5 October 2023

By Email
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Cross-Submission on the Market Study into Personal Banking Services

1. This cross-submission is made on behalf of the community banks[1] and other regulated deposit takers listed at the end of this submission (**RBNZ regulated deposit takers**).

2. As you will be aware, there are 27 Reserve Bank of New Zealand (**RBNZ**) licensed banks in New Zealand, and 15 licensed RBNZ "non-bank deposit takers." The banks are currently regulated under the Banking (Prudential Supervision) Act 1989, with the non-bank deposit takers being regulated under the Non-bank Deposit Takers Act 2013 (**NBDT Act**). The recent enactment of the Deposit Takers Act 2023 (**DTA**) will bring all 42 of these RBNZ licensed deposit takers into a single regulatory regime, with regulations and standards being developed over the next 5 years under the DTA. A key element of the DTA is the introduction of the new Depositor Compensation Scheme (**DCS**) which is scheduled for commencement in October 2024.

3. Another important element under the DTA which is currently under consultation is the proportionality framework. This was a fundamental principle requested by the Finance and Expenditure Select Committee to ensure that competition and fairness was embedded in the new banking legislation. At this stage, we have seen little concrete detail as to what proportionality will really mean in practice to foster competition.

4. We did not make an initial submission to the market study into personal banking services (**Banking Enquiry**) – but ideally would have done so. However, our focus has been on making submissions on three other consultations which had been occurring at the same time which were of critical concern to the RBNZ regulated deposit takers. These are consultations by the RBNZ and the Treasury on:

   (a) Proportionality principles under the DTA;

   (b) Levy principles for the DCS; and

   (c) Statement of Funding Approach by Treasury.

   All of these are relevant to the Banking Enquiry and are attached below.

5. To a large extent, the fact that we did not make an initial submission to the Commerce Commission on the Banking Enquiry is symptomatic of a wider problem. Notwithstanding the creation of the Council of Financial Regulators consultation on legislative changes in the financial sector has been relentless for the last five years (with the generational change in the DTA being the critical focus for the RBNZ regulated deposit takers).

6. We believe that our business models, the nature of how we are regulated now, and the contribution we make to the New Zealand financial system is poorly understood by officials and regulators. Certainly, this is relative to the big banks. It has required significant effort by us to educate officials and regulators on how we operate and the wider benefits we bring to the financial system. This has

[1] We note that the "community banks" are not registered banks but do tend to provide full banking services to their local communities.

become an almost constant exercise given the regular change of personnel amongst officials and regulators responsible for financial regulation.

7. Furthermore, we face significant regulatory uncertainty. The RBNZ has explicitly recognised potential threats to our business models and viability and therefore this ranks a higher risk than:

   (a) cyber-attacks;

   (b) the cost-of-living crisis impact on the customers.

8. The Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) is probably the most obvious example and the RBNZ regulated deposit takers are relieved that most political parties have agreed to review the CCCFA.

9. In relation to the specific submissions made to the Commerce Commission on the Banking Enquiry, we wish to focus the attention in this cross submission to the submissions of the Financial Services Federation (**FSF**) and the collective submission of Kiwibank, TSB Bank, Co-operative Bank and SBS Bank (**challenger banks**). In particular:

   (a) We agree with the FSF that the CCCFA has had a material impact on their ability to compete and requires a disproportionate relative level of resources to deal with compliance compared to the large banks. In addition to constraining our ability to compete by largely standardising lending criteria, it has also had an impact on financial inclusion. Many customers who should have access to credit, no longer can, impacting small business and first home buyers.

      It speaks volumes that most banks have ended up settling claims in relation to breaches of the CCCFA disclosure rules. This just indicates how complex legislation is and how difficult it is to comply with – the only winners are lawyers and accountants putting in place complex compliance systems.

