

# The Treasury

## Statement of Funding Approach Consultation Submissions Information Release

December 2023

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25<sup>th</sup> September 2023

Mr David Hargreaves, Manager, Policy Projects Team  
Prudential Policy Department  
Reserve Bank of New Zealand – Te Putea Matua  
Wellington 6140

By Email to: [dta@rbnz.govt.nz](mailto:dta@rbnz.govt.nz)

Dear Mr Hargreaves,

**Re: DCS levy approach submission**

Thank you for the opportunity to provide our views on the Levy Framework for the Deposit Compensation Scheme (the “Levy Framework”).

Set out below is Xceda’s views on the proposed Levy Framework in general, and then at Appendix 1 we answer the specific questions raised in the Levy Framework Consultation Paper. We have also provided in Appendix 2 our responses to the questions posed in Treasury’s Statement of Funding Approach Consultation Paper.

Please note that with the prior approval of the supervision team of the Reserve Bank of New Zealand (“RBNZ”), this document is submitted as a draft/placeholder. It is subject to a meeting to be held between Xceda’s senior management and the RBNZ on 27<sup>th</sup> September 2023, after which a formal submission will be lodged by Xceda.

Xceda appreciates the opportunity that has been provided to engage in this consultation process with the team at the RBNZ, including in the workshop that was conducted in Auckland on 22<sup>nd</sup> August 2023.

In responding to the Levy Framework Consultation Paper herein, we would also like to refer to the joint submission dated 22<sup>nd</sup> September 2023 by certain members of the NBDT sector, to which Xceda is a signatory (attached hereto). This consultation process around the Deposit Takers Act (“DTA”) and the Deposit Compensation Scheme (“DCS”) has provided a unique opportunity for the NBDT sector to work together to discuss and collaborate on the issues that are important to us and our customers, but also importantly in relation to the future viability of the smaller licensed deposit takers.

**General view of the Levy Framework.**

Xceda supports this consultation process as part of the overall positive impact we believe the Deposit Takers Act 2023 (“DTA”) can have on delivering the following core benefits:

1. Financial stability of the New Zealand deposit taking sector;

2. Competition within the sector, creating a diversity of institutions to provide access to financial products and services for all New Zealanders ; and
3. A framework for the future growth and prosperity of the smaller licensed deposit takers.

In order to continue to work with the RBNZ team in this process, we support the proposal of the NBDT sector (as suggested in our joint submission) to form a working group with the Banks' policy team to ensure that the issues we face are well understood and solutions are jointly developed.

### **Financial Stability**

This is a core principle of the Reserve Bank mandate and this is firmly understood by Xceda. We do believe that the creation of a levy framework that negatively impacts the stability of the smaller licensed deposit takers would be a backward step in the stability of the overall system.

For example, there is the potential that a risk-based levy system where smaller deposit takers could pay up to four times the levy of the major banks would severely impact the viability of the sector. The impact on profitability under a risk-based approach could be material to our sector, which is why we support a flat rate levy structure.

We also do not agree with the comment that a flat rate would not provide an ability to mitigate moral hazard issues. As one of only seven NBDT finance companies, Xceda is acutely aware of the past indiscretions of finance companies, particularly in the GFC era. However we believe that the way in which the current NBDTs operate (including through prudential regulations related to capital adequacy, liquidity practices and corporate governance), and with the future direct supervision by the RBNZ under the DTA, mitigates any potential that the smaller deposit takers present material risk to the overall system. To the contrary, we are extremely aspirational in the belief that the future of licensed deposit takers under the DTA will add and not detract from the overall aim of financial stability. Serving a wider range of customers and bringing diversity to the system should be a goal under the stability mandate.

### **Competition**

We firmly believe in the importance of growing the "challenger bank" sector in New Zealand, and how the DCS can aid this objective. We would like to see the impacts of competition and diversity within the deposit taking sector more expressly addressed in the Levy Framework consultation process.

If a risk-based approach to the levy creates a hindrance to competition and the viability of the smaller deposit takers, then we would consider this a missed opportunity to grow the strength of deposit takers outside the "big four" banks.

Furthermore, we believe it is imperative that under the DTA all licensed deposit takers should be unrestricted in the use of the word "bank". Creating a clear distinction in the market between prudentially regulated licensed deposit takers and those that are not prudentially regulated will enable all licensed deposit takers to compete fairly in the same market. It would also assist customers to easily identify which financial institutions offer protected deposits.

