The Treasury

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

June 2021

This document has been proactively released by the Treasury on the Treasury website at

https://treasury.govt.nz/publications/information-release/additional-documents-related-phase-2-reserve-bank-act-review-december-2019-april-2021

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

[7] 6(e)(ii) - to prevent serious damage to the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the regulation of banking or credit

[27] 9(2)(ba)(ii) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely otherwise to damage the public interest

[29] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[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

[36] 9(2)(h) - to maintain legal professional privilege

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [39] appearing where information has been withheld in a release document refers to section 9(2)(k).

Copyright and Licensing

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

RESERVE BANK OF NEW ZEALAND
TE PŪTEA MATUA

TE TAI ŌHANGA
THE TREASURY

Report: Draft Cabinet Recommendations on the Deposit Takers Act

Date:	25 February 2021	**Report No:**	T2021/313
		File Number:	MC-1-7-3-1-20

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Provide** feedback on the draft recommendations **Indicate** whether you wish to discuss this report further with officials **Refer** a copy of this report to the Minister of Revenue and Minister of Commerce and Consumer Affairs	By 5 March.

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Chris Hunt	Advisor, Reserve Bank Act Review - Phase 2	[39]	✓
Tamiko Bayliss	Director, Reserve Bank Act Review- Phase 2	[35]	

Actions for the Minister's Office Staff (if required)

Refer a copy of this report to the Minister of Revenue and Minister of Commerce and Consumer Affairs

Note any feedback on the quality of the report	

Report: Draft Cabinet Recommendations on the Deposit Takers Act

Executive Summary

This report provides you with a package of policy recommendations on foundational aspects of the Deposit Takers Act (DTA) for approval and feedback.

The DTA will be the culmination of three rounds of public consultation on phase 2 of the Reserve Bank Act Review. The overall obj iew is to modernise the

Reserve Bank's legislation to support the development of a New Zealand economy that is productive, sustainable and inclusive. The DTA will contain the framework for the new prudential regime and the deposit insurance scheme. An overview of these recommendations was provided to you on 11 February 2021 (T2021/154 refers) and discussed with the Review team on 17 February. These recommendations build on in-principle decisions made by Cabinet on key features of the DTA [DEV-19-MIN-0346 and DEV-19-MIN-0161 refer].

You have requested that a bill for the DTA be introduced in 2021. It will be necessary for Cabinet to agree these recommendations by late April 2021 so that the Parliamentary Counsel Office (PCO) can begin drafting the bill for introduction in late 2021.

In order to streamline advice within the tight timeframes and for your convenience, all policy recommendations are drafted as Cabinet recommendations so that they can quickly be incorporated into a Cabinet paper. To assist your review, the analysis and relevant draft Cabinet recommendations are grouped into the following eight sections:

- **Purposes and principles** - the DTA's statutory purposes and decision-making principles which will further clarify the overarching financial stability objective

- **The regulatory perimeter** - the definition of a 'deposit taker' and the consequential treatment of entities that sit on the boundary of that definition

- **Standards and licensing** - the permitted scope and process requirements for prudential standards, and the licensing requirements for deposit takers

- **Liability, accountability, supervision and enforcement** - the liability of entities and individuals for breaches of the DTA, the accountability framework for directors, supervision powers, and enforcement tools.

- **Appeal rights** - procedural safeguards to ensure interested parties are afforded a right of recourse to challenge certain decisions.

- **Resolution and crisis management** - key elements of the resolution framework, including the powers of the Reserve Bank, and your role in the framework.

- **Depositor protection** - the design of the deposit insurance scheme, including the scope of insured products, the functions and governance of the insurer, funding arrangements, and the merits of depositor preference.

- **Miscellaneous and procedural matters**.

Each section summarises the key proposals pertaining to the relevant topic, and

the relevant draft Cabinet recommendations are included for your approval and feedback. We will incorporate any feedback received on these recommendations in the subsequent Cabinet paper.

There is alignment between the Treasury and the Reserve Bank on most of the recommendations. There are a few areas where split recommendations or options are provided. For ease of reference, these recommendations are provided for decision in the Recommended Action section below and have also been highlighted within the report.

Subject to your agreement to the recommendations in this report, and after making changes as a result of your feedback on this report, we will draft a Cabinet paper seeking agreement to the recommendations for your approval. The Cabinet paper will be accompanied by a Regulatory Impact Statement.

Recommended Action

We recommend that you:

1) **note** that this report sets out and proposes a suite of recommendations on a new prudential framework for deposit taking institutions and the introduction of deposit insurance

2) **agree** to the specific draft Cabinet recommendations in this section below and provide feedback on the broader suite of draft recommendations where appropriate

3) **note** that we seek feedback on the draft recommendations by 5 March so that we can provide you with a draft Cabinet paper for ministerial consultation from 22 March and a final Cabinet paper on 7 April for a meeting of DEV on 14 April

4) **note** that the recommendations immediately below relate to matters where there are points of difference between the Treasury and the Reserve Bank

Standards setting

5) **note** the framework for standards-setting anticipates that the Reserve Bank will keep you well-informed of key policy changes (other than those of a minor or technical nature)

6) **note** the Reserve Bank currently consults with you and your Office on key policy changes, an informal practice with no statutory basis

7) **note** that you also have the ability to outline how you would like to be engaged and consulted in any *Letter of Expectation* you may choose to issue to the Reserve Bank

8) **agree** that:

   a. consultation with the Minister of Finance will rely on informal engagement by the Reserve Bank, including as set out in the Letter of Expectations (Reserve Bank recommendation)

   Agree/disagree

   OR

   b. there is a statutory requirement for the Reserve Bank to inform the Minister of Finance of key policy changes (Treasury recommendation)

   Agree/disagree

Appeal rights

9) **note** the Treasury and the Reserve Bank have converged on a system of appeal rights for the Reserve Bank's administrative decision-making powers, but agencies are not aligned on the level of appeal rights for decisions affecting the rights and interests attaching to deposit taking licences and on a number of enforcement or direction powers, reflecting a difference in judgement on the right balance to be struck between protecting the interests of affected parties versus enabling the Reserve Bank to pursue its statutory mandate efficiently and effectively

10) **agree** that, in addition to where agencies are aligned on appeal rights in relation to decision-making powers, the Reserve Bank's administrative decision-making powers should have the following appeal rights attached:

   a. Option 1 (Treasury recommendation)

      - Decisions by the Reserve Bank that affect the rights and interests in relation to an initial licence (i.e. conditions of licence, approvals to carry on certain activities) should be subject to full ('merits') appeal

      - Decisions by the Reserve Bank in relation to enforcement or direction should be subject to appeals on questions of law

      Agree/disagree

      OR

   b. Option 2 (Reserve Bank recommendation)

- Decisions by the Reserve Bank that affect the rights and interests in relation to an initial licence (i.e. conditions of licence, approvals to carry on certain activities) should be limited to appeals on questions of law

- Decisions by the Reserve Bank in relation to enforcement or direction would have no formal appeal rights, other than the inherent judicial review power of the High Court

Agree/disagree

Scope of coverage for deposit insurance

11) **indicate** whether you would like officials to provide you with further options on exclusions from the deposit insurance scheme such as large companies

Yes / No

Other matters

12) **note** the views of the Independent Expert Advisory Panel on the draft recommendations and key aspects of the new prudential framework and deposit insurance (see paragraph 19)

13) **note** that officials will provide you with advice next week on key design elements of the Deposit Insurance Scheme (DIS) including governance and decision-making, funding frameworks, and deposit and depositor eligibility

14) **note** that, to progress drafting instructions in the planned timeframe, it may be desirable for you to take a number of further decisions under Cabinet's delegation, particularly in relation to a moratorium on creditor enforcement actions and transferring other powers available to a statutory manager under the existing Act to the Reserve Bank

15) **indicate** whether you wish to discuss this report further with officials

16) **refer** a copy of this report to the Minister of Revenue, seeking the Minister's agreement to consider whether changes to tax legislation should be made to resolve the tax issues arising from the use of the bail-in resolution tool

Refer/do not refer

17) **refer** a copy of this report to the Minister of Commerce and Consumer Affairs

Refer/do not refer

Hon Grant Robertson
Minister of Finance

Report: Draft Cabinet Recommendations on the Deposit Takers Act

Purpose of Report

1. This report provides you with draft Cabinet recommendations on the foundational aspects of a new prudential regime for deposit takers and the introduction of a deposit insurance scheme. These decisions will inform the drafting of a new Deposit Takers Bill which we anticipate you introducing into the House late this year.

2. The report summarises the key proposals underpinning the new regime and includes the specific recommendations we are asking you to submit to your Cabinet colleagues (subject to your subsequent feedback). The report also identifies any point of difference between the joint agencies leading the Phase 2 Review – the Treasury and the Reserve Bank – and outlines the views of the Independent Expert Advisory Panel on the suite of recommendations.

Background

3. In 2017, the Government announced a review of the Reserve Bank of New Zealand Act 1989 (the 'Review'). Phase 1 of the Review dealt with monetary policy arrangements, resulting in the introduction of a Monetary Policy Committee (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.

4. 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 you on the recommendations put forward by the joint agencies.

Objectives of the Review

5. 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. But this regulatory autonomy needs to be balanced 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.

6. More specifically, the Review's terms of reference outlined characteristics that help define a successful regulatory regime:

    - The purpose of the legislation and the Reserve Bank's objectives are clear
    - The powers available to the Reserve Bank are sufficient to achieve its objectives
    - The roles and responsibilities of key participants, including the Minister, are defined in statute and are clear and coherent
    - The regime engenders trust and confidence in New Zealand's financial markets and in the decision-making processes of the Reserve Bank
    - The regime is enduring
    - The regime provides sufficient flexibility to adapt and evolve in response to market developments
    - There is clarity as to how the regime interacts with other regulatory regimes and government policy as a whole.

7. The Phase 2 Review has involved three substantive public consultations and will culminate with two separate pieces of legislation. The first, will provide for the institutional form and governance of the Reserve Bank. This new Reserve Bank Bill has been introduced into Parliament and is currently before select committee. The second piece of legislation, and the subject of this advice, will set out the Reserve Bank's powers and functions in relation to deposit taking institutions and will introduce a deposit insurance scheme.

8. Taken together, the Reserve Bank Bill and the proposals outlined in this paper for deposit takers will make a significant contribution to the features defining a successful regulatory regime noted above.

The Reserve Bank Bill

9. The Reserve Bank Bill contains features that directly support and complement the new prudential regime for deposit takers being proposed in a new 'Deposit Takers Act' (DTA). These features include:

    - a new primary financial policy objective to protect and promote the stability of New Zealand's financial system
    - a requirement for you to issue a *Financial Policy Remit* which the (new) decision-making board must have regard to when developing prudential policy to achieve the financial stability objective
    - 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), and that these must include how the *Remit* has been considered

- 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.

The third consultation

10. The detailed design elements of the DTA were the focus of the third and final public consultation undertaken last year ('C3'). This consultation was released in March, with the deadline for submissions subsequently extended by six months due to COVID-19.

11. 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:

    - regulating and supervising banks and non-bank deposit takers under a single prudential regime
    - using 'standards' as the primary legislative mechanism for imposing prudential requirements
    - enhancing the accountability and liability of directors of deposit takers
    - broadening the suite of supervisory and enforcement tools available to the Reserve Bank to monitor and effect corrective action
    - establishing a deposit insurance scheme
    - designating the Reserve Bank as the resolution authority with a broader range of powers.

12. 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. We 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.

13. Submitters were broadly comfortable with a number of the proposals laid out in C3 including the approach to the regulatory perimeter, the standards and licencing 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:

    - **Purposes and principles** – although some submitters were supportive, many suggested that concepts of efficiency and the overarching statutory purpose need more prominence.

- **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 Reserve Bank Bill.
- **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.
- **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.

A summary of submissions has been provided to you which contains more detail [T2020/3484 refers].

Follow-up issues

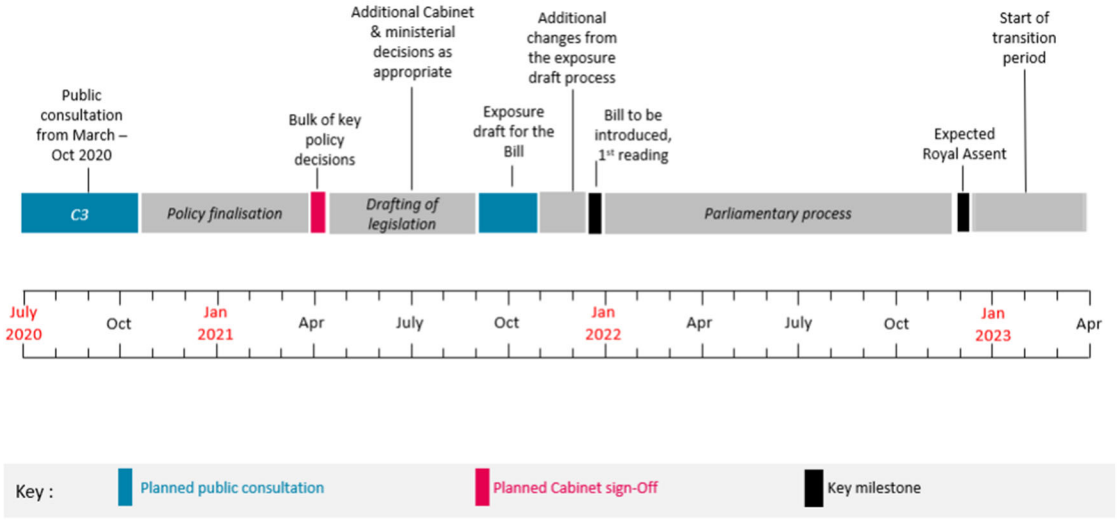
14. Following the conclusion of consultation we have engaged with you on two specific policy issues raised by stakeholders. The first was on the role of 'finance companies' in the proposed prudential framework. You have agreed that finance companies should be included within the deposit-taking perimeter and be able to offer insured deposit products – rather than being treated as a separate class of prudentially regulated entity unable to offer insured products [T2020/3517 refers].

15. The second issue concerned the coverage limit for the deposit insurance scheme which Cabinet had previously agreed as $50,000 per customer, per institution. You have subsequently agreed to increase the coverage limit to $100,000 in response to concerns expressed by smaller deposit takers identified in C3, and in response to broader concerns raised by stakeholders throughout the Phase 2 Review [T2020/3741 refers].

Timelines and milestones for the Deposit Takers Act

16. We have also engaged with you on your expectations around the timeline and associated milestones for delivery of the DTA [T2020/2730 refers]. Based on this feedback we are working to a timeline that anticipates the introduction of a deposit takers bill in late 2021 (see Figure 1 below). To meet this somewhat ambitious timeframe, Cabinet decisions will be required on the foundational aspects of the DTA by late April so that Parliamentary Counsel Office (PCO) can begin drafting an exposure draft for public comment (see the Next Steps section for specific dates around the Cabinet process).

Figure 1: Deposit Takers Act timeline



17. We anticipate that some aspects of the DTA work programme and policy decisions will be amenable to subsequent Cabinet decisions (or managed through ministerial delegation). These will include less material aspects, or areas still requiring further policy development.

18. After the DTA is passed there will be a substantial work programme to implement the new framework. You have indicated that you place a high priority on the implementation approach delivering the deposit insurance scheme (DIS) prior to 2023. Prior to providing the first tranche of recommendations to Cabinet, we will seek to agree an approach to implementation of the DIS for public communication, and test your comfort with the risks associated with the recommended timetable.

Comment from the Independent Expert Advisory Panel

19. The following comments are provided by the Independent Expert Advisory Panel:

> The Independent Expert Advisory Panel (the Panel) commends the RBNZ Act Review team on the tremendous progress achieved on the DTA since the Panel's last meeting. Presentations by the Review team to the Panel at its meeting on 23 February 2021 demonstrated the clarity that is emerging in regards to deposit insurance. The process of engagement between the RBNZ and Treasury is working in a way that is leading to better policy advice.
>
> This joint report prepared for the Minister of Finance is longer than necessary because of the time constraints as the Review Team progresses its work to meet the April deadline for the main provisions of

the DTA to go to PCO. It will be possible to produce a shorter Cabinet paper once the recommendations are agreed.

Below is a list of the key topics where the Panel sees the opportunity for further consideration in shaping the DTA.