      We also agree with the comments made by the FSF in relation to preferential treatment that was provided to the larger banks during Covid. However, preferential treatment was even more stark in relation to the RBNZ regulated deposit takers – all of which are, like the big banks, prudentially regulated by the RBNZ. This is because in addition to the regulatory relief provided by the RBNZ (and Ministry of Business Innovation and Employment) significant benefits were also provided to the banks (particularly larger banks) to insulate them from the effects of Covid. This included access to short term liquidity through term auction facilities, capital relief for giving loan holidays and to long term funding at OCR through the Funding for Lending Scheme and support for lending to business customers through the Business Finance Guarantees scheme. This provided certainty of liquidity to banks as well as the ability for the banks to fund themselves at significantly lower rates than they would have been able to do so through the wholesale or retail markets. None of these benefits were provided in any meaningful way to the RBNZ regulated deposit takers. Notwithstanding this most of the RBNZ regulated deposit takers thrived through Covid because of the dedicated support of their customers, particularly in the regions. However, the RBNZ regulated deposit takers are less insulated to the follow-on impacts of Covid (the cost-of-living crisis) than the big banks. This is because the big banks did not appear to pass on the benefits that they received from RBNZ funding and instead used it to bolster profits and retained earnings.

(b) We note the comments in the joint submission by the challenger banks about the disproportionate regulatory impact of banking regulation between them and the domestic systemically important banks (**DSIB**). By contrast the RBNZ regulated deposit takers have actually had a very stable and fit-for-purpose prudential regime that has operated largely unchanged for over a decade. This was imposed through the NBDT Act and associated regulation – which has almost been entirely unchanged. While becoming a non-bank deposit taker has been hard (there have been no new entrants in the last decade) for those in the regime it has resulted in a period of relative stability as the prudential settings have by and large been right. However:

(i) We have had to pay for our own banking supervision – unlike the banks. This is because the RBNZ has outsourced the supervision of the RBNZ regulated deposit takers to trustees. We have had to pay the trustees for that supervision whereas banks do not have to pay the RBNZ for supervision; and

(ii) We are extremely concerned about the issues raised by the challenger banks about the relative impact of banking regulation. While we support a single prudential regulatory regime (being introduced by the DTA) we believe it is critical that the regime is sensibly and proportionally applied. Given the current regime has worked well for a decade there is no reason for any meaningful change or uplift in regulation. That does not appear to be the approach of the RBNZ though – and hence the focus we had on submitting on the proposed proportionality framework. If this does not happen, we are concerned about further deterioration in competition and banking in New Zealand and further negative impacts on financial inclusion in New Zealand (particularly in the regions where human interaction is highly valued).

(iii) The impact on competition could be even further exacerbated by the RBNZ's proposed funding model for the depositor compensation scheme. The RBNZ regulated deposit takers do not believe the proposed RBNZ approach is supported by data and certainly does not accurately assess the contagion risk posed by the large banks. We believe the best approach for competition in the medium term in New Zealand would be for the DSIBs to fund the cost for the first 5 years (as has happened in other jurisdictions) given they currently have excess profits available to fund it and the rest of the sector does not.

10. In summary the RBNZ regulated deposit takers agree with the FSF on the impact of the CCCFA on competition in New Zealand and believe the negative impact on competition from preferential treatment given to larger banks is even greater than identified in the FSF submission. We have very real concerns that the issues raised by the challenger banks about banking regulation will have an even greater impact on them if the RBNZ uses the Deposit Takers Act to impose even more regulation on them (regulatory creep) when there is no evidence it is needed.

Sincerely,

Community Banks	**Other RBNZ Regulated Deposit Takers**
Nelson Building Society	General Finance Limited
Heretaunga Building Society	Mutual Credit Finance Limited
Wairarapa Building Society	Gold Band Finance Limited
Unity Credit Union	Xceda Finance Limited
Credit Union Auckland Incorporated	
Christian Savings Limited	

Submission on the Levy Framework for the Depositor Compensation Scheme

25 September 2023

Christian Savings Limited

Credit Union Auckland Incorporated

Finance Direct Limited

General Finance Limited

Gold Band Finance Limited

Heretaunga Building Society

Mutual Credit Finance Limited

Nelson Building Society

Unity Credit Union

Wairarapa Building Society

Xceda Finance Limited

SUBMISSION ON THE LEVY FRAMEWORK FOR DEPOSITOR COMPENSATION SCHEME (LEVY CONSULTATION)

Introduction

1. This submission is made on behalf of the non-bank deposit takers listed on the cover page of this submission (**NBDTs**).

2. The NBDTs have appreciated the opportunity to engage with the team at the Reserve Bank of New Zealand (**RBNZ**) responsible for the Levy Consultation at industry-wide briefings at Wellington and Auckland on 16 August and 22 August respectively.

3. This represents our formal response to the Levy Consultation as a group. Many NBDTs have made their own separate submissions given the importance of the issues to all of them. As a consequence, we are only making high level comments on matters of common agreement and have not formally answered the questions attached to the Levy Consultation.