Therefore we respectfully request that the Reserve Bank provides its views on competition amongst licensed deposit takers, and what active measures it is seeking to undertake to foster competition.

## Framework for Growth

Xceda views the Deposit Compensation Scheme (DCS) and its associated levy structure under a lens of how it may impact our aspirations for growth. We believe that it is vital that, for the reasons of stability and competition as outlined above, the DTA and its associated regulations and standards allow licensed deposit takers to prosper.

In other jurisdictions such as Australia and the United Kingdom there has been a growth of deposit takers outside of the major incumbents. As mentioned above, the focus on competition and diversity in our view aids financial stability.

At this stage we are not sure of the intention of the Reserve Bank in relation to the position of the smaller licensed deposit takers, and whether creating pathways for growth is a goal of the Bank. Clarification in this regard would assist not only our understanding of our own position in the sector, but also for our key stakeholders so we can attract the further capital we will need to grow.

In the case of Xceda, we are continuing to develop our business planning for the introduction of the DCS, and hence are actively engaged in this consultation process. As an example of our preparedness for the DCS, we are aware of the concerns of the RBNZ surrounding the “tradability” of debentures. Therefore in August of this year we held a special meeting of our depositors who approved amendments to our Trust Deed to remove such transferability provisions. We also removed any reference in the Trust Deed and our Product Disclosure Statement to the term “debenture”, replacing such terms with “Secured Deposits” (which includes term deposits and savings accounts).

Set out below are Xceda’s responses to the following consultations:

- Appendix 1 – Responses to Levy Framework Consultation Questions; and
- Appendix 2 – Responses to Statement of Funding Approach Questions.

Thank you for the opportunity to present our views on these important matters.

Yours sincerely,

**Daniel McGrath**  
Chief Executive Officer  
Xceda Finance Limited

Attachment: Joint submission of the Non-bank Deposit Takers dated 25<sup>th</sup> September 2023 (submitted by Buddle Findlay).

## Appendix 1 - Responses to Levy Framework Consultation Questions.

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

There are likely to be other options, however for simplicity the options outlined seem sensible at this stage.

- 2) Do you agree with our preferred approach to estimating the protected deposit base?

We agree with the preferred approach, but importantly note that in Section 2.2 (Proposed Solution) of the Consultation Paper there is no mention of the Finance Companies, just the Credit Unions and Building Societies. It is our understanding from the Auckland workshop that a calculation of the adjustment factor for the Finance Companies was not included due to RBNZ not understanding as yet the products being offered by NBDTs. We welcome the opportunity to consult with the RBNZ to aid in this understanding.

As we assume other Finance Companies like Xceda have much larger average account balances more in line with Building Societies, our assumption is a 40% adjustment factor will apply to Finance Companies also. We are happy to provide relevant data and to calculate the average balances if this was helpful for the analysis; and would imagine it would not be difficult for the other Finance Companies to do this exercise also.

- 3) Do you have any comments on the proposed solution?

See comments above. Moreover, we do not believe there is enough data at this stage to propose an alternative solution.

However one suggestion would be to adopt a staged approach for the initial two years so that the levy can be progressively priced into deposits. Given that it is likely that deposit takers may only have as little as 6 months' notice of the calculations prior to implementation, a staged approach over 12 to 24 months would allow a more efficient and accurate transition.

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

We believe it should be reviewed in each of the first two years at least. This would provide deposit takers with certainty and allow adequate planning to take place with as little disruption to our businesses as possible.

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

Our strong view is that a flat-rate levy is the most appropriate to adopt.

In relation to the design of the risk-based approaches, it is our view that the difference in levy rate across the four buckets is too high. A four times multiplier for those deposit-takers deemed to be of the highest risk is too significant and, as detailed in our above submission, will have detrimental impacts on competition in the deposit-taking sector.

Furthermore, in a period of a declining official cash rate, the differences amongst deposit takers under this approach would be accentuated. For example, a 20 to 30 bps difference in the levy in a 2 to 3% official cash rate environment would be extremely material.

As it is most likely that the smallest deposit takers are those with the highest levels of risk, a significantly proportionally higher levy rate will constrain our ability to grow and be more competitive (which in time would lead to a decrease in risk through increased economies of scale). It is equally likely that the largest deposit-takers (the big four banks) are those with the lowest levels of risk and therefore the gap between the big four banks and the remainder of the deposit-takers will continue to grow.

