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Office of the Minister of Finance

Chair, Cabinet Economic Development Committee

Reserve Bank Act Review – Deposit Takers Bill

Proposal

- 1 This paper presents proposals on a set of policy issues relating to the Deposit Takers Bill (referred to below as the DTA). Once decisions are taken, an exposure draft of the Bill will be completed and consulted on later this year. After decisions on any further matters arising from consultation on the exposure draft, it is intended that the Bill be introduced to the House in the second quarter of 2022.

Relation to government priorities

- 2 These proposals are part of a broader review of the Reserve Bank of New Zealand Act 1989, which was part of the previous Government's coalition agreement between the Labour Party and the New Zealand First Party. Phase 1 of the Review, which was completed in 2018, amended the monetary policy framework, creating the Monetary Policy Committee (MPC) and added an objective to support maximum sustainable employment. Phase 2 of the Review is a wide-ranging review of the Reserve Bank's governance and financial policy framework, including the development of a new prudential framework for deposit-taking institutions, and the introduction of a scheme to protect depositors from loss.

Executive Summary

- 3 I am seeking Cabinet decisions to finalise details of a package of proposals agreed on by Cabinet in April (DEV-21-SUB-0076 and companion papers refer) which are the culmination of three rounds of public consultation on Phase 2 of the Reserve Bank Act Review. The overall objective of the Review is to modernise the Reserve Bank's legislation to support the development of a New Zealand economy that is productive, sustainable and inclusive. These proposals will help protect society from the damage to New Zealand's financial system and wider economy that could be caused by unexpected external factors, excessive risk taking by the deposit taking sector, and/or the unmanaged failures of individual deposit takers.
- 4 I am seeking decisions on the following policy issues, principally relating to the crisis management and resolution framework:
 - 4.1 **Purpose of the resolution function and role of the Minister** – I propose minor variations to the purposes of the resolution function, and that they should apply to both the Reserve Bank and the Minister when exercising direction powers under that section of the Act.

- 4.2 **Bail-in** – I am proposing to limit legislative reforms on bail-in at this time, to a simple ‘contractual’ model. Full statutory bail-in powers are complex (and proper analysis and consultation could delay the passage of the DTA). I consider they would be best looked at again after resolution strategies are advanced under the new resolution framework, if further evidence suggests that contractual bail-in and other relevant resolution powers prove inadequate.
- 4.3 **The use of the deposit insurance scheme fund in resolution** – the deposit insurance scheme fund can contribute to the costs of a resolution (including by contributing to no creditor worse off payments) while still meeting the objectives of deposit insurance. I am proposing safeguards for the use of scheme funds to ensure any contribution to the costs of resolution is consistent with the underlying purpose of the deposit insurance scheme.
- 4.4 **No Creditor Worse Off (NCWO) and appeal rights in resolution** – key features of the NCWO mechanism are proposed which will provide for compensation if a resolution has left some creditors or shareholders worse off than they would have been in an ordinary liquidation. I propose that general appeal rights available in resolution are limited to judicial review reflecting the status quo and on the basis that compensation determinations under NCWO will be subject to broad appeal rights.
- 4.5 **Constraints on the ability of creditors to enforce rights against deposit takers in resolution** – I am proposing adjustments to the existing constraints on creditors to ensure that the objectives of the resolution regime are not unduly impeded, and for consistency with international best practice.
- 4.6 **Other matters** – I am proposing minor amendments to the decisions taken around the regulatory regime in April. I also recommend adding scope to provide additional deposit insurance coverage in special cases that cause households to hold ‘temporary high balances’, and an ex post ‘resolution levy’ which would allow the Crown to recoup any public funds expended when supporting an entity in resolution for financial stability reasons.

Background

- 5 In 2017, the Government announced a review of the Reserve Bank of New Zealand Act 1989. Phase 1 of the Review dealt with monetary policy arrangements, resulting in the introduction of the MPC and the introduction of an economic objective of supporting maximum sustainable employment. Phase 2 of the Review, which began in June 2018, focusses on the institutional structure of the Reserve Bank, the framework for the prudential regulation and supervision of deposit takers, and new arrangements for depositor protection.

- 6 A joint Review team comprising members from both the Reserve Bank and Treasury led the Review, supported by an Independent Expert Advisory Panel (the 'Panel'). The Panel is chaired by Suzanne Snively, who also attends joint meetings of senior leadership at the Treasury and the Reserve Bank on the Review. The Panel provides independent advice to me on the recommendations put forward by the joint agencies.
- 7 The overall objective of the Review is to modernise the Reserve Bank's legislation to support the development of a New Zealand economy that is productive, sustainable and inclusive. A modern and fit for purpose prudential regime will contribute to this overarching objective if it provides a credible pre-commitment to the long run goal of financial stability and protects the Reserve Bank's operational independence. This regulatory autonomy is complemented and supported by a robust accountability and transparency architecture that supports quality decision-making and public confidence in the legitimacy of the Reserve Bank as an institution.

Previous Cabinet decisions

- 8 In April 2021, the Cabinet Economic Development Committee, considered four papers relating to the Deposit Takers Bill:
 - 8.1 Overview paper – this paper provided an overview of three detailed decision papers seeking agreement to a new prudential framework for deposit takers, the introduction of deposit insurance, and reform to the crisis management and resolution framework for deposit takers.
 - 8.2 The framework for the regulation and supervision of deposit takers – this paper provided a set of recommendations around the regulation and supervision of deposit takers: the objectives for the Reserve Bank under new sectoral legislation for deposit takers; the prudential boundary for 'deposit taking'; the licensing framework and how prudential requirements will be imposed; a new accountability framework for directors of deposit takers; the suite of supervisory and enforcement tools available to the Reserve Bank; and the appeal rights afforded to parties impacted by prudential decisions.
 - 8.3 Deposit insurance – this paper detailed recommendations for the introduction of a formal scheme to protect depositors from loss in the event that a deposit taker fails. Depositors will be covered up to \$100,000 of their deposits at any single deposit taker. New Zealand is currently an outlier internationally without a deposit insurance scheme.
 - 8.4 Crisis management and resolution – this paper provided a set of recommendations that strengthens New Zealand's crisis management framework. This work has been informed by international experience during and since the global financial crisis, but is tailored to New Zealand circumstances. The suite of recommendations provided for a clear mandate for the Reserve Bank as the resolution authority, while enhancing the powers available to manage a deposit taker in distress. The recommendations also addressed a long-standing gap in the

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government's financial crisis management framework by amending the Public Finance Act 1989 (the PFA) to authorise the Minister of Finance to approve expenditure in a financial crisis even if there is no appropriation in place.

- 9 The Committee took decisions on these papers [DEV-21-MIN-0076, DEV-21-MIN-0077, DEV-21-MIN-0078, and DEV-21-MIN-0079] and these decisions were confirmed by Cabinet on 19 April 2021 [CAB-21-MIN-0128].

