



NBDT Industry Update – Regulatory Stocktake

In July of last year, the Reserve Bank announced it was conducting a Regulatory Stocktake of the prudential requirements for Banks and Non-Bank Deposit Takers (NBDTs).¹

Stocktake Objectives and Scope

The aim of the stocktake is not to alter the fundamental shape of the current prudential requirements for NBDTs (e.g. adequate capital and liquidity, effective governance and risk management) or the supervisory arrangements in place for the sector. Instead, its primary objective is to ensure the efficiency, clarity and consistency of the specific prudential requirements already in place.

A secondary objective of the stocktake is to consider whether there are areas where we can further improve the quality and effectiveness of our current policy development processes. A particular focus of this objective is considering how to further enhance the transparency of our policy development processes and our engagement with stakeholders.

For the NBDT sector, the stocktake comes on the heels of a major review that was conducted in 2013.² The scope of this review was quite broad and resulted in a number of suggested changes to legislation aimed at improving the overall efficiency of the regime, including:

- Better tailoring of the definition of NBDT to entities genuinely carrying out NBDT type business;
- Confirmation of the existing model whereby trustees act as frontline supervisors of NBDTs, but making minor and technical changes to this model with the aim of improving role clarity and enhancing the Reserve Bank's ability to respond promptly and effectively in a crisis;
- Providing greater flexibility in the setting of prudential standards; and
- Providing a more graduated spectrum of remedies for addressing breaches of legal requirements by NBDTs.

The stocktake was not intended to revisit the key conclusions made by this review. While the 2013 review was primarily focused on the legislative framework of the NBDT Act and related regulations, the stocktake focuses on specific prudential requirements.

For NBDTs, this means the focus has been on the prudential requirements set out in the Deposit Takers (Credit Ratings, Capital Ratios and Related Party Exposure) Regulations 2010, the Deposit Takers (Liquidity) Regulations 2010, and a small number of sections in the Non-bank Deposit Takers Act 2013 (the NBDT Act).

¹ The full terms of reference for the project are available on the Bank's website at: http://www.rbnz.govt.nz/regulation_and_supervision/stocktake/5803394.pdf

² A final report on this review is available at: http://www.rbnz.govt.nz/regulation_and_supervision/non-bank_deposit_takers/5475890.pdf

Stocktake Workplan

The focus of the stocktake project has been on the prudential requirements for banks, which are more extensive than those for NBDTs, and had not recently been subject to a comprehensive review. Where possible, and always recognising the fundamental differences between the sectors, the work thus far with banks has had regard to consistency across the sectors the Reserve Bank regulates. The analysis of the suitability assessment process for directors of banks, for example, has considered the approach of the other regimes, and may seek (in the long-term) to better align the approach taken across different prudential regimes. The [full consultation document](#) on the stocktake work with banks is available on our website.

For the banking sector, we are also doing some work to clarify and better communicate our policy making approach (see Part 4 of the Discussion Document for banks). This work may result in several new “statement of approach” documents, which more clearly articulate our approach to regulation, supervision and policy making across regimes. While the documents themselves will be new, the core principles they contain will reflect our current approach. The goal of the documents will be to better articulate the principles of our work and provide greater transparency and accountability.

In working to develop a more specific workplan with NBDTs for the stocktake, the Bank made contact with three NBDT industry bodies late last year, to identify potential areas of focus. We have also been working with industry bodies on an overlapping project, relating to the current setting of the credit rating exemption for NBDTs. This is a specific issue on which the Bank had identified scope for amending prudential requirements for NBDTs, without compromising the soundness and efficiency of the financial system. Below is a summary on how we will be moving ahead with this work.

1. Work Related to Prudential Requirements:

- A. Credit Rating Exemption:** The Bank consulted on the credit rating exemption threshold for NBDTs in late 2014.³ The Bank received three submissions on this consultation and reached a conclusion on this issue earlier this year. The Bank has decided to increase the credit rating exemption threshold from \$20 million to \$40 million, with a requirement for entities under \$20 million to maintain a capital ratio of at least 10%, and entities between \$20 million and \$40 million to maintain a capital ratio of at least 12%. The Bank will shortly announce the transitional arrangements associated with this change.
- B. Capital Review:** We recently announced in our Financial Stability Report that we will be looking again at the capital requirements for banks under the standardised and internal ratings based approaches. As part of this work we will also be reviewing the capital requirements that apply to NBDTs. We are expecting that this review of NBDT capital requirements will commence in the first half of 2016.
- C. Liquidity Review:** The Bank will review the categorization of credit unions’ deposits for liquidity purposes. This will be undertaken as part of a broader review of our liquidity policy for banks in which we will consider the adoption of the Basel III liquidity rules. We expect this work to commence in the second half of 2015.
- D. Clarification of Risk Management Guidelines:** The NBDT licensing process (which was completed in April of this year) brought to light a number of aspects of our requirements and guidelines which could potentially be clearer. We will consider

