The Treasury

Statement of Funding Approach Consultation Submissions Information Release

December 2023

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Reserve Bank of New Zealand
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1. INTRODUCTION

1.1 This is a submission on:

a) Proportionality Framework – consultation paper; and

b) Levy Framework – consultation paper.

NBS also comments on the Statement of Funding Approach – Consultation Paper on the understanding that the Reserve Bank will pass those comments on to the Treasury.

1.2 As you will be aware Nelson Building Society (NBS) is easily the largest of the non-bank deposit takers and as a result it has some specific issues which it would like to comment on in relation to both the proportionality consultation and levy consultation.

1.3 NBS is also party to a group submission from a number of non-bank deposit takers on each of these consultations and confirms its support for all of the points made in those submissions. In particular, NBS believes:

a) The Reserve Bank should develop a simple but safe framework for non-bank deposit takers that modifies and simplifies the standard bank prudential requirements – particularly on capital and liquidity. In fact, NBS notes that the Reserve Bank has already proposed adopting a simplified approach to liquidity rules for non-bank deposit takers. NBS asserts these will provide a sensible and workable liquidity framework for most, if not all, non-bank deposit takers and is a good example of how a simple but safe framework could and should work.

b) Until the Reserve Bank (and Treasury) have better data and a better understanding of the non-bank deposit takers sector (particularly the mutuals – such as buildings societies and credit unions, like NBS) we believe that the Reserve Bank should adopt a standardised approach to levies – i.e., the same levy rate for everyone. We believe that the Reserve Bank should also be encouraging the growth of a more diverse banking sector in New Zealand, both for competition and financial stability reasons. A flat rate levy could help achieve that.

The specific feedback that NBS wishes to make is:

2. PROPORTIONALITY CONSULTATION

<u>Question 6 - Transitioning</u>

2.1 Based on the thresholds which are proposed for differing approaches to regulation, it seems as though NBS is the most likely institution to have to transition between categories. Its assets are currently approximately $1 billion, and it is reasonably plausible that its assets could double in size over the next five years – in which case it would need to transition to the next tier of prudential regulation reasonably soon after the Deposit Takers Act licencing regime has been completed. NBS supports the concept of a transition plan between categories but has had insufficient time to consider whether the proposals in the consultation paper appropriately reflect what it would actually need to do. NBS would be keen to work with the team developing proportionality guidelines on this issue.

Question 7 - Other Elements

2.2 Even with its current scale NBS is having to spend significant resources in uplifting its compliance processes – particularly in respect of consumer lending rules. It seems there is a growing acknowledgment that the regulation and compliance processes in some of these areas do not meaningfully help consumers. NBS has, and will always be**,** concerned with what is best for its clients. It believes it is vital that any additional compliance costs are only imposed where there are clear prudential, and therefore client benefits.

3. LEVY CONSULTATION

Use of Credit Ratings

3.1 NBS's experience with credit rating agencies is such that it does not believe that credit ratings should ever be used as a proxy for risk in the New Zealand market. The approach adopted by rating agencies specifically penalises institutions such as NBS who are not registered banks and have a concentration of assets in regional New Zealand. We have attached extracts from our recent credit rating report and Key Rating Drivers Report to this submission as **Appendix One**. NBDTs, like NBS, provide a face-to-face service offering to people in these communities, including the elderly and other vulnerable groups.

Estimating Protected Deposit Base

3.2 NBS has a high level of deposits over $100,000 which will not be insured and so supports the 40% Adjustment proposed for building societies who are non-bank deposit takers.

Support for the Flat Rate Levy Approach

3.3 NBS does not believe that the Reserve Bank has enough knowledge of the non-bank deposit taker sector and, in particular, the mutual sector, to make an informed decision on the precise factors to be taken into account for any risk-based modelling. Indeed, Reserve Bank officials made that observation at our group meeting in Wellington. Given this information deficiency, a risk-based levy could not meet the “predictability of levies principle” or be clear in its impact on a deposit-taker, as required by legislation, and indeed could exacerbate any risks.

Feedback on Risk Based Approaches

3.4 NBS does not believe that the Reserve Bank and Treasury data properly accounts for significant one-off events like the global financial crisis and the Covid19 pandemic. This could, for example, result in a distortion of any profit metric if it is used in the risk model.

3.5 Furthermore, the profit metric should be significantly adjusted for building societies (and certainly NBS) because:

a) It is mutual, owned by its clients and is therefore not distracted by shareholder returns, which can influence client outcomes of listed banks. NBS offers a superior level of personal service which is highly valued by its base. NBS surveys show that 66% of clients sought a home loan from NBS because it was 'local and they could deal with local people'. Clients choose NBS not for economic reasons, but because we live and work in the same community as them, and therefore genuinely care about their financial well-being.

b) NBS also prides itself on making a meaningful financial contribution to the well-being of its community. It aims to distribute 10% of its after-tax profits into the community every year (by way of sponsorship or donation). NBS has provided over $2.1M in sponsorships over the last 2 years and the budget for this business year is $1.4M. The distribution of these funds into the local charitable sector is very much supported by our clients. They understand that by banking with NBS, they are making a difference in their communities.

3.6 Consistent with NBS's view that there should be a flat rate levy (initially at least) we believe the modelling to determine the funding should also be simplified until there is more data. Maximum losses for NBDT's should be modelled in the same way as small banks. NBS, as the largest NBDT with probably 40% of total exposure of the NBDT group, believes it has the same risk profile as a small bank. NBS has loans of over $700M secured by 1st charge registered mortgages, most secured by residential property, with an average LVR under 40%. Accordingly it would be wrong to use the proposed default rates for NBDTs for NBS – particularly when we are not aware of any evidence to support them.

Risk buckets

3.7 NBS has not had the opportunity to meet with the RBNZ to discuss how the calculations used to allocate risk buckets will apply to it, because it has had other issues it has been focussing on during the consultation period. However, it strongly believes any model used to allocate risk, which will be unique to the New Zealand data, needs much more information and discussion before it should be used. Until the Deposit Compensation Scheme has been operating for some time, it is premature to develop such a model – especially as the adjustment factors applied to each bucket are so arbitrary. Much more thought is required as well as initial experience on market impact of the scheme. NBS sees a significant risk of unintended consequences given the time it has taken New Zealand to adopt a deposit compensation scheme relative to almost all other developed countries.:

3.8 NBS also believes that a more graduated approach should be taken if risk-based levies are to be used. For example, a small change in risk profile taking a deposit taker, for example, from 39.5 to 40.5 on the Reserve Bank's risk scale should not result in a doubling of its deposit insurance levy. If the risk-based approach is to be used (and we seriously question that it should), a more graduated approach is necessary.

4. STATEMENT OF FUNDING APPROACH

4.1 NBS prefers Option A of the options identified by the Treasury for developing the compensation fund. This is primarily because NBS is concerned about the transition risk for challenger banks in particular, in transitioning depositors to insured deposits and the risk associated with those insurance costs which could in some cases amount to a significant percentage of profits relative to the big 5 banks.

4.2 NBS believes the lower range for the fund size and the longer period to raise it can be justified because of:

a) the high levels of capital New Zealand banks need to hold relative to international norms;

b) the massive difference in size between the big 5 banks (for which the fund will never be sufficient if they were to fail) and the NBDTs (where the fund would easily cover a failure and where the contagion impact is likely to be minor given the very different business models and focus on discrete regions for the mutual non-banks at least).

Thank you the opportunity for NBS to make this submission. We look forward to working with regulators to ensure the best outcomes are reached for the wider banking sector.

Tony Cadigan

Chief Executive – NBS