The Treasury

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

June 2021

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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

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RESERVE BANK OF NEW ZEALAND
TE PŪTEA MATUA

TE TAI ŌHANGA
THE TREASURY

Joint Report: Deposit Takers Act – Advice on depositor preference

Date:	4 March	**Report No:**	T2021/460
		File Number:	MC-1-7-3-1-1

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)		By 12 March

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Ashley Dunstan	Advisor	[39] (wk)	N/A (mob)	✓
Tamiko Bayliss	Director, RBNZ Act Review	[35] (wk)	N/A (mob)	

Minister's Office actions (if required)

Return the signed report to Treasury.

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

Enclosure: No

Joint Report: Deposit Takers Act – Advice on depositor preference

Executive Summary

This Report advises you on whether a depositor preference should be introduced alongside the deposit insurance scheme. A depositor preference would establish a priority claim for certain ‘preferred’ deposits against the assets of a failed deposit taker, at the expense of other creditors (who would face higher losses in the event of failure). Whether a preference is introduced, and how it is designed, will affect who bears the costs of deposit insurance, determine the allocation of losses among unsecured creditors in the event of failures, and may affect competition in the deposit taking sector.

Regardless of whether you decide that a preference will be introduced, insured depositors will receive prompt reimbursement of funds up to the $100,000 coverage limit. You have already agreed to a high-level framework for the deposit insurance scheme, including the establishment of a deposit insurance fund. The Reserve Bank and Treasury recommend that the deposit insurance fund will be managed by the deposit insurance scheme based on guidance from the Minister, and that the funds of the deposit insurance scheme can be drawn on for the purpose of protecting insured depositors in resolutions (outside of a liquidation and payout).

The Treasury’s view is that the preference decision is a difficult on-balance judgement weighing up implications for market structure, ease of resolution options, and the burden of costs in a resolution. On balance, the Treasury favours no preference due to the adverse effects on smaller deposit takers of the other options. Our concern with preference for the deposit scheme is that losses are concentrated on uninsured depositors, which may create political economy difficulties in allowing the losses to fall in this way, unless a government was fully committed to imposing losses on uninsured depositors. The Treasury accepts that preference for the deposit scheme would make some resolution options easier, however such resolution options can be facilitated without preference for the deposit insurance scheme.

The Reserve Bank’s view is that preference for the deposit insurance scheme should be introduced. This approach would transfer the losses that would have fallen on insured depositors from the deposit insurance scheme to uninsured depositors and other unsecured creditors, in order to provide certainty and less legal risk in undertaking resolutions that protect insured depositors. The incorporation of deposit insurance within the resolution framework will be simpler, and as such may lower the direct implementation costs for industry. While it would result in potentially higher losses for uninsured creditors in theory, we would not expect this to have a material impact in practice given the increases in capital already signalled and the enhanced crisis management framework under the DTA. In combination, these developments should ensure that issues are dealt with promptly before significant losses for creditors accrue – the goal of resolution should be to act before all positive value is extinguished.

A general or tiered preference that includes all depositors may better facilitate the transfer of an entire deposit book to an acquiring entity or bridge bank, without requiring significant public funding, and reduce the likelihood of depositors facing losses in resolutions of major banks. However, the Reserve Bank and Treasury do not recommend a general or tiered preference, as it would pose risks to the ability of small deposit takers (that are primarily funded from deposits) to attract and retain uninsured deposits and issue wholesale funding.

Recommended Action

We recommend that you:

1) **note** that the Review has consulted on a preference for deposits that would establish a priority claim for preferred deposits against the assets of a failed deposit taker ('depositor preference')

2) **note** that the decision on whether to introduce a preference, and how it is designed, requires judgements about who should bear the costs of deposit insurance and losses in the event of failures and about the importance of reducing operational risks and complexities in a resolution

3) **note** that we are also seeking further decisions on the high-level design of the funding framework for deposit insurance

4) **agree** that the deposit insurance fund should be managed by the deposit insurer

   Agree/disagree

5) **agree** the funds of the deposit insurance scheme can be drawn on for the purpose of protecting insured depositors in resolutions (outside of a liquidation and payout)

   Agree/disagree

6) **note** that use of the funds by the resolution authority would be subject to safeguards and we will seek a delegation from Cabinet for you and your associates to sign out the safeguards