1. Standards – the Panel recommends that the DTA includes reference to the role of COFR in the development of standards

2. 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 monitors. 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.

3. In cases where the Reserve Bank does not support a regulated entity's board appointment, a fair and timely appeal process is required to enable the Reserve Bank's decision to be challenged. The essence of that process needs to be cognisant that the regulated entity has a vacancy that needs to be filled in a timely fashion and that the candidates being challenged are also looking for a quick process to resolve the matter. A legal Appeal Court type process will not be quick and will not support the interests of the Reserve Bank, the regulated entity, and/or the candidate.

4. The Panel supports provisions included in the DTA as safeguards to protect against allegations of over-reach by the Reserve Bank's financial supervision will help to ensure trust and confidence in a regulatory system.

5. A system that makes it clear to consumers what products and services are insured is important. Allowing deposit takers to use a "kite mark" (logo), for example will help to ensure that the consumers are fully aware whether their funds are a deposit or not (that is, consumers need more information than just referencing the word deposit).

6. The Panel recommends that the Review team facilitates 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.

7. The Panel believes that further thought is required about behaviours and needs related to deposits by the Maori community and the Pacific communities.

8. The Panel thinks the Review team is on the right track in regard to the trans-Tasman connection and encourages the Review team to seek further input from APRA as the proposals for the DTA come closer to being finalised.

Summary of the draft Cabinet recommendations

20. This section summarises the draft Cabinet recommendations that we are seeking your feedback on and lists each recommendation under the relevant subsection. Given the breadth of this advice we will consider how best to package the large number of recommendations to Cabinet.

21. We will develop the suite of recommendations based on any feedback you choose to provide. In addition, we will work with the Reserve Bank Legal team (as instructing solicitors) and PCO in order to ensure the recommendations are pitched at the appropriate level, where a balance needs to be struck between specificity and some degree of flexibility afforded to PCO to deliver a coherent exposure draft of the Bill, albeit where the underlying policy intent of each recommendation is clear.

22. The next section summarises your role as Minister of Finance across the proposed new prudential framework. This illustrates how the Review has attempted to balance a government's legitimate interest in financial system outcomes, with the benefits that come with delegating financial system responsibilities to an agency that sits at arm's length.

The role of the Minister in the prudential framework – an overview

23. The Terms of Reference of 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.

24. 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). A government of the day may have a different 'risk appetite' to that of the prudential regulator for financial system outcomes.

25. Situating a role for the Minister of Finance in the prudential framework necessarily involves trade-offs. A greater role for the Minister potentially:

    - promotes democratic legitimacy
    - better manages broader distributional trade-offs and societal preferences
    - reduces the risk of ad hoc changes to the legislative framework arising from political frustration.

26. This greater role needs to be balanced against the risk of:

    - short-termism and inaction bias which can undermine financial stability
    - reduced confidence in the Reserve Bank and its ability to successfully achieve its statutory mandate
    - blurred accountability for financial policy outcomes, and financial stability in particular
    - inconsistency of decision-making and a reduced role for technical expertise.

27. The Phase 2 Review has attempted to strike an appropriate balance between the operational independence of the Reserve Bank and the role provided for the Minister of Finance in the framework.

    - In terms of the institutional settings for governance, the Reserve Bank Bill confers financial stability decision-making rights to a board appointed by you and the board will be required to have regard to the *Financial Policy Remit* issued by you when setting the Reserve Bank's prudential strategic direction; making significant policy decisions; monitoring and reporting on the Reserve Bank's performance; and issuing and reviewing standards. The Reserve Bank will also be required to publish one or more statements of prudential policy providing transparency on how it acts as a prudential regulator and supervisor, as well as regulatory impact assessments of proposed policies.
    - In terms of the prudential framework for deposit takers, the DTA will include a purpose statement and decision-making principles (see further below). This will shape the way in which the Reserve Bank seeks to achieve financial stability through the DTA.

28. The proposals set out below 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).

29. The process for setting prudential requirements through standards provides a role for you in the following ways:

    - Regulations 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).
    - Regulations will 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). The process for setting macro-prudential standards, including the role of the Minister of Finance is illustrated in Figure 2 in the Standards and Licensing later in this report.

30. In the model being proposed the current Macro-prudential Policy MoU becomes redundant, particularly where regulations will be required to define the permitted scope of the Reserve Bank's use of lending standards restrictions.

31. The framework for delegated rule-making through standards anticipates engagement with you and your Office during the process. For example, the Reserve Bank currently consults with you on an informal basis. Any *Letter of Expectation* you may decide to issue the Reserve Bank could formalise your expectations around the nature of your desired engagement with the Reserve Bank. [Note the split recommendation at the front of this paper on a statutory 'inform' provision.]

32. In the context of supervision and enforcement we are proposing to reduce your role (relative to the current framework in the Reserve Bank Act) 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 Insurance (Prudential Supervision) Act 2010.[1] This removes the ability for the government to influence the regulator's decisions that pertain specifically to individual entities.

[1] See for example, BCP 2 that states the supervisor should have full discretion to take any supervisory actions on banks and banking groups.

33. 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. In the proposals outlined in more detail later in this paper, 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.

34. Furthermore we propose that the Minister 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.

35. 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 using powers under the Public Finance Act. 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 Public Finance Act).

36. The DTA will add a new function for the Reserve Bank – deposit insurance. In the model we are proposing you will be required as Minister of Finance to publish a Funding Strategy and set the levies that will be imposed by the deposit insurer on deposit takers. In addition you will:

    - be responsible for managing the Crown's liability under the deposit insurance scheme due to the government 'backstop'
    - be responsible for detailed regulations defining eligible depositors (e.g. trusts or other complex ownership structures).
    - be responsible for adding new products to the scheme that are the same in economic substance as the legislative product boundary.

Purposes and principles of the Deposit Takers Act

37. Legislative purposes and objectives help to communicate the policy intent of the legislation. They provide statutory criteria on which to base

the exercise of regulatory powers and undertake statutory functions, act as a guide to interpret the intent of Parliament, while also providing a basis against which to assess the performance of an entity and hold it to account.

38. The Reserve Bank Bill will be introducing a new primary financial policy objective for the Reserve Bank as prudential regulator – to protect and promote financial stability. This objective is not an end in itself, but rather a means of supporting the overarching statutory purpose set out in the Reserve Bank Bill – to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy.

39. On its own, a primary objective tied to 'financial stability' does not provide sufficient clarity to the Reserve Bank of the outcomes Parliament expects the Reserve Bank to achieve under the DTA. As noted in the previous section, financial stability is not readily amenable to quantification. Previous Cabinet advice noted that the purpose statements in sectoral legislation, like the new DTA, would specify in more detail how the general objective of financial stability is implemented in those Acts [DEV-19-SUB-0345].

40. The proposed statutory purposes for the DTA have been designed to articulate what financial stability means in the context of the regulation and supervision of deposit takers. The proposed purposes for the DTA are:

    - The promotion of the safety and soundness of deposit takers
    - The promotion of public confidence in the financial system
    - The mitigation of risks that arise to and from the financial system

    And, in doing so, it is intended that the actions of the Reserve Bank will contribute to protecting and promoting the stability of New Zealand's financial system.

41. The specification of financial stability in this way makes clear that the Reserve Bank should undertake its prudential function in a way that addresses the both the build-up of systemic risk in the financial sector, while focussing on individual institutions. While New Zealand's deposit taking sector is heavily concentrated and smaller entities do not pose the same risk to New Zealand's financial system compared to the big-4 Australian-owned banks, the introduction of deposit insurance implies the Reserve Bank should direct an appropriate degree of attention to all entities within the prudential perimeter to manage moral hazard and the potential call on the deposit insurance fund from firm failure.

42. Legislative clarity on how the Reserve Bank should undertake its statutory mandate for financial stability is also provided for in the decision-making principles. The principles that have been proposed are

designed to guide the exercise of powers under the DTA, and to ensure that a range of factors are taken into account by the Reserve Bank when pursuing the statutory objectives. This includes ensuring that considerations other than financial stability are taken into account (for example, efficiency-related considerations) and that longer-term risks are well-managed (for example, the risks associated with climate change).

43. Cabinet has previously agreed that these principles sit in the DTA [DEV-20-MIN-0041]. However, we are recommending that consideration will be given to consolidating any generic decision-making principles that can be found in sectoral legislation (i.e. the DTA, the Insurance (Prudential) Supervision Act, and the Financial Markets Infrastructure Bill).

44. The Reserve Bank and the Treasury are well-aligned in terms of the specification of the proposed purposes and principles for the DTA, including how 'efficiency' has been reflected in the decision-making principles as a way of influencing the way the Reserve Bank goes about pursuing financial stability. However, a number of stakeholders have expressed concerned about the apparent 'relegation' of efficiency within the legislative hierarchy (and related concepts such as competition, allocative efficiency and dynamism, market diversity, and growth and innovation). In part, this concern is a re-litigation of Cabinet's earlier decision around re-specifying the Reserve Bank's primary financial policy objective from "soundness and efficiency" to a clearer focus on "financial stability".

45. Putting efficiency concepts into the decision-making principles retains a clear focus for the financial policy objective. Unpacking these concepts into more specific descriptions in the principles (covering minimising costs, competition, proportionality and market diversity, and long-term risks) also ensures clarity in the principles. As demonstrated by the views in submissions, efficiency can mean several distinct concepts. Including it in this way also ensures that efficiency concepts remain a key influence in the way in which the Reserve Bank exercises its prudential powers.

46. Some other stakeholders also expressed concern that the Reserve Bank Bill's overarching purpose tied to well-being did not seem to resonate or flow through to the DTA. However, the overarching well-being purpose is an important part of the overall legislative hierarchy.

Purposes and principles recommendations

Previously noted	1) **Note** that Phase 1 of the Review of the RBNZ Act introduced a new purpose statement to "promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy". This purpose statement will remain in the new RBNZ Act and recognises that monetary and financial policy are not ends in themselves, but are means to improve the prosperity and well-being of New Zealanders 2) **Note** that Cabinet has previously agreed [DEV-19-MIN-0345] that the new RBNZ Act's financial policy objective will be to "protect and promote the stability of New Zealand's financial system" 3) **Note** that Cabinet has previously agreed [DEV-19-MIN-0345] that the new RBNZ Act will require the Minister of Finance to issue a *Financial Policy Remit* and that the board of the Reserve Bank must have regard to it when pursuing the financial stability objective – specifically when acting in relation to the Reserve Bank's strategic intentions and the setting of prudential requirements
New decisions sought	4) **Agree** that the purposes of the DTA will be designed to achieve the following objectives: - the promotion of the safety and soundness of deposit takers - the promotion of the public confidence in the financial system - the mitigation of risks that arise to and from the financial system and in doing so, contribute to protecting and promoting the stability of New Zealand's financial system. 5) **Note** that in addition to the general purposes in the DTA, there will be part-specific purposes (for example, the protection of depositors in the context of deposit insurance).

New decisions sought	6) **Agree** that the Reserve Bank be required to take into account principles (to the extent they are relevant) when exercising its powers under the DTA. It is anticipated that the principles would be along the following lines: i. The desirability of minimising unnecessary costs of regulatory actions. ii. The desirability of taking a proportionate approach to regulation and supervision, and ensuring that similar institutions are treated consistently while recognising the diversity of institutions. iii. The need to maintain competition within the deposit taking sector. iv. The value of transparency and public understanding of the Reserve Bank's objectives and how the Reserve Bank's functions are exercised. v. Consideration of the practice by relevant international counterparts carrying out similar functions, as well as guidance and standards from international bodies. vi. The desirability of ensuring that long-term risks to financial stability are well managed.

Regulatory perimeter

47. Any regulatory regime must clearly identify those persons or entities that powers can be applied to. A well demarcated boundary allows a regulator to assess who can and cannot perform the relevant regulated activity, while providing the focus for regulatory actions on the part of the regulator. In some cases, a regulatory regime may allow a regulator to reach outside any formal perimeter and apply certain powers to non-regulated persons or entities (e.g. information gathering).

48. We are proposing a new prudential regulatory regime for firms that are in the business of ‘borrowing and lending’. Firms that offer transactional ‘banking’ services (such as banks, credit unions and some building societies) are included within this proposed regulatory perimeter. A key issue consulted on was whether finance companies (lenders that issue retail debt securities, but do not take on-call deposits or offer transactional services, and typically have higher risk operational models), should also be included within this regulatory perimeter.

49. You have agreed that finance companies should be included in the regulatory perimeter and should be able to offer insured deposit insurance products, with the Reserve Bank managing moral hazard by imposing sufficiently robust regulatory requirements and risk-based pricing for deposit insurance (T2020/3517 refers).

Wholesale funded lenders

50. C3 sought feedback on the extent to which wholesale funded lenders should be captured by the new regulatory perimeter, noting that they generally present less significant financial stability risks than retail deposit takers. Submissions were mixed on this issue, with representatives of lenders funded via securitisation models strongly opposed to prudential regulation, noting that the financial stability risks of this model are limited, and the sector is not prudentially regulated in other jurisdictions.

51. We recommend an approach that captures those lenders that offer wholesale deposit accounts (such as wholesale banks), but not those who solely raise funds from certain other wholesale sources (such as securitisers and others who raise funds on wholesale capital markets). While wholesale depositors are better placed to manage and assess risks, there would still be significant externalities associated with the loss of access to wholesale deposit accounts in the event of a failure. These risks are lower than would be the case for a retail deposit taker, but the flexibility of the regulatory system will allow for regulatory requirements to be appropriately calibrated to reflect this.

52. Given that ‘deposits’ (as distinct from other sorts of debt securities) are difficult to define in a positive manner, this approach will likely involve capturing all firms in the business of borrowing and lending, then excluding certain categories of wholesale borrowing (these categories might include issuing negotiable debt instruments, from financial institutions, or from associated persons). While further refinement of this approach will occur over the drafting process, we expect that it will largely capture the same set of entities required to be registered/licensed under the current Reserve Bank Act and Non-Bank Deposit Takers (NBDT) Act.

Restricted words

53. We recommend limiting the use of the word ‘deposit taker’ (and similar) to licensed deposit takers and the use of the word ‘bank’ (and similar) to a subset of deposit takers that meet minimum requirements set by the Reserve Bank.

54. The recommendation to restrict the use of the word ‘bank’ to a subset of deposit takers is made on the basis that we expect the regulatory and supervisory approach to smaller deposit takers may be less intensive

than that applied to banks and that many small deposit takers are significantly smaller and have substantially lower credit ratings than registered banks. Retaining a restriction on the use of the word bank should provide additional comfort in adopting a differentiated approach to these firms, which will be particularly important for the transition of the smaller NBDTs into the new regime.

55. The Treasury notes that the restriction will mean that the regime continues to have two distinct tiers and notes that most NBDTs argued that all deposit takers should be able to use the word bank in order to provide a level playing field (as is the case in Australia). The Treasury considers that in the longer term these sorts of restrictions should be reduced or removed in the interests of effective competition. The Reserve Bank considers that the restriction should be a permanent feature of the regime, and notes that in practice requirements set under the regime are likely to include some tiering in any event (to deliver an approach that is proportionate to the size and other characteristics of classes of deposit takers).

Perimeter flexibility

56. The Reserve Bank's broader financial stability and compliance functions will require it to monitor the activities in an 'outer perimeter' of non-deposit-taking lenders for financial stability risks and/or instances of unlicensed entities engaging in restricted activities or regulatory arbitrage. This monitoring would support the identification of financial stability risks outside of the deposit taking sector as well as instances of regulatory arbitrage and breaches of the DTA by unlicensed entities. In addition to the DTA providing for information gathering powers in relation to these firms, we are working with MBIE on the use of the Financial Service Providers Register to collect information on these lenders.

57. This outer perimeter will also need to be supported by tools providing the Reserve Bank with flexibility in how it approaches firms and business models on the boundary of the deposit taking regime. We propose that Reserve Bank should be able to designate individual entities as deposit takers where they are providing services that have the economic substance, but not the legal form, of deposit taking. This should discourage regulatory arbitrage and encourage entities that are setting up just outside the perimeter to engage with the Reserve Bank. The use of this tool would be limited to entities whose activities are very similar in substance to deposit taking. Stakeholders were generally supportive of this proposal, which has parallels with Financial Markets Conduct (FMC) Act and NBDT Act designation powers.