Further Cabinet decisions and decisions taken under delegation

- 10 The Committee noted that additional Cabinet decisions may be required to finalise the Deposit Takers Bill (DEV-21-MIN-0076). Final policy work is being progressed to complete drafting instructions for the Parliamentary Counsel Office (PCO) in respect of the Bill and other legislative amendments (such as amendments to the PFA). Officials have advised me that further Cabinet decisions are needed on significant policy aspects relating to the crisis management framework. I am seeking decisions on these matters in order to progress the Bill so that an exposure draft may be released.
- 11 The Committee authorised me (together with other Ministers where matters involve their portfolios) to further clarify and develop policy matters relating to these papers in a manner not inconsistent with Cabinet's decisions. I have taken some decisions under delegation and expect to take more after exposure draft feedback. These will ultimately be reported back to Cabinet when the Bill is approved for introduction (next year).

Analysis

Purpose of the resolution function and role of the Minister

- 12 Cabinet has agreed that the Minister would have a power to direct the Reserve Bank in certain circumstances when managing a deposit taker in resolution. I have taken decisions about this power under delegated authority. I recommend clarifying that although the purpose of the power is to protect public funds, to avoid conflict between the Reserve Bank and Minister's objectives, in exercising it, the Minister should also consider the overall set of resolution purposes.
- 13 I propose to take further decisions on process requirements and other issues that arise in relation to the direction power under delegated authority after further advice from officials.
- 14 I also propose other minor changes to that set of resolution purposes (which were referred to as objectives in DEV-21-MIN-0079). I propose to make preservation of the creditor hierarchy (that would have occurred in liquidation) a purpose alongside the other resolution purposes. Cabinet previously agreed this would instead be a requirement during the conduct of resolution, except where financial stability considerations required a departure from the ranking. I have also added other purposes that aim to clarify that resolution powers should be used in ways that preserve value and resolve issues promptly.

These purposes apply to resolution actions (including the exercise of powers by the Minister and Reserve Bank).

Bail-in

- 15 “Bail-in”, in the most general sense, provides that certain creditors of a failed deposit taker absorb losses in order to reduce the risk that the deposit taker requires public support. Bail-in can be achieved in a variety of ways – including by drafting liability contracts with explicit clauses that provide for bail-in in certain circumstances (contractual bail-in), a formal statutory power that imposes losses on creditors (statutory bail-in), and through the use of resolution powers that cause certain creditors to absorb losses. An example of relevant resolution powers are the transfer powers available in resolution to shift certain creditors and assets into another company or vehicle that is legally distinct from the deposit taker. These transfer powers are being carried over (with appropriate adaptations) from the 1989 Act.
- 16 In April I asked Cabinet to agree to a series of proposals that would be drafted into a statutory bail-in regime [DEV-21-MIN-0079 refers]. I have subsequently decided that it is preferable to initially focus on contractual bail-in and transfer powers. Statutory bail-in powers would require a significant reworking of the rules the Reserve Bank sets around the liabilities of deposit takers (for example, the wide range of eligible liabilities would all have to acknowledge the bail-in power in their terms and conditions). In other countries these changes have been developed in detail at the same time as statutory powers are designed. The design of statutory bail-in powers, however, is also complex, and could delay the introduction of the broader provisions of the DTA.
- 17 If ongoing policy development (which will happen as the Reserve Bank develops resolution plans and the Statement of Resolution Approach after the passage of the initial Deposit Takers Act) leads to a view that statutory bail-in powers are needed to implement effective resolution strategies, they can be legislated then with more clarity about how to design them. I will direct officials to report to the Minister of Finance on this within two years of the passage of the DTA.
- 18 Contractual bail-in is a simple approach to loss absorbency where the conversion of the instruments occurs following rules established by the contractual terms of the debt, and can occur prior to resolution commencing. This would be coupled with rules requiring deposit takers to issue minimum amounts of ‘bail-in’ debt, which is subordinated to senior debt such as deposits, and has contractual terms that allow the Reserve Bank to convert it. The mechanism used to trigger this conversion would be a direction to the deposit taker (using the direction power set out in the April paper). This is how I propose the law should provide for what was described in the April paper as a deposit taker being “resolved in an open state”.
- 19 This framework could be used to boost loss absorbency in a way that could be useful in working with a foreign regulator of the parent of a New Zealand deposit taker (such as APRA) to stabilise the parent and subsidiary without

triggering formal resolution powers. However, I note that other simpler forms of loss absorbency are currently the priority for the Reserve Bank. Specifically, the Reserve Bank is gradually imposing significant increases in equity requirements on the banking sector. These increases in common equity requirements were introduced as part of a major consultation with the banking sector that has recently been completed and will be implemented over the next 7 years, at significant cost to industry, and will lead to large increases in loss absorbing capital across the implementation period. Requiring debt with contractual bail-in features would most naturally follow after those common equity requirements are fully implemented. The framework I am proposing in this paper would therefore provide the scope for the Reserve Bank to add contractual bail-in terms to debt instruments as part of prudential capital requirements in the future.

Flexibility to extend deposit insurance to cover ‘temporary high balances’

- 20 A number of countries (around 40% in a study of OECD and other major economies) have special rules applying their deposit insurance schemes to temporary high balances (THBs). These are designed to cover special life events where it is common for a large sum to be placed in a single deposit account (for example, when a household has just sold a house). Coverage is usually still limited but a higher limit applies (often 3 to 5 times the base coverage).
- 21 Covering THBs in our Deposit Insurance Scheme (the Scheme) could potentially contribute to financial stability by reducing the likelihood of people suffering hardship as a result of the covered scenarios (e.g. sale of property) happening shortly before a deposit taker fails. If the scenarios are well designed, this should help enhance perceptions that the scheme is equitable, and reduce calls for a wider bailout of a failed institution. The scheme can also mean depositors will not need to spread their funds across different deposit takers for short periods (e.g. after selling a house, when about to purchase another) to achieve protection, reducing transaction costs.
- 22 I propose that the Scheme should have a provision that allows for extended coverage of THBs if regulations are made that specify the conditions (e.g. cases, evidence, limits) under which THBs coverage would apply. This would not be intended as an absolute commitment to introduce THBs coverage, but would make it possible to do so. I do not envisage that THBs coverage would be available when the scheme commences, as a number of more fundamental rules and regulations will have to be first created to get the scheme running (e.g. treatment of trust and client accounts, levy rules).
- 23 A risk of including such a provision is that it could be seen as a commitment to introduce THBs coverage in the future or build unrealistic expectations about its coverage. Internationally, THBs only cover temporary special cases (for example, it would not cover savings for retirement or house deposits). The Reserve Bank proposed leaving THBs for a future review of the DTA for these reasons, but on balance I prefer to have the flexibility to introduce THBs coverage without further legislative change.

