



Phase 2 Review of the RBNZ Act 1989 – Deposit Takers Act (DTA)

Ministerial workshop – DTA Cabinet advice

April 7 2021



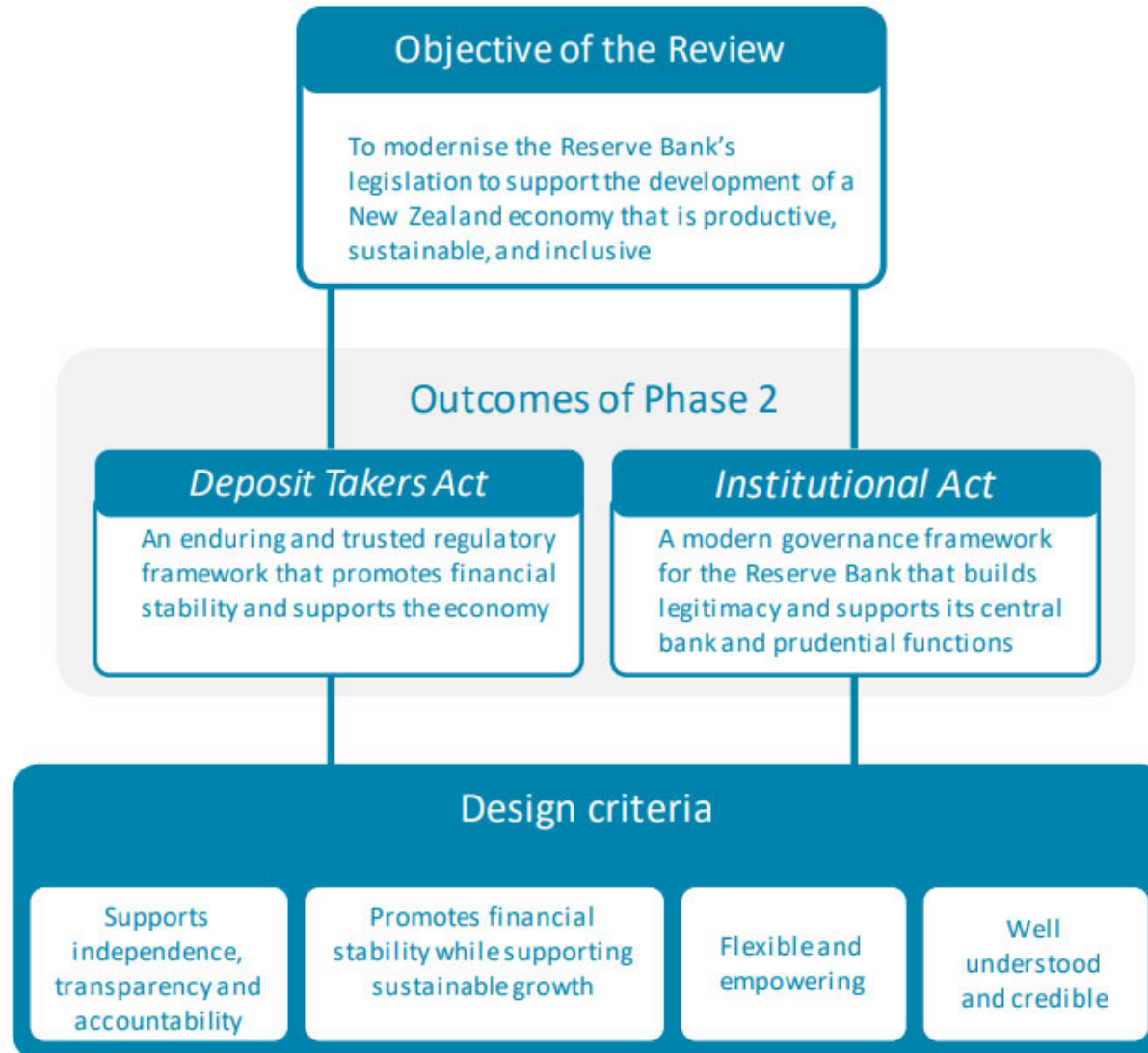
Outline of session

- Background
- Deposit Takers Act – Cabinet recommendations
- Annex: RBNZ Bill

Background

- Nov-2017 new incoming Government announced a review of the RBNZ Act 1989 to create a modern monetary & financial policy framework
- **Phase 1:** focus on monetary policy framework – *completed*
 - Additional objective – ‘maximum sustainable employment’
 - Shift to a committee-based decision-making process (Monetary Policy Committee)
- **Phase 2:** focus on the financial policy aspects of the RBNZ Act – *ongoing*
 - Broadly scoped review – [terms of reference](#) (June 2018), partly informed by New Zealand IMF FSAP 2016/17
 - Joint Treasury and Reserve Bank led review – working-level staff co-located at Treasury
 - [Independent Expert Panel](#) appointed by Minister to support policy process & provide quality assurance
 - Three public consultations
 - Current RBNZ Act ‘split’ into two pieces of legislation – an ‘Institutional Act’, and a new prudential framework for deposit takers and deposit insurance