58. We also propose that the Reserve Bank should be able to exempt an entity or class of entity from requirements that are unnecessary or unjustified in relation to that entity's or class's business model and operations. This would provide the Reserve Bank with significant

additional flexibility in applying the framework, particularly in responding to new and innovative business models that may not have been anticipated in the legislation. Within reasonable limits, the intention is that the use of exemptions would be part of a flexible regime, rather than a reserve power that would only be used in exceptional circumstances. Stakeholders were generally supportive of this proposal.

Regulatory perimeter recommendations

Previous in-principle decision	7) **Agree** to confirm Cabinet's previous in-principle decision to merge New Zealand's two existing prudential regimes for regulating banks and non-bank deposit takers into a single deposit-taking regime [Dev-19-MIN-0161].
New decisions sought	8) **Agree** that the DTA provide for a single, flexible licensing regime that requires deposit takers to be licensed by the Reserve Bank. 9) **Agree** to an activity-based regulatory perimeter that captures as deposit takers persons carrying on the business of borrowing and lending, excluding some types of wholesale funded lenders and firms subject to existing NBDT Act exclusions and exemptions. 10) **Note** that while the scope of the wholesale lender exclusion will be further tested and refined through the drafting process, it is expected to exclude lenders that solely borrow on wholesale capital markets, from financial institutions, or from associated persons. 11) **Note** that the above perimeter would capture current banks, credit unions, building societies and retail-funded finance companies. 12) **Agree** that a financial service provider that is not licensed as a deposit taker may not hold itself out to be a licensed deposit taker. 13) **Agree** that no financial service provider may use the words 'bank', 'banking' and 'banker' (restricted words) when carrying on activities in New Zealand except for licensed deposit takers or persons licensed or registered as a bank in a country other than New Zealand that,

	in each case, have been authorised by the Reserve Bank to use restricted words. 14) **Note** the Reserve Bank will publish a policy framework under which it will authorise the use of restricted words, including setting out the minimum authorisation requirements for deposit takers (such as financial strength requirements). 15) **Agree** that the disclosure, governance and trustee supervision exclusions from the FMC Act that currently apply to registered banks should be extended to all licensed deposit takers. 16) **Agree** that the DTA will allow the Reserve Bank to monitor, through information gathering powers, non-deposit taking lenders for financial stability risks and identify entities that should be designated as deposit takers for purposes of the DTA. 17) **Agree** that the Reserve Bank be empowered to designate an entity as a deposit taker for the purposes of the DTA where the services it provides have the same economic substance as carrying on the business of borrowing and lending. 18) **Agree** that the Reserve Bank be empowered to exempt an entity or class of entity from requirements under the DTA (including the requirement be licensed) and secondary legislation (including standards), subject to conditions (if any) imposed by the Reserve Bank.

Standards and licensing

Standards

59. A key design question for the DTA is how prudential requirements will be set, and by whom. Currently the Reserve Bank makes prudential rules for banks mainly through imposing Conditions of Registration (CoRs), whereas prudential requirements for non-bank deposit takers (NBDTs)

are primarily set via regulations. Key concerns with these approaches include a lack of oversight and transparency in relation to bank CoRs, and the lack of regulatory independence associated with most NBDT prudential requirements being set via regulations.

60. The technical nature of prudential requirements and the long-term nature of costs and benefits mean most prudential requirements are best set by the Reserve Bank, at arm's length from government. This aligns with international best practice, as articulated in the Basel Core Principles for Effective Banking Supervision (the 'BCPs').

61. Cabinet has agreed that 'standards' as a secondary legislative instrument administered by the Reserve Bank will become the primary tool for imposing prudential requirements on deposit takers, with a high degree of flexibility to tailor requirements to individual deposit takers and classes of deposit takers [DEV-19-MIN-0346 refers]. We are proposing that primary legislation will provide clarity over the specific areas where the Reserve Bank may impose standards, with the scope of standards able to be expanded over time on your recommendation through regulations via an Order in Council.

62. The prudential framework will require the flexibility to deal with all deposit taking institutions from very small NBDTs to the largest banks. This will mean the Reserve Bank should be able (and expected) to construct different rule sets for different classes of deposit taker, or one or more specified licensed deposit takers, that are proportionate to the risks involved. We are proposing that the framework will also provide discretion for the Reserve Bank to calibrate institution-specific requirements within a given standard through license conditions or exemptions to reflect the underlying risk profile of that institution ('supervisory adjustment'). For example, within a capital standard, the Reserve Bank would be empowered to add an additional buffer of regulatory capital on to an entity if it was concerned, for example, with how risks were being managed or other aspects of the entity's operations. The Reserve Bank will also be able to collect information and set lending standards for non deposit-taking lenders, including for associated persons of deposit takers where they are a non deposit-taking lender.

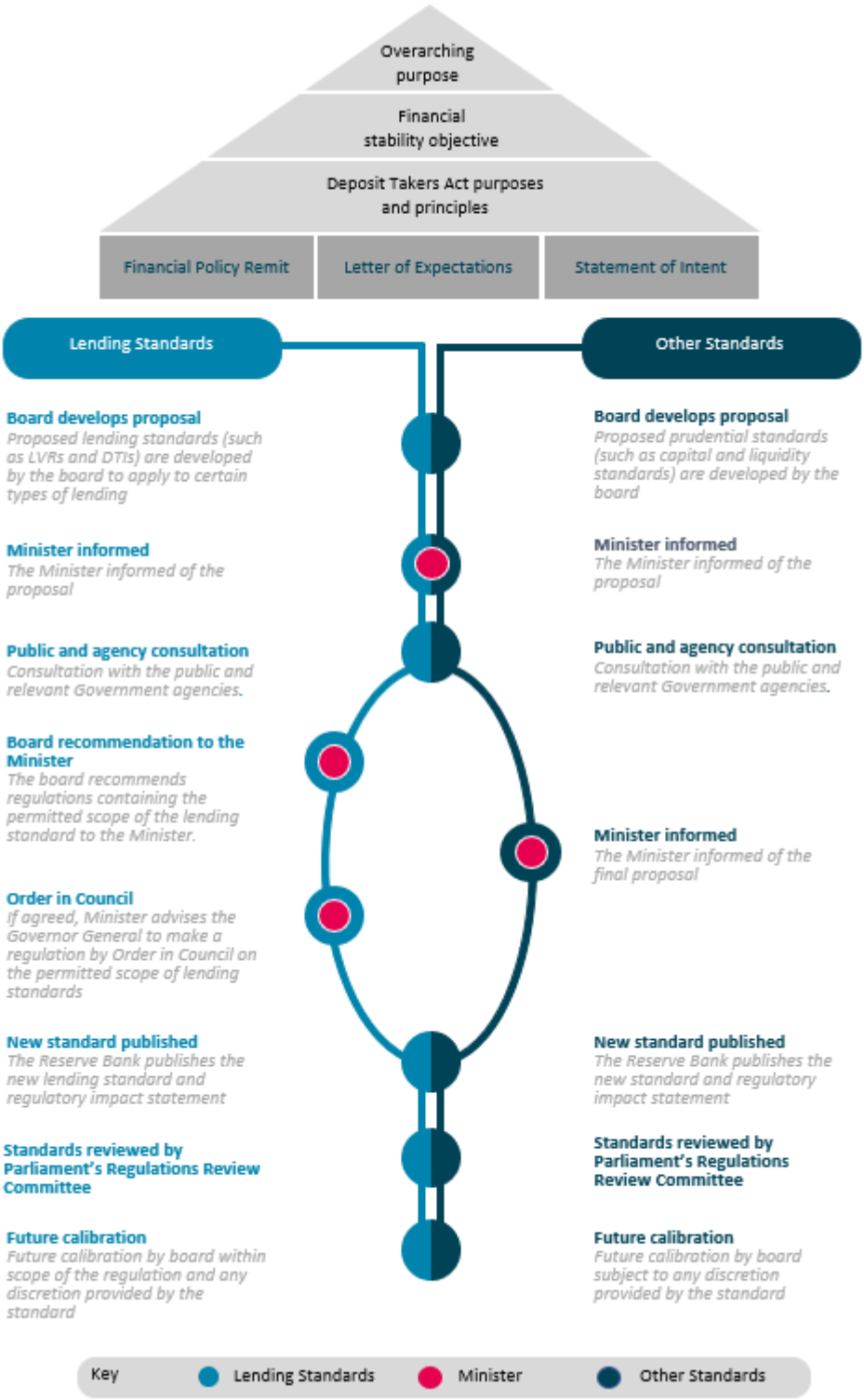
63. There are process and accountability requirements being proposed which will apply to the development of standards, including agency consultation (e.g. with the FMA and Treasury), public consultation and publication of a Regulatory Impact Statement (RIS). The RIS must also demonstrate how the board of the Reserve Bank has had regard to the *Financial Policy Remit* issued by you as Minister of Finance.

64. We are proposing that the DTA will explicitly provide for the Reserve Bank to set standards for property lending. However, the permitted scope of any lending standards (e.g. residential mortgage, rural and commercial

property) will be set out in regulation, with the standard itself containing the specific calibration. Officials will provide you with further advice on what ‘permitted scope’ means in the context of your regulation making power.

65. The decision-making process associated with ‘macro-prudential policy’, which is designed to mitigate the build of systemic risk in the financial system, is proposed to be the same as for any prudential requirement – i.e. the responsibility of the Reserve Bank board, having had regard to the *Financial Policy Remit* and the specific process requirements laid out in primary legislation. The Reserve Bank’s ability to impose lending standards over particular types of property, and through particular tools, will be constrained by the relevant regulations made by Order in Council. The process for setting lending standards, including the role of the Minister of Finance is illustrated in Figure 2.

Figure 2: The process for setting standards



66. There is broad alignment between the Treasury and the Reserve Bank on the process requirements and the need for robust accountability arrangements in respect of standard setting by the Reserve Bank. This includes the importance of the Reserve Bank keeping you informed of any key policy changes, except those of a minor and technical nature.

67. Under current arrangements the Reserve Bank engages and consults with you and your Office on key policy developments, or on matters you may have expressed interest in via the *Letter of Expectations* you may choose to issue to the Reserve Bank. The non-statutory Macro-prudential Policy Memorandum of Understanding (MoU) also lays out expectations on the Reserve Bank for keeping you and the Treasury informed on "significant policy developments relating to macro-prudential policy, and of emerging risks to the financial system".

68. The Treasury sees merit in formalising the process of engaging with you on standards-setting through a statutory requirement on the Reserve Bank to keep you 'informed' of key policy changes. This statutory requirement would complement more detailed guidance provided by the Minister of Finance through a *Letter of Expectations*, as to their expectations as to the nature and timing of being informed.

69. The Treasury considers that the Minister of Finance has a legitimate interest in lending standards given the significant impacts across society. While the current policy framework includes formal agreement from the Reserve Bank to consult the Minister of Finance when it is actively considering macro-prudential tools (as set out in the MoU). However, the need for an MoU should become redundant under the new regime. In addition, good regulatory design should be clear about the roles and responsibilities of parties and statutory provision guards against any slippage in good regulatory practice that may occur over time.

70. The Reserve Bank does not see any compelling reason to formalise current practice in any legislative provision. The current framework has worked well with robust engagement between the Reserve Bank and the Minister of Finance on key policy developments both proposed by the Reserve Bank, and their specific calibration. The Reserve Bank will continue to follow this good regulatory practice under the new prudential regime being proposed, and we anticipate that the new governance board will consider engagement with the Minister of Finance an integral part of the framework. There are always risks with creating more prescriptive legislation, including the risk of more avenues for legal challenge on the Reserve Bank's decisions and the risk that the framework is not optimally future-proofed.

Licensing

71. All regulated entities will need to obtain a licence from the Reserve Bank to undertake the business of borrowing and lending. Primary legislation will set out the relevant criteria for licensing a potential applicant, as well as the specific process requirements. The DTA will detail the criteria for the revocation of a licence. Cabinet has previously agreed that the de-licensing of a deposit taker will not require ministerial consent (which is currently required to de-licence the registration of a bank) [DEV-19-MIN-0346 refers]. We are also recommending that the Reserve Bank consults with the Financial Markets Authority on licensing and de-licensing decisions. This is in line with the aim of encouraging greater coordination and cooperation by financial regulators, including by giving a statutory role to the Council of Financial Regulators (COFR) in the Reserve Bank Bill.

Standards and licensing recommendations

Previous in-principle decisions	19) **Note** Cabinet has previously agreed in-principle [DEV-19-MIN-0346], subject to further policy development, that: - 'standards' set by the Reserve Bank will be the primary tool for imposing regulatory requirements on deposit takers, with a high degree of flexibility to tailor requirements to individual deposit takers and classes of deposit takers - the prudential framework will provide the scope of matters that the Reserve Bank will be able to set standards on, with the ability for the Minister to add additional matters to which standards can relate via regulations - requirements that impact on the rights of individuals to be provided for in primary legislation, in particular, fit and proper requirements for directors and senior executives. *Scope of standards* 20) **Agree** to confirm Cabinet's previous in-principle decision that the Reserve Bank be empowered under the DTA to set regulatory requirements for deposit takers by secondary legislation (prudential standards).

New decisions sought	21) **Agree** that the subject matter of prudential standards be specified in the DTA. 22) **Note** that it is anticipated that the subject matter of standards will include the matters that are to be taken into account when licensing deposit takers 23) **Agree** that the subject matter of prudential standards will include lending requirements (e.g. loan-to-value and debt-to-income ratios). 24)**Agree** that the permitted scope of lending standards be set by regulation 25)**Note** that further advice will be provided on what 'permitted scope' means in the context of the Minister of Finance's regulation making power 26) **Agree** to confirm the in-principle decision that additional matters that may be covered by prudential standards may be prescribed by regulations recommended by the Minister 27) **Agree** the DTA should allow the Reserve Bank to set reporting and lending standards in relation to categories of non-deposit-taking lenders prescribed by regulation 28) **Note** the DTA will not provide the Reserve Bank with the power to impose standards on associated persons of licensed deposit takers, except in relation to recommendation 27 29) **Agree** that standards may apply to all licensed deposit takers, specified classes of licensed deposit takers or one or more specified licensed deposit takers. 30) **Agree** that the requirements imposed on a licenced deposit taker under standards may be modified through administrative instruments, such as license conditions or exemptions. *Process for setting standards*

	31) **Agree** that the following procedural requirements would apply before a standard may be issued by the Reserve Bank: - a requirement to consult with relevant government departments, members of the Council of Financial Regulators and Crown agencies - a requirement to consult affected persons (except for minor amendments to standards, when consultation could be limited to substantially affected persons) 32) **Note** there will be public notification in the Gazette and on the Reserve Bank's website as required by section 74 of the Legislation Act 2019. 33) **Note** as secondary legislation, standards will be subject of Parliamentary disallowance (section 115 of the Legislation Act 2019). 34) **Note** the Reserve Bank of New Zealand Bill requires the Reserve Bank to assess and publish the expected regulatory impact of any policy adopted under prudential legislation, which will include the development of standards under the DTA (except of a minor or technical nature). 35) **Note** the Reserve Bank Bill outlines requirements around the contents of the regulatory impact assessment of any proposed policy, including that pertaining to standards, and this includes how the Board has had regard to the Minister's *Financial Policy Remit*. 36) **Note** the framework for standards-setting anticipates that the Reserve Bank will keep you well informed of key policy changes (other than those of a minor or technical nature). 37) **Note** the Reserve Bank currently consults with you and your Office on key policy changes, an informal practice with no statutory basis.

38) **Note** under the current framework you also have the ability to outline how you would like to be engaged and consulted in any *Letter of Expectation* you may choose to issue to the Reserve Bank.

39) **Agree** that:

a. consultation with the Minister of Finance will rely on informal engagement by the Reserve Bank, including as set out in the *Letter of Expectations* (Reserve Bank preferred option)

Agree/disagree

OR

b. there is a statutory requirement for the Reserve Bank to inform the Minister of Finance of key policy changes (Treasury preferred option)

Agree/disagree

Licensing

40) **Agree** that a person will be entitled to be issued with a licence if the Bank is satisfied as to specified matters. It is anticipated that the specified matters will include the matters listed in sections 73-73B and section 78 of the current Reserve Bank of New Zealand Act 1989 and compliance with the range of matters in the Reserve Bank's Banking Supervision Handbook and Basel Core Principles of Effective Banking Supervision.