Use of the deposit insurance scheme fund in resolution

- 24 Deposit insurance exists to preserve confidence by protecting depositors against the loss of their insured deposits in the event a bank is unable to meet its obligations to depositors. This can be done through commencing a payout under the Scheme. However, depositors may be better protected, and financial stability concerns better addressed, through the use of resolution tools in a way that avoids the need for liquidation and depositor pay-out. Cabinet has made the following decisions [DEV-21-MIN-0078]:
- 24.1 The funds of the Scheme may be released by the Reserve Bank for the purpose of protecting insured depositors in resolution (outside of a liquidation and payout), subject to safeguards that will be set out in legislation;
- 24.2 Safeguards will provide that the overall contribution of the Scheme is expected to be no more than it would otherwise have expected to incur in a liquidation and payout of insured depositors, net of expected recoveries;
- 25 Cabinet noted that further decisions around ‘safeguards’ for use of the Scheme’s funds in resolutions (other than liquidation) would need to include restrictions around the contributions the Scheme can make to resolutions, procedural and reporting requirements, and any other safeguards to align with guidance from international best practice.
- 26 I am proposing the following matters to clarify the circumstances in which the Scheme’s fund can be used to contribute to resolutions, and the safeguards that apply in respect of such contributions:
- 26.1 that the Scheme’s fund may at any time contribute to resolution payments provided:
- 26.1.1 that the Reserve Bank is satisfied that the resolution protects persons covered by the Scheme (including by ensuring ongoing access to protected funds), and
- 26.1.2 the contribution will at all times not exceed a maximum amount. The maximum amount is costs (estimated by the Reserve Bank) that the Scheme would have paid in a hypothetical liquidation to protect depositors, taking into account estimated recoveries from the failed deposit taker in that liquidation;
- 26.2 that contributions permitted by the deposit insurance scheme fund to resolution includes contributions to NCWO payments, subject to compliance with the applicable resolution safeguards;
- 26.3 that contributions will be made on such terms and conditions (including by way of loan or secured funding), as determined by the Reserve Bank;

- 26.4 that if contributions are made by the scheme as part of a resolution, there will be an independent review undertaken assessing compliance with the applicable safeguards.
- 27 Cabinet's decisions recognise that the Scheme can play a broader role in resolution while still meeting the objectives of depositor protection. The insolvency of a deposit taker may entail public policy concerns that are better met by maintaining certain services of the deposit taker through a resolution, as an alternative to wind-down and payout of covered deposits. Resolution tools, such as a purchase and assumption (where a healthy deposit taker purchases assets and assumes liabilities, including insured deposits, of an unhealthy deposit taker), can protect depositors, minimise disruption to customers, support consumer and market confidence, and better preserve value. Such tools, however, are likely to require funding (or trigger compensation payments) in addition to the loss absorption resources and assets available in the failed deposit taker.
- 28 Despite the benefits of permitting contributions from the Scheme's funds outside a liquidation and payout, there is a need for appropriate safeguards to ensure the use of Scheme's funds is consistent with the underlying purpose of the Scheme - to protect insured depositors and thereby contribute to financial stability. I recommend that the safeguards should cap the Scheme's contribution at the net estimated cost of a liquidation at all times, on the basis that this cap is more consistent with the purpose of the Scheme, and limits contributions to what the scheme would have paid in a liquidation and payout scenario.
- 29 As set out below, the DTA will establish a mechanism to compensate creditors if a resolution of a deposit taker has left some creditors worse off when compared to an ordinary liquidation (the NCWO principle). I propose that the Scheme funds can be used to contribute to NCWO compensation payments on the basis that such payments are a cost of resolution. Any contribution would be subject to the safeguard described above.
- 30 Under the proposed safeguards, the Scheme could be asked to contribute to the cost of a resolution that protects other creditors, or to fund compensation of other creditors, as long as the contribution is lower than the estimated net cost of a liquidation. A contribution from the Scheme fund can be justified on the basis that the resolution achieves the objectives of the Scheme to protect depositors, and at no greater cost to the Scheme than what may be incurred in a liquidation and payout scenario. Limiting contributions of the Scheme fund to resolution strategies that only directly benefit insured deposits would reduce the feasibility of resolution options available without recourse to public funds that would otherwise include broader benefits to depositors such as continuity of services, and value preservation.
- 31 To provide a transparent process and incentivise the Reserve Bank to ensure compliance with safeguards, I propose that where contributions are made by the scheme as part of resolution, there is a statutory requirement for an independent review assessing compliance with applicable safeguards.

No Creditor Worse Off (NCWO) and Appeal Rights in Resolution

- 32 As part of the resolution framework, the DTA will establish a mechanism to compensate creditors if a resolution of a deposit taker has left some creditors worse off when compared to the expected outcomes of an ordinary liquidation (the 'no creditor worse off' principle). On 14 April 2021 the Cabinet Economic Development Committee made the following decision [DEV-21-MIN-0079]:
- 32.1 confirmed Cabinet's previous in-principle decision that an after-the-event compensation mechanism be established to compensate creditors if a resolution left some creditors worse off than they would have been in an ordinary liquidation (the 'no creditor worse off' principle)
- 33 The NCWO proposal is grounded in the Financial Stability Board's "Key Attributes of Effective Resolution Regimes for Financial Institutions" ("FSB KA") which recognise that resolution authorities should generally seek to respect property rights when exercising a resolution strategy. If property rights are unclear, investors can find it hard to accurately identify and price risks. However, there is also recognition that sometimes creditors may need to take second place to wider or systemic stability interests. In such cases it is appropriate to provide a compensation mechanism for affected creditors. Internationally, resolution authorities commonly have powers and discretion to act rapidly and flexibly in a crisis, with a provision for ex-post compensation for any additional losses incurred by a creditor as a result of a departure from normal creditor property rights and priorities in insolvency.
- 34 A compensation obligation only arises if creditors or shareholders receive less in a resolution than they would have in a liquidation counterfactual. In a liquidation, returns to creditors are likely to be less than book value as assets are likely to be valued on a gone concern basis given the liquidator's duties to realise the assets of the institution and distribute them. A resolution strategy is likely to try and transfer assets on a going concern basis, preserve value (including for creditors), and avoid financial instability. So, the risk of the NCWO obligation resulting in very large contingent liability is considered small.
- 35 I recommend seven proposals setting out the key aspects of the NCWO mechanism. I propose that detailed decisions on these proposals be taken under delegation. These proposals are included in Annex 1 and are described further below.