Consultation Process

4. Many NBDTs were concerned at comments made at the briefings that officials did not have a good understanding of the non-bank deposit taker sector – particularly given the efforts many NBDTs have made both directly and through the Finance and Expenditure Committee to educate politicians and officials on the value that NBDTs provide to the New Zealand economy. The NBDTs are keen to explore ways with the RBNZ to better "institutionalise" that knowledge – particularly in Ministry policy teams.

5. The NBDTs believe it is fundamental that the RBNZ have a good understanding of their business before attempting any risk-based levy framework. The NBDTs understand that 50% of countries with deposit insurance use a flat-rate levy and while there has been an increasing trend to using risk based (or other differential) levies this appears to be occurring after a deposit insurance scheme has been operating and once better data about what drives failures is available.

6. The NBDTs strongly believe the same approach should be taken in New Zealand and risk-based levies should only be considered once the Deposit Compensation Scheme (**DCS**) has been operating for some time.

7. The NBDTs believe that due to the critical impact of levies on their ability to compete (and in some circumstances potentially existential threat) that it is imperative the RBNZ work closely with them. The NBDTs believe that this would be best done through a working group – with perhaps 3 or 4 NBDT representatives working with the core team at the RBNZ. This in the NBDT's experience best achieves good workable policy. The NBDT's certainly support the comment in the Deposit Taker News – Issue 1 (**DT News**) that it is important the RBNZ keep engagement lines open and not just when it is formally consulting.

8. The NBDTs believe that because the Levy Framework is likely to have a bigger impact on them than banks that consultation with them should be prioritised over banks. We note that Deputy Governor Hawkesby in the DT News indicated the RBNZ was prepared to meet with the NBDT's

earlier than the beginning of 2024, if requested. Accordingly, the NBDTs request a meeting to set up a working group to discuss issues with the Levy Consultation in October or November this year.

Core Concerns

9. Our primary concern with the Levy Consultation is the potential impact of the proposed levies on our competitiveness and as a consequence the impact that it will have on:

   (a) competition within the deposit-taking sector; and

   (b) the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders.

10. The need to maintain competition and the desirability of diversity are both principles that the RBNZ is required to take into account when exercising its functions, powers and duties (section 4 of the Deposit Takers Act 2023 (**DTA**)). It is our view that the Levy Consultation has not sufficiently addressed these factors.

Competition Impact

11. We believe that the risks which the Reserve Bank is seeking to address through a differential, risk-based levy approach are far outweighed by any competition and diversity benefits of, for example, a simple common flat rate levy approach. We are concerned that a risk-based levy approach will have a detrimental impact on competition because it may make it difficult for smaller deposit-takers to compete with the larger banks for deposits and thereby constrain their ability to effectively compete in the deposit taker market.

12. At worst, the current risk-based approach could have a negative impact on financial stability if that caused a lack of liquidity for a range of deposit takers. Given that smaller deposit takers typically serve specific geographic communities or occupations, their failure will leave these communities or occupations unrepresented by any deposit-taker who is not a national/international deposit-taker. That is in direct conflict with a primary objective of the DTA – a deposit-taking sector comprising a diversity of institutions to provide access to financial products and services for a diverse range of New Zealanders.

13. We believe that there is a case to be made that a better approach to levy funding would be reduced levies for smaller deposit-taking institutions as a way of promoting the prosperity and wellbeing of New Zealanders. This is because a reduced levy approach would be competitively beneficial for smaller deposit-takers who serve specific geographic communities and occupations and contribute to a sustainable and productive local economy. The RBNZ should have an objective of growing the 'challenger bank sector' in New Zealand and removing the concentration risk with the big four Australian banks.

14. We would like to see the impacts on competition and diversity within the deposit-taking sector more expressly addressed in the Levy Consultation and for more work to be done on the flat rate levy approach, particularly in relation to the benefits the flat rate approach would have on competition and diversity within the deposit-taking sector.

15. We also believe that the importance of growing a stronger challenger bank sector in New Zealand, and the way that the DCS can aid this, needs to be addressed. This is important to continuing financial stability, and the risk of a managed retreat by one or more of the big four banks does not appear to be considered – yet based on statements made by the big four banks over the last 5 years this is a plausible risk that needs to be considered and accounted for.