41) **Agree** that the fitness and propriety of directors and senior managers of an applicant be a matter the Reserve Bank must be satisfied of before a person is entitled to be issued with a deposit taking licence for fit and proper requirements.

42) **Agree** that the Reserve Bank would be required to consult the Financial Markets

	Authority before granting or declining a licence. 43) **Agree** that the Reserve Bank will have powers to establish licensing conditions, specific to licensed deposit takers. It is anticipated that licensing conditions may be used able to apply standards and relate to the licensing matters and the types of conditions that may be imposed under the Non-bank Deposit Takers Act 2013 and Insurance (Prudential Supervision) Act 2010. 44) **Agree** that Reserve Bank approval be required before a person obtains a controlling interest in a licensed deposit taker. 45) **Agree** that the DTA will include appropriate de-licensing powers, including the circumstances under which the licence of a deposit taker may be revoked *Transparency requirements* 46) **Note** the Reserve Bank Bill requires the Reserve Bank to publish *Statements of Prudential Policy* in order to provide transparency about how it acts as a prudential regulator and supervisor under prudential legislation. 47) **Agree** that the Reserve Bank would be required to publish in its *Statement of Prudential Policy* its policies in relation to how it acts, or proposes to act, in relation to modifying conditions of licence or granting exemptions from requirements imposed by standards. 48) **Agree** that a new Reserve Bank register of licensed deposit takers, with prescribed content requirements

Fit and proper recommendations

New decisions sought	49) **Agree** that the Deposit Takers Bill provide fit and proper requirements for directors and senior managers of deposit takers in line with the fit and proper framework contained in the Insurance (Prudential Supervision) Act 2010, including: a. that directors and senior managers of a deposit taker must be fit and proper persons to hold their respective positions b. that the Reserve Bank be empowered to set fit and proper requirements for deposit takers by standards, including the specification of matters relevant to the consideration of whether a person is fit and proper and requirements for deposit takers to have policies governing the appointment and ongoing fitness and propriety of directors and senior managers c. that a deposit taker be required to notify the Reserve Bank of the proposed appointment of a director or senior manager with a certification from the governing body of the deposit taker that the proposed appointee is a fit and proper person to hold the intended office d. that the Reserve Bank's approval is required prior to the appointment by the deposit taker of a director or senior manager e. that deposit takers be required to notify the Reserve Bank of significant issues that may affect the fitness and propriety of directors and senior managers as and when they occur f. that the Reserve Bank be empowered to direct a deposit taker to remove a director or senior manager of a deposit taker (post-appointment) where the Reserve Bank has reasonable grounds to believe that the director or senior manager is no longer a fit and proper person to hold the relevant position

	g. that the above direction may be for a specified time or subject to other conditions determined by the Reserve Bank h. that the power to not approve a proposed director or senior manager or to remove a director or senior manager be subject to natural justice procedures for the deposit taker and the affected person (e.g. notice, the giving of reasons and opportunity to make submissions) i. that the decision by the Reserve Bank to not approve a proposed director or senior manager or to remove a director or senior manager be subject to appeal by the affected person to the High Court and that the appeal be by way of a rehearing j. that a person dissatisfied with a decision of the High Court may, with leave, appeal to the Court of Appeal k. that the fitness and propriety of directors and senior managers be a mandatory consideration when deciding whether a person is entitled to be granted a deposit taking licence.

Liability, accountability, supervision and enforcement

Liability and accountability

72. Directors of registered banks are currently the focal point for the individual accountability provisions in the Reserve Bank Act. They are faced with criminal liability for making false and misleading attestations in a bank's public Disclosure Statement. However, there are a number of drawbacks in the current approach to this 'self-discipline' as explained in consultation documents and previous Cabinet advice: the disproportionate focus on criminal liability; the point-in-time nature of the director obligation, and; the lack of guidance from the Reserve Bank around what constitutes adequate risk management.

73. Cabinet has previously agreed that the accountability framework for directors of deposit takers be enhanced by imposing positive on-going duties on directors [DEV-19-MIN-0346 refers]. This will support how banks and other deposit takers provide assurance that they are prudently

managing risks to both the Reserve Bank as prudential regulator, and to external stakeholders.

74. As proposed, directors will have a positive and on-going duty to ensure there are adequate systems, processes and policies in place to ensure the entity complies with its obligations. There will be a pecuniary penalty for breaches of this duty by directors. The justification for this duty is the high social and economic costs of imprudently run deposit taking institutions, particularly large and systemically important banks.

75. There will be protections for directors in the form of a defence for a breach of this duty if they can show they took reasonable steps to meet their obligations. In addition they would be able to take out personal insurance against the potential penalty for such breaches. The entity itself would not be able insure or indemnify the director.

76. Cabinet has also previously agreed that a wider accountability regime be established for directors and senior executives of deposit takers and insurers, one that is integrated across the two 'peaks' of New Zealand's regulatory system (i.e. prudential and market conduct). This work will be progressed outside the Phase 2 Review, but will likely require future amendments to the DTA at the point that this more encompassing regime is implemented.

77. In terms of penalties, the DTA will set out the liability of entities and individuals for non-compliance with their prudential obligations. This will include a significant civil pecuniary penalty for breaches of prudential standards by deposit takers, and criminal offences for more egregious and intentional wrongdoing. This is in line with the previous in-principle Cabinet decision to rely on civil pecuniary, rather than criminal, offences as these are seen as more appropriate in the regulatory context.

Supervision and enforcement

78. Supervision and enforcement are tasks undertaken by a prudential authority to monitor the financial health of regulated entities, verify information provided by regulated entities, assess compliance with formal regulatory requirements, and to effect corrective action in the event of non-compliance or to address emerging risks and concerns.

79. There are significant gaps in the Reserve Bank's supervision and enforcement framework, including the limited independent verification of a regulated entity's prudential information, the lack of a comprehensive power for on-site inspections, and a limited enforcement toolkit with a disproportionate focus on criminal penalties. That said, the Reserve Bank's approach has become somewhat less light-handed over time, particularly in recent years with increased investment in supervisory

capability and capacity, including the establishment of a significant Auckland footprint.

80. The majority of stakeholders support a more intensive supervision and enforcement model, and the increased resourcing necessary to achieve this.

81. We are proposing that the DTA will provide the Reserve Bank with an empowering and flexible set of tools to allow it to proactively monitor deposit takers, and enforce compliance, within a framework that promotes a legitimate use of discretion, including clear process requirements and appeal rights where appropriate. The framework, as proposed, will include:

    - a power to enter and remain on the premises of licensed entities (including insurers) for the purpose of an on-site inspection. This will provide assurance that firms are meeting their obligations
    - a power to direct licensed entities to mitigate prudential risks, consistent with Cabinet's earlier in-principle decision that directions would no longer require ministerial consent. This is covered in more detail in paragraph 100 (in the crisis management section).
    - new enforcement tools including statutory public notices, enforceable undertakings and remedial plans
    - a requirement on licensed entities to report breaches of their obligations to the Reserve Bank.

82. The third consultation included questions about the possibility of an inspection power for the FMA, for the purpose of alignment between the twin peaks regulators. MBIE intend to seek Ministerial approval to undertake further targeted consultation to refine its policy thinking on the issues. Subject to this Ministerial approval and consultation, MBIE will seek final policy decisions on this power through the second tranche of DTA policy decisions.

83. To the extent possible, the general powers that the Reserve Bank uses to collect information will be redrafted and consolidated within the Reserve Bank Bill along with related provisions.

Liability, accountability, supervision and enforcement recommendations

Previous in-principle decisions	50) **Note** Cabinet has previous agreed in-principle [DEV-19-MIN-0346], subject to further policy development, that: a. accountability requirements will be enhanced for directors of deposit takers

	established through broad positive duties, with civil penalties as the primary sanction for non-compliance b. subject to further advice from a cross-agency process separate from the Phase 2 Review, integrated prudential-conduct executive accountability regime which extends accountability requirements to include certain senior employees of deposit takers and insurers will be developed c. the Reserve Bank to have a power to undertake on-site inspections of any licensed deposit-taker, and any other regulated entity as appropriate d. the Reserve Bank to be able to issue directions to a deposit taker without Ministerial consent but subject to appropriate thresholds, and to delicense a deposit taker without a ministerial direction e. a more graduated enforcement and penalty framework with a broader range of potential sanctions than the current Reserve Bank Act, such as statutory public notices, infringement fees, enforceable undertakings, and civil pecuniary penalties. 51) **note** that the Reserve Bank will be empowered with flexible regulatory tools which can be used expeditiously and with efficacy to promote financial stability. The extent, scope, and use of these powers will need to be clear and well justified to provide certainty and legitimacy *Director accountability* 52) **Agree** that directors of licensed deposit takers will have a new due diligence duty to ensure there are adequate systems, processes and
New decisions sought	

	policies in place so that the deposit taker complies with its prudential obligations. There will be a civil pecuniary penalty for breach of this duty, subject to appropriate defences. 53) **Agree** that a licensed deposit taker will not be able to insure or indemnify a director against a breach of the due diligence director duty, and that any such insurance or indemnification would be ineffective. 54) **Note** that directors would be able to insure themselves personally against insurable risks (such as a civil pecuniary penalty) in their capacity as directors of a licensed deposit taker. 55) **Note** that this duty will exist alongside other director duties, including fiduciary duties to the company under the Companies Act, and duties under the Financial Markets Conduct Act and Credit Contracts and Consumer Finance Act. 56) **Agree** that licensed deposit takers may be liable to a civil pecuniary penalty if false or misleading information is given to the Reserve Bank or publicly disclosed and, if such a penalty is imposed on a licensed deposit taker, the directors of that licensed deposit taker will be treated as having contravened the requirement in such a case and be liable for a pecuniary penalty, subject to appropriate defences. 57) **Note** that this due diligence duty may be incorporated into a future executive and director accountability regime agreed to in principle by Cabinet, to be progressed by CoFR agencies separately from the Review of the Reserve Bank Act. *Supervisory powers*

	58) **Note** that the Reserve Bank's functions under the Reserve Bank Bill will include acting as a prudential regulator and supervisor and that the supervisory powers under the DTA can be exercised as necessary or desirable to carry out this function. The Reserve Bank will also be able to use these powers in its deposit insurance role. 59) **Agree** that the Reserve Bank will have a power to gather information from financial service providers, associated persons of financial service providers, and other appropriate persons. 60) **Agree** that the Reserve Bank will have a power to require licensed deposit takers to produce a report on a matter relating to its business, operations, or management, or those of an associated person to be carried out by a qualified person approved by the Reserve Bank. 61) **Agree** that the Reserve Bank will have a power, at any reasonable time, to, without notice, enter and remain on the premises of a licensed deposit taker for the purpose of conducting an on-site inspection to carry out prudential supervision and monitor the deposit-taker's compliance with obligations imposed under the DTA. 62)**Agree** that, during an on-site inspection, an employee, an officer or agent of a licensed deposit taker may be required to answer questions and provide any other information that may reasonably be required for the purpose of the inspection. 63) **Note** that MBIE will seek the Minister of Commerce and Consumer Affairs' approval to undertake further targeted consultation on a potential on-site inspection power for the Financial Markets Authority, for the purpose of

	alignment between twin peaks regulators, with a view to seeking final policy decisions through the second tranche of DTA policy decisions. 64) **Agree** that the Reserve Bank may require the production of information and appoint a qualified person to carry out an investigation into the affairs of a licensed deposit taker or associated person for the purpose of investigating conduct that constitutes, or may constitute, a contravention of an obligation imposed under the DTA. 65) **Agree** that a person appointed by the Reserve Bank to investigate whether a person is contravening, or has contravened, an obligation imposed under the DTA, may enter and search any place if the occupier of the place consents or the person obtains a warrant. 66) **Agree** that licensed deposit takers be required to report to the Reserve Bank breaches of obligations imposed under the DTA. 67) **Note** that the Reserve Bank will not be permitted under the DTA to compel privileged, or self-incriminatory information from individuals. 68) **Agree** that information connected with the use of the Bank's powers, and derived information that a licensed deposit taker is required to provide to the Reserve Bank must be kept confidential, and only be released in prescribed circumstances. 69) **Note** that the Reserve Bank will be able to share information with relevant agencies, such as the FMA, using the information sharing power in the RBNZ Bill.

	70) **Note** that the exercise of supervisory powers will be subject to appropriate procedural constraints, in accordance with natural justice requirements. *Enforcement powers* 71) **Agree** that the Reserve Bank would have a power to direct licensed deposit takers to take specified actions (for the scope of this power see the 'early intervention' section in crisis management recommendations below). 72) **Agree** that the Reserve Bank have the power to make an order prohibiting the publication or communication of any information relating to the exercise of supervisory and enforcement powers under the DTA. 73) **Agree** that the Reserve Bank may require the preparation and implementation by a licensed deposit taker of a plan setting out how it would remedy a contravention, or potential contravention, of its prudential obligations under the DTA. 74) **Agree** that the Reserve Bank may accept a written undertaking from any person in connection with compliance with any obligation imposed under the DTA and have the power to apply to the Court to enforce the undertaking and order appropriate remedies for breach of the undertaking, including the payment of an amount up to the amount of any benefit that the person obtained that is reasonably attributable to the breach. 75) **Agree** that the Reserve Bank be able to require that a licensed entity publicly display a notice or warning issued by the Reserve Bank. *Penalties and offences* 76) **Agree** that civil pecuniary penalties may be imposed by the court (with a civil standard of

	proof) for a contravention of a requirement or obligation under the DTA. 77) **Agree** that the Reserve Bank may apply for a civil pecuniary penalty order against any person who has contravened, or been involved in a contravention, of a requirement or obligation under the DTA. 78) **Agree** that in determining the size of a pecuniary penalty the court would be required to consider: - the size of the entity - the extent of the harm, or potential harm, caused - the cooperation with regulators - the recommendation of the Reserve Bank - and any other relevant matters. 79) **Agree** that intentional or reckless non-compliance with the Reserve Bank's supervisory and enforcement powers would be a criminal offence. 80) **Agree** that the DTA include a criminal offence for intentionally misleading the Reserve Bank. 81) **Agree** that the DTA provide for administrative penalties (i.e. infringement notices imposed under the procedure provided in the Summary Proceedings Act 1957) for failing to comply with requirements under the DTA requiring the supply of information to the Reserve Bank. 82) **Note** that further detail of the proposed offences and penalties will be developed by the Minister of Finance under Cabinet's delegated authority provided by recommendation 157. Penalty levels would be comparable with the conduct and competition regimes and could be significant. *Miscellaneous*

	83) **Agree** that the Reserve Bank will have the power to carry out on-site inspections of insurers licensed under the Insurance (Prudential Supervision) Act 2010 comparable to the on-site inspection power for licensed deposit takers.

Associated persons

84. Associated persons are entities that have a relationship with a primary entity, in this case a licensed deposit taker, and can include holding/subsidiary relationships, relationships created through managerial decision-making or relationships built on delegated functions (e.g. outsourcing).

85. The Reserve Bank will be able to set and enforce reporting and lending standards to lenders outside the regulatory perimeter that have been prescribed via regulations. This will capture associated persons that are non-deposit taking lenders. The Reserve Bank will not otherwise be able to set standards for associated persons.

Associated persons recommendations

New decisions sought	84. **Agree** that the definition of an associated person should be along the lines of that used in section 10 of the Insurance (Prudential Supervision) Act 2010 85. **Agree** that the Reserve Bank is able to require an associated person to provide the Reserve Bank's information for the purposes of the Reserve Bank prudential supervision of licensed deposit takers.

Appeal rights

86. The DTA proposals will empower the Reserve Bank to set standards, apply exemptions and designations (secondary legislation) and exercise a range of administrative decision-making powers, including assessing applications for a deposit taking licence, making subsequent changes to an entity's licence conditions, and using various enforcement tools.

87. A system of appeal acts as a procedural safeguard and accountability mechanism to ensure parties whose rights or interests are affected by

the Reserve Bank are afforded a right of recourse to challenge that decision. Appeal rights ensure decisions are in accordance with the law and incentivise the Reserve Bank to make decisions that are of the highest possible quality. However, the system of appeal within the prudential framework needs to strike the right balance between protecting the interests of affected parties versus enabling the Reserve Bank to pursue its statutory mandate efficiently and effectively.

