The Treasury

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Submission on the Statement of Funding Approach – Funding Strategy for the Depositor Compensation Scheme

25 September 2023

Christian Savings Limited

Credit Union Auckland Incorporated

Finance Direct Limited

General Finance Limited

Gold Band Finance Limited

Heretaunga Building Society

Mutual Credit Finance Limited

Nelson Building Society

Unity Credit Union

Wairarapa Building Society

Xceda Finance Limited

SUBMISSION ON THE STATEMENT OF FUNDING APPROACH - FUNDING STRATEGY FOR THE DEPOSIT COMPENSATION SCHEME (DCS) CONSULTATION PAPER (SOFA CONSULTATION)

Introduction

1. This submission on the SoFA Consultation is made on behalf of the non-bank deposit takers listed on the cover page of this submission (**NBDTs**).

2. Many of the NBDTs will be making their own submission. The purpose of this letter is to raise points of common interest and to provide an option for Treasury to meet collectively with the NBDT's or even a working group of them.

3. As many NBDTs will be making their own submission we are not responding formally to the questions in the SoFA Consultation.

Key submissions

4. We believe that:

   (a) the target fund size (of the DCS fund) should be on the lower end of the proposed range being 0.5 per cent of protected deposits, and

   (b) the timeframe for building the DCS fund should be 20 years.

5. We therefore believe option A (as detailed in Table 5 of the SoFA Consultation) is the right option for New Zealand now – we accept that this should be reviewed in light of any changes in the financial system over the next 5 years (including significant new competitors or major changes in market share for the deposit takers market).

6. We have set our reasons for these views below.

Target DCS fund size

7. We believe that the target DCS fund size should be on the lower end of the proposed range in the SoFA Consultation. The top-end of proposed target DCS fund size range, 1.1 per cent of protected deposits, is likely not sufficient to compensate losses as a result of the failure of one of the big 4 banks or Kiwibank. We therefore do not believe the target DCS fund size should consider a failure of one of these five banks. Instead, we believe the target DCS fund size should be predominantly focused on the costs (after recoveries) of the failure of a medium sized bank (with total assets ranging from roughly $2 to $10 billion) and the failure of a non-bank deposit taker. Furthermore, we believe that:

   (a) there is little risk of contagion impact from the failure of a small bank or small non-bank deposit taker and the loss should be viewed as a standalone loss – not across the sector as a whole given the regional and business model diversity that currently exists. For example, it is hard to see the failure of a finance company in Auckland impacting a building society or credit union in the Hawkes Bay (and vice versa); and

   (b) the loss given default ranges used do not appear to be based on current, New Zealand data. It is not plausible to use data from a period prior to non-bank deposit takers being prudentially regulated in order to assess maximum loss. The losses suffered by finance companies in the late 2000s/early 2010s are not indicative of the loss that would be suffered by modern, prudentially regulated non-bank deposit takers.

We believe a much more plausible loss given default range for non-bank deposit takers is the same as currently proposed for small banks 10% - 25%. We also believe, in light of banks having been recently required to increase their prudential capital ratios, and having higher prudential capital requirements than global norms, the loss given default ranges for registered banks should also be much lower. In accordance with Table 4 in the SoFA Consultation, this suggests that the target DCS fund size should be around $800 million.

Timeframe

8. We believe that the timeframe for building the DCS fund should be 20 years. This is because the chance of failure of a deposit-taker in New Zealand is extremely low. The New Zealand capital settings are set in relation to the Reserve Bank of New Zealand's '1-in-200 years' risk appetite, meaning the approximate chance of a failure is very low. The resulting capital settings for non-bank deposit takers are accordingly conservative such that the chance of a financial crisis or deposit-taker failure at any one point in time is also extremely low – but more likely. This means that the timeframe for building the DCS fund can be longer (i.e., 20 years – being the top end of the proposed timeframe range) given the risk of a financial crisis or failure of a deposit-taker in the intermediate time is extremely unlikely. This is more consistent with the 1 -200-years risk profile as opposed to the more conventional 1-in-100 years risk profile.