequent amendments to this legislation when it is passed);
  - 50.3 Cabinet delegate further policy decision to myself, my Associate Ministers of Finance, and other relevant ministers where decisions affect their portfolios and that these decisions will be taken jointly.

### Next steps

- 51 Following Cabinet decisions on the recommendations in the package of Cabinet papers, the Reserve Bank will issue drafting instructions to the Parliamentary Counsel Office. This will enable drafting of a bill and public consultation on an exposure draft, with introduction into the House anticipated late 2021 (see Figure 1).

**Figure 1: Deposit Takers Act timeline**



- 52 There are a number of policy matters which will require additional decisions prior to the completion of the drafting process. These will include less material aspects of the new prudential framework, or areas still requiring further policy development (see Annex 1). I anticipate that a number of these decisions will be taken either under delegation to myself, or jointly with relevant ministers whose portfolios are affected. In the event that ministers with delegated

authority disagree, or where matters raise significant policy issues or issues of public interest, these decisions may be to be taken back to Cabinet for approval.

- 53 After the DTA is passed there will be a substantial work programme to implement the new prudential framework for deposit takers, including the introduction of deposit insurance. I expect that the deposit insurance provisions of the Act will commence with a target timeframe of 2023, prior to the rest of the DTA. I am placing priority on the implementation of deposit insurance so that arrangements are in place to protect depositors, should a deposit taker come under stress before the full DTA is ready for implementation (see Paper 3).
- 54 The parts of the current Reserve Bank Act relating to the regulation and supervision of registered banks and the Non-bank Deposit Takers Act 2013 will remain in force until the remaining parts of the DTA have been fully implemented, thereby overlapping with the introduction of deposit insurance. I have asked officials to undertake further work on the detailed transition timeframe for the rest of the DTA. This will include further engagement with Ministry of Business, Innovation and Employment and the Financial Markets Authority on the interaction between the Bill and financial markets conduct legislation, including on the transition to new disclosure and supervision arrangements.

### **Financial Implications**

- 55 The decisions in this package of Cabinet papers will have direct financial implications for the Reserve Bank as New Zealand's prudential regulator. For example, increasing the operating expenditure of the Reserve Bank to support a broader set of responsibilities associated with a new deposit insurance function. In addition, a significant step shift in the resourcing and funding of the Reserve Bank is required to support a more intensive supervisory and enforcement model. There will also be transition costs tied to implementing the new legislative framework (for example, developing a new rulebook for deposit takers and managing any temporary or interim licensing regime).
- 56 To some extent these expected costs have been anticipated in the 2020-25 Funding Agreement between me and the Governor of the Reserve Bank signed in June 2020. The new agreement provides for an annual average level of operating expenditure of \$115 million over the 5 year period. This compares to the \$80 million budget for the 2019/20 year.
- 57 Decisions around depositor protection will also have indirect financial implications. For example, a Government backstop for deposit insurance will create an explicit contingent liability.

### **Legislative Implications**

- 58 The recommendations in this package of Cabinet papers will be given effect by the Deposit Takers and Depositor Protection Bill, which has a category 4



priority on the 2021 Legislation Programme (to be referred to select committee in 2021).

59 The Deposit Takers and Depositor Protection Act will bind the Crown.

### **Impact Analysis**

60 A quality assurance panel (QA Panel) with representatives from the Reserve Bank of New Zealand, the Treasury and from the Regulatory Impact Analysis Team at the Treasury has reviewed the Regulatory Impact Statement (RIS) “A New Prudential Framework for the regulation and supervision of deposit takers and the introduction of deposit insurance”. The QA Panel considers that it **meets** the Quality Assurance criteria.

61 The Regulatory Impact Statement is clear and comprehensive despite the wide scope of decisions. It clearly sets out the key elements of the reform, distinguishing the aspects of the previous legislation being strengthened (prudential regulation and resolution) and new elements being introduced (depositor protection). The set of decisions is intended to function as a package with different sections of the RIS interacting with each other.

62 While the Reserve Bank and the Treasury both support the need for reform, they have different recommendations on macro-prudential policy, the approval process in changing the scope of lending standards, the deposit insurance limit and depositor preference. The panel notes that judgement makes a significant part of the basis for those recommendations. Notably, the recommended deposit insurance limit stems from different judgements on moral hazard risks between the Reserve Bank and the Treasury.

63 Several chapters included within this RIS interact significantly with proposed changes included in the RBNZ Bill and accompanying RIS. The proposed Ministerial powers discussed within the Macroprudential chapter should be considered alongside the wider governance changes, such as the financial policy remit.

