The Treasury

Statement of Funding Approach Consultation Submissions Information Release

December 2023

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FINANCIAL SERVICES FEDERATION

25 September 2023

Financial Markets
The Treasury
PO Box 3724
Wellington 6140

By email to: sofaconsultation@treasury.govt.nz

Dear Madam/ Sir,

Re: **Statement of Funding Approach for the Depositor Compensation Scheme**

The Financial Services Federation ("FSF") is grateful to the Treasury for the opportunity to respond on behalf of our members to the consultation on the Statement of Funding Approach (SoFA) for the Depositor Compensation Scheme ("the Consultation").

By way of background, the FSF is the industry body representing the responsible and ethical finance, leasing, and credit-related insurance providers of New Zealand. We have over 90 members and affiliates providing these products to more than 1.7 million New Zealand consumers and businesses. Our affiliate members include internationally recognised legal and consulting partners. A list of our members is attached as Appendix A. Data relating to the extent to which FSF members (excluding Affiliate members) contribute to New Zealand consumers, society, and business is attached as Appendix B.

As you will see from Appendix A, the FSF represents several Non-Bank Deposit Takers (NBDTs) including building societies, credit unions and deposit-taking finance companies. It is on behalf of these members that FSF makes their submission.

Introductory Comments

The FSF would like to begin by saying that we have supported the introduction of the Depositor Compensation Scheme (DCS) throughout the entire consultation process. In particular we understand and agree with the importance ofensuring financial stability in NZ. While our members may not be as systemically important as large banks, they are still clearly an important part of competition in New Zealand. Their role in terms of financial inclusion cannot be understated as quite often NBDTs play an important role in terms of banking the "unbankable".

The FSF would also like to reinforce that a major piece of feedback we have received from our members is that the Reserve Bank does not fully understand the sector and instead treats NBDTs as "mini banks". Due to fundamentally different business models this is incredibly flawed thinking. While yes compared to banks NBDTs are tiny, they do operate in a fundamentally different way.

Our members have reported that members of RBNZ have approached them to visit their head offices to learn how the business model works. As we are currently deep in consultation around significant aspects of the Deposit Takers Act and the Act itself has already passed this seems like an oversight. RBNZ and Treasury should have approached our members to understand how their business models worked before they even started drafting the consultations on which we are now having to submit. We also believe it would be useful to see all drafts of the levy proposals before they are finalised by Treasury and RBNZ as this will ensure we can point out glaring issues and unintended consequences before they are implemented.

We would also like to express our disappointment that all three consultations are operating concurrently and on what is a very short timeframe for three very comprehensive topics. Not all of our members have the resources to be able to respond to these important submissions on such a tight turnaround. We would however like to acknowledge the in-person workshops held by the RBNZ. This was an incredibly helpful method of consultation. It was excellent planning to get so many NBDTs in the room and hear what they had to say, we imagine it would have been very helpful for RBNZ and Treasury considering NBDTs were in consensus around the key issues. The FSF highly recommends having similar workshops for future consultations.

The FSF also highly recommends that the Treasury consult with the World Council of Credit Unions (WOCCU), which is the international body for credit unions. This body provides education and support for international governments to ensure that they not only understand the consequences of regulation on the sector, but they implement it in a way that won't be manifestly detrimental to credit unions and other NBDTs. WOCCU would be able to provide both RBNZ and the Treasury with advice about proportionality, liquidity ratios and capital ratios in terms of how they apply to credit unions as this is not the same as the way in which they apply to banks.

While an NBDT may not be systemically important in terms of a failure, they are still incredibly important to the NZ financial sector. This has been evidenced worldwide through the operation of credit unions in times of disaster. In Ukraine, for example, credit unions are continuing to operate for their communities despite being continuously bombed. This is because while an international bank may stop operating in a country in times of disaster an NBDT has certain community ties that allow it to continue. It is important to emphasise that the need for banking does not go away in times of disaster.