Proposal 1: Any pre-resolution creditor or pre-resolution shareholder of an entity in resolution ("prescribed persons") who is financially worse off as a result of a resolution of that entity when compared to their position under a hypothetical liquidation of the entity shall be entitled to compensation

- 36 I propose that any creditor or shareholder of a deposit taker who is in a worse financial position as a result of resolution than they would have been under normal insolvency proceedings be entitled to compensation. This proposal is

consistent with the FSB KAs 5 and is consistent with the legislative obligation in other jurisdictions considered.

- 37 I propose that shareholders will also be included in the NCWO mechanism. Shareholders, like creditors, have rights and entitlements in connection with their shareholding. It is important that the treatment of shareholders is considered in a resolution in a similar manner to creditors. The inclusion of shareholders in the NCWO mechanism is consistent with international practice including in Europe, the United Kingdom, Singapore, Hong Kong and Canada.
- 38 The NCWO mechanism will not apply to overseas licenced deposit takers (commonly referred to as branches) due to the different (and more limited) way New Zealand resolution powers will apply to these types of deposit takers, and for complexity reasons. Under New Zealand law, branches of overseas companies do not have separate legal personality. Therefore, any resolution action taken by the Reserve Bank in respect of these types of deposit takers would be taken in respect of the overseas company itself.
- 39 A NCWO valuation for an overseas company would likely require an assessment of insolvency and regulatory treatment applying in the home foreign jurisdiction, which would be very complex. At an operational level, there would also be challenges for the valuer in accessing the necessary information, the valuation could take a long period of time, and it could be very costly (due to the need to engage experts in the home foreign jurisdiction). Any such assessment is also likely to be heavily qualified in light of these cross border aspects. In light of these complexities, it would not be feasible to require a valuer to make a NCWO compensation determination for a branch.
- 40 I propose that the NCWO mechanism will apply to locally incorporated subsidiaries and associated persons of deposit takers that are placed into resolution. Associated persons are entities that are not deposit takers, but are related in either ownership or decision making to a deposit taker, and can include holding companies, subsidiaries, and entities with interrelated management. The activities of associated persons can present risks to deposit takers, or financial stability risks more broadly, and it is essential that prudential regulators are able to monitor and mitigate these risks. Consistent with the Reserve Bank Act 1989 and the Insurance (Prudential Supervision) Act 2010, the Reserve Bank will have powers to place associated persons into resolution. If a licenced deposit taker enters into resolution, every subsidiary also enters into resolution, unless the resolution order declares a subsidiary is not in resolution.
- 41 The rationale for the application of NCWO to deposit takers also applies to subsidiaries and associated persons. Property rights of shareholders and creditors of associated persons should generally be respected and only altered for compelling public policy reasons. The use of resolution powers that alter the creditor hierarchy is a significant departure from the principles of insolvency law which normally allow creditors and shareholders to identify the risks to which they are exposed. While the use of resolution powers and departing from the creditor hierarchy for subsidiaries and associated persons

may be justified, the principle that creditors and shareholders should nevertheless be left no worse off than in a liquidation also applies. Overseas subsidiaries and associated persons will not be covered by the NCWO mechanism for similar reasons applying to overseas licenced deposit takers described above.

Proposal 2: An independent valuer is appointed by the Minister of Finance to determine whether compensation is payable to prescribed persons

- 42 I propose that the determination as to whether compensation is payable will be made by an independent valuer. The independent valuer would be appointed and removed by the Minister of Finance. The terms and conditions of the independent valuer's appointment, including remuneration, costs and expenses to be met by the Crown, would be agreed between the Minister and the independent valuer. Requirements on independence and expertise will be included in legislation.
- 43 It is common practice internationally for an independent valuer to be appointed by the Minister of Finance (or the Treasury) for the purposes of determining whether compensation is payable to creditors and shareholders impacted by the exercise of a resolution power. Independence (including from the resolution authority and the deposit taker) mitigates against perceived or actual conflicts of interest, and enhances the legitimacy of the NCWO process. Expertise in financial market structures, accounting and strategic performance are likely to be criterion for selection.

Proposal 3: The valuation calculation shall assess the difference between the treatment of prescribed persons claims in a hypothetical liquidation and in resolution, and shall be made in accordance with certain prescribed assumptions and principles

- 44 The proposed NCWO calculation is consistent with Cabinet's decision on the NCWO mechanism which requires compensation for creditors if a resolution leaves some creditors worse off than they would have been in an ordinary liquidation.
- 45 Any public financial assistance will be disregarded in the calculation of insolvency treatment, to ensure the value of a deposit taker's balance sheet is not distorted.
- 46 There are a range of principles and assumptions that may be applied to an insolvency valuation which can impact on the value ascribed to assets, and ultimately the estimated returns to creditors. In addition, it may be appropriate for the valuer to estimate expected resolution recoveries for creditors where the realisation of assets is protracted and recoveries may not be actually received for a long time after the commencement of resolution. I propose that further valuation assumptions and principles may be prescribed by regulation to help ensure a consistent approach to valuations over time and to accommodate future changes on participants in the financial system.

Proposal 4: The independent valuer shall have access to a broad range of information from the Bank and the failed deposit taker necessary to conduct the valuation

- 47 Consistent with the approach taken internationally, I propose the independent valuer be provided with a broad range of information that may be reasonably necessary to perform its functions subject to confidentiality obligations. In order to conduct a fair and realistic valuation, the independent valuer will require access to a broad range of information from the deposit taker and the Reserve Bank.

Proposal 5: The independent valuer shall prepare a valuation report outlining its calculations and the entitlement to compensation of each prescribed person (or class of persons) and give prescribed persons notice of its compensation determination

- 48 I propose that the independent valuer prepare a valuation report containing the compensation determination, and key information relating to the basis of the determination. The report would be notified to interested parties and published.
- 49 The valuation report and accompanying notice will focus on procedural and administrative requirements relating to the NCWO valuation. The valuation report will notify creditors and shareholders of its compensation determination, and the basis on which it has been made. The procedural information from the Reserve Bank accompanying the notice will deal with practical aspects such as notice, publication, payment provisions (if applicable) and how to lodge objections.

Proposal 6: Appeal rights on points of fact and law shall be available to prescribed persons and the Reserve Bank and the Crown in respect of compensation determinations by the independent valuer subject to appropriate limitation periods

- 50 Consistent with the approach taken internationally, I propose that the appeal rights for the NCWO determination are broad and include questions of law and fact arising from the determination. Broad appeal rights would support the objectives of credibility, accountability and legitimacy. This approach is common internationally and consistent with the approach taken domestically with specialist tribunals (including the Land Valuation Tribunal and the Weather Tight Homes Tribunal).
- 51 In addition to these rights being available to creditors, they shall also be available to the Reserve Bank and the Crown who have a legitimate interest in ensuring that the valuation report complies with the legislative framework.