7) **agree** to either:

   a. make no changes to the creditor hierarchy so that the costs of deposit insurance are more likely to fall on those who benefit under the scheme, with the ability to mitigate risks to the Crown through the charging of levies and the deposit insurance fund, and to facilitate resolutions that protect insured depositors through the use of the funds of the scheme (Treasury position)

   Agree/disagree

   OR

   b. a preference for the deposit insurance scheme in order to enhance the effectiveness of resolution tools that protect insured depositors and align with decisions you have already taken on the scope of bail-in powers, with the impact on uninsured creditors heavily mitigated by higher capital requirements and the enhanced crisis management framework delivered through the DTA (Reserve Bank position)

   Agree/disagree

8) **note** that a preference that includes all depositors would better facilitate the transfer of the entire deposit book to an acquiring entity or bridge bank, without requiring

significant public funding, and reduce the likelihood of depositors facing losses in resolutions of larger banks.

9) **note** that the Reserve Bank and Treasury do not recommend a preference that includes all depositors, as this approach would pose risks to the ability of small deposit takers to attract and retain uninsured deposits, and to issue wholesale funding

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

Refer/Not referred

Tamiko Bayliss
Director, Reserve Bank Act Review

Hon Grant Robertson
Minister of Finance

Purpose of Report

1. This Report advises you on:

- how the deposit insurance scheme (DIS) would operate in the absence of a depositor preference, including remaining high-level decisions on the funding framework (section 1)
- whether to introduce a preference for the DIS, meaning that it would receive payment in a liquidation before uninsured depositors and other unsecured creditors (section 2).
- the pros and cons of preferring all depositors to other unsecured creditors, and the different options for how this could be done (section 3).

2. Regardless of whether a depositor preference is introduced, insured depositors will be fully protected up to the coverage limit and receive prompt access to those funds. A preference would, however, alter the losses faced by the DIS, and how deposit insurance is integrated into resolution tools.

3. **Annex 1** provides an overview of the trade-offs between the options assessed in the Report.

Deposit insurance scheme with no preference

You have agreed to high-level aspects of the funding framework

4. The deposit insurance scheme will be fully funded by deposit takers – any losses that are made on the scheme over time will not be borne by the Crown. Ministers would have flexibility to allocate levies across deposit takers and over time, with the DTA providing high-level legislative principles to guide these decisions. The Minister will publish a Funding Strategy that will be required to explain the approach to setting levies, as well as other aspects of the funding for the DIS.

5. You have agreed that a deposit insurance fund should be established to increase the public legitimacy of levies by strengthening their link with the purpose of depositor protection. You have also agreed that Ministers can choose to charge levies with the objective of building reserves in the fund. Under this approach, the fund would also aim to support public confidence in the ability of the scheme to payout depositors, by providing a ready source of funds that can be drawn on without recourse to the Crown backstop.

6. You have agreed to a crisis management framework where creditors should not be left worse off than they would have been under a normal insolvency process (the 'no creditor worse off' or 'NCWO' principle) and, if they are, then they should be compensated financially. The Review needs to ensure that resolution tools and the creditor hierarchy are structured so that they are able to work together to enable the orderly resolution of a failed institution without transgressing the NCWO principle and creating an NCWO compensation liability.

The Deposit Insurance Fund can be used to reduce the likelihood of calling on the Crown backstop

7. The Reserve Bank and the Treasury recommend that the fund is managed by the DIS (ie the Reserve Bank). This would give the DIS greater control over payout outcomes it is responsible for and simplify payout processes for small deposit takers where the backstop does not need to be drawn on. The legitimacy of the levies may be further enhanced by having funds managed by the agency tasked with protecting depositors and at arm's length from the Crown. The DIS will have a legislative function to manage the fund and it would be expected to do this in a way that is consistent with the purpose of protecting depositors and thereby contributing to financial stability.

8. The Crown would still need to manage its liability to fund payout amounts that exceed the size of the fund, and would therefore have an interest in the management of the fund with a view to ensuring that overall Crown liquidity risks are well managed. The Minister will set out, on the advice of the DIS and the Treasury, how the fund should be managed and invested as part of the Funding Strategy.[1] We also expect that the Treasury and the Reserve Bank will establish a Memorandum of Understanding so that there are sufficient information flows relating to liquidity management.