Profitability

Profitability in the financial/lending sector is currently a key topic in light of the market inquiry into personal banking services that the Commerce Commission has just begun. This partially came out of the offshore banks announcing their "excess" profits. In contrast to this most of the NBDTs are not-for-profits or are "profit conscious". What this means in practice is that rather than paying out profits to shareholders their profits are reinvested back into the NBDT in order to achieve better outcomes for their customers. So, while a risk-based approach that cuts into banks' profits will have little effect on their day to day it will have a massive effect on NBDTs.

In some cases, NBDTs will be required to pay as much as 400% more proportionately than the large banks based on which bucket they land in. That NBDT will then have two options, do they either absorb the cost themselves from their profits (which as we have established are minimal and usually reinvested into the community) or do they pass it onto their customers through factors such as lower interest rates on deposits or higher interest rates on loans?

Competition

As mentioned above the Commerce Commission has recently done a consultation on their terms of reference for a market study into personal banking services. We recommend that Treasury reads our submission which can be found here. Our submission focuses on the competition between NBDTs and Banks in regards to their main products, transactional accounts and home loans. In a time of such over regulation of NBDTs (and finance providers as a whole) competition is being threatened as a result of the regulatory burden. As an example, one of our NBDTs has 13 team members in total, including their Chief Executive, to run their whole operation. This means that when a new regulatory regime comes out, they don't have the capacity to introduce a whole new team to deal with that specific piece of regulation like the banks do.

An example of overregulation in the sector would be an NBDT who does consumer lending. They are regulated by RBNZ as an NBDT and in regard to their Anti-Money Laundering obligations. They are also going to be required to be licensed by the Financial Markets Authority under their new Conduct of Financial Institutions licensing regime. Then they will also be regulated by the Commerce Commission for their consumer loans. Finally, they will also be regulated by the Privacy Commissioner for their use and storage of customer data. This means there are four separate regulators for one very small entity. This number will soon be five when the Consumer Data Right regime is bought in and the Ministry of Business, Innovation and Employment take on their new regulatory role.

The risk-based levy setting approach

The risk-based approach itself is flawed for all the reasons mentioned above but to further demonstrate this point we would like to go into more detail. In the scenario mentioned above if the NBDT chooses to pass the cost onto its customers this will have a massive effect on its ability to operate competitively in the market. This will detrimentally affect New Zealand's financial system as NBDTs play a massive part in the efficacy of the system as a whole.

As it is the NBDTS will lose customers due to the $100,00 protection cap per institution. A customer with $1 million may decide to distribute their funds amongst 10 different institutions so that the entire amount is protected. Due to this we believe that RBNZ should heavily consider providing a liquidity product for a number of years after the introduction of the DCS. While NBDTs will benefit a little bit from the spread it will not be enough to cover the loss. Banks will be able to absorb these losses however certain NBDTs have a captive customer base. An example of this is the Police and Families Credit Union which can only service police personnel and their families. Regional credit unions and building societies have similar issues. This realistically will cause some NBDTs to go out of business and further weaken competition in the market.

NBDTS also play a hugely important role in access to banking, not only physically but in terms of banking the “unbankable”. These are people who would not be accepted at a traditional bank for reasons such as not having a fixed address, not having access to a computer, or because they live in the regions etc. Banks while large are inflexible whereas NBDTs are better equipped to tailor their approach to the individual customer. This is important and Treasury needs to protect this by carefully considering their approach to setting the SoFA.

The FSF has elected to only answer the consultation questions listed below. Please assume we have no comment on anything not answered below.

Consultation Questions

1. **Are there other principles that you think we should consider?**

   The FSF submits that the DCS must take account of the principle of proportionality. While the funding approach in general is incredibly important, the Treasury also needs to take account of how the funding approach will affect different business structures. For example, how the DCS will affect banks versus NBDTs.