In terms of the ability to manage capital and profitability, under a risk-based approach the smaller deposit takers could experience material changes in the risk metrics from year to year (or even shorter periods). Capital planning would therefore be impacted, resulting in a much less certain environment for the smaller deposit takers. Forward planning to ensure stability becomes more challenging than the certainty of a flat-rate levy system.

International experience suggests a flat premium is the right approach for a new deposit compensations scheme. Our research indicates that 60% of international jurisdictions use either a flat-rate approach or a combination of flat-rate and risk-based methods.

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

We reiterate that our strong view is that a flat-rate levy is the most appropriate to adopt.

This is because a flat-rate levy has the benefits of proportionality between deposit-takers and promoting competition between deposit-takers. A flat-rate levy additionally promotes the prosperity and wellbeing of different communities, cultures and occupations throughout New Zealand who are served by specific deposit-takers (rather than national or international deposit-takers) whose primary focus is on supporting these communities, cultures and occupations rather than strictly maximising profit.

We believe it is simply not possible to come up with a credible risk based premium structure without extensive data. That data and an appropriate methodology can only realistically be determined after the DCS has been running for some time and there has been an opportunity transition deposit takers to the DCS with the least risk to the system and of unintended consequences. The miniscule value of formulating a credit risk based premium structure on the ability to raise the compensation fund strongly favours a standard fee approach – particularly given we understand over 90% of deposits are with the biggest five retail banks.

## Appendix 2 - Responses to Statement of Funding Approach Questions.

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

Yes, the impact of competition and a pathway for the growth of the licensed deposit takers sector outside the four major retail banks.

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

Yes, we believe that adopting a target fund approach is the most appropriate approach to the DCS funding strategy. This is because a target fund approach allows for long-term transparency between the government and deposit-takers. This additionally has the benefit of allowing the fund to build up over a sustained period of time, meaning that levy payments will not impossibly burdensome in the short to medium term.

We believe that the balance between the efficiency, equity and resilience principles should be weighted in favour of the efficiency and equity principles (i.e., that levies are not front loaded, or are only front loaded to a minimal degree, in the short term). This would also be consistent with encouraging competition and diversity in the financial sector. This is for the reasons set out above, namely that the capital settings in New Zealand make it so that bank failure in the intermediary period is highly unlikely.

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

Yes, we believe that the target fund size should take into account likely recoveries. This is because not considering likely recoveries would be extremely inefficient. Having a target DCS fund which does not consider likely recoveries, despite the knowledge that a majority of costs of the DCS will be recovered following an insolvency event of a deposit taker, is illogical, a significant expense for deposit-takers. Any target fund size that does not consider likely recoveries would only result in a higher amount of levies payable, despite the fact that the target fund size will never be required in reality.

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

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

Yes – but NBDTs and banks should have input into the terms of engagement.

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

No – we believe it is wrong, for example, to use US data. It is a fundamentally different market. Australia, the UK and Canada are the most comparable markets (and we do not understand why you have not included the UK in your comparisons yet included very different markets like Taiwan, Switzerland and the US).

- 7) Do you agree with the assumed losses given the default for the different classes of deposit takers? If not, why not? What would be an alternative approach?

No – the data is inadequate and appears to pre-date prudential regulation of non-bank deposit takers and a higher bank capital ratios. This data needs to be more future looking and factor in the current regulatory environment.

- 8) What is your preferred target fund size? Why?

0.5% of deposits because of the composition of the market now and because it is a new scheme and any implementation impacts should be minimised.

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

We are of the view that the timeframe for building the DCS fund should be 20 years. This is because the New Zealand capital settings are sufficiently conservative (to match a RBNZ risk appetite of '1 in 200' years) that bank failure and financial crisis in the intermediate build-up period is extremely unlikely. As such the DCS fund can be built up over a longer time, which allows for levies to be spread across a longer period.

- 10) Do you prefer an alternative timeframe? Why?

No.

- 11) Which of the three options do you prefer and why?

Option A because it reflects the risk in the New Zealand sector and it will enable the impacts of the DCS on competition and financial inclusion to be better managed, with the least immediate financial impact.

- 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 initial comment.

- 13) Do you have any other comments or matters covered in this discussion document?

Please note our extensive comments in relation to the DCS Levy Framework.



Our final comment would be that in the governance of the new DCS Fund, we would recommend that representatives of the deposit taking institutions are able to participate in some capacity to ensure that the industry has input into the operations of the Fund. For example, at least one representative from each group of deposit takers.

DRAFT