Phase 2 Review's objectives and design criteria



Deposit Takers Act – Cabinet advice



Overview of Cabinet advice

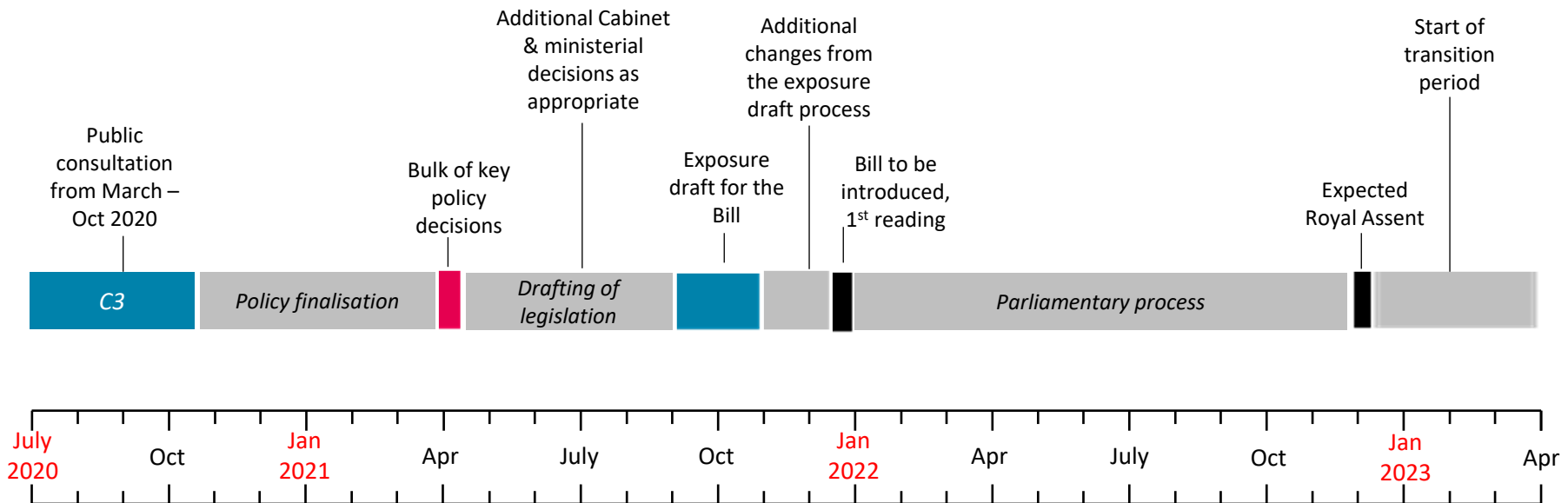
- Cabinet advice focussed on **foundational** decisions necessary for a new prudential framework for deposit takers and introduction of deposit insurance, organised into four separate papers:
 - Cabinet Paper 1: **Overview**
 - Cabinet Paper 2: **Framework for the regulation and supervision of deposit takers**
 - Statutory purposes and principles
 - Regulatory perimeter
 - Standards and licensing
 - Director liability regime
 - Supervisory and enforcement powers
 - Cabinet Paper 3: **Deposit insurance**
 - Cabinet Paper 4: **Crisis management and resolution**

Timelines for Cabinet decisions

- Review team incorporates feedback from ministerial and agency consultation **1-6 April**
- Final version of Cabinet papers to the Minister of Finance **7 April**
- Lodgement of Cabinet papers **8 April**
- DEV **14 April**
- Cabinet **19 April**
- RBNZ prepares drafting instructions for PCO
- 2nd order policy issues addressed in parallel with drafting
- Exposure draft for public consultation (**around August/September**)


