The Treasury

Statement of Funding Approach Consultation Submissions Information Release

December 2023

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25 September 2023

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RE: Levy Framework for the Depositor Compensation Scheme

The Heretaunga Building Society supports and is a signatory to the group submission signed by the majority of non-bank deposit takers on the proposed methods for calculation Depositor Compensation Scheme levies. This submission should be read in conjunction with the group submission for completeness.

As offered by you we ask that you forward this letter to the Treasury.

The Heretaunga Building Society appreciated the chance to meet with representatives of the Reserve Bank at the consultation workshop in Wellington on 16 August 2023. We also appreciated the opportunity to meet with you one-on-one on Monday 18 September, and found that session helpful.

We have identified that the range of levies that could be applied, based on the consultation ranges, is significant. The levies could amount to 3% of our pre-tax profits at the lower end, or up to 40% of our pre-tax profits at the upper end. It is of concern to us that the range of potential outcomes for us and our clients based on the proposals put forward is so extensive, and it highlights the regulatory uncertainty that we are under during the current climate of change. Depending on the approach taken, it could impact the viability of our business, and our ability to serve our local communities in a way that we have successfully managed for over 90 years.

It is of particular concern to us that under the proposed risk-based approaches, we end up in bucket 4 (riskiest) under the credit rating approach as we have a credit rating exemption, and under bucket 1 (least risky) using the composite risk measures. This highlights the fact the that Reserve Bank have not yet developed a fair and reasonable approach to risk measurement, and therefore the only viable option is to adopt a flat rate approach to levies until such time as the risk posed by smaller financial institutions is better understood in the context of the purpose of the Deposit Compensation Scheme.

If a risk-based approach were to be taken, it appears disproportionate to have the ‘riskier’ institutions paying up to 400% more than the ‘less risky’ institutions. This disproportionate impact does not appear to take into account the fact that we are all subject to prudential supervision by the Reserve Bank, and will be required to abide by capital adequacy and liquidity standards as determined appropriate by the Reserve Bank to promote financial stability.

As outlined in our responses to specific questions below, we also support a target fund size at the lower end of the proposed range, and support a target timeframe of 20 years to build the fund. There are three benefits of this approach:

1. Along with using a flat rate approach to levies, this creates a more proportionate impact on bank and non-bank deposit takers profits.
2. It allows participants in the Deposit Compensation Scheme a more prolonged adjustment period to understand and deal with the impact of the levies.
3. It reduces the likelihood of incumbent deposit takers effectively subsidising new entrants to the sector, as the adjustment coefficient should be more stable over time.

Our responses to specific questions tabled in the Reserve Bank consultation document are provided below:

Consultation question 1:
Do you think there are any other options for estimating the protected deposit base which are not explored above?

Yes, but we support the preferred approach.

Consultation question 2:
Do you agree with our preferred approach to estimating the protected deposit base?

Yes

Consultation question 3:
Do you have any comments on the proposed solution?

Use most up to date survey data available.

Consultation question 4:
Do you think the proxy should be reviewed one or two year(s) after the DCS is in place?

Two years – to reduce compliance costs.

Consultation question 5

Do you have any specific feedback on the design of the risk-based approaches?

As we set out in our response to Consultation question 6 and in our opening remarks, we believe that a flat-rate levy approach is the most fit for purpose.

The credit rating approach cannot be applied to institutions that have an exemption from credit rating, as this applies to the smallest deposit takers and undermines the proportionality principle.

The composite risk indicator is better than the credit rating approach in terms of fairness, but including a ‘return on assets’ measure does not recognise the place of mutuals in maintaining the diversity and inclusiveness of our financial system.

Consultation question 6

Which levy method of calculating or ascertaining the amount of levies do you think is most fit-for-purpose?

We are of the view that a flat-rate levy approach is the most fit for purpose, most simple and most easy to understand. We refer to our earlier concerns about the disparity in outcomes between the risk based measures, and the follow on arbitrary impact on profits.

If a risk-based approach is taken, the range needs to be drastically reduced between buckets, in recognition of the level of prudential supervision we all operate under. It is also punitive to use a credit rating approach for entities that have an exemption.

Our responses to specific questions in the Treasury consultation paper are provided below:

Consultation question 1:

Do you agree with adopting a target fund approach to communicate the future path of levies?

Yes.

Consultation question 2:

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

We believe there is limited evidence to reliably determine the likelihood of a deposit taker failing and what likely recoveries there should be. However, if failures are taken into account so to should recoveries be.

Consultation question 3:

Do you agree with using the discretionary method? If not, why not? What method would you recommend and why?

We agree with using the discretionary method because of the limited data and information available in New Zealand to estimate the costs to the DCS.

Consultation question 4:

Do you think we should commission independent modelling to estimate the DCS’s expected losses?

The incremental benefit is likely to be low given the lack of reliable data and the markedly different regulatory context in the future.

Consultation question 5:
Do you agree with our 'severe-but-plausible' failure scenarios? Are there other scenarios we should consider on modelling assumptions that are more appropriate?

One feature of failure scenarios which appears missing in The Treasury's analysis is the extent of 'contagion'. It would be more likely for the failure of larger deposit takers to have an impact on other larger deposit takers through inter-company balances and arrangements.

It is also harder to imagine widespread liquidations in the non-bank deposit taker sector, but easier to imagine the failure of a specific deposit taker. The nature and business models of the non-bank deposit taker sector are more varied than the business models of the larger players. Therefore, the various players have different risk profiles. We believe a more realistic scenario would be the failure of one or possibly two non-bank deposit takers but not widespread failures.

Consultation question 6:
Do you agree with the assumed losses given the default for the different classes of deposit taker? If not, why not? What would be an alternative approach?

No comment.

Consultation question 7:
What is your preferred target fund size? Why?

As discussed in our opening remarks, we prefer a target fund size at the lower end of the range.

Consultation question 8:
Do you prefer a 10-, 15-, or 20-year timeframe to build up the DCS fund? Why?

We would prefer a 20 year timeframe to allow for new entrants to contribute to the scheme. Otherwise, the scheme needs a mechanism to ensure that new entrants contribute their fair share, perhaps as some form of catch up levy arrangement.

A longer time frame would also provide more time to understand the risk profile of levy payers and to adjust the framework in response to new insights. There is too little reliable insight into the likelihood and impact of failures, especially when the regulatory regime will be so different from the current regime, especially for non-bank deposit takers. The RBNZ's Proportionality Framework consultation paper dated 31 July 2023 indicates that non-bank deposit takers should expect requirements will be strengthened under the Deposit Takers Act with increased expectations on the RBNZ as a modern prudential regulator.

Consultation question 9:
Do you prefer an alternative timeframe? Why?

We would prefer a longer timeframe but going much beyond 20 years may result in an insufficient fund.

Consultation question 10:
Which of the three options do you prefer and why?

Option A because all the comments in the options analysis are better than the status quo. This still provides for a reasonable sized fund, is more equitable than the other two options and provides greater scope to adjust and refine levies in response to new insights.

Consultation question 11:
Do you agree with how we have described the process for updating the SoFA? Have we missed any key triggers for a review?

We believe there could be more consideration of a scenario where the extent of failures of deposit takers is lower than previously assumed, therefore suggesting a reduction in levies.

Another potential trigger to consider would be if actual investment returns or projected investment returns for the levy fund differ significantly from current assumptions.

Consultation question 12:
Do you have any other comments or matters covered in this discussion document?

No

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