³ http://www.rbnz.govt.nz/regulation_and_supervision/non-bank_deposit_takers/5862623.pdf.

whether any changes are necessary to clarify the requirements themselves, or whether it is sufficient to provide better guidance on these topics. We will also consider whether additional information should be provided to the Bank to monitor the implementation of these guidelines. We expect to begin this work in late 2015.

2. Work Related to Policy Making Processes and Engagement with Industry

One of the main themes that has come up in our work is the issue of communication with industry and the overall transparency of our policy making approach. Full background on this work, as it relates to the banking sector, is provided in Part 4 of the Discussion Document for banks. We have also received similar comments on this issue from other stakeholders (including a number of NBDTs) in the recent Stakeholder Engagement Survey that the Bank conducted. We propose to address this issue through the following:

- A. **Clarification of the Bank's "policy-making approach"** through the creation and publication of the document referenced in Appendix F of the Consultation Document for banks. We will seek to incorporate this document in the section of our website dedicated to NBDTs, integrating it into some of the other background documentation on the site.
- B. **Improvements to the NBDT section of the RBNZ website**, particularly the "new initiatives" section. Building on the improvements made to the banking section of the website, we will aim to make similar though tailored improvements in the NBDT section. On the new initiatives page, we will be seeking to develop a consistent structure to that with banks, with the same distinction in terms of types of work currently being conducted (current, past and future policy work). As with the Banking industry, we will also aim to keep this section of the website updated on a more regular basis. Because the work covers a narrower range of prudential requirements, and the Bank is not the direct supervisor of NBDTs, the content may not be as extensive, or be updated quite as frequently (updates would be made on an as needed basis). At a later stage in the process, we may seek more specific feedback from targeted user groups on this issue.
- C. **Creation of an e-mail list serve targeted at the NBDT sector.** Although the Bank prefers to communicate via trustees, who are the direct line supervisors of NBDTs, there are cases in which the Bank would like to communicate directly with all licenced NBDTs together. The mailing list would be on a subscription basis, similar to those for the banking and insurance sectors. At this stage, we are not proposing to publish an industry newsletter for NBDTs, but instead would seek to update industry, through communications like this one, on more of an ad-hoc basis.

We note that there are two issues raised by stakeholders, both related to our regulations on related party exposures, on which we do not propose to carry out additional work at this time:

- **Related Party Exposure Limits**: We recognise that for member owned organisations, members are those most engaged and likely to step forward as Directors. For smaller organisations, we recognise that these limits can result in their breaching related party exposure requirement unless the new directors scale back the scope of their transactions with the organisations. It can also make it hard for members to qualify as "independent" directors. While we appreciate the challenges that these limits create, we believe they are still justified to address the kinds of risks that can arise out of related party transactions. We have considered other approaches to restricting potentially inappropriate transactions, for example having related party

transactions signed off by a trustee or auditor. We are nonetheless concerned that the requirement to disclose these transactions and have them signed off by a trustee or auditor may not adequately address the associated risks.

- **Set-off When Calculating Related Party Exposure:** Industry bodies also raised concerns about being unable to set-off related party savings against loan exposures even where the savings are provided as security for the loan. Our policies on this issue for NBDTs are aligned with the approach we take for banks. In both cases, we consider related party exposures independent of credit risk mitigation. We have taken note of concerns raised on this issue, but are not proposing any changes or further work on this issue at this time.

Regarding the changes to the composition of the sector, the Bank is aware of the changes in funding models of a number of institutions, and of the overall consolidation of the sector. The Bank monitors the NBDT and the broader non-bank lending sector, and reports on this work in our semi-annual Financial Stability Report. The Bank will continue with this work and would welcome specific input or observations on these developments from individual NBDTs or industry bodies.

Request for Feedback

We would welcome feedback from NBDTs and NBDT industry bodies regarding any aspect of the work discussed above. We would also welcome specific comments on the draft statement of our policy making approach in Appendix F of the discussion document for banks. Please direct any comments to our stocktake team at: stocktake@rbnz.govt.nz