Minister expects introduction before end of 2021


Depositor Takers Act



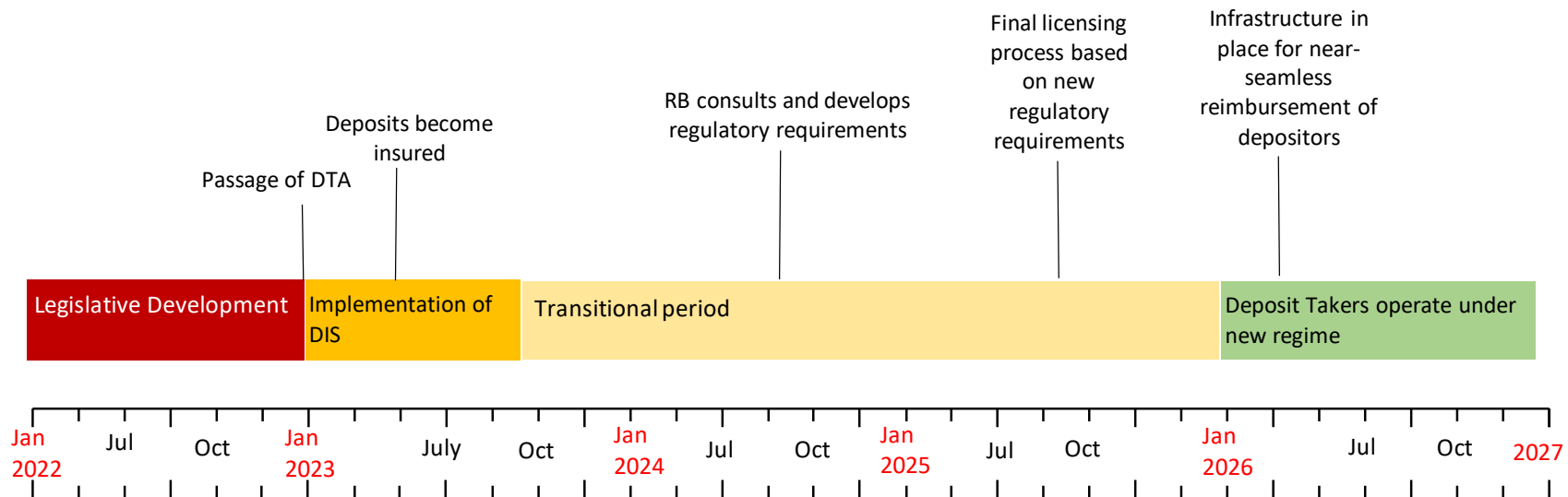
Key :

 Planned public consultation

 Planned Cabinet sign-Off

 Key milestone

Expected process for implementing the new deposit takers regime



- Substantial work to develop regulatory requirements and complete licensing once DTA is passed
- Deposit insurance scheme (DIS) targeted for commencement in mid-to-late 2023, ahead of the rest of the DTA
- Depositors will be protected during the transition, and additional risks from bringing forward implementation are manageable

Deposit insurance



The Review has received stakeholder feedback supporting a higher limit

Table: Comparison of different coverage limits using updated data from deposit takers

	Coverage limit		
	\$50,000	\$100,000	\$250,000
% of depositors fully covered	89%	93%	97%
% value of deposits covered	27%	38%	54%
\$ value of deposits fully covered (gross exposure for the Crown)	\$86 billion	\$122 billion	\$174 billion

- NBDTs and small banks raised concerns about the impact of a \$50,000 limit on their stability and liquidity
- Increasing the limit to \$100,00 would also increase confidence in safety of deposits, reduce implicit guarantees and respond to broader stakeholder concerns
- More intensive supervision and use of risk-based levies expected to mitigate risks associated with greater Crown contingent liability

The role and governance of the deposit insurance scheme

- **Deposit insurance scheme (DIS)** will seek to “protect [insured] depositors and in so doing contribute to financial stability”.
- The **deposit insurer** will be located in the Reserve Bank and will have:
 - A statutory purpose to promptly reimburse eligible depositors in a liquidation
 - Duties to promote public awareness, monitor risks to the DIS; collect levies; and administer, operate and invest the deposit insurance fund
- The Board will be responsible for the role of deposit insurer but can delegate functions to a legally separate subsidiary
- The **resolution authority** (also located in the Reserve Bank) will be responsible for “protecting [insured] depositors” in non-liquidation resolutions

Depositor preference

- Review has consulted multiple times on various options for depositor preference and C3 consulted on two proposals:
 - **Status quo:** may better allocate costs of deposit insurance to those who benefit from insurance.
 - **Preference for the DIS:** enhances effectiveness of resolution tools that protect insured depositors.
- Some stakeholder feedback supportive of **general depositor preference** to facilitate resolutions that protect all depositors
- Finely balanced recommendation to introduce deposit insurance without any change to the creditor hierarchy

Funding framework

- Cabinet has made an in-principle decision that the DIS will be **fully funded**
- A **deposit insurance fund** will support public perceptions that levies are being used consistent with the purpose of the DIS
- Legislation will require the Minister to set the **funding strategy** for the scheme at least every 5 years
- Funding strategy will be guided by legislative principles and must cover:
 - risks to the DIS
 - guidance for levy-setting
 - the approach to management of the fund
 - how the Crown's role as backstop will be managed
- Minister will **set levies** based on the funding strategy and advice of the deposit insurer

Product boundary and the role of the DIS

Eligible depositors

- Cover transactional, savings and term deposits currently offered by registered banks, and the equivalent products offered by other licensed deposit takers
- Product boundary set in legislation, with an ability to add substantively similar products through regulations

Eligible depositors

- Exclusions for more sophisticated depositors that can be readily identified
 - Financial institutions, related parties, large non-financial corporates, Government bodies + FX.
- More detailed rules (e.g. trusts) to be set via regulations

Ensuring clarity for investors

- Word “deposit” can’t be used when marketing ineligible products

Statutory purposes and principles



Background to the purposes

- Cabinet has previously agreed that the Reserve Bank will have a new financial objective based on *protecting and promoting the stability of New Zealand's financial system* that will sit in the new RBNZ Bill. This singular objective is a change from the dual objective in the 1989 Act, which uses the language of “sound and efficient.”
- The financial stability objective is not an end in itself, but rather a means of supporting the overarching statutory purpose of the RBNZ Bill, which is to *promote the prosperity and wellbeing of New Zealanders and contribute to a sustainable and productive economy*.
- Following consultation, we are now proposing the following set of specific purpose clauses for the DTA, to build on from the financial stability objective:
 - Promote the safety and soundness of individual deposit takers
 - Promote public confidence in the financial system
 - Mitigate the risks that arise to and from the financial systemand, in doing so, contribute to protecting and promoting the stability of New Zealand's financial system.

