RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

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Deputy Governor
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18 November 2020 - Parts of this document have been redacted as they do not relate to the early release of the Funding for Lending Programme announcement, and to protect the commercial position of recipients.

[redacted]

By email: [redacted]

Dear [redacted],

I am writing in acknowledgement of a range of correspondence from the non-bank deposit taking (NBDT) sector in recent months over the potential impacts of a Funding for Lending Programme (FLP) on NBDTs, and some proposals the sector has made to support wider participation in the scheme.

As you may be aware, the Monetary Policy Committee (MPC) of the Reserve Bank of New Zealand (RBNZ) today announced the launch of the FLP as a monetary policy tool. We are using this tool to help ensure a robust recovery of the New Zealand economy, and to help the MPC meet their objectives of stable prices and maximum sustainable employment.

More detail on the programme is available in the November *Monetary Policy Statement*, with a term sheet and operational details to be released in coming weeks. The FLP is available to existing RBNZ counterparties with eligible collateral and the infrastructure to transact with the RBNZ. In theory, NBDTs could access the FLP if these criteria are met – however, we understand that in most cases, NBDTs would not have assets (collateral) eligible for this facility; additionally, we appreciate that the costs of establishing the required infrastructure is likely to be prohibitive.

Given this, a number of institutions in the sector have raised concerns over the competitive impact of the FLP on NBDTs. A key concern is that the programme will lower funding costs for large banks, and leave the NBDTs at a competitive disadvantage – hampering their ability to provide credit to certain areas of the financial system.

We understand this concern, and hope you draw comfort from our expectation that the FLP will lower funding costs by a similar degree for both large banks and NBDTs. We expect the FLP to lower interest rates in two ways:

1. The average cost of participants' funding is lowered directly, as market sources of funding are substituted with cheaper FLP funding (*direct channel*).

2. The availability of FLP funds should decrease demand for other sources of funding (e.g. retail deposits and wholesale funds). This should lower the average interest rate on these sources of funding – lowering the average funding costs for a broad range of financial institutions (*indirect channel*).

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We expect the indirect channel to account for the substantial majority of FLP transmission to interest rates. Essentially, as term deposit rates drop, the benefits of lower funding costs will flow through to the NBDT sector - although we acknowledge that due to the NBDTs' liquid assets largely being held in term deposits within the banking sector there will be some partial offset from lower returns on these assets. Looser monetary policy should also support a recovery in business activity and employment - limiting the extent of loan defaults.

That said, given this is a new tool, there is uncertainty around how it will transmit to financial markets; thus, we will watch the pass-through of funding costs to different sectors of the financial services industry very closely.

At the same time, we are looking at ways to ensure all participants realise the benefits of the RBNZ's alternative monetary policy tools. This is something that will take time, and we cannot guarantee that there will be a solution that fully meets the requests of the NBDTs. These measures involve balancing the benefits of wider participation with the RBNZ's own risk tolerance, and exploring ways to minimise the added administrative costs of participation that NBDTs could face. As internal work progresses on exploring these issues, we will keep the industry informed and consult where necessary.

[redacted]

However, I also wish to acknowledge the perceived inequities that the NBDT sector may feel the RBNZ has created through its actions since the onset of the COVID-19 pandemic. I wish to assure you that, consistent with our mandate, the RBNZ's actions since the crisis have been solely focused on promoting the maintenance of a sound and efficient financial system and have not in any way been intended to favour one sector of the financial sector over another.

While we will continue to work with the NBDT sector to ensure a level playing field in the financial sector exists, please appreciate that this must be done within our own mandate, risk appetite, and principles.

Yours sincerely,

[redacted]

Geoff Bascand
Deputy Governor / General Manager Financial Stability

CC [redacted]

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