9. The future decision on the size of the fund, and the timeframe over which it reaches that size, will require Minister's to set a risk appetite for providing funds through the Crown backstop. There will be a trade-off between the benefits for the Crown of reducing its borrowing requirement against adding to the cost of financial intermediation through higher levies. Seeking to build reserves in the fund would also concentrate the burden on deposit takers – and likely their depositors – during the early years of the DIS. The deposit insurance fund would not eliminate the need for a Crown backstop.[2]

The DIS should be able to contribute to non-liquidation resolutions

10. We recommend that the Reserve Bank as resolution authority be able to draw on DI funds for resolutions (other than a liquidation) for the purpose of protecting insured depositors. This would allow for deposit insurance to be integrated into resolution tools without any changes to the creditor hierarchy, to ensure that depositors would receive prompt access to funds regardless of the resolution method used. The approach is also consistent with resolutions potentially resulting in better outcomes for insured depositors and the DIS, relative to a liquidation (which can involve large fixed costs and would require the DIS to execute a payout process to reimburse depositors).

[1] A possible outcome is that Ministers set out an expectation that levies are held in off-market government securities to minimise efficiency costs, consistent with the model currently used for the Natural Disaster Fund managed by EQC. This would reduce some of the inefficiency in duplication of liquidity management between the DIS and the Treasury.

[2] A rule of thumb used overseas is that the DIS should seek to build 1-2 percent of insured deposits ($ 1-2 bn) during its first 10 years. If the resulting levies were to be fully passed on to insured depositors, their deposit rates would fall by 10-20 basis points per annum. All else equal, the size of the deposit insurance fund is likely to be lower if the Government decided to give a priority claim to DIS.

11. The use of the funds by the resolution authority would be subject to safeguards that ensure that the funds are being used in a manner that is consistent with the purpose of protecting depositors. Guidance from the International Association of Deposit Insurers (IADI) suggests that these safeguards should include the need to demonstrate that the contribution of the DIS would not exceed the cost of a liquidation (after recoveries) and the resolution will place insured deposits in a viable entity. We will seek a delegation from Cabinet for you and your associates to sign out the final safeguards.

Deposit insurance could be operationalised without depositor preference

12. The Treasury supports introducing deposit insurance without a depositor preference.

13. Without any change to the creditor hierarchy, the costs of introducing deposit insurance would be more likely to fall on those who benefit from the scheme. Deposit takers benefit from more stable funding as a result of the DIS, and would pay for the losses of the DIS through levies over time. These costs would potentially be passed on to depositors, who benefit from being promptly compensated up to $100,000 in the event of failure.

14. Depositors would be promptly reimbursed under all resolution tools without the introduction of a depositor preference. For example:

    a. Another deposit taker may wish to acquire the insured deposits and certain assets of a failed deposit taker through a purchase and assumption (P&A) transaction. In such a case, the DIS would be able to provide cash or other assets to increase the likelihood of this transaction proceeding. Insured depositors would receive prompt access to protected funds and ongoing account services at the purchasing deposit taker, and the upfront costs to the DIS are likely to be substantially lower than a deposit insurance payout. The provision of cash or assets by the DIS would mean that the resolution can be undertaken in a way that protects depositors and does not require a NCWO payment.

    b. Flexibility to use the funds of the DIS in resolutions would also facilitate integration of deposit insurance with Open Bank ResolutionThe DIS could provide upfront funds to 'top-up' the deposits of insured depositors based on an estimate of the haircut they would face in line with the creditor hierarchy, or an indemnity could be provided to the statutory manager to allow it to draw on the assets of the DIS to make payment to depositors. Introducing a preference for the DIS would further reduce complexity in integrating deposit insurance with OBR (see next section).

Preference for the deposit insurance scheme

15. This option would give insured depositors priority (i.e. a higher ranking claim in the creditor hierarchy in relation to their insured deposits) over other unsecured creditors in a liquidation. In practice, this would mean that the deposit insurance scheme would have preferred access to the failed deposit taker's assets, as it will subrogate for ('stands in the shoes of') the claims of insured depositors after they have been compensated.

16. Depositor preference (in some form) has become increasingly common in other jurisdictions. A recent survey conducted by IADI found that, of the 73 respondents, 71 percent had some form of depositor preference.