Decision-making principles

- Cabinet has also previously agreed that the Reserve Bank will have a set of decision-making principles, that will guide the exercise of powers under the DTA, and ensure that a range of factors are taken into account when the Reserve Bank is pursuing its objectives.
- Decision-making principles also present in other sectoral legislation: Insurance (Prudential Supervision) Act, Non-bank Deposit Takers Act and the Financial Market Infrastructures Bill.
- The recommended decision-making principles are:
 1. The desirability of minimising unnecessary costs of regulatory actions
 2. 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
 3. The desirability of sectors regulated by the Reserve Bank being competitive, taking into account the size of the market
 4. The value of transparency and public understanding of the Reserve Bank's objectives and how the Reserve Bank's functions are exercised
 5. Consideration of the practice by relevant international counterparts carrying out similar functions, as well as guidance and standards from international bodies
 6. The desirability of taking into account long-term risks to financial stability

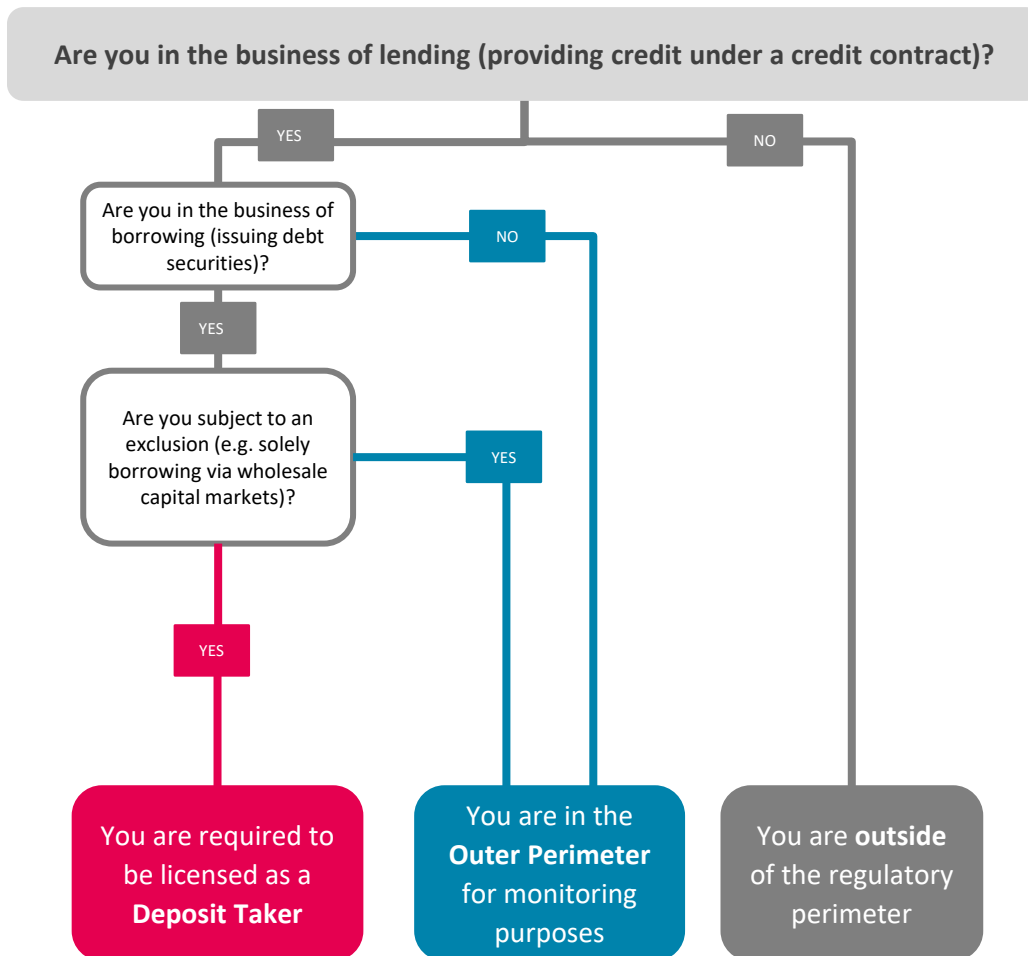
Themes in submissions

