The Treasury

Statement of Funding Approach Consultation Submissions Information Release

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Statement of Funding Approach Submission

First Credit Union Incorporated wishes to make a submission on the Treasury's consultation paper for the Statement of Funding Approach for the Deposit Compensation Scheme under the Deposit Takers Act 2023.

About First Credit Union Incorporated

First is one of New Zealand's largest credit unions. As at 30 June 2023, First had around 56,000 members, total assets of around $460 million, and members' funds of slightly under $70 million. Established in 1955, First has a proud history of supporting its members and living its ethos of "people helping people".

First plays an important role in the deposit-taking sector, supporting inclusiveness by servicing a segment of the market that can be overlooked by the main banks. In addition, over recent years First has supported the stability of the credit union sector by acquiring smaller credit unions that were unlikely to remain economically viable over the longer term.

First is a licensed non-bank deposit taker under the Non-bank Deposit Takers Act 2013, and an issuer of financial products to retail investors under the Financial Market Conduct Act 2013. In addition, First's subsidiary, First Insurance Limited, is a licensed insurer under the Insurance (Prudential Supervision) Act 2010.

Overview of First Credit Union's submission

First's primary submission is that a 20-year timeframe to build up the DCS is required. In First's view, a longer timeframe is necessary to ensure equity by spreading the costs of the DCS over as large a cohort as possible to avoid disproportionate costs falling on any particular group. A longer timeframe will also reduce the effect of the levy on smaller deposit takers, and the potential impact of the levy as a barrier to entry, limiting competition and growth in the market.

More detail is included on the **accompanying** submission. First has separately submitted to the Reserve Bank on the Levy Framework consultation paper.

Further contact

Thank you for the opportunity to submit. I would be pleased to answer any questions you have, and look forward to further engagement as the implementation of the Deposit Takers Act continues.

Yours faithfully

FIRST CREDIT UNION INCORPORATED

Simon Scott
Chief Executive Officer

Consultation paper question	First's response
Are there other principles that you think we should consider?	First agrees with the principles outlined in the consultation paper. There are no other principles that First believes should be considered. Given the long-term benefits provided by the DCS, First believes equity and efficiency are key principles. The funding strategy should spread the costs of the DCS over as large a cohort as possible to avoid disproportionate costs falling on any particular group.
Do you agree with adopting a target fund approach to communicate the future path of levies? Why or why not?	First agrees with the proposed adoption of a target fund approach. In First's view, the target fund approach for charging levies should focus on the core principles of equity and efficiency by spreading levies over a longer period. First is concerned about the impact of the levy on smaller deposit takers. In addition, a higher levy will inevitably be a barrier to entry, limiting competition and growth in the market. First does not support insurance-based pricing or *ex post* funding. First agrees a lack of information and data makes insurance-based pricing impractical and considers it preferable to target a particular fund size rather than charging ongoing levies regardless of the fund size. First also agrees that *ex post* funding raises moral hazard concerns.
Do you agree that the target fund size should take into account likely recoveries from failed deposit takers? Why, or why not?	First agrees the target fund size should take into account likely recoveries from failed deposit takers. While this would place greater reliance on the Crown backstop, taking likely recoveries into account is more equitable and more efficient because it reflects the actual long-term costs of the DCS.
Do you agree with using the discretionary method? If not, why not? What method would you recommend and why?	First agrees with the proposed use of the discretionary method given the lack of data available in New Zealand to estimate the costs of the DCS.
Do you think we should commission independent modelling to estimate the DCS's expected losses?	Given the importance of accurately estimating the costs of the DCS First believes it would be worthwhile commissioning independent credit modelling. However, there will be a need to be realistic – if the output of the modelling is ultimately not considered sufficiently robust or reliable, then it should not be used. In the United States of America the National Credit Union Administration facilitates an insurance scheme for credit unions separately from the Federal Deposit Insurance Corporation. The NCUA publishes loss reviews of credit unions that may be helpful for either the Treasury or an independent modeller in estimating the potential costs of the DCS as it applies to credit unions.[1] As can be expected given the relative sizes of each sector, the losses associated with a credit union failure are generally much smaller than the losses associated with a bank failure. In addition, First notes that in New Zealand credit unions and other mutuals have shown an ability to manage financial distress through mergers and acquisitions. We suggest this factor should also be taken into