2. **Do you agree with adopting a target fund approach to communicate the future path of levies? Why or why not?**

   Yes we do. This will give entities captured under the DCS some stability in terms of being able to predict how the future of the scheme will affect them. As established in our submission on RBNZ’s levies proposal however we strongly disagree with the idea of setting levies on the risk-based approach. This would be unfairly detrimental to NBDTs for all the reasons we have already outlined in our introduction to this submission.

3. **Do you agree that the target fund size should take into account likely recoveries from failed deposit takers? Why, or why not?**

   Yes the FSF agrees with this in principle.

9. **Do you prefer a 10-, 15-, or 20-year timeframe to build up the DCS fund? Why?**

   The FSF strongly supports option C, the 0.5 per cent fund over 20 years. Anything more then this would have an extremely detrimental affect on NBDTs due to their not-for-profit business structure.

10. **Do you prefer an alternative timeframe? Why?**

    No, see answer to question 9.

11. **Which of the three options do you prefer and why?**

    Option C as discussed above at question 9.

12. **Do you agree with how we have described the process for updating the SoFA? Have we missed any key triggers for a review?**

    No, we do not believe that the Treasury has omitted any key triggers for updating the SoFA.

13. **Do you have any other comments on matters covered in this discussion document?**

    Please see our comments above about competition and profitability.

In summary the FSF agrees with the DCS in principle but submits that all accompanying issues need to be applied proportionally as it is incredibly unwise to treat an NBDT in the same way as you would treat a bank.

Please do not hesitate to reach out if you wish for us to speak further on any of the points made in this submission.

Yours sincerely,

Katie Rawlinson
Legal and Policy Manager
Financial Services Federation

Appendix A

FINANCIAL SERVICES FEDERATION

FSF Membership List as at August 2023

Non-Bank Deposit Takers, Specialist Housing/Property Lenders, Credit-related Insurance Providers	Vehicle Lenders	Finance Companies/ Diversified Lenders	Finance Companies/ Diversified Lenders, Insurance Premium Funders	Affiliate Members	Affiliate Members contd., and Leasing Providers
XCEDA (B) Finance Direct Limited ➢ Lending Crowd Gold Band Finance ➢ Loan Co Mutual Credit Finance <u>Credit Unions/Building Societies</u> First Credit Union Nelson Building Society Police and Families Credit Union <u>Specialist Housing/Property Lenders</u> Basecorp Finance Limited First Mortgage Managers Ltd. Liberty Financial Limited Pepper NZ Limited Resimac NZ Limited <u>Credit-related Insurance Providers</u> Protecta Insurance Provident Insurance Corporation Ltd	AA Finance Limited Auto Finance Direct Limited BMW Financial Services ➢ Mini ➢ Alphera Financial Services Community Financial Services Go Car Finance Ltd Honda Financial Services Kubota New Zealand Ltd Mercedes-Benz Financial Motor Trade Finance Nissan Financial Services NZ Ltd ➢ Mitsubishi Motors Financial Services ➢ Skyline Car Finance Onyx Finance Limited Scania Finance NZ Limited Toyota Finance NZ ➢ Mazda Finance Yamaha Motor Finance	Avanti Finance ➢ Branded Financial Basalt Group Blackbird Finance Caterpillar Financial Services NZ Ltd Centracorp Finance 2000 Finance Now ➢ The Warehouse Financial Services ➢ SBS Insurance Future Finance Geneva Finance Harmoney Humm Group Instant Finance ➢ Fair City ➢ My Finance John Deere Financial Latitude Financial Lifestyle Money NZ Ltd Limelight Group Mainland Finance Limited Metro Finance Nectar NZ Limited	NZ Finance Ltd Personal Loan Corporation Pioneer Finance Prospa NZ Ltd Smith's City Finance Ltd Speirs Finance Group(L &F) ➢ Speirs Finance ➢ Speirs Corporate & Leasing ➢ Yoogo Fleet Turners Automotive Group ➢ Autosure ➢ East Coast Credit ➢ Oxford Finance UDC Finance Limited Yes Finance Limited <u>Insurance Premium Funders</u> Elantis Premium Funding NZ Ltd Financial Synergy Limited Hunter Premium Funding IQumulate Premium Funding Rothbury Instalment Services	Buddle Findlay Chapman Tripp Credisense Ltd Credit Sense Pty ltd Experian Experieco Limited EY FinTech NZ Finzsoft Happy Prime Consultancy Limited KPMG Lendscape Ltd Loansmart Ltd LexisNexis Motor Trade Association One Partner Limited PWC Sense Partners Simpson Western <u>Credit Reporting, Debt Collection Agencies,</u> Baycorp (NZ)	Centrix Credit Corp Debt Managers Debtworks (NZ) Limited Equifax Gravity Credit Management Limited IDCARE Ltd Illion Quadrant Group (NZ) Ltd Recoveriescorp NZ Ltd <u>Leasing Providers</u> Custom Fleet Euro Rate Leasing Limited Fleet Partners NZ Ltd ORIX New Zealand SG Fleet Total 95 members