- A number of stakeholders have expressed concern by the ‘relegation’ of efficiency (and related concepts) within the legislative hierarchy. In part, this concern is a re-litigation of Cabinet’s earlier decision around changing the Reserve Bank’s financial policy objective from ‘soundness and efficiency’ to a singular focus on ‘financial stability.’ Similar concerns have also been expressed in the select committee process for the RBNZ Bill.
- Unpacking efficiency concepts into the decision-making principles retains the single, clear objective:
 - It allows for a detailed expression of what is meant by efficiency. The submissions demonstrated that it can mean different things (e.g. competition, market diversity, allocative efficiency) to different people.
 - Including it in this way also ensures that efficiency concepts remain very influential when the RBNZ is exercising its powers under the DTA.
- Some other stakeholders also expressed concern that the Reserve Bank Bill’s overarching purpose tied to well-being did not seem flow through to the DTA. The well-being purpose is an important part of the overall legislative hierarchy and we will work with drafters to ensure that it is carried across to the DTA.

Regulatory perimeter



Regulatory perimeter



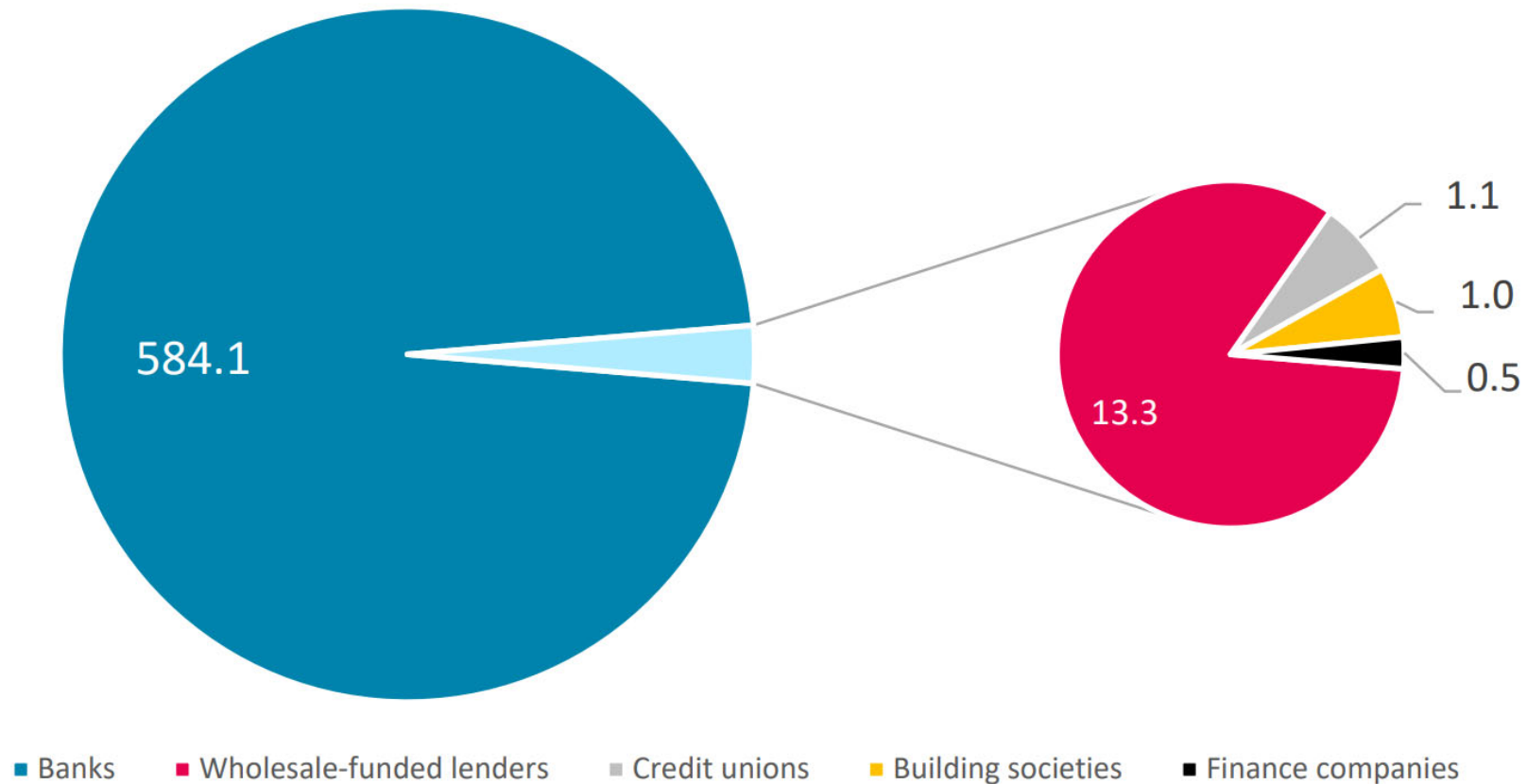
Focusses on entities that borrow from retail customers/investors, or that otherwise offer 'deposit'-type products

Would capture:

- Retail banks
- Wholesale banks
- Credit unions
- Building Societies
- Retail funded finance companies