### **Human Rights**

64 My officials will be working with the Ministry of Justice to ensure that any concerns relating to the New Zealand Bill of Rights Act are addressed.

### **Consultation**

65 The following agencies were consulted on the contents of this package of Cabinet papers: the Ministry of Business, Innovation and Employment; the Financial Markets Authority; Parliamentary Counsel Office; Inland Revenue; and the Ministry of Justice. The Department of the Prime Minister and Cabinet has also been informed.

66 Three rounds of public consultation have taken place as part of Phase 2 of the Review. The first round closed on 25 January 2019 and received 67 submissions. A second round of consultation closed 16 August 2019 and received 45 submissions. The third consultation closed 21 October 2020

(following a six-month extension to the original deadline for submissions due to COVID-19). This consultation received 45 written submissions on the detailed design aspects of a new prudential regime for deposit takers and the introduction of deposit insurance.

### *Views of the Independent Expert Advisory Panel*

- 67 The Independent Expert Advisory Panel (the Panel) commends the Reserve Bank Act Review team on the tremendous progress achieved on the DTA and the clarity that is emerging about deposit insurance. The process of engagement between the Reserve Bank and Treasury is working in a way that is leading to robust policy advice.
- 68 This advice to Cabinet covers the key details of the Reserve Bank's prudential framework and of the deposit insurance scheme required to meet deadlines to get the Bill to the House in a timely fashion. Below is a list of the key topics where the Panel sees the opportunity for further consideration in shaping the DTA.
- 68.1 Council of Financial Regulators (CoFR) – the Panel commends the statutory recognition of CoFR in the RBNZ Bill.
- 68.2 Standards – the Panel advises that CoFR's views be considered where relevant in the development of standards.
- 68.3 Public Finance Act support in crisis – the Panel concurs with the recommended changes to the Public Finance Act aimed to support the ability of the Government act quickly and use public funds in a financial crisis.
- 68.4 Licensing would benefit from principles for what constitutes 'Fit and Proper' to enable the Reserve Bank to be clear about the credentials expected of directors appointed to the boards of those organisations that the Reserve Bank regulates. The licensing process must also be sufficiently robust and flexible to allow for a diverse set of skills to be represented within those boards, and for any challenge to be dealt with expeditiously, avoiding as much as possible litigation.
- 68.5 The Panel supports provisions included in the DTA as safeguards (i.e. rights of appeal) to protect against allegations of over-reach by the Reserve Bank in the course of its regulatory activities, as these will help to ensure trust and confidence in a regulatory system.
- 68.6 Consumer protection – as part of the implementation and design of the deposit insurance scheme, the Panel emphasises the importance of being clear to consumers what products and services are insured. Consumers need more information than just referencing the word 'deposit' to be able to make informed decisions. The needs and behaviours of different communities who hold deposits (such as Māori and Pacific communities) should be considered as part of the design of the scheme.

- 68.7 The Panel recommends that there be a scenario exercise with resolution experts on the process of deposit insurance pay-out to test the operational management of the scheme and whether there should be any further legislative provisions to support an orderly process.
- 68.8 The Panel thinks the proposals on crisis management are on the right track regarding the trans-Tasman connection and encourages communication with APRA as the proposals for the DTA come closer to being finalised.

## **Communications**

- 69 I recommend that Cabinet decisions, the package of Cabinet papers and related material will be publicly released on the Treasury and Reserve Bank websites shortly after decisions are made.
- 70 In addition I plan to announce some of the key decisions shortly after the Cabinet meeting, and the timeframe for the implementation of deposit insurance.

## **Proactive Release**

- 71 I intend to proactively release supporting material and advice (such as policy advice reports, Panel papers and presentations) relating to these recommendations.

## **Recommendations**

The Minister of Finance recommends that the Committee:

- 1 note that this paper is a companion and overview paper to three decision papers seeking agreement to a new prudential framework for deposit takers and the introduction of deposit insurance:
  - 1.1 Paper 2: The framework for regulating and supervising deposit takers;
  - 1.2 Paper 3: Depositor protection and deposit insurance;
  - 1.3 Paper 4: Crisis management and resolution;
- 2 note Papers 2-4 contain specific recommendations on the foundational aspects of the new prudential framework under the relevant topics;
- 3 note I expect that further policy decisions (including the matters set out in Annex 1) will be needed to finalise the Deposit Takers Act (the DTA), and it is possible that additional Cabinet decisions will be required;
- 4 note that a number of the decisions on the matters set out in Annex will be able to be made under the delegations recommendations below (recommendations 7 to 9), and this will be determined at the time the relevant policy work is undertaken;

