

NBDT Industry Update – Regulatory Stocktake

Summary of feedback from NBDT industry bodies and Reserve Bank responses

Introduction

1. On 21 July 2015 we published the consultation document *Regulatory Stocktake of the Prudential Requirements Applying to Registered Banks*, and a separate “Industry Update” for NBDTs.¹
2. Our primary objective in conducting the stocktake has been to enhance the efficiency, clarity and consistency of the specific prudential requirements applying to banks and NBDTs. By reducing any unnecessary costs or restrictions arising out of the current framework, we aim to help facilitate innovation and the efficient allocation of resources in the market, while still achieving our core financial stability objectives.
3. For NBDTs, the stocktake follows on from a review of the NBDT regime that was conducted in 2013. The stocktake was not intended to revisit the key conclusions made by this review. While the 2013 review was focused on the legislative framework of the NBDT Act and related regulations, the stocktake focuses on the specific prudential requirements for NBDTs (capital, liquidity, etc.). Most of the Non-bank Deposit Takers Act 2013 (including those parts that relate to licensing, supervision, and investigations/enforcement) is outside of scope of the project.
4. The secondary objective of the stocktake has been to consider whether there are areas where we can further improve the quality and effectiveness of current policy development process across our prudential and macro-prudential functions. A particular focus of this objective is considering areas where further enhancements can be made to the transparency of our policy development processes and our engagement with stakeholders.
5. Feedback from banks on the consultation document *Regulatory Stocktake of the Prudential Requirements Applying to Registered Banks* is included in a [separate paper](#). This document provides a summary of the written feedback received on the Industry Update for NBDTs, and our responses to that feedback.
6. The Industry Update was not a consultation document, but instead an update on our responses to various NBDT related matters that had been raised in the initial scoping phase of the stocktake (through initial verbal and written feedback provided in late 2014). We received written comments on the Industry Update from Co-Op Money NZ (who represent credit unions and building societies), and the Financial Services Federation (who represent a range of entities including finance companies). We have also had discussions with the Trustee Corporations Association.
7. The Industry Update was divided into two parts, one of which related to prudential requirements applying to NBDTs, and one of which related to our policy making processes and engagement with industry. The document below uses the same structure.

¹ The NBDT Industry Update can be found at: http://www.rbnz.govt.nz/regulation_and_supervision/non-bank_deposit_takers/nbd-t-industry-update-regulatory-stocktake.pdf. The Terms of Reference for the project are also available at: http://www.rbnz.govt.nz/regulation_and_supervision/stocktake/5803394.pdf.

1- Work Related to Prudential Requirements

Summary of what we said/proposed	Feedback	Reserve Bank response
<p>Credit Rating Exemption: The Reserve Bank consulted previously (in late 2014) on the credit rating exemption threshold for NBDTs, and 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%.</p>	<p>One submitter argued that credit ratings should not be requirements for its members. It noted that the Basel Committee on Banking Supervision (BCBS) is moving away from reliance on credit ratings in its capital framework in favour of risk weights based on risk factors that are pertinent to particular loan categories. This submitter suggested that the requirement for NBDTs to have credit ratings is inefficient and inconsistent with comparable regulatory regimes overseas. It noted that it would like to see the Reserve Bank conduct a first principles review of the credit rating requirement for NBDTs, with a view to assessing its efficacy and cost-effectiveness.</p> <p>The other submitter was supportive of the proposed exemption threshold but commented that associated capital increases are not a necessary consequence of an increase in the exemption threshold. This submitter felt that the proposal to increase capital ratios might better have been addressed as part of the capital review proposed for 2016.</p>	<p>We expect to publish a summary of the submissions received on the public consultation on the credit rating exemption very shortly. This document will explain the reasons why we require NBDTs to have a credit rating, and the reasons for the changes in the exemption threshold.</p> <p>The planned NBDT capital work is described below.</p>
<p>Capital Review: 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.</p>	<p>Both submitters welcomed this work and are keen to be involved in it.</p> <p>One submitter felt that the higher capital ratios required of its members are arbitrary and are not based on methodical assessment by the Reserve Bank of the inherent probability of</p>	<p>Consideration of NBDT capital requirements will follow from the review of capital requirements for banks, which was discussed in our November 2015 Financial Stability Report. The bank capital review will take note of changes to international capital adequacy</p>