Credit Ratings

16. We believe there are some inherent challenges with credit ratings which would need to be addressed before being used as a basis for calculating risk-based levies. For example:

    (a) you are proposing to use an entity rating as opposed to an issue rating (for retail deposits) and there could be substantial differences between the two ratings;

    (b) the big four banks' credit ratings are heavily influenced by the credit rating of their parent banks (which tends to be the same, even though the credit risk of the two entities is not the same) and also factor in likely government support;

    (c) credit ratings have proved inherently flawed in recent financial crises (for example Moody's had a "Grade A" rating and an "investment grade" issuer rating on Silicon Valley Bank prior to its collapse).

Composite Risk Indicators

17. In relation to your proposed composite risk indicators, we comment:

    (a) deposit compensation will apply only to prudentially regulated entities. As long as an entity meets the required prudential standards there is a strong case to be made that the simplest and fairest approach for all is to have a single flat rate levy;

    (b) the risk indicators are assessed at an entity level. For many banks up to 30% of their best assets will be pledged either through covered bond arrangements or internal residential mortgaged-backed securities. This means that for these banks their 30% best assets will not be available to general unsecured creditors in an insolvency event, and as such those assets should be removed when assessing asset quality;

    (c) the analysis does not take into account the depositor priority that will exist for a majority of non-bank deposit takers at least while trustees are still involved in supervising them. These depositors currently have a first ranking security and will continue to have this until trust deeds are phased out;

    (d) the assessment does not take into account that risk weighting for non-bank deposit takers ultimately results in non-bank deposit takers being required to hold higher absolute levels of capital than banks with equivalent assets. This is because the risk weighting percentages of assets are not the same between non-bank deposit takers and registered banks;

    (e) the reference to profitability does not consider that credit union and building societies are not motivated solely by profit, and instead have significant additional motivations including "doing

the right things for members" and supporting their communities. It is unfair to include profit as a guide when that is only relevant to companies (other than co-operative companies).

Moral Hazard

18. We do not agree with your comment that a flat rate would provide no ability to mitigate any moral hazard problems. In our view, the moral hazard, "the incentive for increased risk-taking", which you assert does not exist. Internationally (and in New Zealand) the moral hazard associated with entities engaging in risky lending has been dealt with through both capital adequacy requirements and the cost of capital. Furthermore, as far as we are aware there is no evidence that depositors provide realistic discipline on an entity's lending practices. The moral hazard reflects, in our view, outdated economic thinking and should be removed as a factor being considered in relation to the levy framework approach.

19. We note that based on the proposed, as per the Treasury's "Statement of Funding Approach – Funding Strategy for the Depositor Compensation Scheme" consultation paper, target size of the depositor compensation scheme fund the Crown is likely to be fully covered for deposit-takers such as the non-bank deposit takers but not in the situation of the failure of a bigger bank. International experience has suggested that there is a case for an additional levy premium payable by the big banks. This is because the risk posed to the overall financial system and wider economy by the failure of a big bank is significantly larger because of the severe contagion impacts and systemic importance to the financial system and economy. The loss given default for a big bank will not be confined to its deposit base but will have much wider economic and social ramifications. The large banks paid a premium when the temporary deposit scheme was introduced in the global financial crisis, and we can see a strong case for doing so again.

20. Finally, while we understand the RBNZ's reluctance to publicly do so, we strongly believe that the RBNZ does need to consider the moral hazard that for a big bank the compensation cap of $100,000 is not the real cap, and the Crown will likely cover the total amount of deposits in the case of a failure. Recent international experience all points to this being a significant and real moral hazard with a high probability of occurring in the circumstance that a systemically important bank fails (see for example Silicon Valley Bank or the government assisted takeover of Credit Suisse by UBS).

Risk Based Premiums are Premature

21. International evidence is that 50% of deposit compensation schemes funded on an ex-ante basis are funded using a flat rate levy premium. Those deposit compensation schemes that have moved to risk-based levy premiums have typically done so only after they have data to support a risk-based approach and when the scheme is more established. There is no reason for New Zealand to take a different approach.

22. There is no evidence that the RBNZ has sufficient data or a detailed enough understanding of NBDTs business market and risks to formulate an effective model to assess risk in the NBDT sector - especially as most of the data relied on by the RBNZ seems to be related to periods before NBDTs were prudentially regulated. We believe that prudential regulation has significantly de-

risked the NBDT sector and present-day evidence would show this. It is also not appropriate to use overseas data as a proxy without clear evidence that it correlates accurately with the New Zealand market and will continue to do so.