88. The Reserve Bank's standard-setting, exemptions and designation powers will be subject to judicial review, which would allow applicants to challenge the process by which decisions are made (in particular, whether the Reserve Bank acted within its powers and consistently with the legal framework). As secondary legislation, these powers of the Reserve Bank would be subject to scrutiny by Parliament via the Regulations Review Committee, and can be disallowed by the House in certain circumstances. The DTA will also specify appropriate procedural safeguards for the exercise of these powers.

89. The DTA will introduce a range of decision-making powers that will be applied to individual regulated entities or persons, such as licensing powers and enforcement actions. The Treasury and the Reserve Bank have converged on a system of appeal rights for the Reserve Bank's administrative decision-making powers. In addition to these powers being subject to judicial review, we are proposing that the DTA will, where appropriate, provide for a right of appeal if the rights or interests of a particular person are affected by an administrative decision[2].

90. Agencies agree that an appeal enabling the merits of a decision to be re-examined through an assessment of questions of fact (a 'merits review') should be provided for fit and proper decisions in relation to directors and senior employees, along with civil and criminal breaches. In addition, agencies agree that the decision to not grant a deposit taker licence would be subject to a merits review appeal.

91. However, agencies are not aligned on whether decisions by the Reserve Bank that affect the rights and interests in relation to an initial licence (i.e. conditions of licence, approvals to carry on certain activities) should be subject to full ('merits') appeal (Treasury preferred) or limited to questions of law (Reserve Bank preferred).

92. In addition, agencies are not aligned on whether decisions by the Reserve Bank in relation to enforcement or direction should be subject to appeal on questions of law (Treasury preferred) or have no formal appeal

[2] There are a number of decision-making powers for which existing legislation sets out the procedure for the conduct of the proceedings, including appeal rights. This includes the Search and Surveillance Act 2012 and the Criminal Procedure Act 2011.

rights attached, other than the inherent judicial review power of the High Court, which encompasses questions of law (Reserve Bank preferred).

93. The package of proposals is set out in the recommendations below. The different conclusions by the Treasury and the Reserve Bank reflect a difference in judgement on the right balance to be struck between protecting the interests of affected parties versus enabling the Reserve Bank to pursue its statutory mandate efficiently and effectively. In general, a limitation reflects the need for certainty, including potential risks to financial stability, and the expertise of the decision maker.

    Appeal rights for decisions made by the resolution authority will be considered once the no creditor worse off framework has been confirmed. Officials consider that appeals should likely be limited to no creditor worse off compensation.

Appeal rights

New decisions sought	*Appeals from fit and proper decisions* 94. **Agree** that the decision by the Reserve Bank to not approve a proposed director or senior manager or to remove a director or senior manager be subject to appeal by the affected person to the High Court and that the appeal be by way of a rehearing. 95. **Agree** that a person dissatisfied with a decision of the High Court may, with leave, appeal to the Court of Appeal. *Appeals from decisions to decline a licence* 96. **Agree** that the decision by the Reserve Bank to not grant a deposit taker licence be subject to appeal by the licence applicant to the High Court and that the appeal be by way of a rehearing. 97. **Agree** that a person dissatisfied with a decision of the High Court may, with leave, appeal to the Court of Appeal. ***<u>Treasury preferred recommendations</u>*** *Appeals from decisions affecting the rights and interests attaching to deposit taking licences*

	98. **Agree** that decisions by the Reserve Bank that affect the rights and interests in relation to an initial licence (i.e. conditions of licence, approvals to carry on certain activities) be subject to appeal by the affected person to the High Court and that the appeal be by way of a rehearing. 99. **Agree** that subsequent decisions by the Reserve Bank that affect the rights and interests that attach to deposit taking licences that are already approved (i.e. changes to conditions of licence, changes to the licence holder (approvals of change of ownership, corporate form etc), approvals to carry on or cease certain activities) be subject to appeal on questions of law, with the decision appealed against continuing in effect until the appeal has finally been disposed of (unless the Court orders otherwise). *Appeals from decisions on enforcement or direction* 100. **Agree** that decisions by the Reserve Bank in relation to enforcement or direction be subject to appeal on questions of law, with the decision appealed against continuing in effect until the appeal has finally been disposed of (unless the Court orders otherwise). ***Reserve Bank preferred recommendations*** *Appeals from decisions affecting the rights and interests attaching to deposit taking licences* 101. **Agree** that decisions under the Deposit Takers Bill affecting the rights and interests that attach to deposit taking licences (i.e. conditions of licence, changes to the licence holder (approvals of change of ownership, corporate form etc) and approvals to carry on or cease carrying on certain activities) be subject to appeal on questions of law, with the decision appealed against continuing in effect until the appeal has finally been disposed of (unless the Court orders otherwise).

	102. **Agree** that a person dissatisfied with a decision of the High Court may, with leave, appeal to the Court of Appeal. *Appeals from decisions by the Resolution Authority* 103. **Note** that appeal rights for decisions made by the resolution authority will be considered once the no creditor worse off framework has been confirmed, but that officials consider that appeals should likely be limited to no creditor worse off compensation. *Judicial Review* 104. **Note** that the inherent power of the High Court to review the lawfulness of a decision taken under the Deposit Takers Act will be available, including in respect of the exercise of powers for which an appeal right is not provided for in the Deposit Takers Act (e.g. powers to make secondary legislation through setting standards and exemptions or designations).

Crisis management and resolution

94. Crisis management is a key part of the regulatory system's financial safety net, along with prudential regulation and supervision, a central bank's ability to supply liquidity (i.e. lender of last resort), and depositor protection.

95. New Zealand's legislative framework for bank crisis management, being largely based on statutory management, has not been meaningfully 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.

96. The Review's recommendations build on Cabinet's in-principle decision to designate the Reserve Bank as the resolution authority for deposit

takers, with more explicit statutory resolution functions and objectives, and the introduction of the statutory bail-in power.

97. The introduction of the bail-in resolution tool, creditor safeguards aligned with international best practice, and a review of the role of the Minister in crisis management are among the most significant elements of the crisis management piece in the Review. The resulting package seeks to strike a workable balance between the desirability of the Reserve Bank to act swiftly and independently and the ability for the Minister to manage fiscal and wider social and economic impacts while enhancing the toolkit to reduce the likelihood of taxpayer bailouts.

98. Due to the breadth of crisis management, the Review will present proposals to you across two tranches of advice. The first tranche – included in this report – covers:
    - 'early intervention' powers
    - statutory criteria for placing an entity 'into resolution' and exercising resolution powers
    - empowering the Reserve Bank as a resolution authority
    - liabilities eligible for statutory bail-in
    - the role and powers of the Minister of Finance in crisis management
    - amendments to the Public Finance Act 1989 to provide authority to incur expenditure without an appropriation in a financial crisis

99. A subsequent tranche of advice will cover remaining areas of crisis management reform, most of which function as a 'supporting' framework for the recommendations included in this report. These further areas include:
    - remaining powers for the resolution authority
    - resolution funding
    - the 'no creditor worse off' creditor safeguard
    - other legal safeguards and technical provisions (e.g. moratoria on creditor enforcement claims, stays on early termination rights, safeguards for directors when acting under the direction of the resolution authority)
    - the tax implications of statutory bail-in
    - transparency and accountability provisions

- whether licensed deposit takers should remain within the scope of statutory management under the Corporations (Investigations and Management) Act 1989.

Early intervention triggers and powers

100. The Reserve Bank currently has the power to direct registered banks in situations where certain statutory triggers have been met (essentially where the Reserve Bank has reasonable concerns about the soundness of the registered bank and the risks it may pose to the financial system). These powers can also be used in an enforcement setting to effect corrective action and ensure compliance with prudential requirements. Cabinet has previously agreed to remove the current requirement for there to be Ministerial consent to using direction powers. These powers have been redeveloped to make them fit coherently with the wider set of changes.

101. The proposed statutory triggers for direction powers are where the Reserve Bank has reasonable grounds to believe that:

    - there is a contravention, or a likely contravention, by a licenced entity 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
    - the business of the licenced entity is not being conducted in a "prudent manner"; or
    - the circumstances of the licenced entity are such as to be prejudicial to the soundness of the licenced entity or the financial system.

102. The proposed terms of the directions are whatever the Reserve Bank believes is necessary 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. The scope of the direction powers would also include all of the existing direction powers contained within the 1989 Act, and the following additional new powers, to give the Reserve Bank the ability to direct a licenced entity to:

    - implement a recovery plan, or
    - issue additional shares.

103. It is also proposed that direction powers be available for use by the Reserve Bank in the context of associated persons. Although associated persons as unlicensed entities are out of the scope of prudential regulation, they can create wider risks and costs to society through their

impact on licensed entities. Allowing the Reserve Bank to direct associated persons would enable it to manage these risks.

104. It is important that direction powers strike a balance between enabling the Reserve Bank to respond proactively in times of financial stress, but also ensuring that there is certainty for industry and protection from overreach. Having a clear set of statutory triggers and requiring that regulatory actions are in proportion to the risk or the harm will ensure that there are checks on the Reserve Bank's use of these powers.

105. It is also proposed that the Reserve Bank have the ability to remove, replace or appoint directors of a licenced entity. This ability currently exists in the 1989 Act and should be included in the DTA.

Criteria for placing an entity into resolution and exercising resolution powers

106. It is proposed that there is a set of clear statutory triggers for placing a licensed entity into resolution, that will enable the Reserve Bank to act proactively when licenced entities are in decline. These triggers should be based on the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions (the 'FSB's Key Attributes') and should be comprised of a non-viability test and a necessity test. The non-viability test should be satisfied when one or more of the following applies to a licensed entity:

    a) The value of the deposit taker's assets is or is likely soon to be less than the value of its liabilities.
    b) The deposit taker is unable or likely to become unable to pay its debts as they fall due.
    c) 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.
    d) 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.

107. The necessity test should be satisfied when there is no reasonable prospect based on the supervisory/Resolution Authority opinion of the non-viable deposit taker being remedied outside resolution to the satisfaction of the resolution authority.

108. Both the non-viability test and the necessity test would need to be satisfied for a resolution to be initiated.

109. Elements of the non-viability test have been amended post the third consultation, in part due to concerns raised in submissions. Several of the submitters expressed concern that elements of the test (in particular, limb C, which in the proposal in consultation was linked to de-licensing)

would operate as too low of a bar for putting an entity into resolution. The reasons for this centred around the fact that a licenced entity might still be financially viable, despite meeting this element of the test. There was also concern that this test might operate as a "hair trigger", when it should instead be reserved for the most serious contraventions.

110. Limb C has been re-framed to focus this part of the test on persistent and serious contraventions, consistent with the test in IPSA. Triggers for resolution should provide a balance between clear and well-defined scenarios for a serious regulatory action, as against an empowered resolution authority that is able to act proactively in emerging financial crises, before the point where an entity is balance sheet insolvent. In addition, the elements of the non-viability test would not justify putting an entity into resolution in of themselves, as the necessity test must also be met. This means that the Reserve Bank would also need to show that resolution is the only reasonable option at that time, in addition to showing that non-viability test has been met.

111. An additional limb (D), has also been added to the non-viability test. This limb will capture situations where a deposit taker is failing or has failed to maintain a minimum amount (or ratio) of capital, as per the requirements of their licence or under a standard.

112. The Review is developing advice on a further possible trigger for resolution to deal 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.

Empowering the Reserve Bank as the resolution authority

113. An effective resolution authority requires access to a full range of resolution options and supporting powers in the 'resolution toolkit' and flexibility in how it can use them. Some of these powers are significant and can involve overriding individual property rights in order to safeguard the public interest and financial stability. International good practice guidance – the FSB's Key Attributes – is nevertheless clear that the powers are required, provided they are balanced by creditor safeguards, particularly the safeguard that no creditor must be left worse off than they would have been in a liquidation ('NCWO'). Cabinet has already agreed in principle to introducing the NCWO safeguard.

114. The Review recommends that the existing process for placing a deposit taker 'under statutory management' and the appointment of a statutory manager be replaced with placing an entity 'into resolution' (provided the above statutory resolution criteria have been met). Once an entity has been placed into resolution, the Reserve Bank as resolution authority would have access to the full range of resolution powers. These powers would include the ability to appoint one or more 'resolution managers'

(either from within the Reserve Bank or an external person) to take control of the entity (as a statutory manager would under the 1989 Act). The resolution manager would be able to exercise resolution powers on behalf of the Reserve Bank and the Reserve Bank would be responsible for the resolution manager's performance. This approach aligns with international good practice guidance and addresses industry's request that the existing statutory management model be overhauled with that work guided by the FSB Key Attributes.

115. An effective resolution regime also needs to be able to resolve a range of institution types, sizes, and complexity in a range of failure scenarios. Broadly speaking, the regime needs to be able to deliver three types of resolution in an orderly manner without causing disruption to critical financial services or damage to financial stability. The three types are:

    (i) **Orderly closure and liquidation** at the point of non-viability without endangering the financial system as a whole. This type of resolution lends itself to small deposit takers. A prompt payout of insured deposits is critical to its credibility.

    (ii) **A transfer of key deposit accounts and other critical liabilities to another entity** – either a temporary bridge bank or directly to an acquiring entity – together with either good assets from the failed entity or other financial resources. Assets and liabilities not transferred would remain in the failed entity and be wound down. This type of resolution is generally called a 'partial transfer' or a 'purchase and assumption' where, at a minimum, insured deposits would be transferred. However, it can also involve a greater set of functions and services being maintained in a bridge banking model – for example, as envisaged under the existing OBR policy. This type of resolution ensures the ongoing provision of services to customers of the failed entity but does not result in the entity itself continuing.

    (iii) **Open resolution**, where the failing entity is stabilised and resolved (at least temporarily) in a manner that keeps the doors of the failing entity open and services operational. Access to deposit accounts is uninterrupted. Stabilisation generally requires the entity to be recapitalised. Recapitalisation can happen via 'bailing in' suitable prepositioned and subordinated liabilities, including those of a parent institution in the case of a subsidiary such as one of New Zealand's big four banks. This type of resolution is in practice generally reserved for large or systemically important institutions that provide services critical to the financial system. If there are insufficient prepositioned liabilities to bail in, continuity of key services could also be ensured through other options, eg a transfer process in (ii) above.

116. In line with international guidance and global post-GFC reforms, the Review has sought to provide the Reserve Bank with a resolution toolkit that increases the range of alternatives to taxpayer bailouts.

117. Resolution types (i) and (ii) can be catered for by transferring existing statutory management powers to the Reserve Bank as the resolution authority and through implementation of the deposit insurance scheme. Resolution type (iii) is supported by the new statutory 'bail-in' power together with prepositioned suitable liabilities (discussed further below). Prior to resolution, the first line of defence is equity capital, currently being enhanced by the Reserve Bank. As equity capital weakens, the early intervention powers discussed above are important

118. Cabinet has already 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]. The Review is still working through the technical details of a number of existing statutory management powers to ensure that what is transferred is fit-for-purpose.

119. The following existing statutory management powers have been reviewed so far and can be recommended to be conferred on the Reserve Bank as the resolution authority:

- the power under section 127 of the 1989 Act to suspend payments or to cancel an obligation to provide funding to a person, with existing exclusions from that power updated to include payments and transfers to central counterparties and designated settlement systems

- the ability under section 142 of the 1989 Act to apply to the High Court for directions concerning the business or property of an entity under statutory management (with further work required on the grounds on which a liquidator may be appointed by the High Court)

120. In addition, it is proposed that the powers available in respect of a deposit taker that is in resolution would also be available in respect of an 'associated person' that has been put into resolution. It would also be necessary that the Reserve Bank be able to immediately place into resolution a new company established to hold some of the business of a deposit taker that is in resolution.

121. Remaining existing statutory management powers require further technical review work. Recommendations on those powers and related provisions such as a moratorium on creditor enforcement actions and a temporary stay on contractual early termination rights will be provided in subsequent advice. To progress drafting instructions in this area, it may be desirable for you to take a number of decisions under Cabinet's

delegation. We will liaise with the Cabinet Office to ensure that the final Cabinet paper is specific enough to facilitate this.