Proposal 7: The Crown shall satisfy any compensation that is not met in full by the deposit insurance scheme fund (noting the contributions by the scheme fund to NCWO payments are limited by applicable safeguards)

- 52 I propose that NCWO compensation be first satisfied by contributions from the deposit insurance scheme fund. As noted above, I propose that the Scheme's

fund may be used to contribute to NCWO compensation payments subject to safeguards designed to ensure the objectives of the scheme are met. The use of the Scheme's fund first is also consistent with the Reserve Bank's objective to minimise the reliance on public funds in resolution.

- 53 However, safeguards on the use of the Scheme's fund may mean that there are insufficient funds to cover all or part of the NCWO compensation payment. In such cases, I propose that such payments be made by the Crown through a permanent legislative authority situated in the DTA. This arrangement would effectively mirror the arrangements for the Scheme backstop which also relies on a permanent legislative authority.
- 54 Reliance on other funding models would not address the policy intent that any NCWO compensation obligation is promptly paid (any delays or uncertainties associated with the payment of compensation would undermine the credibility of the NCWO mechanism). An appropriations model under the Public Finance Act (PFA) would not address the policy intent for prompt payment. Sufficient funds may not be available under an existing appropriation, and Parliament may not be able to agree to make a new appropriation available in a timely manner.
- 55 I am satisfied that the risks associated with public funds being deployed to satisfy NCWO compensation payments can be appropriately managed under the proposed resolution framework including through my involvement in resolution planning, and in the lead up and entry into resolution (noting that entry into most resolutions will require my agreement). The resolution objectives of the Reserve Bank require it to seek to minimise the reliance on public funds.

Appeal rights for resolution actions

- 56 Appeal rights for resolution actions by the Reserve Bank are closely connected with appeal rights available in respect of payments made to creditors to compensate them for altering their rights in a resolution. I propose that appeal rights for resolution actions be limited to judicial review only. This maintains the existing position under the Reserve Bank Act 1989. I consider that that appeal rights should be limited on the basis of the need for certainty, the need to act quickly and flexibly, the nature of financial stability risks, and the expertise of the decision maker. The FSB KAs recognise the need to limit appeal/review rights for resolution actions. FSB KA 5.5 provides:

“The legislation establishing resolution regimes should not provide for judicial actions that could constrain the implementation of, or result in a reversal of, measures taken by resolution authorities acting within their legal powers and in good faith. Instead, it should provide for redress by awarding compensation, if justified.”

- 57 Allowing only judicial review for resolution actions is consistent with the FSB KA's and mitigated by the proposal above for broad appeal rights to be available for NCWO determinations by the independent valuer.

Recovering of public funds expended in resolution

- 58 The resolution regime and prudential framework for deposit takers are being designed to reduce the risk a deposit taker will need resolution, and make it possible for resolution to be done in a way that will not create substantial fiscal risks. Nevertheless circumstances may still arise where the Government is prepared to commit public funds in support of a resolution which ultimately leads to losses for the Government. Other countries have developed funding mechanisms, often designed to be activated after losses have occurred, in order to recover those costs over time from the surviving industry, who benefit from the financial stability the intervention provided.
- 59 Any such levy making power will be complicated to design. Firstly, the circumstances where recovery of public funds via a levy is permitted will have to be defined. This is likely to require mechanisms for measuring the net loss the Government incurred, and establishing that the purpose of the intervention was financial stability related (the Government may support the resolution for other reasons). Secondly, while the actual levies can be set by regulation, regulation making tests will have to be designed to guide the Minister of Finance in deciding who should face levies and how quickly the costs should be recovered.
- 60 I am seeking further advice from officials about detailed options for the implementation of an ex post resolution levy. It could go in the DTA, although the Reserve Bank and Treasury have noted it could delay the overall process. It may also fit in other legislation, as it is a fiscal tool, and depending on scope could go beyond the deposit taking sector and cover other financial firms like insurers. To make it possible to place a resolution levy power in the DTA, I am asking Cabinet to authorise me to take further detailed decisions on how it would fit into the DTA, work with officials to test that possibility with industry in the exposure draft process, and then report back to Cabinet on the intended final approach to resolution levies prior to the introduction of the DTA.

Constraints on the ability of creditors to exercise rights against a deposit taker in resolution

Background

- 61 The new resolution regime in the DTA aims to either allow the affairs of a distressed deposit taker to be restructured so that it can continue on in business, or where that is not possible, ensure that the distressed deposit taker is wound down in an orderly manner that minimises disruption.
- 62 This process can be impeded by third parties enforcing rights against a deposit taker after it has been placed into resolution. These impediments can take a variety of forms. In particular:
- Enforcement of debts and security interests by creditors: can result in losses crystallising and compounding the deposit taker's existing shortfall of assets vis-à-vis liabilities;

- Disorderly close out by derivative counterparties: Close out rights refer to a bundle of rights commonly included in derivatives contracts. These include rights to accelerate the speed at which obligations fall due (acceleration rights), terminate obligations otherwise owing (termination rights), and set-off/net obligations (set off and netting rights). Exercising these rights can result in losses crystallising, and the enforcement of rights over certain collateral, thereby compounding the deposit taker's existing shortfall of assets vis-à-vis liabilities. The exercise of these rights can also mean that certain risks faced by the entity (e.g. foreign exchange and interest rate risks) are no longer hedged, thereby increasing the likelihood that the entity will suffer otherwise avoidable losses in the future;
- Cessation of, or disruption to, essential services provided to the deposit taker by third parties: On entry into insolvency proceeding or resolution, certain service providers may have contractual rights to terminate the provisions of services they provide to a deposit taker.

63 The resolution regime in the DTA will address, or appropriately mitigate, most of these issues (for example, through a moratorium on the enforcement of creditor claims against a deposit taker in resolution). However, I am recommending two additional changes to address further issues that have been identified.

Proposal 1: A short stay on the ability of derivatives counterparties to exercise any close out rights against a deposit taker in resolution

64 The existing proposals do not address in an appropriately tailored manner the risk of a disorderly close out by derivatives counterparties. In particular:

- They are too narrow in scope: They restrict the exercise of some, but not all, close out rights while a deposit taker is in resolution, so do not fully address the risk of a disorderly close by derivative counterparties; and
- They are too long in duration: Certain rights associated with the close out of derivatives (e.g. payment of any net exposure the deposit taker may owe to a derivative counterparty) are potentially frozen for a significant period by the current proposals. This is out of step with the standard approach internationally, and in the long run could have a negative effect on the ability of large New Zealand deposit takers to enter into derivatives contracts with foreign counterparties (which is essential to their ability to manage certain financial risks).

65 To address these problems, I recommend that the resolution regime in the DTA provide that:

- a person cannot exercise close out rights in relation to a derivative due to a deposit taker entering into resolution (i.e. that the enforcement of these rights be subject to a stay);

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- this stay lasts until the close of the first full day after the date on which the deposit taker is placed into resolution, unless this time period is shortened or extended by the Reserve Bank; and
- this stay may be shortened at the Reserve Bank's discretion, but may only be extended where the Reserve Bank is satisfied of certain matters (e.g. that the deposit taker either meets minimum capital requirements, or there are other satisfactory arrangements in place to ensure that it can meet obligations to its derivatives counterparties).

