The Treasury

Statement of Funding Approach Consultation Submissions Information Release

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25 September 2023

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

ASB Bank Limited (**ASB**) welcomes the opportunity to provide feedback to Te Tai Ōhanga – The Treasury (**Treasury**) on its Statement of Funding Approach – Funding Strategy for the Depositor Compensation Scheme (**SoFA**).

ASB's purpose is to accelerate the progress of all New Zealanders. We therefore support legislative changes that aim to create a trusted and consistent regulatory framework for banks and other deposit taking institutions, promote financial stability, and support the economy.

ASB generally supports the approach taken by Treasury with regards to determining the proposed fund size for the Depositor Compensation Scheme (**DCS**) and the timeframes to build up the DCS fund. Our responses to each of the questions in the Consultation Paper are provided in the Appendix to this letter. ASB's key concerns are outlined below:

- Sufficient time is provided to deposit takers to implement the scheme once the SoFA and DCS regulations have been finalised. We understand the expectation is that the DCS will launch within three months of the DCS and SoFA regulations being finalised. This does not allow enough time for deposit takers to train front line staff and prepare customer communications regarding the details of the scheme, enabling staff to advise and support customers who may be ineligible for the scheme or whom otherwise have complex banking arrangements. Introducing the DCS without proper clarity for depositors on whether their money is protected risks undermining public confidence in the scheme. Further, banks will need to be in a position to be able to operationalise the pay out options as presented in the RBNZ workshop in August, in the event a deposit taker fails shortly after launch. Establishing processes and controls to support customer identification, verification and timely pay outs will take time. ASB therefore recommends that the DCS should not come into force for 12 months to ensure a consistent and practical implementation across the industry and promote the scheme's credibility, noting a 6-month minimum time period may be possible but has implementation risks.

- The DCS fund should be granted income tax exemption status for levies received and investment returns This tax approach would align with the objectives and principles outlined in the consultation paper for the SoFA (resilience and efficiency), as well as with treatment of similar funds in comparable offshore jurisdictions and with how ACC levies and investment returns are treated domestically. Taxing the DCS fund's income would likely ultimately cost customers more for the protection provided by the DCS and significantly extend the timeframe required to reach the target fund size.

- The RBNZ should confirm that the DCS levies charged will be exempt from GST on the basis that they are for a financial service within the definition in section 3 of the Goods and Services Tax Act 1985.

The recommendations above are consistent with ASB's submission as part of the RBNZ's DCS Levy Framework consultation, as well as our previous submissions throughout the development of the Deposit Takers Act.

We acknowledge that ASB's submission may be published on Treasury's website and may be released in response to a request under the Official Information Act. ASB does not seek confidentiality for any aspect of this submission, other than my direct contact details below.

ASB looks forward to ongoing engagement as the consultation progresses. If you require any further information in relation to this submission, please contact Kristina Kilner, Head of Government Relations and Regulatory Affairs, at [23]

Yours faithfully

Carl Ferguson
Chief Financial Officer
ASB Bank Limited
[23]

Appendix – Responses to the Consultation Paper questions

Q1. Are there other principles that you think we should consider?

ASB generally agrees with the proposed objectives and decision-making principles for development of the SoFA.

We recommend that the potential for 'moral hazard' (i.e. increased deposit inflows to riskier deposit takers and the associated increased financial stability risks) is also included. When developing the SoFA, moral hazard will be particularly relevant when determining the:

- conceptual funding approach;
- timeframe to reach the target fund size (assuming a target fund size approach is adopted);
- process for levy contributions once the target fund size has been reached; and
- process for the entry and exit of deposit takers from the scheme (and their contributions to the DCS fund).

Q2. Do you agree with adopting a target fund approach to communicate the future path of levies? Why or why not?

ASB supports the adoption of a target fund approach. This is consistent with the objectives and principles for the SoFA as outlined in the SoFA consultation paper and also aligns with the approach taken in most comparable offshore jurisdictions.

Unlike the 'ex-post' funding approach, a target fund approach will also reduce moral hazard risk across the deposit taking sector by ensuring that all deposit takers contribute to the potential costs of their failure.

ASB agrees that an insurance-based pricing model would be difficult to model due to the lack of data regarding deposit taker failures.

Q3. Do you agree that the target fund size should take into account likely recoveries from failed deposit takers? Why, or why not?

ASB agrees that the target fund size should take into account likely recoveries from failed deposit takers. This approach provides a more accurate estimate for the actual costs of the scheme and reflects that losses are often very difficult to estimate at the time of a deposit taker failure. This approach is also consistent with guidance from the International Association of Deposit Insurers (IADI)[1].

