

# The Treasury

## Additional Documents Related to Phase 2 of the Reserve Bank Act Review - December 2019 to April 2021 - Proactive Release

June 2021

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- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment
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MC-1-7-3-1-13

Date: 5 March 2020

To: Minister of Finance  
(Hon Grant Robertson)

Deadline: 9 March 2020 (before Cabinet)

## **Aide Memoire: Cabinet item for 9 March 2020 – Reserve Bank Act Review – Release of the third consultation document**

On 4 March 2020, the Cabinet Economic Development Committee referred the release of the third public consultation document (C3) for Phase 2 of the Reserve Bank Act Review (the Review) to the Cabinet meeting of 9 March 2020 for further consideration.

This Aide Memoire updates the summary information and suggested talking points provided to you in an Aide Memoire of 28 February (T2020/474) for the DEV meeting on 4 March.

C3 follows Cabinet's in-principle decisions in December 2019 on the prudential regulation of deposit takers and deposit insurance. The release of the document will commence a public consultation period starting on or around Tuesday 10 March 2020 through to the week beginning 20 April 2020. It will inform advice for the final set of decisions for the Deposit Takers Act which, in turn, will inform the drafting of the Bill.

Below we provide more detail on the Review's progress and the content of C3, using material from the Cabinet paper. Suggested talking points for Monday's Cabinet meeting are attached as Annex 1.

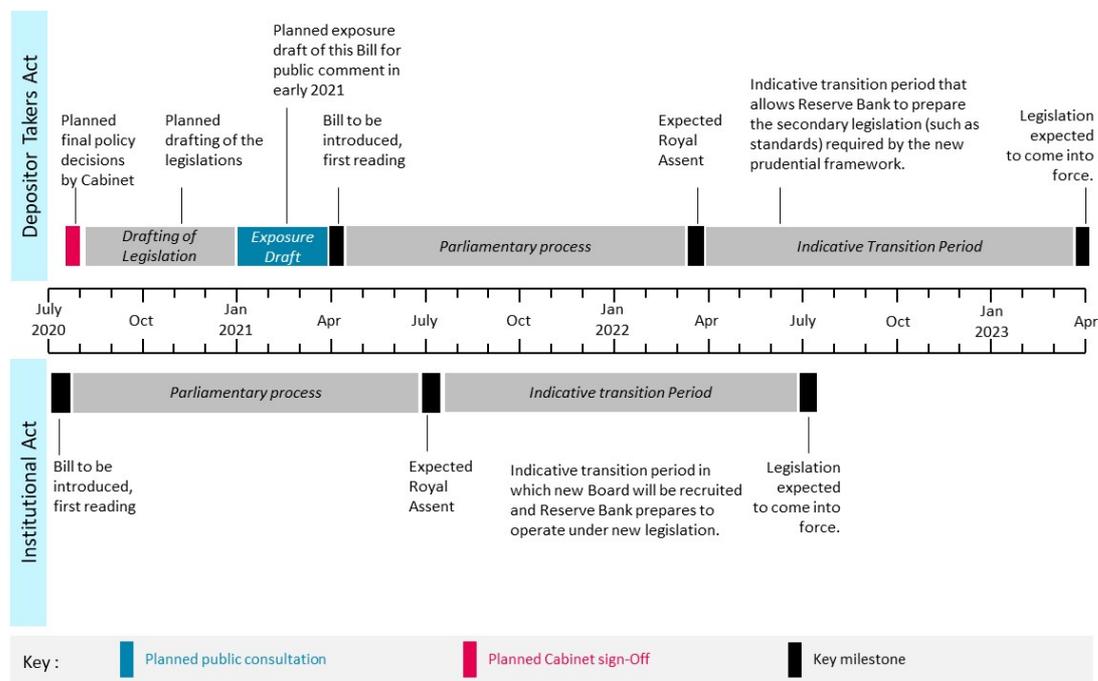
The information and talking points provided below are the same as provided previously except with the addition of some notes on feedback from the Independent Expert Advisory Panel and some talking points to explain bail-in.

