



Cabinet Economic Development Committee

Minute of Decision

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Reserve Bank Act Review: Deposit Takers Bill

Portfolio Finance

On 20 October 2021, the Cabinet Economic Development Committee (DEV):

Background

- 1 **noted** that on 14 April 2021, DEV agreed to a package of proposals relating to the new prudential framework for deposit takers, the introduction of deposit insurance, and the design of the deposit insurance scheme [DEV-21-MINS-0076-0079];
- 2 **noted** 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 (the Bill), so that an exposure draft may be released;

Resolution objectives

- 3 **noted** that Cabinet has agreed that the Reserve Bank will have certain statutory objectives in performing the resolution function [DEV-21-MIN-0079, paragraphs 4 and 60];
- 4 **noted** that paragraphs 5 to 6 below modify these decisions;
- 5 **agreed** that the above statutory objectives for the resolution function will be captured in the Bill as statutory purposes, along the following lines:
 - 5.1 to enable the orderly resolution of licenced deposit takers;
 - 5.2 to avoid significant damage to the financial system that could result from the failure of a licenced deposit taker (refer to section 68(b) of the Reserve Bank of New Zealand Act 1989), 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 Reserve Bank of New Zealand Act 1989);
 - 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 **agreed** 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 paragraph 41 below;

Bail-in

- 7 **agreed to recommend** that Cabinet rescind the decisions that would have provided the Reserve Bank with a statutory bail-in power, together with supporting provisions, in the Bill [DEV-21-MIN-0079, paragraphs 36, 37, 38, 41, 42, 46 and 47];
- 8 **noted** that the Minister of Finance has 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 legislation;
- 9 **agreed** 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 **agreed** that the Reserve Bank will be able to use the direction power to direct a deposit taker to trigger those contractual bail-in rights (replacing DEV-21-MIN-0079, paragraph 52);

Temporary high balances

- 11 **noted** that Cabinet has agreed that the deposit insurance coverage limit for the deposit insurance scheme be set at \$100,000 per eligible depositor, per licenced deposit taker;
- 12 **agreed** that the Bill 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 **agreed** 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 **noted** that Cabinet has agreed to the use of the deposit insurance scheme fund in resolution, subject to appropriate safeguards;

- 15 **agreed** 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 **agreed** 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 **agreed** that contributions permitted by the deposit insurance scheme fund to resolution include contributions to No Creditor Worse Off payments, subject to compliance with the maximum amount safeguard;
- 18 **agreed** 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;
- 19 **agreed** 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 **agreed** 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 **noted** 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, paragraph 61];
- 22 **noted** that paragraphs 23 - 27 below modify this decision;
- 23 **agreed** 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 **agreed** that 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 **agreed** 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 **agreed** to the proposals set out in Annex 1 to the paper under DEV-21-SUB-0204, which set out key aspects of the NCWO mechanism;
- 27 **agreed** 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 **agreed** 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 **agreed** 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 any other form of judicial appeal;

Resolution levy mechanism

- 30 **agreed** that the Bill may include a resolution levy to recover losses made by the Crown in supporting an entity in resolution for financial stability reasons;
- 31 **noted** that the Minister of Finance intends 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 Bill;

Impediments to resolution

- 32 **noted** 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 **noted** that a small number of the impediments noted in paragraph 32 above are not currently addressed, or appropriately mitigated, in the resolution regime that will be included in the Bill, leading to the proposals outlined below;
- 34 **agreed** 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 **agreed** that the prescribed period noted in paragraph 34 above 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 **agreed** that the Bill 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 **agreed** 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 Bill), replacing DEV-21-MIN-0077, paragraph 45;
- 38 **authorised** the Minister of Finance to release an exposure draft of the Bill for public feedback;
- 39 **noted** that the Minister of Finance expects further policy decisions (including matters arising from the exposure draft process) will be needed to finalise the Bill, and that it is possible additional Cabinet decisions will be required;
- 40 **noted** that when consulting on the Exposure Draft, the Reserve Bank will seek comments on the suitability of the resolution regime for smaller, non-systemic licenced deposit takers (e.g., credit unions) and may subsequently seek further approvals from Cabinet or under delegated authority;
- 41 **authorised** the Minister of Finance to further clarify and develop policy matters included in the paper under DEV-21-SUB-0204 in a manner not inconsistent with the policy intent, 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 **authorised** the Minister of Finance to develop commencement, transitional and any savings provisions with the Parliamentary Counsel Office, through the drafting process;
- 43 **noted** that the drafted commencement and transitional provisions will be subject to approval by Cabinet when it considers the Bill for introduction;
- 44 **invited** the Minister of Finance to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above paragraphs.

Janine Harvey
Committee Secretary

Present:

Hon Grant Robertson (Chair)
Hon Dr Megan Woods
Hon David Parker
Hon Nanaia Mahuta
Hon Poto Williams
Hon Damien O'Connor
Hon Kris Faafoi
Hon Willie Jackson
Hon Michael Wood
Hon Meka Whaitiri
Hon Phil Twyford
Dr Deborah Russell MP

Officials present from:

Office of the Prime Minister
Officials Committee for DEV