Appendix B

FINANCIAL SERVICES FEDERATION (FSF)

THE NON-BANK FINANCE INDUSTRY SECTOR - 2022

48%

NON-BANK | BANK

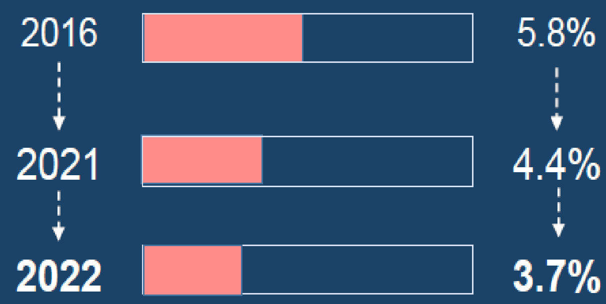
of personal consumer loans are financed by the **non-bank sector** represented by FSF members.

Setting industry standards for responsible lending, promoting compliance and consumer awareness.

Percent of Loan Requests Approved

46%

Percent of Loan Book in Arrears



KEY FACTS: THE NON-BANK FINANCE INDUSTRY SECTOR

FSF Members (as at 28 Feb 2022)

Number of Members	57
Number of Employees	3,561
Applications Processed	1,085,739
Loan Requests Approved	495,434
Percent of Loan Book in Arrears	3.7%

Bank Sector (as at 28 Feb 2022)

Value of Mortgage Loans	$329B
Value of Consumer Loans	$7.6B
Value of Business Loans	$118B

Non-Bank Sector Share (as at 28 Feb 2022)

% of Total Mortgage Loans	0.4%
% of Total Consumer Loans	47.7%
% of Total Business Loans	5.9%

Insurance Credit Related (as at 28 Feb 2022)

Number of Employees	237
Number of Policies	311,409
Gross Claims (annual)	$27.2M
Days to Approved Claim	20 days

Consumer Loans (as at 28 Feb 2022)

Total Value of Loans	$8.1B
Number of Customers	1,699,683
Number of Loans	1,584,984
Monthly Instalments:	$330M
Average Value of Loan:	
Mortgage	$171,932
Vehicle Loan	$12,393
Unsecured	$2,467
Other Security	$5,754
Lease Finance	$2,804
Average Monthly Instalment:	
Mortgage	$257
Vehicle Loan	$463
Unsecured	$144
Other Security	$302
Lease Finance	$241

Business Loans (as at 28 Feb 2022)

Total Value of Loans	$7.3B
Number of Customers	136,830
Number of Loans	264,827
Monthly Instalments:	$590M
Average Value of Loan:	
Mortgage	$443,784
Vehicle Loan	$28,869
Unsecured	$7,443
Other Security	$32,374
Lease Finance	$24,921
Average Monthly Instalment:	
Mortgage	$2,281
Vehicle Loan	$1,064
Unsecured	$799
Other Security	$11,044
Lease Finance	$939