### **Review Progress**

After completing changes to the governance arrangements for monetary policy (Phase 1), Phase 2 has focused on the wider governance of the Reserve Bank, powers related to financial regulation, and the provision of deposit insurance. The wider governance reforms are being progressed in the 'Institutional Act', which is currently being drafted and is expected to be introduced to Parliament later in the year (see Figure 1).

We are aiming for final decisions on the reforms to financial regulation and the introduction of deposit insurance (which are the focus of C3) to be agreed by Cabinet in early August. After drafting and consultation on an exposure draft, the Deposit Takers Bill is targeted for introduction to the House around April 2021.

**Figure 1: Indicative timeframe for legislative process**



**Matters addressed in C3 (listed by chapter)**

1. Update on the Review.
2. The purposes of the Deposit Takers Act – the proposed purposes of the legislation and the specification of the Reserve Bank’s decision-making principles.
3. The regulatory perimeter – the definition of a ‘deposit-taker’ and the consequential treatment of entities that sit on the boundary of that definition.
4. Standards and licensing – the permitted scope and process requirements for prudential standards and the licensing requirements for deposit takers.
5. Liability and accountability – the liability of entities and individuals for breaches of the Deposit Takers Act and the proposed accountability framework for the directors of deposit takers.
6. Supervision and enforcement powers – the supervision powers of the Reserve Bank and the enforcement tools available to it to effect corrective action.

7. Resolution and crisis management – the design of some key elements of the new framework, especially the triggers for resolution and the liabilities eligible for bail-in, plus the application to deposit takers of statutory management under the Corporations (Investigation and Management) Act 1989.
8. Depositor protection – the design of the deposit insurance scheme, including the scope of insured products, the functions and governance of the insurer, and how the deposit insurer will be funded. The chapter also discusses the option of giving depositors preference, or priority, over other unsecured creditors in a liquidation.

### **Feedback from the Independent Expert Advisory Panel**

The Independent Expert Advisory Panel (the Panel) met you on Monday 2 March and you agreed they could forward final suggestions through to the Review team for minor amendments to C3. Feedback received from the Panel included the following:

- Clarifying the twin-peak approach for the public (the Reserve Bank as prudential supervisor and the Financial Markets Authority (FMA) as the conduct supervisor) and noting the stewardship roles carried out by the Treasury and the Ministry of Business, Innovation and Employment. We have added a graphic and further text on this in the executive summary.
- A Panel member asked the team to provide further information on the proposal to extend Financial Markets Conduct Act 2013 (FMC Act) exemptions that currently apply to banks to other types of deposit takers (e.g. credit unions). This proposal would exempt these deposit takers from disclosure requirements in relation to basic deposit products and remove FMC Act governance and supervision requirements, reflecting the fact that these entities will be directly supervised by the Reserve Bank and subject to more rigorous governance requirements than currently apply under the current non-bank deposit takers regime. We have added text to clarify that prudential regulation and supervision would provide sufficient assurance around governance, while the new conduct licensing regime being introduced through the Financial Markets (Conduct of Financial Institutions) Amendment Bill will provide a greater degree of FMA oversight and assurance around deposit taker conduct.
- Making it clear where managed funds (eg, KiwiSaver) sit in relation to deposit insurance (ie, that they will not be covered). This was already in C3, but has been emphasised further.

The Panel has emphasised the importance of engaging with non-specialist audiences (eg, retail investors) on the consultation material. The Review team is finalising a pamphlet and supporting survey that seeks the views of retail investors on C3 proposals that will directly affect them (such as the scope of products covered by deposit insurance). The Review team has also sought meetings with groups that represent or provide insights into the views of retail investors. The Panel has recommended that these measures are supported by direct engagement with members of the public, and the Review team is exploring how to best to go about this.

The Panel also asked how the Review team will engage with foreign regulators of the parents of key New Zealand banks (notably the Australian Prudential Regulation Authority [APRA]). The Review team has had informal contact with APRA through the Review process and will continue to do so. Looking further, ongoing engagement between New Zealand and Australian agencies is expected to continue, particularly through the Trans-Tasman Banking Council. This will be encouraged by Review elements such as the proposed regulatory principle requiring consideration of practices of relevant international counterparts.