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	<p>default by its members versus registered banks. It supported the proposed review given that there are inconsistencies, ambiguities and unintended consequences that can arise under the existing regime. This submitter emphasised that a fundamental aspect of the review should be a reconsideration of the minimum capital ratio requirement applicable to NBDTs and the issue of competitive neutrality vis a vis the capital ratio requirements for registered banks.</p>	<p>standards. These are currently being worked through by the BCBS, who we expect will finalise proposals over the course of 2016. Changes to the credit risk standard for standardised banks are likely to be particularly relevant for NBDTs, although the Reserve Bank will continue to tailor the NBDT capital requirements to the particular characteristics of the sector in New Zealand.</p>
<p>Liquidity Review: The Reserve 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.</p>	<p>One submitter commented that the categorisation of credit unions deposits with banks under BS 13 (which sets out banks' liquidity requirements) should be changed given the nature of those deposits. Amongst other things, this would allow credit unions to earn better rates of interest on these deposits. The other submitter argued there should be competitive neutrality for different types of NBDTs for these purposes.</p>	<p>We will take these concerns into account as we conduct our planned review of banks' liquidity requirements.</p>
<p>Clarification of Risk Management Guidelines: The NBDT licensing process brought to light a number of aspects of our requirements and guidelines which could potentially be clearer. We will consider 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 Reserve Bank to monitor the implementation of these guidelines.</p>	<p>One submitter noted that clarification on what aspects of the risk management guidelines are considered material and what needs to be approved by the Trustee would be helpful.</p>	<p>We will take these concerns into account as we pursue further policy work in this area.</p>

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

Summary of what we said/proposed	Feedback	Reserve Bank response
<p>Clarification of the Reserve Bank’s “policy-making approach” through the publication of a finalised version of the document in Appendix F of the Consultation Document for banks. We will also 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 website.</p>	<p>Both submitters were generally supportive of the proposals to strengthen the Reserve Bank’s policy-making framework.</p> <p>One submitter felt that, although the draft statement of approach to policy-making goes some way to addressing industry concerns about the existing framework, it does not go far enough. At a minimum, this submitter would like to see the document also include the following points:</p> <ul style="list-style-type: none"> • A comprehensive, transparent cost/benefit analysis framework for all significant policy proposals in a form that enables meaningful scrutiny by all stakeholders. Cost benefit analysis prepared by the Reserve Bank should be subject to independent scrutiny; • Greater independent expert involvement in policy proposals; • Early stage consultation with all stakeholders; • A minimum consultation period of two months, and longer for large, complex proposals; • Regular ex-post reviews of the cost-effectiveness of policies; More effective and more transparent forward planning by the Reserve Bank for all policy initiatives such that industry can have an opportunity to plan ahead for 	<p>We will continue to develop our statement of approach to policy-making. As part of this process, we expect to make some other modifications to document (which is currently in draft/outline form). However, none of the changes will be fundamental.</p> <p>We will modify the document to state that “our aim is to consult over a 6 to 10 week period depending on the significance of the proposal.” We will keep the caveat that there may be rare cases where circumstances mean we adopt a shorter consultation period. In these cases, we will seek to be clear about why a longer period is not possible.</p> <p>As discussed under the section related to our website (see below), we will aim to make better use of the “new initiatives” section of our website to provide more updated information on policy initiatives.</p> <p>We also believe the proposed mailing list will contribute to improved communication and greater transparency (by notifying interested stakeholders of the latest NBDT news releases and other public statements from the Reserve Bank regarding the sector).</p> <p>We will continue with our regular engagement with the FMA and continue to seek to coordinate with them, wherever possible.</p> <p>We believe that the proposals also reasonably address the other points raised by submitters.</p>