Other wholesale-funded lenders would not be licensed or supervised but would be within an 'outer perimeter' for monitoring purposes

Bank and non-bank lending sector assets



Billion NZD as at September 2019

Approach to small deposit takers

Background

- Risk that smaller deposit takers may struggle to meet the compliance burden associated with a 'bank-like' level of prudential regulation
- Need to balance the benefits of a diverse deposit taking market against the need to provide sufficient assurance of the soundness of all deposit takers

Proposed approach

- Flexibility for the Reserve Bank to calibrate the approach for smaller deposit takers, with decision-making principles supporting proportionality and competition. Other factors, such as financial inclusion, could be included in the *Financial Policy Remit* issued by the Minister of Finance
- Equivalent treatment to banks under conduct legislation. Existing disclosure, governance and supervision exclusions for registered bank would be extended to all deposit takers (as these issues will be addressed under the DTA)
- The Reserve Bank would determine which deposit takers are permitted to call themselves 'banks', in accordance with a published policy. Factors such as financial strength would be taken into account

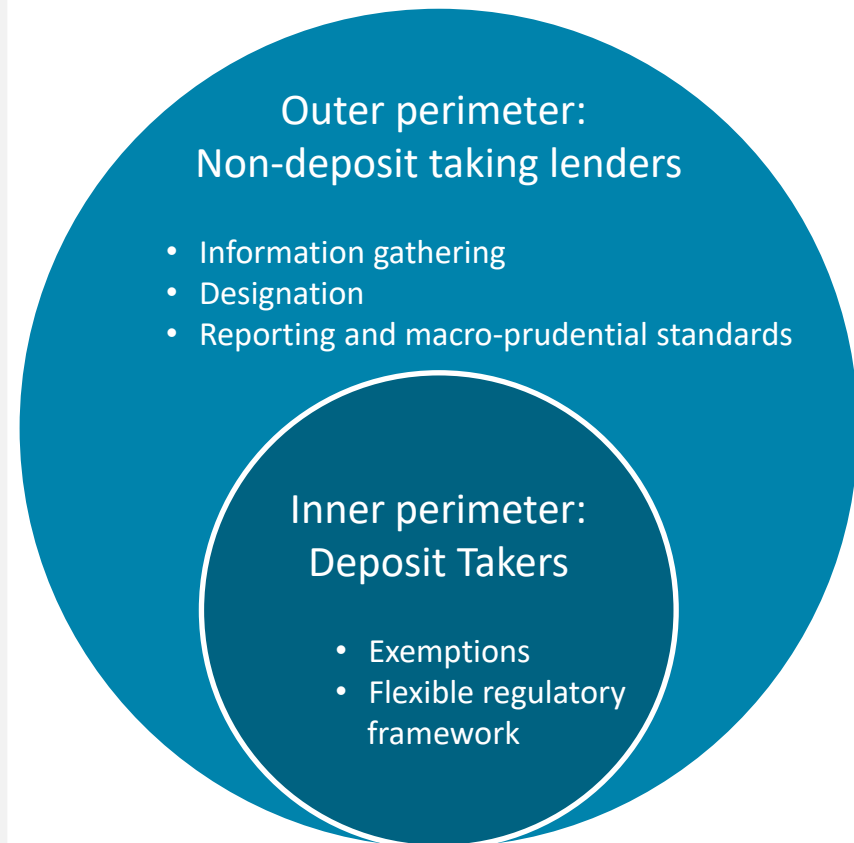
Approach to finance companies

- Retail funded finance companies (i.e. those that issue debentures or term deposits to retail customers) would continue to be prudentially regulated and would be able to take insured deposits
- There will be a need to manage the moral hazard risks associated with insuring finance company term deposits (a reduction in market discipline could lead to lower lending standards and high lending growth)
- The Reserve Bank will use higher barriers to entry, prudential standards, more intensive supervision and risk-based insurance pricing to manage the moral hazard risks associated with insuring finance company term deposits

Perimeter flexibility

Proposed approach

- Monitoring of non-deposit taking lenders for both financial stability risks and regulatory arbitrage
- Use of the Financial Service Providers Register to support monitoring
- Power to designate entities as deposit takers on the basis of the economic substance of their business
- Enable the Reserve Bank to set reporting standards and lending standards in relation to categories of non-deposit taking lenders that are prescribed via regulations
- Empower the Reserve Bank to exempt entities from requirements under the DTA



Prudential standards and licensing



Standards

- Cabinet has agreed that ‘standards’ will be the Reserve Bank’s main tool for imposing prudential requirements on deposit takers
- Standards will replace **conditions of registration** for banks and **regulations** for non-bank deposit takers
- Standards are legislative instruments that will be drafted by the Reserve Bank and reviewed by Parliament’s Regulations Review Committee. This will increase accountability and legitimacy of the Reserve Bank’s prudential framework. The Committee can disallow standards if they are outside the empowering provisions in primary legislation
- The scope of standards will be set out in the Deposit Takers Act. This will cover the current Conditions of Registration, the Banking Supervision Handbook and the Basel Core Principles