- 5 agree that provisions that are necessary or desirable to ensure consistency with other prudential legislation and the Reserve Bank of New Zealand Bill (the RBNZ Bill) will be included in the DTA;
- 6 agree that prudential provisions (such as certain supervisory powers) that are approved under the DTA Cabinet decisions, but also appear in other prudential legislation (such as the Insurance (Prudential Supervision) Act 2010) should be consolidated into the RBNZ Bill, where this is feasible and appropriate;
- 7 agree that the Minister of Finance is authorised to further clarify and develop policy matters relating to the proposals in the suite of DTA Cabinet advice in a manner not inconsistent with the policy recommendations in this advice, in consultation with the Associate Minister of Finance and the Minister of Commerce and Consumer Affairs;
- 8 agree that the Associate Minister of Finance and Minister of Commerce and Consumer Affairs shall be jointly authorised to further the proposals in the suite of DTA Cabinet advice (along with the Minister of Finance), where the clarification and development of policy matters involves their ministerial portfolios;
- 9 authorise the Minister of Finance and the Minister of Revenue to make decisions on dealing with the tax implications of statutory bail-in;
- 10 invite the Minister of Finance to report back to Cabinet, at the point of seeking Cabinet's agreement to the Bill, on the decisions taken under the delegated authority sought in recommendations 7 to 9 above;
- 11 invite the Minister of Finance to issue drafting instructions to the Parliamentary Counsel Office to give effect to the proposals in the suite of Cabinet papers on the DTA;
- 12 authorise the Minister of Finance to develop commencement, transitional and any savings provisions with the Parliamentary Counsel Office, through the drafting process;
- 13 note that the drafted commencement and transitional provisions will be subject to approval by Cabinet when it considers the Bill for introduction.
- 14 agree that Cabinet's decisions and the suite of Cabinet papers be publicly released.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance



## Annex 1: Post-April decisions

<b>Purposes and objectives</b>	<ul style="list-style-type: none"> <li>▪ Consideration of consolidating/rationalising sectoral principles in RBNZ Act</li> <li>▪ Statutory purposes/objectives guiding the exercise of the Minister of Finance’s powers under the DTA</li> </ul>
<b>Regulatory perimeter</b>	<ul style="list-style-type: none"> <li>▪ Finalising detail of approach to wholesale lenders</li> <li>▪ Other further detail related to foundational decisions</li> </ul>
<b>Standards and licensing</b>	<ul style="list-style-type: none"> <li>▪ Specifying scope of standards and process-related requirements in more detail</li> <li>▪ Specification of licensing and de-licensing tests</li> <li>▪ Consideration of transitional issues (e.g. merits of provisional/transitional licences etc.)</li> </ul>
<b>Liability, supervision and enforcement</b>	<ul style="list-style-type: none"> <li>▪ Legislative location of various supervisory powers (and general question of consolidation across sectoral Acts)</li> <li>▪ Further detail on specification of supervisory/enforcement tools as appropriate</li> <li>▪ Calibration of penalty levels</li> <li>▪ Scope of criminal offences vis-a-vis intentional/reckless non-compliance</li> </ul>
<b>Crisis management and resolution</b>	<ul style="list-style-type: none"> <li>▪ Remaining powers for the resolution authority (including moratoria on creditor enforcement claims and stays on early termination rights)</li> <li>▪ Legal safeguards and certainties</li> <li>▪ Tax implications of statutory bail-in</li> <li>▪ Creditor safeguards</li> <li>▪ Resolution funding</li> <li>▪ Transparency and accountability requirements</li> <li>▪ Whether deposit takers should continue to be within the scope of statutory management under the Corporations (Investigation and Management) Act 1989</li> </ul>
<b>Deposit insurance</b>	<ul style="list-style-type: none"> <li>▪ Transitional arrangements to enable the DIS to be in place prior to the full commencement of the DTA</li> <li>▪ How the funding strategy will work in practice and exact scope</li> <li>▪ Powers necessary to make payout and related provisions</li> <li>▪ Process requirements for setting levies</li> <li>▪ Process requirements for setting the deposit insurer’s operational budget and related budgetary oversight mechanisms</li> <li>▪ Further detail on triggers for activating the scheme</li> <li>▪ Further detail on safeguards for use of the deposit insurer’s funding in resolution, and associated process requirements</li> <li>▪ Transparency and reporting requirements for the DIS and the Deposit Insurance Fund</li> <li>▪ Whether to allow for regulations that would provide additional coverage for depositors with temporarily high balances</li> <li>▪ Operational definitions of depositors excluded from the scheme</li> </ul>