Bail-in

122. The GFC demonstrated the need for resolution authorities to have tools to resolve failing banks quickly, without destabilising the financial system or exposing taxpayers to loss. The international bailouts of large institutions during the GFC were costly for governments and, ultimately, taxpayers. The solution envisaged at the global level was to internalise losses through 'bail-in', the main tool underpinning the FSB Key Attributes and reforms in many other jurisdictions. By credibly shifting the cost of a crisis from taxpayers to investors and creditors, the new framework also aimed to reduce moral hazard and restore the level playing field for larger and smaller banks by eliminating the implicit subsidies enjoyed by the former.

123. The Reserve Bank's OBR policy relies on existing powers to set aside a portion of a failing entity's liabilities for loss-allocation in a subsequent liquidation once surviving parts of the firm are transferred to a new entity. However, the Review is proposing that the Reserve Bank be given a direct power to write down or convert liabilities into equity. Alongside the implementation of deposit insurance (discussed below), these new powers should help to further ensure that the costs of a crisis fall to investors and creditors rather than taxpayers.

Eligible liabilities

124. Cabinet has already agreed in principle that the Reserve Bank should have a power to write down or convert to equity unsecured liabilities (statutory bail-in) [DEV-19-MIN-346]. The Review now provides advice on the liabilities that should be eligible for statutory bail-in in New Zealand and a number of other features of bail-in.

125. Not all unsecured liabilities lend themselves to being bailed in. The Review is proposing that liabilities eligible for bail-in be closely aligned with international practice (particularly the UK and EU, which a number of other jurisdictions have also followed). A proposed list of exclusions (see recommendation 137137) would leave eligibility for bail-in essentially limited to subordinated capital and debt instruments (including structurally subordinated debt issued to a holding company or a parent institution), uninsured deposits, and unsecured wholesale debt.

126. Bail-in would not apply to existing fixed-term debt instruments. With respect to fixed-term debt, it would only apply to such instruments issued after the date that the Deposit Takers Act or any relevant Regulations enter into force. Prospective application enables investors to assess and price the risk of bail-in into their decision-making at the time of making their investment. This approach was supported by the banking sector. For the avoidance of doubt, this restriction on retrospective application

would not apply to uninsured deposits as they are not 'issued' as investment instruments.

127. There are likely to be disclosure implications for bail-inable liabilities under the financial markets conduct regime. These implications will need to be worked through with the Ministry of Business, Innovation and Employment and the Financial Markets Authority.

128. While the scope of bail-in is relatively broad, and may be applied broadly as part of a type (ii) resolution, further refinement and pre-positioning would be required to support a type (iii) resolution because:
    - the availability of certain otherwise eligible liabilities (short-term debt and uninsured deposits) cannot be relied upon for planning purposes and
    - some bail-inable liabilities will need to be subordinated to other liabilities that otherwise rank equally in the creditor hierarchy.

129. The Review has considered two options for setting out which liabilities are eligible for minimum requirements for bail-in planning:
    - One option (the Review's preferred option) is for the Reserve Bank to define eligibility through standards.
    - An alternative option is to set the eligibility through Regulations by Order in Council. This second option could be a requirement in the DTA or it could be an *option* under the DTA which the Minister of Finance could exercise if the Minister felt that the visibility of a Regulation was desirable.

130. Putting the eligibility criteria in a Regulation would provide up-front clarity to uninsured depositors and short-term wholesale investors that they would not be bailed in as part of open resolution plans.

131. But having eligibility for minimum bail-in requirements set out in standards is consistent with the Reserve Bank's approach to setting eligibility for prudential capital requirements, and indeed allows minimum bail-in requirements to be seen as an extension of capital requirements. It also allows for alignment between Reserve Bank communications on bail-in planning and communications on the implementation of its capital review decisions. The Review therefore favours having eligibility for minimum bail-in requirements set in standards.

132. The Reserve Bank would have the power to direct deposit takers to maintain minimum amounts of certain bail-inable liabilities and the nature of those minimum liabilities would be defined in standards, including requirements for them to be contractually subordinated to other liabilities.

Writing down share capital and cancelling shares

133. Cabinet's previous in-principle decision on bail-in was phrased in terms of writing down or converting to equity unsecured liabilities. The Review recommends a clarification to this aspect of the bail-in power. In a liquidation, equity and associated instruments would be the first to absorb losses. If, in the event of a resolution for which bail-in is to be used, there remained any shares with value, it would be important that those shares can be written down prior to bailing in eligible liabilities. For the avoidance of doubt, the Review therefore proposes that the bail-in power includes the power to write down share capital or to cancel shares.

The legislative instrument for defining the scope of bail-in

134. Cabinet has agreed in-principle that legislation would provide for the Governor-General, by Order in Council, to make Regulations specifying types or categories of unsecured liabilities that would be excluded from bail-in [DEV-19-MIN-0346]. Following the further work that has been undertaken on the scope of bail-in, consideration of the Legislation Design and Advisory Committee (LDAC) Legislation Guidelines, and consultation with LDAC, it is proposed that the scope of bail-in be specified in primary legislation.[3]

135. However, recognising that financial instruments can evolve over time, the Review considers it appropriate for the DTA to provide for the Governor-General to make Regulations by Order in Council on the advice of the Minister of Finance that specify additional unsecured liabilities as ineligible for bail-in.

Contractual recognition of New Zealand bail-in powers

136. In line with international good practice and to minimise the risk of legal challenge to a bail-in (e.g. in a foreign jurisdiction), bail-inable debt instruments will need to include contractual terms under which the holder of the instrument recognises and agrees that the instrument is subject to New Zealand law on bail-in (and the subordination of that instrument, as applicable) and agrees to be bound by the terms of a bail-in under those statutory powers.

137. It is proposed that the specific wording for that contractual recognition be set in standards so that the wording can be modified as required from time to time in line with international developments.

[3] In LDAC's view, "the scope of the bail-in power is a matter of significant policy." LDAC considers that, "At the very least, the [Deposit Takers] Bill will need to set out the policy basis for determining what are the eligible liabilities and, in principle, these eligible liabilities should be specified in the primary legislation."

Potential tax implications of bail-in

138. A bail-in could lead to a significant amount of debt forgiveness income for the entity in resolution and therefore a potentially significant tax liability. While it is consistent with our tax system to recognise taxable income as arising in these circumstances, it is also important that a tax liability does not imperil the viability of a bail-in, particularly if a bail-in was considered necessary to maintain critical financial services and to protect financial stability.

139. Inland Revenue acknowledges that recognition of any tax liability that could not immediately be offset through tax losses might undermine the effectiveness of a bail-in. Any potential solution to this issue would need to balance the integrity of the tax system and the objectives of the bail-in and would likely require a targeted amendment of tax legislation.

140. We propose that you consult with the Minister for Revenue on whether any changes to tax legislation should be made to resolve this issue.

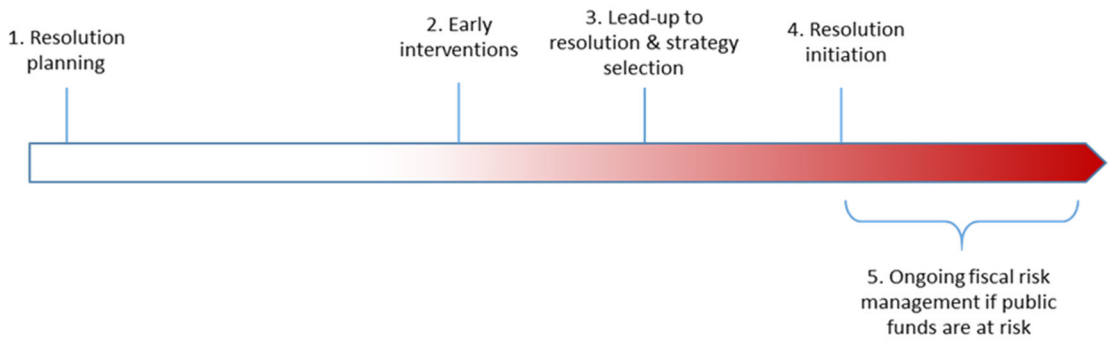
<u>The role of the Minister of Finance in crisis management</u>

141. A Minister of Finance has key responsibilities on behalf of the government in a deposit taker failure. These include:
    - understanding and managing the economic and social impact risks associated with deposit taker failure and the management of such failures
    - the wider international (especially trans-Tasman) relationship dimensions of the management of the failure of any of New Zealand's foreign-owned banks
    - managing expectations that public funds will be put at risk to manage a deposit taker failure, and
    - managing fiscal risk to the government in the event that public funds are put at risk to manage a deposit taker failure.

142. The crisis management framework needs to strike a balance between an appropriate level of operational independence of the Reserve Bank in performing the resolution authority function on one hand and appropriate opportunities and levers for the Minister of Finance to manage the government's interest in crisis management on the other.

143. Figure 3 below shows five key points of ministerial interest in crisis management.

Figure 3: Key points of ministerial interest in crisis management



Planning and engagement prior to resolution

144. At point 1 – during normal times – the Reserve Bank will be required to develop resolution plans for deposit takers (advanced planning being critical to smooth and orderly resolutions). Resolution plans should set expectations as to how a deposit taker would be resolved in the event of triggering the conditions for resolution.

145. It is proposed that, alongside the development of these resolution plans, the Reserve Bank will be required to consult the Minister of Finance in the preparation of a general 'statement of approach to resolution'. The statement of approach would be required to be published and should include:
    - the expected resolution strategy for different types of deposit taker[4]
    - the approach to collaborating with other agencies (e.g. the Treasury) in resolution planning
    - how the Reserve Bank will inform and engage with the Minister of Finance and other agencies on the use of crisis management and resolution powers (including the use of early intervention powers such as directions and removing/appointing directors and on consultation prior to an entity being put into resolution – points 2 and 3 in Figure 3).

146. Consultation with the Minister of Finance on the statement of approach to resolution is intended to provide an opportunity for the Minister to be comfortable with the Reserve Bank's approach to resolution planning and preferred resolution strategies, especially on the costs and benefits of different resolution strategies and – importantly – to manage expectations of reliance on public funds.

[4] Publication of such a statement will be an important basis for setting expectations of investors and other creditors and enabling them to appropriately price risk into their investment decisions.

Placing a deposit taker into resolution

147. Placing a deposit taker into resolution (point 4 in Figure 3) unlocks the ability of the resolution authority to exercise significant powers of intervention. Reasonable cases can be made for the decision being made by an independent regulator or for the decision being made by the Minister.

148. The Review has considered two approaches. The first approach is that Parliament empowers the Reserve Bank as resolution authority to take the decision. This approach recognises that assessing a deposit taker's situation against the statutory criteria for resolution requires a substantial degree of technical expertise or expert judgement of complex issues.

149. There are judgements to be made, but these are judgements that an independent regulator, rather than a Minister, may be best placed to make. It also helps to avoid risks of politicising the decision (particularly the risk of Ministers being pressured to opt for taxpayer bailouts instead), recognising that it is not always helpful to have Ministers involved. Providing that the Minister had been consulted on, and is comfortable with the resolution strategy and that wider economic, social, and international impacts have been appropriately considered and addressed, the final decision could be taken by the resolution authority acting in accordance with its statutory objectives.

150. The second approach is that the decision be taken by the Minister of Finance – on the recommendation of the Reserve Bank. This approach recognises that, in some cases at least, the potential impacts of the approach to resolution could be seen as warranting the explicit endorsement of the government of the day and the additional 'legitimacy' that a formal government approval imparts. The risks are that politicising the decision could result in sub-optimal approaches to resolving the failed entity.

151. International practice varies. The UK and Australia, for example, fully empower their resolution authorities to put an entity into resolution but with close consultation with their respective Treasuries. Canada, on the other hand, requires an order of the 'Governor in Council'.

152. The Review proposes a combination of the two approaches outlined above:
    - An **open resolution based on bailing in prepositioned, subordinated wholesale instruments or a parent entity's funding** (i.e. bail-in is limited to the minimum and subordinated bail-inable resources that were required as part of resolution planning) would be able to be **executed by the resolution authority without formal involvement of the Minister of Finance**. Such resolutions aim for a rapid recapitalisation using

the internal resources of the failed entity resulting in uninterrupted operations including continued access to accounts and critical financial services.

- In **all other cases, formal ministerial agreement would be required**. These are resolutions where:
  - losses are envisaged to be imposed on a broader set of creditors that are not prepositioned for it as part of minimum requirements supporting an open resolution
  - the deposit taker would be wound down after transferring deposits and matching assets to another entity
  - the deposit taker may be closed and a deposit insurance payout made.

153. Irrespective of whether the Reserve Bank is empowered to put a deposit taker into resolution or whether it requires a decision from the Minister of Finance, further work is needed on the options for the 'legal instrument' that the DTA would require to be transmitted. Recommendations on the legal instrument will be provided in a subsequent tranche of advice.

Managing fiscal risk to public funds

154. Point 5 in Figure 3 refers to the management of fiscal risk to the government if a resolution were to put public funds at risk – e.g., through a government guarantee or equity injection. Only the Minister of Finance has the ability to commit or put at risk public funds in a resolution. An important question is whether the Minister should have statutory powers to direct the management of risk to any public funds that have been committed.

155. The Reserve Bank will have a resolution objective to protect public funds. Nevertheless, there is inherent uncertainty in crises so the crisis management framework should provide sufficient levers for the Minister of Finance to demonstrate an ability to prudently manage fiscal risks facing the government in line with the principles of responsible fiscal management set out in section 26G of the Public Finance Act 1989. There may be some scope to include risk management clauses in the terms and conditions of an instrument that provides public funds, but the efficacy of such clauses may not provide sufficient surety. A residual ministerial lever to manage fiscal risk may be necessary if, after a resolution's initiation, the Minister of Finance weights the need to protect public funds differently than the Reserve Bank does in balancing its multiple resolution objectives (of which protecting public funds is just one).

156. The Review therefore proposes that the DTA provides the Minister with the ability to direct the Reserve Bank on the management of risks to

public funds in a resolution. In other words, the Minister would be able to direct the Reserve Bank to take an action in the course of a resolution provided that it is for the purpose of managing risks to public funds.

157. Providing the resolution authority's statutory objectives are clear and pitched towards the desired outcomes, then in the normal course of a resolution the resolution authority should be able to carry out its functions to meet those objectives and without political interference. Ministerial involvement risks blurring accountability for decisions that can have far-reaching impacts. The intention would therefore be that the Minister's direction power is a residual lever only in order to enable the Minister to protect the financial position and interests of the Crown if necessary and not used for day-to-day intervention in a resolution.

158. Procedures for issuing a direction should be consistent for directions issued under other legislation such as the Crown Entities Act (e.g. tabling the direction in the House) subject to any commercial confidentiality requirements. The DTA will need to make appropriate provision for prioritising a direction over the Reserve Bank's other statutory resolution objectives if there were to be a conflict.

159. For the purposes of this direction power, 'risk to public funds' is proposed to cover the Crown's financial interest in making commitments such as government guarantees, loans, indemnities, share purchases and underwriting, and equity injections. It would exclude 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 (conditions for which would be governed under separate provisions).

<u>Public Finance Act amendment providing authority to incur expenditure without an appropriation in a financial crisis</u>

160. The Review's terms of reference include consideration of the current limitations of the Public Finance Act 1989 the authority to use public funds in a timely manner in a financial crisis.

161. The use of public funds in resolving a failed financial institution carries significant risks, particularly in terms of moral hazard and raising expectations that the government will bail out failed financial institutions. Nevertheless, having the ability to deploy a public funds solution has a place in a comprehensive financial crisis management and resolution framework – as a last resort option in certain circumstances.

162. These circumstances would generally be when other options – including those developed in this Review – are not able to ensure an orderly resolution that avoids damage to the wider financial system, whether it be by avoiding contagion or ensuring the continuation of financial services critical to the wider economy. These circumstances would

generally not include bailing out a small deposit taker, where closure supported by deposit insurance should provide a credible alternative to government bailouts.

163. A potentially critical gap in New Zealand's current legislative framework is the ability of the government to use public funds in a financial crisis where:
    - funding needs to be provided quickly to protect financial system stability, avoid further damage to the financial system, and maintain critical financial services, and
    - the funds required exceed Imprest Supply or an existing available appropriation or there is no appropriation.

164. This gap applies not just in relation to deposit takers, but also in relation to insurers and other critical parts of the financial system such as financial market infrastructure. The Review has considered how to address this gap in relation to all of these types of financial entities – as long as they are regulated by the Reserve Bank.