Q4. Do you agree with using the discretionary method? If not, why not? What method would you recommend and why?
Q5. Do you think we should commission independent modelling to estimate the DCS's expected losses?

ASB agrees with using the discretionary method for estimating the potential costs of the DCS. A lack of historical data regarding deposit taker failures would make statistical modelling difficult. For this

[1] IADI Enhanced Guidance for Effective Deposit Insurance Systems: Ex Ante Funding (2015)

reason, we would also not recommend commissioning independent modelling to estimate the DCS's expected losses as this would not necessarily yield more accurate results than the discretionary approach used by Treasury.

Q6. Do you agree with our 'severe-but-plausible' failure scenarios? Are there other scenarios we should consider or modelling assumptions that are more appropriate?
Q7. 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?

ASB agrees with the 'severe-but-plausible' failure scenarios outlined in the SoFA consultation paper. These scenarios provide a reasonable benchmark for the likely scope of deposit taker failures and reflects some of the relevant key aspects of the New Zealand financial system, in particular:

- current (and future) minimum capital adequacy requirements;
- potential use of OBR to support a resolution; and
- enhanced supervision of deposit takers under the Deposit Takers Act.

ASB also broadly agrees with the assumed losses given default for each class of deposit taker. These loss estimates appear reasonable based on historical observations both domestically and offshore.

Q8. What is your preferred target fund size? Why?

ASB's preference is for a target fund size in the range of 0.80% to 1.00% of protected deposits.

A fund of this size would be sufficient to support public confidence in the DCS, whilst balancing the efficiency of the scheme with the possible usage of the crown backstop. It would also mitigate moral hazard by ensuring deposit takers contribute to the potential costs of the scheme and support an effective risk-based levy approach (noting a risk-based levy approach is ASB's preference).

A target fund size in this range would also broadly align with several comparable jurisdictions offshore including Canada (0.85%) and most European Union member states (0.80%).

Whilst ASB acknowledges the absence of any 'depositor preference' in New Zealand compared to many offshore jurisdictions (which potentially lowers recoveries for the DCS fund in the event of a failure), this is offset by high (and increasing) capital adequacy levels in New Zealand and the relatively simple business models of New Zealand deposit takers. The flexible mandate the DCS fund will have with regards to potentially contributing a bank resolution (possibly via OBR) also provides support for the proposed target fund size recommended above.

Q9. Do you prefer a 10-, 15-, or 20-year timeframe to build up the DCS fund? Why?
Q10. Do you prefer an alternative timeframe? Why?

ASB's preference is for a timeframe of between 15-20 years to build up the DCS fund.

A longer timeframe to reach the target size allows for the costs of the scheme to be spread more evenly across deposit takers and will reduce the potential moral hazard associated with the DCS over the long-term. Although this does potentially have a short-term trade-off with regards to the effectiveness of a risk-based levy, this risk can be managed within the levy framework itself by ensuring levies are appropriately differentiated.

A longer timeframe to reach the target fund size will likely support more stable levies over time, as it would provide more opportunities to re-calibrate levies based on future developments such as actual deposit taker failures, or the introduction of more accurate reporting of the protected deposit base, such as when the 'Single Customer View' requirements come into effect. This last point could be important given initial DCS levies will be based on an estimate for the amount of protected deposits, which may lead to over/under collection of levies during this period. A longer timeframe will help to mitigate this risk.

A longer timeframe also reflects the relatively stable financial stability position of the deposit taking sector in New Zealand.

Q11. Which of the three options do you prefer and why?

ASB's preference is for 'Option B' (i.e. target fund size of 0.80% and a timeframe to build up the DCS fund of 15 years). The rationale for this view is consistent with our comments outlined above with regards to the target fund size and timeframe.

Q12. Do you agree with how we have described the process for updating the SoFA? Have we missed any key triggers for a review?

ASB generally agrees with the process described for updating the SoFA.

We would also recommend an additional trigger be included relating to the development of the 'Single Customer View' requirements (or similar) that enables more accurate reporting of the protected deposit base. This would ensure that the SoFA can be recalibrated based on the most accurate data and levies adjusted accordingly.

In addition, it may be appropriate to include a trigger on or around the time of the introduction of the remaining parts of the Deposit Takers Act (circa 2028). This would ensure that the new prudential, supervisory, disclosure and crisis management requirements under the DTA are reflected in the SoFA once they have been developed and implemented.

Q13. Do you have any other comments on matters covered in this discussion document?

ASB has no additional comments.