66 This approach will mitigate the risk of a disorderly close out of derivatives in an appropriately tailored way. It is also consistent with international best practice, and in broad terms the approach taken in the recently enacted Financial Market Infrastructures Act 2021.

Proposal 2: Prohibition on the exercise of certain contractual rights against a deposit taker solely due to its entry into resolution

67 Parties may have certain contractual rights against a deposit taker:

- Where the deposit taker has entered into insolvency proceedings or resolution; or
- Once the deposit taker is in insolvency proceedings or resolution, if pre-insolvency or resolution obligations have not been satisfied.

68 These rights may include, for example, the right to deny a liability or obligation that the party would otherwise owe to the deposit taker, or the right to accelerate a liability owed to the party by the deposit taker (so that it falls due earlier than would otherwise have been the case). The exercise of these rights can impede the resolution of a deposit taker in various ways, such as by crystallising certain liabilities of the deposit taker earlier than would otherwise have been the case, or by meaning that a service provider no longer has to provide essential services to the deposit taker in resolution.

69 The current proposals address the second issue in paragraph 67 by applying the same rules as in section 275 of the Companies Act 1993 (which in summary prevents the providers of certain essential services from ceasing to provide those services due to their having not been paid amounts owing prior to liquidation commencing).

70 However, the current proposals do not address the first issue in paragraph 67 (i.e. they still allow a party to exercise these rights where they are available solely due to a deposit taker being placed into resolution, or due to resolution powers being applied in relation to that deposit taker).

71 To address this issue, I recommend that the resolution regime in the DTA prohibit the exercise of certain rights against a deposit taker solely on the basis it has been placed into resolution or made subject to resolution powers. These rights include the right to deny a liability or obligation owed to the

deposit taker, and the right to accelerate a liability owed by the deposit taker to the party.

- 72 This approach aligns with that taken in comparable Australian legislation, and in the recently enacted Financial Market Infrastructures Act 2021. It is important to note that it does not prohibit any other grounds for exercising these rights against a deposit taker in resolution (e.g. failure to be paid for services provided to the deposit taker after its entry into resolution would still be an available ground for ceasing to provide those services).

Regulatory and Supervisory matters

- 73 The regulatory regime imposes duties on directors with significant potential civil penalties for non-compliance (I expect these to be fines with an upper limit in the region of \$1 million). In April, Cabinet agreed that it would not be possible for directors to be insured or indemnified against this liability by a deposit taker. However, I have been advised that this may be too restrictive and could create a significant barrier to finding candidates for directorships. I propose that insurance or indemnification should be possible, but only in certain limited circumstances (such as the penalty arising from actions that were done in good faith, and the insurance being established following a specific process set down in the DTA).

Next steps

- 74 Following Cabinet decisions on the recommendations, the Reserve Bank will issue further drafting instructions to the Parliamentary Counsel Office. This will enable drafting of a bill and public consultation on an exposure draft, with introduction into the House anticipated in April/May 2022.
- 75 There are a number of policy details relating to these proposals which will require additional decisions prior to the completion of the drafting process. I anticipate that a number of these decisions will be taken either under delegation to myself, or jointly with relevant ministers whose portfolios are affected.
- 76 After the DTA is passed there will be a substantial work programme to implement the new prudential framework for deposit takers, including the introduction of deposit insurance. I expect that the deposit insurance provisions of the Act will commence with a target timeframe of 2023, prior to the rest of the DTA. I am placing priority on the implementation of deposit insurance so that arrangements are in place to protect depositors, should a deposit taker come under stress before the full DTA is ready for implementation.
- 77 The parts of the current Reserve Bank Act relating to the regulation and supervision of registered banks and the Non-bank Deposit Takers Act 2013 will remain in force until the remaining parts of the DTA have been fully implemented, thereby overlapping with the introduction of deposit insurance. I have asked officials to undertake further work on the detailed transition timeframe for the rest of the DTA. This will include further engagement with

the Ministry of Business, Innovation and Employment and the Financial Markets Authority on the interaction between the Bill and financial markets conduct legislation, including on the transition to new disclosure and supervision arrangements.

Financial Implications

- 78 The proposals in this paper build on the package of decisions made by the Cabinet Economic Development Committee in April 2021 on the Reserve Bank's prudential and supervisory framework [DEV-21-MIN-0076, DEV-21-MIN-0077, DEV-21-MIN-0078, and DEV-21-MIN-0079]. These decisions will have direct financial implications for the Reserve Bank as New Zealand's prudential regulator. To some extent these costs have been anticipated in the 2020-25 Funding Agreement between me and the Governor of the Reserve Bank signed in June 2020. Further details are provided in Paper 1 (Overview) which was considered by Cabinet Economic Development Committee in April 2021.
- 79 A compensation obligation arising under the NCWO mechanism could have financial implications for the Crown. It is not possible to quantify the financial implications because failures of large deposit takers are rare, and whether a compensation obligation arises will depend on the circumstances applying to a distressed institution at the time of failure, and the use of the resolution powers by the Reserve Bank. The failure of a large deposit taker is not common, and other key features of the financial safety net (such as prudential regulation and supervision) are expected to identify and address risks before a failure arises. Even in the event of a failure, the risk of a compensation obligation arising under the NCWO mechanism resulting in a large liability is considered small including for the following reasons:
- 79.1 the value of the assets of a distressed entity in a resolution are likely to be higher when compared to a liquidation. A liquidation is likely to discount the book value of an entity's assets given the liquidator's duties to realise and distribute assets to creditors. A resolution strategy is likely to try and transfer assets on a going concern basis and preserve franchise value.
- 79.2 a large proportion of creditor claims are likely to relate to deposits that will be fully protected by the deposit insurance scheme. If insured deposits are protected by resolution actions, the DIS fund will be able to contribute to any NCWO compensation mitigating the need for a Crown contribution.

Legislative Implications

- 80 The recommendations in this Cabinet paper will be given effect by the Deposit Takers Bill. The priority of the Bill in the 2022 Legislation Programme is to be determined.
- 81 The Deposit Takers Act will bind the Crown.

Regulatory Impact Statement

- 82 A Regulatory Impact Statement (RIS) for these decisions has been prepared, and reviewed by an independent assessor from within the Reserve Bank of New Zealand. The assessor considers that it meets the Quality Assurance criteria.
- 83 The Regulatory Impact Statement provides sufficient background to support the decisions which need to be taken at this stage to complete the design of the new deposit takers regime and deposit insurance regime. The RIS identifies the impacts of the various options but recognises that they cannot be quantified accurately given that they relate to resolving failing institutions and the nature and scale of any failure cannot be predicted. The RIS shows evidence of appropriate consultation, given the nature of the policy proposals being considered. The RIS clearly identifies the different types of decisions that need to be made.