17. The Reserve Bank recommends that a preference for the deposit insurance scheme is introduced.

Implications for the funding model of the DIS

18. A preference for the DIS weakens the link between who bears the immediate costs of the scheme and its beneficiaries. Losses would be borne in the first instance by the uninsured depositors and other unsecured creditors of the failing deposit taker, rather than those who benefit from the DIS. The change to the creditor hierarchy would be clear ahead of failures, and to some extent non-preferred creditors may be able to shift the costs back to deposit takers by seeking compensation through higher returns (see section below 'implications for deposit takers').

19. A preference for the DIS reduces the likelihood that the DIS would face losses in a liquidation to near-zero at the vast majority of deposit takers.[3] In terms of insurance pricing, this means that the expected cost of providing insurance be near-zero, which would be likely to reduce the levies collected under the DIS (and the size of the fund would likely be lower than otherwise). However, an ex ante fund may still play a role in providing an additional funding source for immediate payout to insured depositors.

20. A preference for the DIS would also mean that any contribution made by the Crown through the backstop would almost certainly be repaid at the end of a liquidation. As a result, it would be less likely that the Crown would fund losses to the DIS for an extended period of time (which would otherwise happen if failures occur before a fund is built, or losses turn out to be larger than anticipated) or need to charge large *ex post* levies (which could further weaken economic activity in the aftermath of a financial crisis).

Reducing complexity of resolution tools

21. A preference for the DIS would better facilitate the integration of deposit insurance with certain resolution tools, such as P&A transactions or existing resolution tools such as OBR. Although resolution tools can be facilitated to protect depositors with no change to the creditor hierarchy, a preference for the DIS would enable the Reserve Bank to execute resolutions in a way that protects depositors with the greatest possible speed and certainty.

22. [36].

23. A preference for the DIS would also better align with the decisions you have recently taken to exclude insured deposits (and by implication, the DIS) from the scope of bail-in. Placing the DIS higher in the creditor hierarchy would also reduce any potential NCWO compensation that may be payable if the bail-in tool were applied to liabilities other than those prepositioned and subordinated as part of open resolution planning. Without a preference for the DIS, there is a greater likelihood that NCWO issues may arise when using bail-in as part of a closed resolution.

[3] Reduced losses also extend to other resolution tools with the introduction of the no creditor worse off principle. Outside of the credit union sector, other deposit takers receive more than half of their funding from creditors that would rank below the DIS, This means that losses would have to reach exceptionally high levels based on international experience before the DIS makes a loss.

24. If you do wish to maintain a *pari passu* framework, then there may be a need to expand the eligibility for statutory bail-in to include insured deposits. This will not impact the outcome for insured depositors, who will be made whole in all cases, but it will mean that statutory bail-in powers can be used with losses imposed on the deposit insurance scheme rather than creating a NCWO exposure. This will enable better management of the potential exposure, and ensure that NCWO remains a backstop protection for creditors, rather than a critical mechanism through which we facilitate resolutions

Implications for deposit takers

25. Although deposit takers would likely benefit from lower levies, a preference for the DIS may result in a small increase in the cost of funding from non-preferred creditors. [4] That is, compensation may be sought ahead of a crisis for the increased losses they would face in the event of failure, especially among more sophisticated wholesale investors that routinely monitor the risk-taking of their bank. This may be beneficial for the stability of the financial system to the extent that more market discipline is applied.

26. The benefits to small deposit takers associated with lower levies may be offset by challenges attracting and retaining uninsured deposits or wholesale funding as a result of the preference for the DIS.[5] However, ordinary depositors are likely to treat deposits as a safe investment regardless of the creditor hierarchy. In addition, risks to competition need to be assessed in light of the introduction of deposit insurance and the proposed $100,000 coverage limit, which will likely see smaller deposit takers more easily able to attract funding up to the coverage limit.

An option to prefer all depositors

27. The scope of a preference could be broadened to cover uninsured depositors, either through a general depositor preference (all depositors rank equally ahead of wholesale creditors) or a tiered depositor preference (the same as general preference except the DIS ranks ahead of uninsured depositors). This section focusses on general preference and then concludes by outlining the main differences between these two options.

28. A general or tiered preference were discussed in the consultation materials for the final consultation on the Review. However, the proposal for consultation focussed on the options of retaining the status quo creditor hierarchy or introducing a preference for the DIS. Deposit takers are strongly against the introduction of a general or tiered preference, while three submissions were made in support. The IMF normally recommends either a general or tiered preference in its Financial Sector Assessment Programmes.[6]

29. The Reserve Bank and Treasury do not recommend the introduction of a general or tiered preference.

[4] A preference for the DIS would prefer fewer creditors than a general or tiered preference, and so would have a materially lower impact on wholesale funding costs. See footnote 7 for a summary of the evidence on the increase in funding costs resulting from general preference.

