The Treasury

Statement of Funding Approach Consultation Submissions Information Release

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Deposit Takers Act consultations – levy framework, proportionality framework and statement of funding approach

Thank you for the opportunity to submit our views on RBNZ's consultations on the levy framework for the Depositor Compensation Scheme (**DCS**) and proportionality framework for developing standards under the Deposit Takers Act (**DTA**), and The Treasury's consultation on the statement of funding approach for the DCS.

This is a joint submission on behalf of The Co-operative Bank Limited, Kiwibank Limited, SBS Bank and TSB Bank Limited.

Each bank has contributed to NZBA's submission and some have responded individually to the consultations, however, we considered it would also be worthwhile to highlight where our interests are aligned as smaller domestically owned banks.

In relation to NZBA's submission, we would like to reinforce the point made there that the timeline for implementing the DCS should be lengthened. Short timeframes for delivering significant reforms like the DTA and DCS are felt most acutely by smaller domestically owned banks, particularly where there is a very short period between the finalisation of technical requirements and the implementation date. That is because we have fewer resources to deliver these regulatory reforms which also compete for priority with our strategic objectives like growth and innovation. Trade-offs between regulatory requirements and strategic objectives impact on our ability to compete and challenge the big four Australian owned banks for market share. While we anticipate that the proposed proportionality framework (which we welcome and strongly support) will alleviate some of these challenges in the context of our prudential requirements, it will have limited (if any) benefit in the context of the DCS.

Our key submissions on each of the consultation papers are as follows.

Levy framework for the DCS

- We support the composite risk indicator model for calculating the DCS levy. Subject to the following feedback, we consider that this model is most likely to deliver a levy that is fair to all deposit takers.
- We support the design of the four risk buckets and would not support bucket 1 being split (as was discussed at the recent workshop on DTA implementation). Splitting bucket 1 would most likely impact smaller banks and would mean that deposit takers competing in the same market are treated differently (i.e., subject to higher levies), contrary to s 4(b) of the DTA. It is logical that most banks fit in bucket 1 due to the RBNZ's conservative capital requirements.
- In relation to the risk metrics, we have the following feedback:
    - The risk indicator framework does not differentiate between banks that calculate their capital ratios using the standardised vs internal ratings based (**IRB**) methodologies. The IRB methodology allows the domestic systemically important banks (**D-SIBs**) to calculate a lower risk weighted asset outcome than a standardised bank for key exposures, namely residential mortgages and lending to small and medium

enterprises. As a result, for the same amount of capital against the same exposure, the D-SIBs report a higher capital ratio. This risk indicator would treat IRB banks as 'safer' than standardised banks when the underlying risk exposure and the amount of loss absorbing capital held is the same. To enable an apples-with-apples comparison, the capital adequacy risk indicator should be based on the standardised capital ratio for all banks. The implementation of dual reporting makes this feasible.
    - In determining the risk weighting methodology, best practice from equivalent regimes overseas should be reviewed and aligned (where appropriate) to reflect the purpose of the DCS. One example of a potential discrepancy is the possible over-weighting of short-term metrics such as profitability at the expense of longer-term metrics such as capital and liquidity.
- We strongly oppose a risk-based levy determined by credit ratings. This approach would contribute to an uneven playing field as the D-SIBs benefit from the strong credit ratings of their Australian parents, despite limits under Australian law and prudential rules on the support parents can provide to their overseas subsidiaries.
- We also oppose the flat rate approach to calculating the DCS levy on the basis that it is not proportionate, may not reflect the likelihood of a compensation event for a particular deposit taker occurring, may drive risk-taking behaviour by some deposit takers, and its implementation could lead to unfair outcomes for some deposit takers and potentially customers as well.

Proportionality framework for developing standards under the DTA

- Subject to the following feedback, we strongly support the introduction of a proportionality framework and look forward to working with RBNZ to apply it to the existing prudential requirements. If implemented well, the proportionality framework will introduce scalability which will decrease the regulatory burden on smaller domestic banks that have simpler business structures, pose less risk, and have less capacity to implement complex requirements. This, in turn, will facilitate competition.
- As discussed above, if 'strength' is used as a dimension for tailoring requirements, it must be based on equivalent measures (e.g., the standardised approach to calculating capital requirements) so that banks that are non-D-SIBs are not unfairly penalised.
- While we are supportive of the three-tier model, we consider deposit takers should be grouped along the lines of the existing D-SIB/non-D-SIB/NBDT categorisation. Introducing a new method of categorisation to deliver the same outcome introduces unnecessary complexity and ambiguity to the regulatory regime. We note that the policy justification for introducing the D-SIB categorisation applies also to the proportionality framework – the intention of both is to recognise that the failure of some market participants would have a larger impact on the financial system than others, such as non-D-SIBs and NBDTs.

Statement of funding approach – funding strategy for the DCS

- We support Option A as this approach prioritises lower upfront costs and aligns with the risk profile of the New Zealand market and given recent capital uplift.