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	<p>possible changes to the regulatory environment;</p> <ul style="list-style-type: none"> • Greater effectiveness between the Reserve Bank and FMA on policy initiatives where they involve overlapping considerations. 	
<p>Improvements to the NBDT section of the Reserve Bank 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.</p>	<p>One submitter felt that the current website is not intuitive to navigate, and makes it difficult to find relevant information. It suggested that reorganisation of the website should focus on providing a clear and logical structure for each of the various types of end user (NBDTs, banks, supervisors, general public). This submitter recommended a consistent Reserve Bank website design for each industry group enabling access in a user-friendly manner to relevant legislation, regulations, conditions of registration, prudential guidelines, standard letters to industry participants, policy guidance, discussion documents and statistics. The other submitter noted that updating the NBDT section of the website more regularly would be very welcome, as would a more developed “new initiatives” page.</p>	<p>We will aim to begin our tailored improvements to the website in the new year. We may use our annual web survey to consult on specific aspects of this.</p> <p>We will also aim to keep the new initiatives more up to date, and to establish a more consistent structure across webpages relating to the various industries we regulate.</p>
<p>Creation of an e-mail list serve targeted at the NBDT sector. Although the Reserve Bank generally prefers to communicate via trustees, who are the frontline supervisors of NBDTs, there are some policy issues on which the Reserve Bank would like to communicate directly with all licenced NBDTs. The proposed mailing list would be on a</p>	<p>Both submitters supported this proposal and noted that they and all their members would likely subscribe. One submitter noted that Reserve Bank’s current communications via Trustees can sometimes add unnecessary cost. This submitter also commented that care should be taken that the material sent to this list is also recorded on the website, to be sure</p>	<p>We will proceed with the plans to set up this mailing list as soon as possible. This mailing list will primarily be used for policy-related matters (but may also notify interested stakeholders of the latest NBDT news releases and other public statements from the Reserve Bank regarding the sector).</p>

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subscription basis, similar to those for the banking and insurance sectors.	it is easy to search for after the e-mail has been sent.	
<p>We note that there are two issues raised initially by stakeholders, both related to our regulations on related party exposures, on which we <u>do not</u> propose to carry out additional work at this time:</p> <ul style="list-style-type: none"> • Related Party Exposure Limits; and • Set-off When Calculating Related Party Exposure: 	One submitter noted that its members would still favour taking account any set-off rights an NBDT may have when calculating related party exposures.	We have noted these issues but do not propose to carry on future work on them at this time.
As part of the stocktake, a number of stakeholders have also noted the significant changes in the composition of the sector in recent years. The Reserve Bank monitors the NBDT and the broader non-bank lending sector, and reports on this work in our semi-annual Financial Stability Report. The Reserve Bank will continue with this work and would welcome specific input or observations on these developments from individual NBDTs or industry bodies.	One submitter noted that there has certainly been consolidation in the NBDT sector and changes in funding models so that many lenders no longer fund themselves by raising deposits from the public. This submitter noted that this is not in the best interests of the New Zealand public as it has undermined competitiveness in the sector and taken away choice for depositors. This submitter would be keen to be involved in any consultation about this matter.	We do not currently have plans to consult on this issue, but have taken the comments into consideration. We will continue to monitor the composition of the sector and any further changes to it over time.

Other Topics Raised

NBDT industry bodies also raised various other topics that were outside the scope of the stocktake, including:

- **Suitability:** Suitability checks can be a barrier to making important senior appointments as they take a long time to complete;
- **Deposit Insurance:** One submitter noted that New Zealand is the only advanced economy in the world without some form of deposit insurance or deposit guarantee scheme and made a case for serious consideration of deposit insurance in New Zealand, applicable to banks and NBDTs; and

- **Trustees:** One submitter noted that the shape of the current regime is still quite new and that its members would generally not be keen to see further material changes after such a short time. However, it noted that if there were changes proposed to the model whereby the Reserve Bank was to become both regulator and supervisor and these would significantly reduce the cost of supervision, then clearly they would be supportive.

While these comments relate to issues that are outside the scope of the Stocktake, we will keep them in mind should any further work on these issues be carried out in the future.

Conclusion

In the course of the Stocktake, we have identified a number of changes that, once implemented, will help us achieve our objectives of greater clarity, consistency and efficiency in our regulations and our processes for introducing or changing regulations. We appreciate the feedback provided thus far by NBDT industry bodies and look forward to continuing to work with them while proceeding with the various projects and changes discussed in this paper.