[5] The base of creditors that stands first in line to absorb losses (after capital) in the event that these small deposit takers fail would shrink, therefore concentrating losses. For example, consider a small deposit taker with $100 in assets is funded with $10 capital, $45 uninsured deposits and $45 insured deposits. If the deposit taker fails with losses of $30, an uninsured depositor with $150,000 receive approximately $125,000 under a preference for the DIS vs almost $140,000 without.

[6] See https://www.imf.org/en/Publications/TNM/Issues/2020/12/22/The-Case-for-Depositor-Preference-49766

Implications for resolution tools

30. A general preference would effectively improve the safety of uninsured deposits. The likelihood of depositors bearing losses would be made more remote by prioritising their claim over other unsecured creditors, on the basis that depositors are less well placed to monitor risk than wholesale creditors and that deposits play an important role in facilitating economic activity. This would primarily benefit depositors at the major banks, given that other deposit takers do not use a material amount of non-deposit funding.

31. A general preference may help strengthen the *ex ante* commitment to allow a major deposit taker to be resolved, by reducing the likelihood that uninsured depositors bear loss. Uninsured deposits could include the working capital of small and medium-size businesses, or individuals' lifesavings beyond the $100,000 coverage limit. A general preference will not impact significantly on the decision making around the failure of a smaller deposit taker.

32. The likelihood of uninsured depositors facing losses in the future will, however, be mitigated by other reforms. The Reserve Bank is introducing substantially higher capital requirements in coming years and will be able to require deposit takers to preposition additional liabilities that could be bailed-in ahead of depositors in the event of failure. The Reserve Bank will be required to consult the Minister of Finance in preparing the statement of approach to resolution, which could include discussing whether the planned approach relies too much on imposing losses on uninsured depositors.

33. Any residual benefits of extending the scope of preference would apply in resolutions where the deposit taker has a substantive amount of wholesale funding. In the event that a major bank is subject to bail-in, for example, the likelihood of losses being imposed on depositors would be made even more remote. It would also facilitate resolutions that involve the transfer of an entire deposit book, as long as sufficient healthy assets and wholesale creditors exist at the failed deposit taker. This could include a P&A resolution of a smaller deposit taker that has a reasonable amount of unsecured, non-deposit funding. In the absence of general preference, the use of resolutions that transfer the entire deposit book would likely result in a NCWO payment and require the Government to support the resolution with public funds.

Implications for deposit takers

34. Extending the scope of preference would concentrate losses on wholesale investors, and would be expected to result in a larger ongoing increase in wholesale funding costs for deposit takers than under a preference for the DIS. Furthermore, a general preference would create a sharper boundary between depositors and wholesale investors. At the margins of the boundary the distinction between wholesale creditors and large depositors would be somewhat arbitrary, and there would be a risk that non-deposit funding is transformed into deposit funding to take advantage of its preferential status.

35. Engagement with institutional investors suggests that the increase in funding costs would be moderate. International evidence also suggests a moderate impact is likely, and that the impact is context-specific.[7] The implementation of the Reserve Bank's capital review is likely to assist in minimising any additional funding costs of non-preferred creditors.

[7] The IMF cites staff analysis of the introduction of tiered preference in European countries. The analysis found that overall funding costs did not increase for the large banks in the study, although the spread between deposit and bond rates increased by between 40 and 70 basis points (due to a decline in deposit rates).

36. The major banks are likely to benefit from a reduced cost and improved stability of deposit funding, owing to the greater safety that a general preference affords their depositors. The financial system would benefit from the increased market discipline that is likely to be applied to major banks.

37. Small deposit takers are likely to find it more difficult to attract and retain deposits or access wholesale markets under a general preference. Although the amount of losses faced by depositors at small banks would be unaffected, their relative safety would decline as a result of general preference.[8] In addition, smaller deposit takers would face a higher cost of wholesale funding if they were to make greater use of these markets in the future, which may limit their ability to grow.

38. A tiered depositor preference would combine the benefits of a general preference with a preference for the DIS. It would enhance the recoveries of the DIS in a liquidation, and support the effectiveness of resolutions that protect insured or all depositors. However, a tiered preference would introduce more complexity into the creditor hierarchy and would pose the same risks to small deposit takers as a general preference.

