The Treasury

Statement of Funding Approach Consultation Submissions Information Release

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Deposit Takers Act consultations

Thank you for the opportunity to submit The Co-operative Bank's (**Co-op Bank**, **we, us, our**) views on the Treasury's Statement of Funding Approach – Funding Strategy for the Depositor Compensation Scheme (the **Paper**).

Co-op Bank is a registered bank structured as a co-operative company under the Co-operative Companies Act 1996. While we share some of the characteristics of a company structure, we are customer-owned and operate as a co-operative.

We appreciate the opportunity for consultation. Some of our feedback on the Paper has been incorporated into the NZBA submission, and in a joint submission made on behalf of The Co-operative Bank Limited, Kiwibank Limited, SBS Bank and TSB Bank Limited. Accordingly, in this submission we address in further detail some of the aspects of those submissions that we wanted to elaborate on further, or in respect of which we may have a more specific view.

Our comments on the Paper are set out at Annexure A. In summary we:

- agree with the target fund approach and are not in favour of the 'ex post levy' option or insurance based pricing;
- agree that recoveries would be expected to be made available as part of any resolution process;
- agree with using the discretionary method for estimating the likelihood of a failure event and associated costs given the limited availability of data;
- accept that there is no perceived benefit from additional failure scenario modelling from the Treasury;
- accept the current modelling assumptions;
- agree that a target fund size of 0.5 per cent of protected deposits would result in an appropriate fund whilst mitigating impacts to customers;
- agree that Option A, an approach that prioritises lower upfront costs with a target fund built over 20 years, would align with the risk profile of the NZ market (i.e., there have been very few failures of deposit takers in recent years). Our agreement is on the basis that:
    - 20 years in line with likelihood of failure risk;
    - spreading the associated levy over a longer period reduces the annual impact on customers (if passed on) or profitability (if absorbed); and
    - this option is in line with the 'net impact' in the table on page 19 of the Paper; and
- agree to the proposed changes to the SoFA e.g., a review of the SoFA every 5 years and increased levies following a failure.

Yours sincerely,

Jon Armour

Chief Product Officer
The Co-operative Bank Limited

Annexure A

References in this section are per the Statement of Funding Approach Consultation Paper - including the questions noted in the green boxes.

Section 3: Statement of Funding Objectives and Principles

Are there other principles that you think we should consider?

We **agree** that the defined principles support the establishment of a fund over time and likelihood of failure, and we have not noted any additional principles.

We do note that in order to meet the principle of public confidence, while not directly related to the funding strategy, customers may seek assurance (at the inception of the DCS) as to whether their deposits are covered.

This will require certainty, through timely and effective communication, with regard to the SCV and product definitions (in particular) prior to the DCS taking effect. It is important that our front-line bank staff and customers have access to this detail so they can properly understand the protections offered under the scheme and not inadvertently commit an offence by informing someone they are protected when they are not.

Section 4: Conceptual approaches to the funding strategy

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

We **agree** with the target fund approach i.e., build towards a set long run DCS target, as a percentage of insured deposits.

We are not in favour of the 'Ex post levy' option or insurance based pricing for the same reasons outlined by the Treasury (e.g., we believe an ex post levy would be inequitable as a failed deposit taker would not pay, and there is not enough data to do insurance based pricing comprehensively).

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

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

We **agree** that recoveries would be expected to be made available as part of any resolution process. Recoveries are part the resolution process and should therefore be factored in when determining the target fund size. We also acknowledge that the timing of recoveries may require the Crown backstop to ensure prompt payment from the DCS fund.

Section 6: Methodology for assessing the funding obligation of the DCS (likelihood and costs of failure)

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

We **agree** with using the discretionary method for estimating the likelihood of a failure event and associated costs given the limited availability of data.

We also **agree** that there is no perceived benefit from additional failure scenario modelling from the Treasury.

Section 7: Using 'severe but plausible' failure scenarios to estimate costs to the DCS (Loss estimation)

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

We **agree** with and accept the current modelling assumptions.

Section 8: Options for a target fund size

What is your preferred target fund size? Why?

We **agree** that a target fund size of 0.5 per cent of protected deposits would result in an appropriate fund whilst mitigating impacts to customers.

Whilst 0.5 is at the lower end of the range, the consultation document notes this is consistent with the approach of setting a target fund size that factors in recoveries from a failed deposit taker, albeit involving greater reliance on the Crown backstop. It would likely cover a material proportion of the costs of contributing to a resolution of a large bank or enable the DCS to compensate depositors if multiple non-bank deposit takers failed.

Note that we are relying on the Treasury's scenario analysis and protected deposit modelling to support the target fund size. We also note that further detail is required on the modelling options and fund rules, including in respect of the following matters:

- Does the current modelling include fund earnings and admin fees?
- Implications when the fund meets its target?
- Implications when new entrants are introduced?
- The Crown cost (i.e., the cost to the fund for the Crown maintaining a 'liquidity buffer' such that the impact on the target fund size can be determined, in other words what is the relative impact on Options A through C?)

Section 9. Timeframe to reach target fund size

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

We **agree** that an approach that prioritises lower upfront costs with a target fund size built over 20 years would align with the risk profile of the NZ market (i.e., there have been very few failures of deposit takers in recent years).

Subject to the Crown liquidity fee being reasonable, we believe that the advantages from funding over 20 years outweigh the disadvantage of having a lower buffer in the unlikely event of one of the large banks failing within the first 20 years of the DCS. The Paper noted that this provides a more equitable funding approach and enables more efficient funding over the long-term.

Additionally, we believe that this sends the right signal to the market (i.e., a large bank failure within 20 years is regarded as highly unlikely).

Section 10: Options analysis

Which of the three options do you prefer and why?

We **agree** with Option A (0.5 over 20 years) on the basis that:

- 20 years in line with likelihood of failure risk;
- spreading the associated levy over a longer period reduces the annual impact on customers (if passed on) or profitability (if absorbed);
- this option is in line with the 'net impact' in the table on page 19 of the Paper; and
- the equity and efficiency arguments that the Reserve Bank has stated are reasonable.

While the term of 20 years is favourable, the Crown cost (i.e., the cost to the fund for the Crown maintaining a 'liquidity buffer') as noted in section 8 is required to confirm the true cost of Option A.

We understand a second SoFA consultation paper will be published in early 2024 covering operational aspects such as:

- The investment approach for the fund;
- Implications when the fund meets its target fund size;
- How new deposit takers/market entrants are treated; and
- Costs associated with the Crown holding liquidity for the backstop.

Once known, these issues may have an impact on whether Option A remains our preferred option.

Section 11: Changes to SoFA

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

We **agree** to the proposed changes to the SoFA e.g., a review of the SoFA every 5 years and increased levies following a failure.

Section 12: What happens next

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

No further comments