165. A key enabler for governments to respond to emergencies quickly and effectively is authority to incur expenditure without an existing appropriation to meet the needs of the emergency. Section 25 of the Public Finance Act 1989 provides for unappropriated expenditure when either a state of emergency is declared under the Civil Defence Emergency Management Act 2002 or a situation occurs that affects the public health or safety of New Zealand or any part of New Zealand that the government declares to be an emergency. Neither of these scenarios would support unappropriated expenditure in support of a failing financial institution.

166. Imprest Supply could be used to provide financial support to an entity, but it is not possible to know in advance the size of a financial failure or how much contingency will exist in Imprest Supply at the time to meet a financial support package. Imprest Supply cannot therefore be relied upon in a financial crisis, particularly if the failing entity were a large one or if multiple entities required support.

167. Parliament can be asked to pass specific spending authority through an Appropriation Act or additional Imprest Supply. However, a government cannot always rely on the availability of Parliament to do so in the time required. Resolution of a financial entity must be able to be executed in a timely manner and, at least initially, often out of the public eye; speed is usually of the essence if damage to the wider financial system and economy is to be avoided.

168. The Review proposes a new section in the Public Finance Act similar to existing section 25 but focussed on and tailored to the requirements of a

financial crisis (whether in banking or insurance, such as the post-Canterbury earthquake AMI Insurance crisis in 2011).

169. A standing authority to spend without an appropriation in a financial crisis should be available only in extraordinary circumstances. Like the existing section 25, this power would by-pass the usual processes for obtaining spending approval from Parliament or agreement from Cabinet to use Imprest Supply. It is therefore important that the circumstances in which this power can be exercised are limited and are only where it is impracticable to use other options to resolve the situation.

170. Such statutory conditions on the use of the power can also help guard against the risk of creating an expectation of government bailouts which, in turn, could have unwanted moral hazard implications.

171. We therefore propose that a power for the Minister of Finance to approve expenditure in a financial crisis without an appropriation should apply only to financial entities regulated by the Reserve Bank and can only be exercised where the following conditions are met:

    i. 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

    ii. The Minister is satisfied that the expenditure is:

        a) necessary or expedient in the public interest, and

        b) necessary to maintain the stability of the financial system and the continuity of critical financial services

    iii. 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, and

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

172. Making this amendment as part of the Review's other proposed crisis management reforms – particularly the introduction of the bail-in power and statutory requirements on the Reserve Bank to minimise the need to apply public funds to resolve a failed deposit taker – may help to further mitigate any adverse public perceptions of the new power.

173. The proposed amendment would be intended to enable financial support packages to be approved only for deposit takers, insurers, and payments systems when financial stability was at risk or that provide financial services critical to the functioning of the wider economy, and only as a last resort.

Recommendations – crisis management

Previous in-principle decisions	105) **Agree** to confirm Cabinet's previous in-principle decision [DEV-19-MIN-0346] that legislation will designate the Reserve Bank as the resolution authority for licensed deposit takers 106) **Agree** to confirm Cabinet's previous in-principle decision [DEV-19-MIN-0346] that statutory functions for the Reserve Bank as resolution authority will include the following: a. to prepare and maintain a plan to resolve licensed deposit takers in the event of a possible failure; b. to test the effectiveness of each plan at regular intervals; c. to coordinate with other authorities, both in New Zealand and overseas, as necessary to be prepared for the possible failure of a deposit taker; d. in the event of the failure of a licensed deposit taker, to exercise the powers under the DTA consistently with the objectives under that Act; 107) **Agree** to confirm Cabinet's previous in-principle decision [DEV-19-MIN-0346] that the Reserve Bank will have the following statutory objectives in performing the resolution function: a. enable all licensed deposit takers to be resolved in an orderly manner; b. avoid significant damage to financial system in the event of the failure of a licensed deposit taker, including by maintaining the continuity of systemically important financial functions and preventing contagion; c. to the extent not inconsistent with paragraph 107b directly above:

New decisions sought	i. minimise the cost of resolution and avoid unnecessary destruction of value and interference with property rights ii. protect public funds, including by minimising the need to apply public funds to resolve the failure of a deposit taker 108) **Agree** and that the objective in recommendation 107c applies to the extent that it is not inconsistent with recommendations 107a., 107b, and 106 *Direction powers and triggers for intervention* 109) **Agree** that the Reserve Bank would have a power to direct a licenced deposit taker, to be used if it has reasonable grounds to believe that: a. There is a contravention, or a likely contravention, by a licenced 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 b. The business of the licenced deposit taker is not being conducted in a "prudent manner"; or c. The circumstances of the licenced deposit taker are such as to be prejudicial to the soundness of the licenced deposit taker or the financial system. 110) **Agree** that the terms of the direction would be whatever the Reserve Bank believes is necessary 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. 111) **Agree** that the scope of the direction power would include all of the powers currently

	contained within section 113A of the current Reserve Bank Act 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 licenced deposit taker to: a. implement its recovery plan or b. issue additional shares. 112) **Agree** that non-compliance by any person (including the licenced deposit taker itself, directors and senior management) with a direction would be a criminal offence. 113) **Agree** that the Reserve Bank should be able to issue directions to an associated person where it has reasonable grounds to believe that this is necessary in order to manage the difficulties faced by a licenced deposit taker, because the affairs of the associated person and the licenced deposit taker are so closely connected, or are impacting on the solvency of the licenced deposit taker 114) **Agree** that the full scope of direction powers should be available to the Reserve Bank in the context of associated persons, provided that the trigger for directions to that associated person has been met. 115) **Agree** that the Reserve Bank should have the power to remove, replace, or appoint directors of a licenced entity, where any of the triggers for intervention set out in recommendation 109 are satisfied, and the Reserve Bank believes it is necessary to remove, replace or appoint directors of the entity. 116) **Agree** that, consistent with Cabinet decision to remove Ministerial consent [CAB-19-MIN-0675 refers], Ministerial consent would no longer be required where the Reserve Bank removes, replaces or appoints directors of a licenced entity. *Triggers for placing a deposit taker into resolution and exercising resolution powers*

	117) **Agree** that the criteria to place a licenced 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. 118) **Agree** that the policy intent is for non-viability to occur when one or more of the following applies to the licensed deposit taker: a. The value of the deposit taker's assets is or is likely soon to be less than the value of its liabilities. b. The deposit taker is unable or likely to become unable to pay its debts as they fall due. c. 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 d. 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. 119) **Agree** 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. 120) **Note** that the Review is developing advice on additional resolution triggers that deal 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. 121) **Agree** that the Reserve Bank may put an associated person into resolution and exercise resolution powers on that associated person 122) **Note** that further advice will be provided on the triggers for placing an associated person into resolution

	Empowering the Reserve Bank as Resolution Authority
Previous in-principle decisions	123) **Note** that Cabinet has 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]
New decisions sought	124) **Agree** that the Reserve Bank will have the power to appoint directly one or more persons (acting jointly or individually) as resolution manager of an entity that is in resolution 125) **Agree** that the resolution manager may be a Reserve Bank official or another person determined by the Reserve Bank 126) **Agree** that the Reserve Bank would be responsible for the performance of the resolution manager and that person would be: a. subject to oversight by the Reserve Bank b. subject to and required to comply with instructions and directions by the Reserve Bank c. accountable to the Reserve Bank, and d. subject to removal and replacement by the Reserve Bank 127) **Agree** that a resolution manager will be able to take actions to give effect to any of the Reserve Bank powers in respect of a deposit taker in resolution (including taking actions as an agent of the failed deposit taker), but only as the Reserve Bank's delegate and in accordance with direction by the Reserve Bank 128) **Agree** that powers currently vested in a statutory manager under section 127 of the Reserve Bank 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 the existing exclusions from that power (s127(4)) be

	updated to include payments and transfers to central counterparties and designated settlement systems 129) **Agree** that section 142 of the Reserve Bank 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 updates to reflect that the Reserve Bank will be the resolution authority 130) **Agree** that the Reserve Bank may incorporate a new entity to receive assets and liabilities of a failed deposit taker 131) **Agree** that such a new entity may itself be placed into resolution as part of the resolution of the failed deposit taker's affairs 132) **Agree** 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 133) **Note** 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 that further technical design work is required, and advice will be provided in a subsequent report 134) **Note** that further advice will be provided on remaining existing statutory management powers and related provisions are still being reviewed and recommendations for their inclusion in the DTA will be made in a subsequent report *Bail-in* 135) **Agree** to confirm Cabinet's previous in-principle decision [DEV-19-MIN-0346] 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
Previous in-principles decisions	

New decisions sought	136) **Agree** that the bail-in power includes the power to write down share capital and to cancel shares 137) **Agree** that the following liabilities be excluded from the scope of statutory bail-in: a. secured liabilities, including those related to covered bonds b. client assets held by a deposit taker in trust or in a custodial capacity c. liabilities owed to an employee or former employee of the deposit take arising out of the employment relationship d. tax liabilities owed by the deposit taker to Inland Revenue e. contributions to retirement savings schemes (e.g., KiwiSaver) owed by the deposit taker f. 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 g. liabilities owed by the deposit taker to the DTA deposit insurance scheme h. 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) 138) **Note** that the above exclusions are expected to leave the following unsecured liabilities as eligible for statutory bail-in: a. subordinated capital and debt instruments b. any structurally subordinated debt issued to a holding company or a parent, and

	c. other unsecured debt (such as wholesale debt and uninsured deposits) that is not excluded under recommendation 100 above 139) **Agree** that eligibility of liabilities for 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 bail-in 140) **Agree** that eligibility of debt instruments for statutory bail-in would only apply to liabilities issued or renewed from or after the date that the eligibility provisions of the Deposit Takers Act enters into force 141) **Agree** 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 142) **Agree** 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 standards 143) **Agree** 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 standards 144) **Note** 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* 145) **Agree** that the Reserve Bank be required to publish a statement of approach to resolution 146) **Agree** that the Reserve Bank's statement of approach to resolution be required to include matters along the following lines:

	a. the expected resolution strategy or strategies for different types of deposit taker b. the approach to collaborating with other agencies (e.g. the Treasury) in resolution planning c. how the Reserve Bank will engage with the Minister of Finance and other agencies on the use of crisis management and resolution powers (including the use of early intervention powers such as directions and removing/appointing directors and on consultation prior to an entity being put into resolution) 147) **Agree** 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* 148) **Agree** that the Reserve Bank be able to execute a resolution without further authorisation where: a. the entity in resolution is resolved in an open state and b. where use of statutory bail-in is limited to liabilities that have been prepositioned for an open resolution bail-in in line with a standard issued by the Reserve Bank 149) **Agree** 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 150) **Note** that further advice will be provided on the options for the legal instrument that the DTA would require to be transmitted at the point of placing a deposit taker into resolution

	Managing fiscal risk to public funds 151) **Agree** 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 152) **Agree** that the Minister of Finance's direction power is intended as a residual lever only in order to enable the Minister to protect the financial position and interests of the Crown and not used for day-to-day intervention in a resolution 153) **Agree** that, for the purposes of the Minister of Finance's direction power, 'risk to public funds' covers the Crown's financial interest in making commitments such as government guarantees, loans, indemnities, share purchases and underwriting, and equity injections and would exclude the Reserve Bank's use of its own funds (provided such use fell within any agreed framework for the 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) 154) **Note** that further advice will be provided on the process to be followed in exercising the Minister of Finance's direction power, including the statutory purposes for which the Minister may exercise the power, and on the Reserve Bank's accountability for its statutory objectives where a direction is in conflict with those objectives *Public Finance Act 1989 amendment to provide authority to incur expenditure without an appropriation in a financial crisis* 155) **Agree** 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 the following conditions have been met: a. 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 b. The Minister is satisfied that the expenditure is: i. necessary or expedient in the public interest, and ii. necessary to maintain the stability of the financial system and the continuity of critical financial services c. 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, and d. the Minister is satisfied that adequate arrangements will be in place to prudently manage fiscal risks to the government arising from the expenditure. *No creditor worse off*
Previous in-principles decisions	156) **Agree** to confirm Cabinet's previous in-principle decision (DEV-19-MIN-0346) 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 157) **Agree** to confirm Cabinet's previous in-principle decision (DEV-19-MIN-0346) 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 158) **Note** that further advice will be provided on the 'no creditor worse off' compensation mechanism

Depositor protection

159) Deposit insurance is a key feature of almost every financial system safety net in other developed countries. Deposit insurance schemes ('DIS') 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.

160) In June 2019, Cabinet announced that New Zealand would establish a permanent DIS, with a coverage limit in the range of $30,000-$50,000, per depositor, per institution [DEV-19-MIN-0161 refers]. In late 2019, Cabinet made the following additional in-principle decisions [DEV-19-MIN-0346 refers]:

- the DIS's objective should be to "protect depositors from loss, and in so doing, contribute to financial stability"
- the maximum amount of coverage for a single depositor at a single institution would be $50,000
- membership of the DIS should be compulsory for all licensed deposit-taking institutions
- the Government will provide a funding backstop to enhance the credibility of the scheme, with any funds provided ultimately recouped from member institutions

161) The Review received substantial feedback from deposit takers and other stakeholders that the coverage limit should be higher than $50,000. You agreed to increase the coverage limit for the deposit insurance scheme from $50,000 to $100,000, reflecting that this would help mitigate risks to competition and financial sector inclusion highlighted by small deposit takers, while also responding to broader concerns raised by stakeholders in the last two consultations [T2020/3741 refers].

<u>Governance and mandate of the deposit insurer</u>

162) Functions define what a statutory entity can do. We recommend that the DIS's functions be along the lines of:

- promptly reimbursing protected depositors in a liquidation,
- collecting levies for the DIS,
- promoting public understanding of the DIS, and
- monitoring risks to the DIS.

163) These functions will provide guidance on the expected role of deposit insurance, and provide a clear mandate for use of the powers created by the DTA for these activities. We will provide further advice on whether the DIS has an additional function to manage any amounts in the deposit insurance fund (refer to 'Funding Framework' section below)

164) The role of the deposit insurer will be narrow to avoid costly duplication of the Reserve Bank's supervision and resolution roles. Particularly, the function of the DIS to promptly reimburse depositors only applies when an entity is placed into liquidation. In the event that other resolution tools are used, the resolution authority will have control over the outcomes for depositors. Reflecting this critical role in achieving the objectives of deposit insurance, we will advise you in the future on whether the resolution authority should be made responsible for protecting depositors through an additional resolution objective.

165) Officials will provide you with further advice on whether the DIS should be able to contribute funds towards resolutions other than liquidation, and any safeguards around the use on funds in such circumstances.

166) Given the relatively narrow focus of the insurer and the synergies with other safety net functions, the Review proposes that the insurer would be the responsibility of the Reserve Bank Board (rather than a stand-alone entity). The Board would be responsible for the DIS achieving its objectives and the successful execution of the functions described above.

167) We recommend that legislation should contain a mechanism for the Reserve Bank to establish a subsidiary related to deposit insurance that would:

- hold funds of the DIS that will be used for payout;
- make recoveries from the assets of the failed deposit taker (along with housing the associated legal right); and
- undertake any other functions delegated to it by the Board (for example, making the actual payment to depositors).

This would allow a for a clear delineation of the Reserve Bank's and the Deposit Insurer's balance sheets and mitigate the risk that the Reserve Bank itself is drawn into litigation associated with the operational functions of the DIS.

Funding framework

168) The Review has consulted on the key financial settings for the DIS to ensure funding is available to promptly reimburse depositors in the event of failure. The funding arrangements have been designed to support public confidence, to be cost effective, and to provide a predictable and well understood framework for deposit takers and the wider public.

169) We propose that the Minister is required to publish a Statement of Funding Approach (funding strategy) for the DIS at least every 5 years. The funding strategy is similar to a statement prepared by the Minister responsible for ACC, and the Treasury's proposal as part of the Review of the EQC framework [T2020/2886 refers].

170) The Funding strategy will be required to set out matters including risks to the DIS, guidance for levy setting, how payouts will be funded, and how the Crown's role as backstop to the DIS will be managed. Officials see the funding strategy as a key component to promote public confidence in the DIS, by disclosing how the DIS will have sufficient funding from a whole-of-Crown perspective, regardless of the amount accumulated in any fund.[5]

171) The Funding strategy provides for significant flexibility to adapt the funding model over time as the financial system changes. The requirement for the funding strategy to be published will provide ongoing transparency about the funding approach. We also recommend that the advice provided by the DIS in relation to the funding strategy and levies be published.