23. We believe it is vital that transition risks to the Deposit Compensation scheme are minimised. We believe attempting to impose risk-based premiums at the outset will likely materially increase transition risks. We believe a significant risk of unintended consequences if the RBNZ moves to a risk-based levy at the outset without a detailed assessment of the impact that would have on transition.

Conclusion

24. 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 5 retail banks.

Submission on the Proportionality Framework – For Developing Standards Under the Deposit Takers Act

25 September 2023

Christian Savings Limited

Credit Union Auckland Incorporated

Finance Direct Limited

General Finance Limited

Gold Band Finance Limited

Heretaunga Building Society

Mutual Credit Finance Limited

Nelson Building Society

Unity Credit Union

Wairarapa Building Society

Xceda Finance Limited

SUBMISSION ON THE PROPORTIONALITY FRAMEWORK - FOR DEVELOPING STANDARDS UNDER THE DEPOSIT TAKERS ACT

Introduction

1. This Submission on the Reserve Bank of New Zealand (**RBNZ**) consultation paper "Proportionality Framework – For Developing Standards Under the Deposit Takers Act" (the **Consultation Paper**) is made on behalf of the non-bank deposit takers (**NBDTs**) listed on the cover page of this submission and follows on from the industry briefings which members attended in both Wellington and Auckland on 16 and 22 August 2023 respectively.

2. We all found those briefings helpful. Hopefully, as a result of those meetings, you will appreciate the level of commitment from the boards, chief executives and other senior executives at NBDTs to work with the RBNZ to get, amongst other things, a fit for purpose proportionality framework.

3. While we appreciate the Proportionality Framework is just a framework, not standards or regulation, we do believe it sets an important tone for the relationship between NBDTs and the RBNZ both during the transition period for the Deposit Takers Act 2023 (**DT Act**) and for ongoing supervision. To that end we note that the RBNZ's relationship charter encourages honest frank feedback between it and regulated entities with a view to achieving sound and efficient outcomes. This submission is made consistently with those principles to support the development of a Proportionality Framework that will achieve good outcomes for the New Zealand Financial System.

Core Purpose

4. We believe that the Proportionality Framework must be developed in light of the core purpose for its inclusion in the DT Act. The requirement for the RBNZ to develop a proportionality framework was introduced as a direct result of the Finance and Expenditure Committee's recognition of the important outcomes achieved by the NBDT sector and the need to create a regulatory environment where NBDTs could thrive and grow. We do not believe the Proportionality Framework is consistent with its purpose. We attach, as an Appendix, extracts from Hansard which we believe support that view.

5. In addition, the DT Act requires the RBNZ to take into account the impact of its policies on, amongst other things:

   (a) the diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders; and

   (b) the need to maintain competition within the deposit taker sector; and

   (c) the need to avoid unnecessary compliance costs.

6. The Proportionality Framework was intended to be a key tool for ensuring that due consideration was given to these principles. There is no evidence in the Consultation Paper of how these factors have been taken into account and the weightings given to them. We are keen to understand your approach to these important issues better.

Competition

7. It is important that the Proportionality Framework considers the impacts on competition – particularly in light of concerns which have led to a Commerce Commission enquiry into retail banking in New Zealand.

8. We believe a lack of competition in banking is affecting the prosperity and wellbeing of New Zealanders and resulting in a less sustainable and productive economy which is the core purpose of the Deposit Takers Act.

9. Without effective competition and a growing challenger bank sector we believe the financial stability risks to New Zealand will be accentuated because the sector is so heavily dominated by the four large Australian banks and there is a plausible risk of a managed withdrawal of one or more of them (noting we have already seen evidence of that from two of them over the last three years). We note this diverges from the Bank of England “strong and stable” consultation paper referenced on page 8 of the Consultation Paper, where the Bank of England has considered all of their primary and secondary objectives, specifically including competition.

10. Indeed, it is not clear to us from the Consultation Paper what the RBNZ's interpretation of "proportionality" is (Question 1 of the Consultation Paper). Presumably it is contained in the last three paragraphs of page 8 of the Consultation Paper. However, to the extent that there is any meaningful definition within those paragraphs we are concerned that this overtly focuses on simplicity going hand in hand with increased prudential conservativeness (see paragraph 14, below). We don’t believe that such an approach is consistent with the quoted BIS standards or the Bank of England ‘strong and simple’ approach, both of which recognise that level of conservatism should correlate to the risk posed to financial system stability.