David Hargreaves, Principal Advisor, Reserve Bank Act Review, [39]

Victor Kuipers, Senior Advisor, Reserve Bank Act Review, [39]

Tamiko Bayliss, Director, Reserve Bank Act Review, Reserve Bank Act Review, [39]

## Annex 1: Talking points for Cabinet

- I am seeking Cabinet's approval to release a consultation document on the design of a new regulatory framework for deposit takers and the new deposit insurance scheme.
- This consultation is part of the Phase 2 Review of the Reserve Bank Act, being jointly led by the Treasury and the Reserve Bank, supported by an Independent Expert Advisory Panel.
- The 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.
- Phase 1 of the Review modernised the Reserve Bank's monetary policy framework. Phase 2 is a broad review of the Reserve Bank's governance and accountability framework and its financial regulatory powers.
- Changes to the governance of the Reserve Bank are being progressed as part of a separate 'Institutional Act' which I expect to introduce into Parliament in the middle of this year.
- This consultation paper builds on the in-principle decisions on the regulation of deposit takers and on depositor protection that Cabinet made in June and December 2019. These included:
  - the Reserve Bank would retain responsibility for prudential regulation and supervision
  - the creation of a single, flexible prudential regulation regime for banks and other deposit takers
  - the introduction of a deposit insurance scheme with a maximum coverage of \$50,000 per depositor per institution
  - increased accountability requirements for directors of deposit takers
  - strengthened crisis management and resolution tools and powers for the Reserve Bank.
- This consultation document covers the broad range of policy decisions that will be needed to progress legislation. Many of these issues are detailed and some will have significant implications for regulated firms and their customers. [See the main text of this Aide Memoire for a list of main topics covered in the consultation document, or refer colleagues to paragraph 20 in the Cabinet paper.]

- Stakeholders are likely be most interested in:
  - the regulatory approach to finance companies and wholesale-funded lenders
  - the scope of the Reserve Bank’s standard-setting power, including in relation to macro-prudential standards such as loan-to-value ratios
  - the specification of new accountability duties on directors of deposit takers
  - the products that would be covered by deposit insurance
  - the implications for depositors, other creditors and industry of deposit preference and future funding arrangements for deposit insurance.
  
- The new bail-in tool for crisis management, while increasingly common internationally, may still be unfamiliar to many New Zealanders. A brief description is provided here:

### **What is bail-in?**

- Bail-in is the write-down or conversion of liabilities (eg, wholesale debt) to equity (shares). That gives the failing bank more equity, which can be used to absorb losses and to return the bank to meeting regulatory capital requirements.
- There are two types of bail-in: statutory bail-in (based on legislation) and contractual bail-in (based on the terms of a contract between the bank and its creditor).
- It is proposed that statutory bail-in would be triggered by the resolution authority (the Reserve Bank) but only where it has determined that the bank has failed to meet certain ‘viability’ thresholds (see section 7.1 of C3). Creditors that are bailed-in will have the protection of the “no creditor worse off than in liquidation” (NCWO) safeguard (which is also being introduced as part of the reforms). NCWO will provide statutory bailed-in creditors with compensation if the resolution action results in them incurring losses greater than would have been incurred in an ordinary liquidation.

### **Why have a bail-in power?**

- A failing large and complex bank may need to be kept open to maintain the continuity of essential financial services and avoid damage to wider financial stability (i.e., open resolution, rather than closed resolution). Bail-in powers were developed in the aftermath of the global financial crisis to enable authorities to quickly recapitalise and restore to viability a failing bank. Bail-in could reduce the need for taxpayer bailouts or other taxpayer support. Authorities may also decide to use other tools.

### **What are the consultation questions?**

- In December 2019, Cabinet agreed in-principle that the Reserve Bank will have a statutory bail-in power. The questions in this consultation are “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?” and “Should statutory bail-in have retrospective application?” (that is, apply to pre-existing liabilities).
- A six week consultation period is proposed, through to the week commencing 20 April 2020. While this timeframe is tight, it is necessary to allow policy decisions on the Deposit Takers Act to be made prior to the election.
- The Minister of Finance intends to report back to Cabinet with final policy decisions for the Deposit Takers Act in early August 2020, with a view to releasing an exposure draft of the legislation in early 2021 and introducing legislation to Parliament in the first half of 2021.