172) We recommend that the legislation provide the Minister with a set of broadly worded considerations that will be used to guide the setting of the Funding strategy and levies, including considerations along the lines of:

a. the deposit insurance scheme should be funded by industry over time
b. the financial position of the Crown
c. that the levies reflect the amount of claims made or likely to be made by a licensed deposit taker or class of licensed deposit taker
d. the stability of licensed deposit takers or a class of licensed deposit takers
e. the desirability of consistency and predictability in levies.

[5] The project for modernising the Earthquake Commission Act sought to address a similar issue. While the Crown guarantee for EQC should be sufficient to support public confidence, as the value of the Natural Disaster Fund declines, the public became concerned that claims may not be honoured or could be treated differently.

173) We note that 'fully funded' in this context means levies will cover the operating costs and long-run expected losses the DIS incurs, taking into account recoveries made from the assets of failed deposit takers.

174) The Minister of the day will have discretion to allocate levies across deposit takers and over time based on how they weight these criteria, and may take into account other factors provided they are explained in the funding statement. The Minister must also have regard to the Funding strategy and the published advice of the DIS when setting levies.

175) As noted above, Cabinet has agreed that the government will provide a backstop for the scheme in the event that other funding sources are not sufficient to fund the upfront payout of insured depositors.

176) In the event that there is a large call on the Crown backstop, raising the required amount within the time needed to reimburse depositors promptly may be more challenging and costly than a planned, managed, and incremental increase in the debt program. As such, we propose that a liquidity arrangement between the Crown and the Reserve Bank be prepositioned.[6] The terms and conditions for provision of liquidity will be prepositioned at the time of the Funding strategy being developed.

177) We recommend that the legislation establish a Deposit Insurance Fund (DIF) that would capture levies from scheme members.[7] This approach will enhance public perceptions that levies are being used consistently with the purpose of the scheme, and make it easier to demonstrate to the public that the costs of the DIS are fully funded by deposit takers.

178) Ministers would be able to set levies for the purpose of building reserves in the DIF in consideration of the financial position of the Crown. We note that it may be difficult to justify charging enough levies to materially reduce the reliance on the backstop if an insured depositor preference is introduced. An insured deposit preference would make it very unlikely that the scheme faces any loss after recoveries.

---

[6] This approach has been adopted for the Singapore Deposit Insurance Corporation and Australia's Financial Claims Scheme.

[7] The International Association of Deposit Insurers recommends that a deposit insurance fund is created using levies, which are typically concentrated on deposit takers in the early years of the scheme and invested in safe and liquid assets. The approach of building ex ante levies in a target fund is used by most jurisdictions with deposit insurance regimes (the UK and Australia are notable exceptions). IADI recently surveyed member institutions and found that 64 (93%) of respondents use ex ante funding, pool these levies into a fund and commit to a target size of the fund. Of the 64, 44 (69%) have a target fund and 20 (31%) do not. Of the 20 without a target fund, 19 have plans to set one.

179) We will provide you with further advice on the following matters relating to the funding framework:

- whether there is a requirement in legislation to invest levies in particular assets (eg safe and liquid assets).
- who is best placed to manage the investments of the DIF (likely to be either the Reserve Bank or the Treasury)
- process requirements for levy setting (e.g. public consultation and frequency of review) and the appropriate vehicle to do this (i.e. the DTA or the Funding Strategy)
- the budgetary oversight of the deposit insurer's operating expenses, which will be covered through levies.
- transparency and reporting requirements on the fund's performance, and inflows and outflows from the fund

Boundary for eligible products and depositors

180) Clear and well understood rules defining the level and scope of coverage are critical for ensuring that depositors are clear on which products are (and are not) covered by the DIS so that they can arrange their financial affairs accordingly, and the scheme is able to promptly reimburse depositors.

181) We recommend that the coverage limit and scope of products covered by the DIS be set in legislation, consistent with guidance from LDAC. Any future change to the coverage limit and the scope of coverage would have significant impacts on depositors and, if you decide to implement insured depositor preference, uninsured creditors. The durability of the legislative boundary will be supported by an ability of the Minister to add products to the DIS that are the same in economic substance, and ongoing monitoring and guidance provided by the deposit insurer.[8]

182) We recommend that the scheme covers transactional, savings and term deposits currently offered by registered banks, and the equivalent products offered by NBDTs. These products represent a well-understood boundary for deposits that is both familiar to depositors and that deposit takers can readily measure. Transactional accounts provide critical services to the economy, while savings and term deposits are widely held products used by New Zealanders as a savings vehicle.

183) A clear and consistent boundary will be defined between these insured products and retail debt securities, such as bonds, debentures

[8] We expect the DIS would develop an approval or non-objection regime for assessing products, and maintain a definitive list of all of the insured products issued by each deposit taker.

and capital notes, which are not proposed to be eligible.[9] Excluding debt securities from the DIS would provide for the continued existence of higher risk and return debt products that can be offered to retail investors. Deposit takers will not be able to use the word "deposit" when marketing these products, and amendments will be made to the disclosure regime prior to implementation of the DIS so that it is clear to investors that these products are not covered by the DIS.

184) We recommend that the following eligibility rules would be set through primary legislation:

- Amounts held in joint accounts are split equally across account holders and count towards eligible deposits, up to the coverage limit for each depositor. This applies the principle of per depositor, per institution coverage to this widely held product.
- Depositor groups that will be excluded from the DIS. We propose to exclude financial institutions (highly sophisticated depositors that are readily measured), foreign currency deposits (significantly add to the complexity of the payout process) and related parties (could reduce incentives for prudent management especially at small deposit takers).

185) We note, under these proposals, the DIS would cover the first $100,000 of deposits held by some sophisticated depositor groups, such as institutional and large investors and non-financial corporates. We have not recommended broader exclusions as this: may add complexity to the payout process; may require more costly IT investments to operationalise the DIS; and would only result in small reduction in the exposure of the DIS.[10] Officials can provide further advice on particular categories that could be excluded (e.g. large companies) if you see benefits in further restricting eligibility.

186) We recommend that detailed eligibility rules are established via regulations set by Order in Council. Such rules would include the treatment of trusts, sole proprietors, unincorporated and incorporated societies, partnerships and custodians.

Operational and transitional matters

187) We understand that a priority for you is to have the DIS implemented by 2023. As part of implementation, deposit takers will most likely be required to invest in IT systems in order to promptly calculate insured deposit amounts according to eligibility rules. Officials are currently exploring options for reimbursing insured depositors in the

[9] A common approach used internationally to define debt securities as instruments that can be sold in a secondary market. Debentures offered by finance companies would appear to violate such as a requirement, as the investment can theoretically be transferred to another party. Finance companies that wish to offer insured deposits will therefore need to adjust their products to remove this feature.

event of failure, with a view to ensuring the legislation empowers the DIS to use the most effective reimbursement strategy.

Deposit insurance

Previous in-principle decisions	159 **Note** Cabinet has previous agreed in-principle [DEV-19-MIN-0346], subject to further policy development, that: a. the deposit insurance scheme's objective should be to "protect depositors from loss, and in so doing, contribute to financial stability" b. the maximum amount of coverage for a single depositor at a single institution will be $50,000 c. membership of the scheme should be compulsory for all licensed deposit-taking institutions d. the scheme will be fully funded by levies on member institutions e. the Government will provide a funding backstop to enhance the credibility of the scheme, with any funds provided ultimately recouped from member institutions. 160 **Note** that recommendations to confirm or modify these decisions are below. 161 **Note** that officials will provide you with advice on the timeframes for implementation of the Deposit Insurance Scheme prior to seeking decisions from Cabinet
	Governance and decision-making
New decisions sought	162 **Agree** that there will be legislative functions for the deposit insurance scheme. It is anticipated that those functions will be along the following lines: a. promptly reimburse eligible depositors in a liquidation b. promote public awareness, c. monitor risks to the deposit insurance scheme, and d. collecting levies.

	163 **Agree** that the Reserve Bank will be the deposit insurer and will be responsible for carrying out the functions of the deposit insurance scheme.
Previous in-principle decision	164 **Agree** to confirm Cabinet's previous in-principle decision that the deposit insurance scheme' objective will be along the lines of "protecting depositors from loss and thereby contributing to financial stability"
New decisions sought	165 **Agree** that the DTA will allow the Reserve Bank to establish a subsidiary under its ownership and control for the purpose of operating and/or administering the deposit insurance scheme. 166 **Agree** that the permitted role of any subsidiary in the deposit insurance scheme is likely to include: a. managing any funds to be used for the purpose of paying out eligible depositors. b. holding and enforcing rights of subrogation acquired as a result of deposit insurance pay outs c. undertaking other functions relating to the deposit insurance scheme delegated to it by the Reserve Bank, such as making payment to eligible depositors. *Funding* 167 **Agree** that the DTA will require the Minister to publish a Statement of Funding Approach (funding strategy) for the deposit insurance scheme. 168 **Agree** that the funding strategy will include information along the following lines: a. risks to the deposit insurance scheme b. guidance for levy setting c. how payouts will be funded, including liquidity sources for the deposit insurance scheme d. how the Minister intends to manage the Crown's exposure under the scheme.

	169 **Agree** that the funding strategy must be published at least every 5 years and, in setting the funding strategy, the Minister must consult the public and have regard to the advice of the Reserve Bank and the Treasury. 170 **Agree** that levies for the deposit insurance scheme will be set by the Minister and, in setting the levies, the Minister must follow the funding strategy and have regard to published advice of the Reserve Bank. 171 **Agree** that in setting the funding strategy and levies for the deposit insurance scheme, the Minister will be required to take into account certain considerations. 172 **Agree** that the considerations in 171 will include matters along the following lines: a. the deposit insurance scheme should be funded by industry over time b. the financial position of the Crown c. that the levies reflect the amount claims made or likely to be made by a licensed deposit taker or class of licensed deposit taker d. the stability of licensed deposit takers or a class of licensed deposit takers e. the desirability of consistency and predictability in levies. 173 **Agree** that the DTA will establish a deposit insurance fund that will capture levies collected from deposit takers. 174 **Agree** that if the balance of the deposit insurance fund is not sufficient to meet deposit insurance scheme payment obligations, the Crown will provide the required funding to the deposit insurer to satisfy those deposit insurance scheme payment obligations. 175 **Note** that the Reserve Bank has agreed to provide liquidity to the Crown to support a rapid payout of deposit insurance to eligible depositors, in certain circumstances, and that this role will be prepositioned ahead of the

	implementation of the deposit insurance scheme.
	176 **Note** that the policy intention is that any risk arising from liquidity provided by the Reserve Bank to the Crown under the arrangements noted directly above will be borne by the Crown.
	Scope of coverage
Previous in-principle decisions	177 **Note** the Reserve Bank and the Treasury provided advice to the Minister of Finance in December on the coverage limit in response to stakeholder feedback and that the Minister agreed to recommend to Cabinet that this be increased from $50,000 to $100,000 per eligible depositor, per licensed deposit taker.
New decisions sought	178 **Agree** that the deposit insurance coverage limit for the deposit insurance scheme be set at $100,000 per eligible depositor, per licensed deposit taker.
	179 **Agree** that membership of the scheme will be compulsory for all licensed deposit-taking institutions.
	180 **Agree** that changes to the deposit insurance coverage limit will require parliamentary approval.
	181 **Agree** that the eligible products covered by the scheme will be transactional, savings and term deposits currently offered by registered banks and the equivalent products offered by non-bank deposit takers.
	182 **Agree** that the DTA allow the Minister to add eligible products for deposit insurance through Order in Council for products that are of the same economic substance as those specified in the DTA.
	183 **Agree** that deposits held by financial institutions, related parties of scheme members and foreign currency deposits be excluded from coverage by the scheme and that this exclusion will be set out in the DTA.

	184 **Indicate** whether you would like officials to provide you with further options on exclusions from the deposit insurance scheme such as large companies *Yes / No* 185 **Agree** that a person's share of jointly held eligible products should count towards that person's individual claim on the deposit insurance scheme (up to the $100,000 limit for each individual depositor) and that this should be in the DTA. 186 **Agree** that Minister will have the ability to define through regulations how eligibility applies to certain complex ownership structures (e.g. trusts). 187 **Agree** that deposit takers cannot use the word "deposit" in marketing products that are not eligible products. 188 **Note** that consequential amendments to the Financial Markets Conduct Act and Regulations, including disclosure requirements, are likely to be required as a result of the deposit insurance proposals, and these will be developed ahead of the implementation of the deposit insurance scheme. 189 **Agree** that eligible depositors will become entitled to a payout from the deposit insurance scheme in respect of eligible products that they hold up to the $100,000 limit from the earlier of: • the time a licensed deposit taker is put into closed resolution, or • the time a licensed deposit taker is placed into liquidation. 190 **Agree** that the DTA provide that the deposit insurer will have a right of subrogation to the extent of any payout to an eligible depositor, and these provisions will be based on similar provisions contained in the Crown Retail Deposit Guarantee Scheme Act 2009.

Provisions from current prudential legislation

New decisions sought	191 **Agree** that the following provisions of the Reserve Bank Act 1989 be carried across to the DTA (subject to drafting modifications): - Section 68A (Trans-Tasman co-operation) - Section 139A – 139J (covered bonds) - 192 **Agree** that comparable provisions to sections 60, 62-63, and 67- 71 of the Insurance (Prudential Supervision) Act 2010 (relating to financial strength ratings) be included in the DTA (subject to necessary drafting changes or modifications).

Further matters

New decisions sought	193 **Note** we expect that further policy decisions will be needed to finalise the DTA the most substantive of which are outlined in following table.

Post-April decisions	
Purposes/objectives	▪ Consideration of consolidating/rationalising sectoral principles in RBNZ Act ▪ Statutory purposes/objectives guiding the exercise of the Minister of Finance's powers under the DTA
Regulatory perimeter	▪ Finalising detail of approach to wholesale lenders ▪ Other further detail related to foundational decisions
Standards & licensing	▪ Specifying scope of standards and process-related requirements in more detail ▪ Specification of licensing and de-licensing tests ▪ Consideration of transitional issues (e.g. merits of provisional/transitional licences etc.)
Liability, supervision and enforcement	▪ Legislative location of various supervisory powers (and general question of consolidation across sectoral Acts) ▪ Further detail on specification of supervisory/enforcement tools as appropriate ▪ Calibration of penalty levels ▪ Scope of criminal offences vis-a-vis intentional/reckless non-compliance
Associated persons	▪ Any further refinement as appropriate
Crisis management & resolution	▪ Remaining powers for the resolution authority (including moratoria on

	creditor enforcement claims and stays on early termination rights) ▪ Legal safeguards and certainties ▪ Tax implications of statutory bail-in ▪ Creditor safeguards ▪ Resolution funding ▪ Transparency and accountability requirements
Deposit insurance	▪ Institutional location of the deposit insurance fund ▪ Transparency and reporting requirements for deposit insurance fund and scheme ▪ Safeguards on use of funds in resolutions ▪ Triggers for activating the scheme ▪ Pay-out process and related provisions ▪ Offences for failure to pay levies (if any) ▪ Process requirements for levies ▪ Budgetary oversight for the deposit insurer

194 **Authorise** the Minister of Finance to make further policy decisions required to finalise the Deposit Takers Act (including those matters outlined in the table above), in consultation with the Associate Ministers of Finance, the Minister of Commerce and Consumer Affairs, and the Minister of Revenue.

195 **Invite** the Minister of Finance to issue further drafting instructions to the Parliamentary Counsel Office to give effect to the proposals in this paper.

196 **Agree** that Cabinet's decisions and this paper be publicly released.

Agree / disagree

Next steps

188) The key dates are as follows

Current timetable	Key action
5 March	Your feedback on draft Cabinet recommendations
By 17 March	Draft Cabinet paper(s) and RIS for your feedback
22 March – 1 April	Ministerial and agency consultation for your feedback
5-7 April	Incorporate comments from ministerial feedback
By 7 April	Final version of Cabinet paper(s) to you
8 April	Lodgement of Cabinet paper(s)
14 April	DEV
19 April	Cabinet