[1] See https://ncua.gov/about and https://ncua.gov/about/inspector-general/oig-reports/material-loss-reviews

Consultation paper question	First's response
	account in modelling the DCS's expected losses relating to the mutual sector.
Do you agree with our 'severe-but-plausible' failure scenarios? Are there other scenarios we should consider or modelling assumptions that are more appropriate?	First generally agrees with the 'severe-but-plausible' failure scenarios proposed. However, given the significant differences between mutuals (credit unions and building societies) and other NBDTs, First believes a scenario where widespread liquidations occur in the NBDT sector is more likely to be a scenario where liquidations are confined to finance companies rather than also extending to mutuals. In addition, consistent with the commentary relating to the failure of a medium-sized bank, First suggests that a significant mutual's failure may ultimately also be better addressed by way of a resolution. Large mutuals can have a significant number of members (for example, First currently has 56,000 members) many of whom rely on the mutual for day-to-day banking services.
Do you agree with the assumed losses given default for the different classes of deposit taker? If not, why not? What would be an alternative approach?	First does not agree that the assumed loss percentages for NBDTs (which the consultation paper indicates is derived from losses in the New Zealand finance company sector) can be extrapolated to also apply to NBDTs that are mutuals. To First's knowledge, there has been no recent failure of a mutual in New Zealand to draw data from. Rather, credit unions and other mutuals have shown an ability to manage financial distress through mergers and acquisitions. In addition, the business model and risk profile of mutuals and finance companies are different. Credit unions and other mutuals are more "bank like" and operate conservatively with a focus on inclusiveness by servicing a segment of the market that can be overlooked by the main banks. In First's view, any hypothetical loss from the failure of a mutual is more likely to be at a level like that assumed for a small-to-medium sized bank. First believes these percentages should be adopted for an assumed loss in the mutual sector.
What is your preferred target fund size? Why?	First does not have a strongly held view on the preferred target fund size. First is comfortable with a target fund size sitting at the mid-point of the range, provided a longer timeframe is taken to build up the DCS fund. See First's response to the next question.
Do you prefer a 10-, 15-, or 20-year timeframe to build up the DCS fund? Why?	First strongly submits that a 20-year timeframe to build up the DCS is required. A longer timeframe is necessary to ensure equity by spreading the costs of the DCS over as large a cohort as possible to avoid disproportionate costs falling on any particular group. First is also concerned about the impact of the levy on smaller deposit takers. In addition, a higher levy will inevitably be a barrier to entry, limiting competition and growth in the market. First submits that a 20 year timeframe will minimise these risks. First acknowledges the potential moral hazard concerns with building up the DCS over a longer period. However, as the consultation paper notes, moral hazard problems will be mitigated through prudential regulation and supervision activities. They can also be reflected in a risk-adjusted levy.

Consultation paper question	First's response
Do you prefer an alternative timeframe? Why?	First strongly submits that a 20-year timeframe to build up the DCS is required. First does not prefer an alternative timeframe.
Which of the three options do you prefer and why?	First prefers option A (0.5 per cent over 20-years) on the basis that it best ensures equity and efficiency. However, as mentioned above, First would be comfortable with a larger DCS fund size provided it is built up over a 20-year timeframe. First does not prefer option B (because of the 15-year timeframe) and strongly opposes option C (because of the 10-year timeframe).
Do you agree with how we have described the process for updating the SoFA? Have we missed any triggers for a review?	First agrees with the proposed process for updating the SoFA and does not believe there are any other triggers for a review.
Do you have any other comments on matters covered in this discussion document?	First does not have any other comments on the matters covered in the discussion document. However, First refers you to our submissions to the Reserve Bank on the levy framework, which may provide further insight.