The Treasury

Statement of Funding Approach Consultation Submissions Information Release

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Statement of Funding Approach - Funding Strategy for the Depositor Compensation Scheme ("SoFA")

The Corporate Trustees Association ("CTA") welcomes the opportunity to provide comments in response to Treasury's Consultation Paper dated July 2023 on the "Statement of Funding Approach – Funding Strategy for the Depositors Compensation Scheme" ("Consultation").

CTA is the industry association for New Zealand's four licensed supervisors. Collectively supervising 15 Non-Bank Deposit Takers ("NBDTs"), Supervisors are licensed by the Financial Markets Authority under the Financial Markets Supervisors Act 2011 and fulfil a statutory role under that Act supporting investor protection.

I attach CTA's responses to the Consultation questions which addresses only those questions which relate to the role of supervisor.

CTA consents to this submission being released if requested under the Official Information Act 1982.

Please contact me if you require any further information from CTA members.

Angus Dale-Jones

Executive Director

Section 3 Principles to guide the Statement of Funding Approach

Question:

Are there other principles that you think we should consider?

Response:

CTA agrees with the principles as set out in the Consultation.

Section 4 Target fund approach

Question:

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

Response:

CTA supports the target fund approach. This approach is flexible and transparent and is in line with international practice.

CTA suggests that Supervisors retain a security trustee role after the transition to the Reserve Bank supervision occurs under the Deposit Takers Act 2023.

Under this proposal, Supervisors would act on instruction from the Reserve Bank of New Zealand ("RBNZ") to enforce the security. This adds several benefits to the RBNZ, the Depositors Compensation Scheme ("DCS") fund and to investors.

The benefit for the RBNZ would be the ability to appoint receivers. Without the retention of the Supervisors' security the RBNZ would not be able to appoint receivers. Receivers can be appointed quickly and have a range of powers that liquidators do not have.

The DCS fund would benefit because of the retention of a first ranking security which would mean the recoveries to the DCS fund will always be higher.

Investors with investments above $100k would also benefit as their security position would be stronger, and returns from the liquidator/receiver would therefore be higher.

Section 5: The role of post-failure recoveries in the funding strategy

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

Response:

CTA agrees that the target fund size should take into account recoveries from failed deposit takers.

Figure 1 (page 6) in the Consultation assumes a liquidation would take 12-18 months. CTA understands that this is based on international precedents. CTA notes that while most of the assets would be realised in first years of a liquidation, many liquidations of New Zealand finance companies took significantly longer with some lasting over ten years. We suggest a review of the outcomes of the receiverships and liquidation of New Zealand finance companies to better estimate the repayment period to the DCS fund.

Liquidators are required to produce six monthly reports. CTA suggests that if a failure occurs the SoFA is reviewed following the liquidator publishing their reports (at least annually). The liquidators recoveries for a large deposit taker could have a material impact on the SoFA funding requirements (and timeframes), and to the Crown (if acting as a backstop).

Section 6: Methodology for assessing the funding obligation of the DCS in severe but plausible failure scenarios

Question:

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

Response:

CTA agrees that the discretionary method is appropriate. There is insufficient recent data to create any kind of statistical model that would yield reasonable results for New Zealand. Although data from the failure of finance companies during the Global Financial Crisis could be used due the number of failures during that time, there are a number of reasons why this may not be appropriate:

1) the majority of New Zealand finance company failures occurred during an unprecedented international financial crisis;
2) the size of the industry was materially different (it was significantly larger); and
3) the regulatory environment and legislation had a focus on disclosure with fewer prudential and conduct requirements.

Question:

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

Response:

CTA considers that independent modelling to estimate the DCS's expected losses would be worthwhile. In CTA's view the independent modelling should apply a discretionary approach (for the reasons set out above).

Section 7: Using 'severe-but-plausible' failure scenarios to estimate costs to the DCS

Question:

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

Response:

CTA agrees with the 'severe-but-plausible' failure scenarios.

We have conservatively assumed that a medium-sized bank could be liquidated or placed into receivership for the purpose of estimating the potential cost to the DCS.

Question:

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?

Response:

The assumed losses appear reasonable. There were a wide range of recoveries from NBDTs during the Global Financial Crisis. For the reasons set out in answer to section 6 above, CTA believes the assumed loss given default would be lower than during the GFC.

Section 8: Options for a target fund size

Question:

What is your preferred target fund size? Why?

Response:

CTA supports a target fund size in the mid-range of 0.5 to 1.1 per cent of protected deposits i.e 0.8 percent. We estimate this to be equivalent to a fund size of approximately $1 billion based on the estimated current level of protected deposits. CTA feels that this strikes a balance between the interests of the Crown (as backstop) and the cost to depositor takers.

CTA notes that if supervisors are retained as security trustees (as per Section 4) this would have essentially the same impact as depositor preference for NBDTs.

Section 9. Timeframe to reach target fund size

Question:

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

Response:

CTA supports a 15-year timeframe to balance the competing considerations for the Crown backstop and deposit takers. CTA believe this is the most equitable approach which also includes consideration of moral hazard risk. CTA notes this is longer than most of the international comparisons.

Question:

Do you prefer an alternative timeframe? Why?

Response:

No – for the reasons set out in the response above.

Section 10. Options analysis

Question:

Which of the three options do you prefer and why?

Response:

CTA prefers Option B: 0.8 per cent fund over 15 years, for the reasons set out in our responses to section 8 and 9 above. In CTA's view this option balances the principles of resilience, system alignment, equity and efficiency.

Section 11. Changes to the Statement of Funding Approach

Question:

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

Response:

For the reasons set out in section 5 above, CTA considers an additional trigger should be the publication of liquidator/receivers reports on failed deposit takers.

In addition, the SoFA should have a force majeure trigger to account for unforeseeable and unavoidable catastrophes that interrupt the expected course of events (e.g. another Global Financial Crisis).

Section 12. What happens next?

Question:

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

Response:

CTA has no further comments.

Supervisors are happy to meet with Treasury and RBNZ to discuss the transition to the DCS, the prudential risks and the compliance requirements.