Standards - process

- The Reserve Bank would be required to:
 - Prepare a **Regulatory Impact Assessment** (including reference to the **Financial Policy Remit**)
 - Consult with members of the Council of Financial Regulators (CoFR)
 - Consult publicly (except for minor amendments)
 - Inform the Minister of Finance of new standards or changes to standards (except for minor or technical changes)
 - Publicly notify changes to standards in the Gazette and the Reserve Bank website
- Lending standards will empower the Reserve Bank to use instruments such as restrictions on loan-to-value ratios (LVRs) and debt-to-income ratios (DTIs). The types of lending that lending standards can be applied to will be prescribed by regulation (see next slide)

Standards – role of the Minister

- The Minister can specify a government's 'risk appetite' and wider government goals in the **Financial Policy Remit** the Reserve Bank should have regard to in setting prudential standards to achieve its financial stability objective
 - Not a 'give effect to' requirement
 - Modelled after UK Chancellor's letters to the FPC and PRC, and content similar to the *Statement of Expectations* APRA is subject to
- The Minister will also have a role in defining the **types of lending** that lending standards can be applied to via regulations (which are made by the Governor General by Order-in-Council). The Minister can make regulations changing the types of lending covered by lending standards after **consultation** with the Reserve Bank (but the Minister will *not* be involved in calibrating lending standards)
- Deposit Takers Act will require Reserve Bank to **inform** Minister of new, or changes to, prudential standards. This formalises current convention

Licensing

- The Reserve Bank will license deposit takers in the new framework
- The proposed licensing process is:
 - Licensing would be based on the Reserve Bank's assessment of an applicant's ability to comply with the DTA, standards and licence conditions
 - Directors and senior managers meet fit and proper requirements
 - The Reserve Bank consults with the Financial Markets Authority before granting or declining a license
 - Applicants would be given notice and an opportunity to respond before a license is declined or license restrictions imposed
 - The Reserve Bank can impose license conditions on an applicant
- License applicants will have full appeal rights ('merits review') for fit and proper assessments and initial license decisions. Appeals on license conditions will be restricted to appeals on questions of law

Director accountability



Director accountability

- Cabinet has previously agreed that the accountability framework for directors of deposit takers will be strengthened and enhanced by the imposition of positive and on-going duties
- Currently, this regime rests on point-in-time 'attestations' made by directors to the Reserve Bank, with criminal liability attached for faulty disclosure
- As proposed, directors will instead have a 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, as well as appropriate defences

Director accountability

- The justification for this duty is the high social and economic costs of imprudently run deposit taking institutions, particularly large and systemically important banks, and that accountability should squarely rest on those individuals running these entities
- It is envisaged that this accountability regime for directors of deposit takers will be, in due course, incorporated within a broader financial executive accountability regime (to include executives, and to cover other financial institutions such as insurers, and reference conduct obligations). However, this is not within scope of the Review

Supervision and enforcement



Supervisory powers

- A focus of the Review has been on enabling a more intensive supervisory approach. This will support the Reserve Bank to actively monitor the health of regulated entities, verify information and assess compliance
- The most significant new tool is the proposed introduction of an on-site inspection power – allowing the Reserve Bank to perform unannounced and warrantless visits to sites of licensed deposit takers and insurers
- The new legislation will more generally modernise and strengthen the Reserve Bank's supervisory and information gathering powers to enable robust oversight of the financial system in the interests of financial stability, and to encourage active cooperation and coordination across the regulatory system

Enforcement tools

- The approach proposed by the Review is focussed on civil pecuniary, rather than criminal, penalties for breaches of prudential standards. Civil pecuniary penalties are more proportionate, easier to apply in practice, and in-line with the conduct 'peak'.
- Criminal penalties will remain for deliberate non-compliance with the directions of the Reserve Bank, and other intentional wrongdoing.
- As with the supervisory powers the Reserve Bank's enforcement powers will be modernised to provide flexible and empowering tools to direct entities, enter into enforceable undertakings, require action plans, and so forth.