Human Rights

- 84 My officials will be working with the Ministry of Justice in relation to the DTA to ensure that any concerns relating to the New Zealand Bill of Rights Act are addressed.

Population Implications

- 85 The recommendations in this Cabinet paper will help protect society from the damage to New Zealand's financial system and wider economy that could be caused by the failure of deposit takers, and are not expected to have specific implications for any population group.

Consultation

- 86 The following agencies were consulted on the contents of this paper: the Ministry of Business, Innovation and Employment; the Financial Markets Authority; Parliamentary Counsel Office. The Department of the Prime Minister and Cabinet has also been informed.

Views of the Independent Expert Advisory Panel

- 87 The Panel is supportive to what is being proposed for the Deposit Takers legislation. It commends the Reserve Bank, Treasury and Review Team for progress made to address the many complex topics to be covered.
- 88 From the beginning of discussions about depositor protection, the Panel has emphasised the importance of being aware of the trans-Tasman relationship. This is particularly important, given the relative size of New Zealand's four largest deposit takers who are subsidiaries of four large Australian banks. The Panel acknowledges that the no creditor worse off (NCWO) provisions in crisis resolution have been thoroughly addressed. The proposed NCWO protections include feature designed to alleviate concerns that may have been held from a trans-Tasman banking perspective.

- 89 The Panel recognises that depositor compensation is a new initiative for New Zealand, requiring robust legislation. It appreciates that due to time pressure and the normal processes around the preparation of legislation, some key issues are still being worked through and some features have been deferred to secondary legislation.
- 90 In regards to Ministerial directive power for resolution action when public funds are used, the Panel would like to see some further consideration of the rationale for this, but is supportive of it being subject to the same objectives as specified for the resolution authority. An important related point is that deposit and business transfers in a resolution be done in a way that doesn't confer undue competitive advantage to any particular firm. The Panel suggests consideration also be given to including this in the objectives assigned to the resolution authority.

Communications

- 91 I recommend that Cabinet decisions, the Cabinet paper and related material will be publicly released.

Proactive Release

- 92 I intend to proactively release supporting material and advice (such as policy advice reports) relating to these recommendations.

Recommendations

The Minister for Finance recommends that the Committee:

- 1 **note** that in April 2021, Cabinet confirmed decisions made by the Cabinet Economic Development Committee on a package of proposals on the new prudential framework for deposit takers, the introduction of deposit insurance, and the design of the deposit insurance scheme.
- 2 **note** that further decisions are needed to clarify further policy aspects and matters of detail relating to these proposals in order to progress the Deposit Takers Bill so that an exposure draft may be released.

Resolution Objectives

- 3 **note** that Cabinet has agreed that the Reserve Bank will have certain statutory objectives in performing the resolution function (DEV-21-MIN-0079 decision 4 and 60).
- 4 **note** that recommendations to modify these decisions are set out below.
- 5 **agree** that the above statutory objectives for the resolution function will be captured in the DTA as statutory purposes along the following lines:
 - 5.1 to enable the orderly resolution of licenced deposit takers;

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- 5.2 to avoid significant damage to the financial system that could result from the failure of a licenced deposit taker (refer to s68(b) of the 1989 Act), including:
 - 5.2.1 by maintaining the continuity of systemically important activities undertaken by licenced deposit takers in New Zealand;
 - 5.2.2 by mitigating, or otherwise managing, any loss of confidence in, the financial system resulting from the failure of a licenced deposit taker;
- 5.3 to protect eligible investors to the extent they are covered by the deposit insurance scheme;
- 5.4 while also providing that in carrying out a resolution in accordance with the purposes, the Reserve Bank should seek to minimise the cost of dealing with a licenced deposit taker having regard to the following factors:
 - 5.4.1 preserving the value of the entity in resolution to maximise recoveries;
 - 5.4.2 maintaining the ranking of claims of creditors (refer section 121(d) of the 1989 Act);
 - 5.4.3 protecting “public money”, by dealing with a licenced deposit taker under this part with a view to minimising, and otherwise managing, any reliance on public money in resolution;
 - 5.4.4 resolving the issues of the entity as quickly as possible.
- 6 **agree** that the Reserve Bank and the Minister will have the same statutory purposes when performing the resolution function with any exceptions (e.g. related to the test for exercising the Minister’s direction power) to be determined under delegated authority as set out in recommendation 41 below.

Bail-in

- 7 **agree** to rescind the Cabinet decisions that would have provided the Reserve Bank with a statutory bail-in power, together with supporting provisions, in the DTA (DEV-21-MIN-0079 decisions 36, 37, 38, 41, 42, 46 and 47).
- 8 **note** that I have asked officials to report on the need for statutory bail-in powers (given other alternatives such as the contractual and transfer powers) within two years of the passage of the DTA.
- 9 **agree** that the Reserve Bank will be able to issue prudential standards to require a deposit taker to issue instruments with contractual bail-in rights.

- 10 **agree** that the Reserve Bank is to be able to use the direction power to direct a deposit taker to trigger those contractual bail-in rights (replacing DEV-21-MIN-0079 decision 52).

Temporary High Balances

- 11 **note** that Cabinet has agreed that the deposit insurance coverage limit for the deposit insurance scheme be set at \$100,000 per eligible depositor, per licensed deposit taker.
- 12 **agree** that the DTA include a provision that allows for the deposit insurance coverage limit to be extended to provide coverage of balances in certain special temporary circumstances such as the sale of a property, if regulations are made that specify the conditions (e.g. cases, evidence, limits) under which the “temporary high balances” coverage would apply.
- 13 **agree** that regulations to deal with how temporary high balances coverage applies may be made by Order in Council on the advice of the Minister of Finance.

The use of the deposit insurance scheme fund in resolution

- 14 **note** that Cabinet has agreed to the use of the deposit insurance scheme fund in resolution subject to appropriate safeguards.
- 15 **agree** that the deposit insurance scheme fund may at any time contribute to resolution provided that safeguards along the following lines are met:
- 15.1 that the Reserve Bank is satisfied that the resolution protects persons covered by the scheme, including by ensuring ongoing access by those protected persons to funds protected by the scheme, and
- 15.2 that the contribution will at all times not exceed a maximum amount.
- 16 **agree** that the “maximum amount” described above will be along the lines of costs estimated by the Reserve Bank that the scheme would have paid to persons covered by the scheme in a hypothetical liquidation of a failed deposit taker as at the date of entry into resolution, taking into account estimated recoveries from the failed deposit taker in the course of that hypothetical liquidation.
- 17 **agree** that contributions permitted by the deposit insurance scheme fund to resolution includes contributions to No Creditor Worse Off payments, subject to compliance with the maximum amount safeguard.
- 18 **agree** that for any contributions by the deposit insurance scheme fund to resolution, any estimate by the Reserve Bank of the costs and recoveries under the hypothetical liquidation will be based on information that was known to the Reserve Bank, and any assumptions the Reserve Bank sees fit in the circumstances.