11. We are also concerned about a number of comments made in the Consultation Paper which seem to run directly counter to one of the purposes of the DT Act – supporting New Zealanders having reasonable access to financial products – and the intentions of the Finance and Expenditure Committee. This requires weight to be given to competition and inclusion to the extent that it is not inconsistent with financial stability.

12. In particular, we would be keen to understand the basis for comments such as:

    - "Some deposit takers may need to modify their business model to meet the minimum standards".
    - "Others may need to assess their viability in line with operating in a well-regulated competitive marketplace".

    We do not believe either of those comments are consistent with the parliamentary intention when enacting the DT Act. No discussion or evidence has been provided in the Consultation Paper which suggests that this is required for financial stability. We refer again to the comments of the Finance and Expenditure Committee which noted that in determining risk, it needed to be

acknowledged that NBDTs were a very small part of the sector and that this needed to be taken into account when determining the risk they posed to financial stability.

Classification

13. We agree with the thresholds for different categories of deposit takers which you have suggested in the Consultation Paper. Experience has been that these thresholds will need to be periodically reviewed (say every five years) to take into the account the growth of the New Zealand financial sector and potentially other factors.

14. We do not, however, agree with the approach you have proposed for setting standards in each of the respective categories you have identified. We believe the appropriate approach should be (in italics and highlighted below):

Group	RBNZ application of standards	Proposed application of standards	Thresholds
Group 1	Comprehensive prudential requirements	***Enhanced prudential requirements***	Deposit takers with total assets of NZ$100 billion or more
Group 2	Enhanced prudential requirements	***Standard prudential requirements***	Deposit takers with total assets of NZ$2 billion or more, but less than NZ$100 billion
Group 3	Baseline prudential requirements	***Simplified prudential requirements***	Deposit takers with total assets less than NZ$2 billion

15. We believe this is consistent with the approach which the Finance and Expenditure Committee was suggesting and with the core principles that the RBNZ must take into account in relation to developing its policies.

16. Indeed, we believe the RBNZ has already applied a simplified prudential approach, or at least proposed to, in relation to its liquidity framework. We ask the RBNZ to reconsider the application of standards to one which we believe is more consistent with parliamentary intention.

17. As noted above, we are particularly concerned about various references in the Consultation Paper to offsetting simplicity with increased prudential requirements. An example of where this currently applies is the capital adequacy regime, where non-bank deposit takers are required to apply significantly higher risk weightings to their assets than banks, despite the fact that the assets are largely comparable. This approach risks creating a misleading impression of capital adequacy and a non-competitive playing field. As an example, a study of credit unions in Ireland, which are subject to a similar simplified standard, calculated the capital adequacy of credit unions under the Basel III /

CRD framework and showed that their simplified capital ratio of 14.1% translated into a capital ratio of 31.6% under the bank framework.[1]

Purpose of DTA

18. We do not believe the purpose of the DT Act is to impose a more intensive regulatory regime as was suggested in the Consultation Paper. We believe its purpose is to move New Zealand to a more conventional framework of supervision by the RBNZ including for example by:

    (a) Requiring the RBNZ to impose prudential requirements through standards not, for banks, not conditions of registration – that are not legislative instruments (with the checks and balances that come with that);

    (b) Enabling greater onsite supervision;

    (c) Introducing a more conventional recovery and resolution framework; and

    (d) Introducing deposit insurance.

19. We do not believe the purpose was to intensify regulation.

20. We believe that Parliament made it clear at the Finance and Expenditure Committee Hearings that it was expecting a simplified prudential framework for non-bank deposit takers (much as the Bank of England has a strong but simple framework for smaller deposit takers).

[1] Regulatory Capital for Irish Credit Unions: Time for Change? CEO-Forum-Regulatory-Capital-for-Irish-Credit-Unions-v1_0.pdf (cuceoforum.ie).

APPENDIX ONE:

Parliamentary Expectations

(a) We note that in the Hansard report on the Third Reading, Ingrid Leary stated that the RBNZ had undertaken to come back to the Select Committee with the proportionality framework and stated that "*we just all wanted [the undertaking by the Reserve Bank to come back to Select Committee] in the Hansard to ensure that they do that because a lot of the devil will be in the detail, and the proportionality and the functioning of those standards will be really important. We are aware that the Reserve Bank is in effect writing its own rules, so that oversight will be critical*."