Crisis management and resolution



Crisis Management

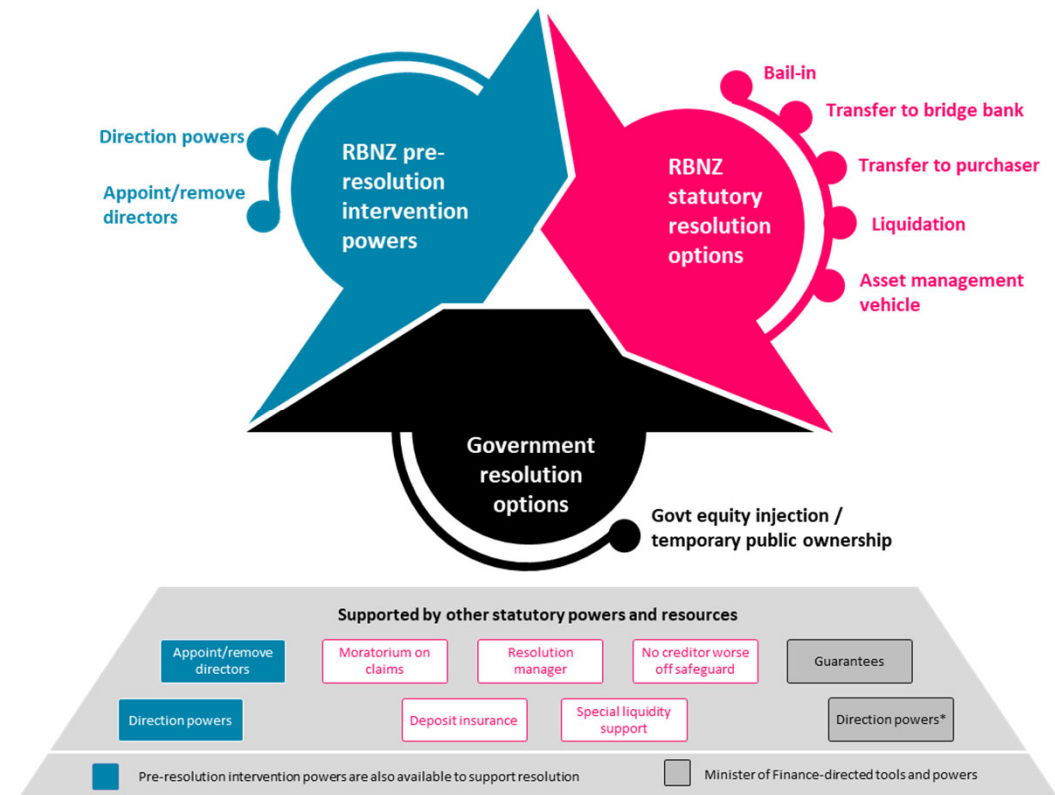
Alignment with international best practice

- Grounded in the Financial Stability Board's (FSB) **Key Attributes**
- Close reference to other jurisdictions' post-global financial crisis reforms
 - EU (BRRD)
 - UK (Banking Act 2009 etc)
 - Hong Kong (FIRO)
- Framework built around:
 - A designated resolution authority
 - Statutory resolution objectives
 - Clear criteria for entering resolution (before balance sheet insolvency)
 - Full suite of resolution powers
 - Best practice creditor safeguards (apply creditor hierarchy + NCWO)

Crisis Management

Cabinet Paper Proposes

- RBNZ as resolution authority with related functions, objectives
- Pre-resolution direction powers
- Broad powers including power to write down or convert liabilities to equity (bail-in). Existing powers of statutory manager transferred over (after further review)
- Minister authorises resolution except for 'open' resolution (a targeted bail-in that doesn't interrupt operations)
- Power for minister to direct conduct of resolution to safeguard risks to public funds (as a last resort)



* Proposed new power for the Minister of Finance to direct the Reserve Bank when public funds are at risk.

Crisis management

- RBNZ resolution planning function and 'Statement of Approach to Resolution' (public high-level statement on approach to resolving deposit takers)
- Bail-in power
 - Closely aligned with international practice (EU, UK). Power is broad but open bail-in is more targeted (at subordinated and prepositioned liabilities)
 - Resolution authority may set 'minimum requirements' of these liabilities

Key work remaining under delegated authority

- Design of compensation mechanism and appeal process ('no creditor worse of' [NCWO])
- Linkages with standard insolvency processes and creditor rights (e.g. to seek liquidation or cancel contracts)
- Final decisions after policy analysis of suite of existing powers of statutory manager
- Technical details of operating the bail-in power

Annex: Reserve Bank Bill



Reforming the RBNZ's institutional arrangements

- The Bill establishes a **new governance model** for the Reserve Bank...
 - Shifts from a single decision-maker model for governance and financial policy matters, to a collective, board-based model
 - Board will be responsible and accountable for all of the Reserve Bank's functions – other than monetary policy
- ... strengthens **accountability and transparency**...
 - Adopts updated accountability and reporting mechanisms, in line with modern New Zealand state sector practice
 - Strengthens monitoring and increases Auditor General and Ombudsman oversight
- ...and maintains Reserve Bank **operational independence**
 - The Reserve Bank retains operational independence in relation to both monetary and financial stability matters
 - Funding agreement, accountability framework and remits seek to balance independence and accountability considerations

Changes to the financial stability objective

- The Bill provides a clear **financial stability objective** for the Reserve Bank...
 - Replaces the existing 'soundness and efficiency' mandate
 - Improves clarity on the overall goal of the Reserve Bank's prudential functions
- ...balanced by a **financial policy remit**...
 - Issued by the Minister and reviewed at least every five years
 - Sets out Government policy preferences and objectives that the RBNZ must have regard to when setting prudential policy
 - Cannot require the performance or non-performance of a particular act
- ...and **decision making principles** in sectoral Acts
 - Require the RBNZ to take into account factors such as competition and regulatory efficiency