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- 19 **agree** that contributions by the deposit insurance scheme fund to resolution will be made on such terms and conditions (including by way of loan or secured funding), as the Reserve Bank sees fit in the circumstances.
- 20 **agree** that if contributions are made by the scheme as part of a resolution, there will be an independent review undertaken assessing compliance with the applicable safeguards.

No Creditor Worse Off (NCWO)

- 21 **note** that Cabinet has agreed that an after-the-event compensation mechanism be established to compensate creditors if a resolution left some creditors worse off than they would have been in an ordinary liquidation (the 'no creditor worse off or NCWO' principle) deposit takers (DEV-21-MIN-0079 decision 61).
- 22 **note** that recommendations to modify this decision are below.
- 23 **agree** that pre-resolution shareholders and pre-resolution creditors of locally incorporated licenced deposit takers are to be eligible for NCWO compensation if they are in a worse financial position as a result of resolution than they would have been under a hypothetical counterfactual liquidation.
- 24 **agree** pre-resolution shareholders and pre-resolution creditors of locally incorporated subsidiaries or associated persons of licenced deposit takers which are placed into resolution, are to be eligible for NCWO compensation if they are in a worse financial position as a result of resolution than they would have been under a hypothetical counterfactual liquidation.
- 25 **agree** that pre-resolution shareholders and pre-resolution creditors of overseas licenced deposit takers (commonly referred to as branches), overseas associated persons and overseas subsidiaries will not be eligible for NCWO compensation.
- 26 **agree** to the proposals set out in Annex 1 setting out key aspects of the NCWO mechanism.
- 27 **agree** that where NCWO compensation payments are not met in full by the deposit insurance scheme fund, the Crown will provide the required funding to satisfy the outstanding obligation.
- 28 **agree** that if the Crown has an obligation to pay any outstanding obligation under the NCWO mechanism, the Minister shall, without further appropriation, provide to the Reserve Bank out of public money such sums.

Judicial review for resolution

- 29 **agree** that all powers exercised by the Reserve Bank or a resolution manager in relation to the resolution of a deposit taker are subject to judicial review and not in any other form of judicial appeal.

Resolution levy mechanism

- 30 **agree** that the DTA may include a resolution levy to recover losses made by the Crown in supporting an entity in resolution for financial stability reasons.
- 31 **note** that I intend to take further detailed decisions on how this levy mechanism should operate under delegation, work with officials to test that possibility with industry in the exposure draft process, and report back to Cabinet on the intended final approach to resolution levies prior to the introduction of the DTA.

Impediments to resolution

- 32 **note** that the resolution of a licenced deposit taker can be impeded by third parties enforcing contractual rights against that deposit taker (for example, by requiring the repayment of existing debts at the same time the deposit taker is being restructured, or by allowing a third party to deny a liability or obligation they owe to a deposit taker in resolution).
- 33 **note** that a small number of the impediments noted in recommendation 32 are not currently addressed, or appropriately mitigated, in the resolution regime that will be included in the DTA, leading to the recommendations below.
- 34 **agree** that the DTA provide that contractual right to close out derivative contracts cannot be enforced against a licenced deposit taker until a prescribed period after the commencement of resolution.
- 35 **agree** that the prescribed period noted in recommendation 34 be until the end of the first full day after the licenced deposit taker is placed into resolution, but that the Reserve Bank also have the power to shorten, or (subject to conditions being met) extend this period.
- 36 **agree** that the DTA prohibit parties from exercising certain rights against a deposit taker solely on the grounds that it has been placed into resolution or been made subject to resolution powers (for example, the right to deny a liability or obligation owed to the deposit taker).

Regulatory and Supervisory Matters

- 37 **agree** that a licenced deposit taker may only insure or indemnify a director against a breach of the due diligence director duty in limited circumstances (such as the actions being done in good faith, and the insurance or indemnity established following a specific process set down in the DTA), replacing DEV-21-MIN-0077 decision 45.
- 38 **agree** that the Minister of Finance is authorised to release an exposure draft of the Deposit Takers Bill for public feedback.
- 39 **note** I expect further policy decisions (including matters arising from the exposure draft process) will be needed to finalise the DTA, and it is possible that additional Cabinet decisions will be required.
- 40 **note** that when consulting on the Exposure Draft the Reserve Bank will seek comments on the suitability of the resolution regime for smaller, non-systemic

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licenced deposit takers (e.g., credit unions) and may subsequently seek further approvals from Cabinet or under delegated authority.

- 41 **agree** that the Minister of Finance is authorised to further clarify and develop policy matters in this Cabinet Paper in a manner not inconsistent with the policy recommendations contained in the paper, in consultation with the Associate Minister of Finance and the Minister of Commerce and Consumer Affairs, including in relation to the following subject areas:

41.1 use of the deposit insurance scheme fund in resolution;

41.2 NCWO;

41.3 resolution for smaller, non-systemic deposit takers.

- 42 **authorise** the Minister of Finance to develop commencement, transitional and any savings provisions with the Parliamentary Counsel Office, through the drafting process.

- 43 **note** that the drafted commencement and transitional provisions will be subject to approval by Cabinet when it considers the Bill for introduction.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance

Annex 1 – proposals setting out key aspects of the NCWO mechanism

Proposal 1: Any pre-resolution creditor or pre-resolution shareholder of an entity in resolution (“prescribed persons”) who is financially worse off as a result of a resolution of that entity when compared to their position under a hypothetical liquidation of the entity shall be entitled to compensation

Proposal 2: An independent valuer is appointed by the Minister of Finance to determine whether compensation is payable to prescribed persons

Proposal 3: The valuation calculation shall assess the difference between the treatment of prescribed persons claims in a hypothetical liquidation and in resolution, and shall be made in accordance with certain prescribed assumptions and principles

Proposal 4: The independent valuer shall have access to a broad range of information from the Bank and the failed deposit taker necessary to conduct the valuation

Proposal 5: The independent valuer shall prepare a valuation report outlining its calculations and the entitlement to compensation of each prescribed person (or class of persons) and give prescribed persons notice of its compensation determination

Proposal 6: Appeal rights on points of fact and law shall be available to prescribed persons and the Reserve Bank and the Crown in respect of compensation determinations by the independent valuer subject to appropriate limitation periods

Proposal 7: The Crown shall satisfy any compensation that is not met in full by the deposit insurance scheme fund (noting the contributions by the scheme fund to NCWO payments are limited by applicable safeguards)