39. If you decide that uninsured depositors should be included within the scope of the preference scheme, you can request further advice from officials on how this should be done, which could be provided as part of the cover note for the Cabinet paper for the Deposit Takers Act.

[8] For example, if the bank in footnote 5 had $20 in wholesale funding (which replaced deposits) at the time it failed, no depositors would suffer a loss under general preference.

Annex: High-level benefit analysis of depositor preference options.

	Deposit insurance with no depositor preference (baseline and Treasury recommendation)	A preference for the deposit insurance scheme (Reserve Bank recommendation)	General depositor preference**
Option	*Levies cover the long-run costs of the scheme and the Minister can use levies to build reserves in the Deposit Insurance Fund.*	*The claims of the DIS against the failed deposit taker are preferred to all other unsecured creditors. Levies may be lower reflecting the reduced expected losses of the DIS.**	*Depositors are preferred to all other unsecured creditors (and DIS ranks equally with uninsured depositors).*
Distribution of costs of depositor protection and resolution losses	0 Deposit takers and (to the extent passed on) depositors that benefit from the DIS are pay for the costs of the DIS through levies. Losses in the event of failure distributed equally across unsecured creditors.	- DIS losses are shifted to uninsured depositors and wholesale creditors, shifting the incidence of the costs of the DIS away from those who benefit from the scheme. Reallocation of losses may result in a small increase in market discipline.	? Costs of failure concentrated on as wholesale creditors (if any). Uninsured depositors receive additional protection at major banks with wholesale funding. Reallocation of losses may result in increased market discipline.
Credibility and effectiveness of resolution tools	0 Resolution tools can be integrated with deposit insurance but with more complexity.	+ Reduce complexity in using resolution tools that protect insured depositors such as OBR, purchase and assumption. Aligns with decisions already taken on scope of bail-in powers.	0/+ May strengthen *ex ante* commitment to resolve large deposit takers by reducing the likelihood that losses are imposed on uninsured depositors.
Role of the Crown backstop	0 Reliance on Crown backstop can be materially reduced through building reserves in the deposit insurance fund.	0/+ Improved speed and amount of recovery for backstop funds for all resolutions. Very low likelihood the Crown needs to fund losses to the DIS for an extended period.	0 Reliance on Crown backstop can be materially reduced through building reserves in the deposit insurance fund. Recoveries from resolutions of major banks increased, but not for smaller entities.
Ability of small (primarily deposit-funded) deposit takers to compete	0 Pay higher levies reflecting higher risks to the DIS. Will find it easier to attract deposits up to the coverage limit (applies to all options).	0 Lower levies due to reduced risk to DIS. Higher losses for uninsured depositors held at small deposit takers (relative to large deposit takers with wholesale funding).	- Pay higher levies reflecting risk to the DIS. Uninsured depositors at large banks likely to bear smaller losses (relative to small deposit takers).
Funding costs of deposit takers	0 Deposit takers pay for the costs of the DIS through levies.	0 Small increase in funding costs for wholesale funding, offset by lower cost of deposits.	- Moderate increase in the cost of wholesale funding, may be offset by decline in cost of uninsured deposits for major banks.
Choose this option to…	*Allocate costs of the DIS to those who benefit from insurance, with an option to mitigate reliance on backstop through building reserves in the fund.*	*Enhance effectiveness of resolution tools that protect insured depositors, acknowledging that DIS costs are shifted to uninsured depositors and wholesale creditors.*	*Facilitate transfer of entire deposit book and reduces likelihood of depositors facing losses in resolutions of major banks, acknowledging that there are greater risks to the ability of small deposit takers to attract and retain deposits and raise wholesale funding*

* A preference for the DIS does not alter the size of the payout that needs to be funded at the point of failure, but will increase the speed of the recovery. The Minister would have flexibility to continue to charge the same levies with a preference for the DIS, if he or she placed a high weight on reducing reliance on the Crown for upfront funding of payout. In this case, a preference for the DIS would have a larger negative impact on competition and the funding costs of deposit takers.

**A further option is a tiered depositor preference that would prefer all depositors to other unsecured creditors and rank the deposit insurance scheme ahead of other depositors. A tiered preference would achieve the same benefits as a preference for the DIS and general preference for effectiveness of resolution tools, but would have the largest negative impact on competition and dynamism.