(b) Assuming that you will be sending it back, will you address how the proportionality framework deals with the following comments and expectations made by the Select Committee, namely:

(i) that the registered banks account for $650 billion in assets in the New Zealand market, whereas the non-bank deposit taking sector accounts for just over $3 billion, and that members of the Finance and Expenditure Committee felt it incredibly important that the regime really looked at where the risk to financial stability was and responded in a proportionate fashion.[2]

(ii) that clause 3 and clause 4 of the Deposit Takers Bill were amended by the Finance and Expenditure Committee to ensure that "*the principles of stability, diversity and proportionality fed through in a coherent way to ensure we have a stable financial system and to ensure that the system has diversity and that the management of it – the supervision of it – has proportionality*", which does not suggest that diversity and proportionality are subordinate, but rather integral to financial stability.[3]

(iii) that the Finance and Expenditure Committee acknowledged the role of credit unions, building societies and finance companies in providing access to finance for communities not well served by banks and that they intended there to be adequate consideration given to how we can ensure there continues to be a place for them.[4]

(iv) that they would like to see a much bigger role for the likes of credit unions in our society so that people have access to finance and financial services on a cost-effective basis.[5]

(v) that many of the changes made by the Finance and Expenditure Committee were intended to ensure "*that smaller players and a diversity of players in the market can thrive*" and that a "*more nuanced approach to regulation would ultimately lead to greater competition and that in turn would lead to more stability.*"[6]

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[2] (29 June 2023) 769 NZPD (Deposit Takers Bill – Third Reading, Hon Dr David Clark.
[3] (29 June 2023) 769 NZPD (Deposit Takers Bill – Third Reading, Hon Grant Robertson.
[4] (29 June 2023) 769 NZPD (Deposit Takers Bill – Third Reading, Hon Julie Anne Genter.
[5] (29 June 2023) 769 NZPD (Deposit Takers Bill – Third Reading, Hon Julie Anne Genter.
[6] (29 June 2023) 769 NZPD (Deposit Takers Bill – Third Reading, Ingrid Leary (Finance and Expenditure Committee).

APPENDIX TWO:

Proportionality Framework Consultation Questions

1	Do you have any comments on our interpretation of the meaning of proportionality? *We agree with the strong and simple approach to proportionality.* *However, we do not believe that the example given of credit ratings is valid – given that New Zealand is an outlier in requiring them at all in the context of prudential regulation*.
2	Do you have any comments on the proposed scope of the proportionality framework? *We agree with the scope of the proposed proportionality framework*.
3	Do you have any comments on our proposed three tier grouping approach for designing proportionate standards? *We support the three-tier approach for designing proportionate standards – although we note that Australia does have a transition regime for new entrants which we believe New Zealand should consider at some stage*.
4	Do you have comments on the relevant factors we have identified for tailoring standards proportionally? *We do not believe that you have considered all relevant factors in tailoring standards for proportionality. Section 4 of the DT Act sets out mandatory requirements that the RBNZ must consider when developing standard. Particularly relevant for a proportionality framework are:* • *the diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders;* • *the need to maintain competition within the deposit taker sector; and* • *the need to avoid unnecessary compliance costs*. .

5	Do you have any comments on our proposed approach to grouping deposit takers? In Particular we would welcome comments on the following: • The metric for establishing groups (total assets of a deposit taker); • The basis for assessing this metric (average total assets over a one-year period); • The thresholds for each of the groups; • The situations for applying variation from the grouping approach. *We support the metrics for establishing categories of deposit takers – particularly their simplicity. We also believe that they will work in a practical manner given the size of the current institutions in the New Zealand market. For example, in practice, it will be some time before a deposit taker is likely to transition between groups and so the regime should be better equipped when that does happen*
6	Do you have comments on our proposed approach for transitioning deposit takers between groups? *We support the approach for transitioning depositors between groups. This will need to be reviewed in light of any practical issues which might arise during the transition process. It is, for example, likely that transition will be significantly more complex than the one page commentary suggests*.
7	Do you have any other elements that you think we should clarify in the proportionality framework? *We believe it is important that you clarify that the purpose of the DT Act is not to intensify regulation – it is focused on equipping the RBNZ to adopt a more conventional approach to supervision of deposit takers (ie a more active approach to supervision rather than increasing regulatory standards) and to consolidate the regime.* *The RBNZ should identify all the principles it is required to consider under the DT Act – and the framework which it will use to consider them*. As the entities for whom the framework was introduced, this gives us no greater clarity or comfort around the approach the RBNZ will take in developing standards. We would like to see the RBNZ commit to clear intended outcomes that it is trying to achieve with the proportionality framework and the principles that it will apply in each instance.

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

25 September 2023

Christian Savings Limited

Credit Union Auckland Incorporated

Finance Direct Limited

General Finance Limited

Gold Band Finance Limited

Heretaunga Building Society

Mutual Credit Finance Limited

Nelson Building Society

Unity Credit Union

Wairarapa Building Society

Xceda Finance Limited

SUBMISSION ON THE STATEMENT OF FUNDING APPROACH - FUNDING STRATEGY FOR THE DEPOSIT COMPENSATION SCHEME (DCS) CONSULTATION PAPER (SOFA CONSULTATION)

Introduction

1. This submission on the SoFA Consultation is made on behalf of the non-bank deposit takers listed on the cover page of this submission (**NBDTs**).

2. Many of the NBDTs will be making their own submission. The purpose of this letter is to raise points of common interest and to provide an option for Treasury to meet collectively with the NBDT's or even a working group of them.

3. As many NBDTs will be making their own submission we are not responding formally to the questions in the SoFA Consultation.

Key submissions

4. We believe that:

   (a) the target fund size (of the DCS fund) should be on the lower end of the proposed range being 0.5 per cent of protected deposits, and

   (b) the timeframe for building the DCS fund should be 20 years.

5. We therefore believe option A (as detailed in Table 5 of the SoFA Consultation) is the right option for New Zealand now – we accept that this should be reviewed in light of any changes in the financial system over the next 5 years (including significant new competitors or major changes in market share for the deposit takers market).

6. We have set our reasons for these views below.

Target DCS fund size

7. We believe that the target DCS fund size should be on the lower end of the proposed range in the SoFA Consultation. The top-end of proposed target DCS fund size range, 1.1 per cent of protected deposits, is likely not sufficient to compensate losses as a result of the failure of one of the big 4 banks or Kiwibank. We therefore do not believe the target DCS fund size should consider a failure of one of these five banks. Instead, we believe the target DCS fund size should be predominantly focused on the costs (after recoveries) of the failure of a medium sized bank (with total assets ranging from roughly $2 to $10 billion) and the failure of a non-bank deposit taker. Furthermore, we believe that:

   (a) there is little risk of contagion impact from the failure of a small bank or small non-bank deposit taker and the loss should be viewed as a standalone loss – not across the sector as a whole given the regional and business model diversity that currently exists. For example, it is hard to see the failure of a finance company in Auckland impacting a building society or credit union in the Hawkes Bay (and vice versa); and

   (b) the loss given default ranges used do not appear to be based on current, New Zealand data. It is not plausible to use data from a period prior to non-bank deposit takers being prudentially

regulated in order to assess maximum loss. The losses suffered by finance companies in the late 2000s/early 2010s are not indicative of the loss that would be suffered by modern, prudentially regulated non-bank deposit takers.

We believe a much more plausible loss given default range for non-bank deposit takers is the same as currently proposed for small banks 10% - 25%. We also believe, in light of banks having been recently required to increase their prudential capital ratios, and having higher prudential capital requirements than global norms, the loss given default ranges for registered banks should also be much lower. In accordance with Table 4 in the SoFA Consultation, this suggests that the target DCS fund size should be around $800 million.

Timeframe

8. We believe that the timeframe for building the DCS fund should be 20 years. This is because the chance of failure of a deposit-taker in New Zealand is extremely low. The New Zealand capital settings are set in relation to the Reserve Bank of New Zealand's '1-in-200 years' risk appetite, meaning the approximate chance of a failure is very low. The resulting capital settings for non-bank deposit takers are accordingly conservative such that the chance of a financial crisis or deposit-taker failure at any one point in time is also extremely low – but more likely. This means that the timeframe for building the DCS fund can be longer (i.e., 20 years – being the top end of the proposed timeframe range) given the risk of a financial crisis or failure of a deposit-taker in the intermediate time is extremely unlikely. This is more consistent with the 1 -200-years risk profile as opposed to the more conventional 1-in-100 years risk profile.