Deposit Takers Bill

Exposure Draft: Explanatory Notes

6 December 2021

Reserve Bank of New Zealand
Te Pūtea Matua

Contents

Submission contact details

The Reserve Bank invites submissions on the exposure draft by 5pm on 21 February 2022. Please note the disclosure on the publication of submissions below.

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Publication of submissions

All information in submissions will be made public unless you indicate you would like all or part of your submission to remain confidential. Respondents who would like part of their submission to remain confidential should provide both a confidential and public version of their submission. Apart from redactions of the information to be withheld (i.e. blacking out of text) the two versions should be identical. Respondents should ensure that redacted information is not able to be recovered electronically from the document (the redacted version may be published as received).

Respondents who request that all or part of their submission be treated as confidential should provide reasons why this information should be withheld if a request is made for it under the Official Information Act 1982 (OIA). These reasons should refer to the grounds for withholding information under the OIA. If an OIA request for redacted information is made the Reserve Bank will make its own assessment of what must be released taking into account the respondent's views.

The Reserve Bank may also publish an anonymised summary of the submissions received in respect of this exposure draft.

1 Introduction

The incoming Government in late 2017 announced an intention to review the Reserve Bank of New Zealand Act 1989, beginning with monetary policy arrangements. The second phase looked at the governance of the Reserve Bank, and matters related to prudential policy. A team of Reserve Bank and Treasury staff conducted policy work (including a 3-stage consultation process) between mid-2018 and 2021.

This led to two pieces of major reform. Firstly, the Reserve Bank of New Zealand Act 2021 (the Act) modernises the institutional arrangements of the Reserve Bank by replacing the single decision-maker model for financial policy with a governance board, while strengthening reporting and accountability requirements. The new Act also provides a clearer financial policy mandate for the Reserve Bank focussed on promoting financial stability; requires the Minister of Finance to issue a Financial Policy Remit to the Reserve Bank, and; provides statutory recognition for the Council of Financial Regulators to underscore the importance of cooperation and coordination across the financial system.

The second is the Deposit Takers Bill, dealing with framework for the regulation and supervision of financial firms that take deposits from the public and that lend to households and businesses and the introduction of a formal scheme to protect depositors from loss. A draft of this Bill (the exposure draft) is now being released for public comment before being finalised for introduction into Parliament. The Bill is based on a set of Cabinet decisions from April 2021, with some further decisions taken subsequently under a delegation provided for in that paper, or in a subsequent (October 2021) Cabinet paper. Those Cabinet papers are available here, and some of the key decisions are shown in Figure 1.

Figure 1 Key Cabinet decisions

Objectives

- Promote the safety and soundness of each deposit taker
- Promote public confidence in the financial system
- Avoid or mitigate the adverse effects of risks arise to or from the financial system
- Therefore to protect and promote financial stability

Regulatory perimeter

- A single regime for all deposit takers
- Cover firms in the business of borrowing and lending
- Requirements can be targeted to different classes of entities
- Powers to manage entities close to the boundary (exemption, deeming in)

Liability, accountability, supervision & enforcement

- Enhanced director accountability for deposit takers
- On-site inspection power
- Wider range of enforcement powers
- Graduated penalty framework
- Positive duty on directors
- Details on nature and size of penalties
- Design of other supervision /enforcement powers

Crisis management

- Reserve Bank-resolution authority, with clear objectives and functions
- Comprehensive set of resolution powers
- 'No Creditor Worse Off' provisions
- Substantial detail on resolution powers and No Creditor Worse Off provisions
- Decision to not implement statutory bail-in at this time

Depositor Compensation Scheme

- $100,000 per depositor, per institution
- Depositors to be promptly compensated
- Transactional, savings and term deposits
- Fully funded by levies on deposit takers with a Crown backstop
- Scheme located in the Reserve Bank
- Further details of design decisions as drafted in the Bill

Standards and licensing

- Standards as the main tool for imposing prudential requirements
- Clear and empowering scope of standards that can be set by the Reserve Bank
- Licensing procedures and safeguards

- Cabinet decisions by April 2021.
- Policy developed since April 2021.

The purpose of this document is to help stakeholders understand the exposure draft by summarising key aspects of the Bill and providing some additional context in respect of Cabinet decisions reflected in the Bill.

The Deposit Compensation Scheme (DCS) is a significant new function of the Reserve Bank and its implementation will have implications for regulated industry, particularly in terms of information gathering and information systems. Annex A highlights various aspects relating to the implementation of the DCS for feedback.

The deadline for submissions on the exposure draft is 21 February 2022. Following an analysis of submissions, and any consequential amendments to the Bill, Cabinet approval will be sought to introduce the Bill into Parliament around May 2022.

2 Outline of the Bill

The Bill establishes a standalone Act that will replace the existing regimes for the regulation of banks and non-bank deposit takers (the remaining parts of the Reserve Bank of New Zealand Act 1989 (the 1989 Act)) and Non-Bank Deposit Takers Act (the NBDT Act 2013). It also establishes the DCS, as an additional function of the Reserve Bank.

Summary of contents of Bill

Part	Key content
1	Purposes of regime and guiding principles
2	Licensing of deposit takers
3	Regulation of deposit takers
4	Supervisory powers
5	Enforcement powers
6	Depositor Compensation Scheme[1]
7	Crisis management regime (including 'No Creditor Worse Off' safeguard)
8	Miscellaneous (including restricted words, trans-Tasman co-operation and exemption powers)

The approach to transition from the existing legislation to the new Deposit Takers Act (the DTA) is still being considered and is briefly discussed at Section 3 of this document. It is recognised that industry will need sufficient time to transition to the regime under the DTA, and it will take time for the Reserve Bank to consult with affected parties and implement new regulatory requirements of the DTA.

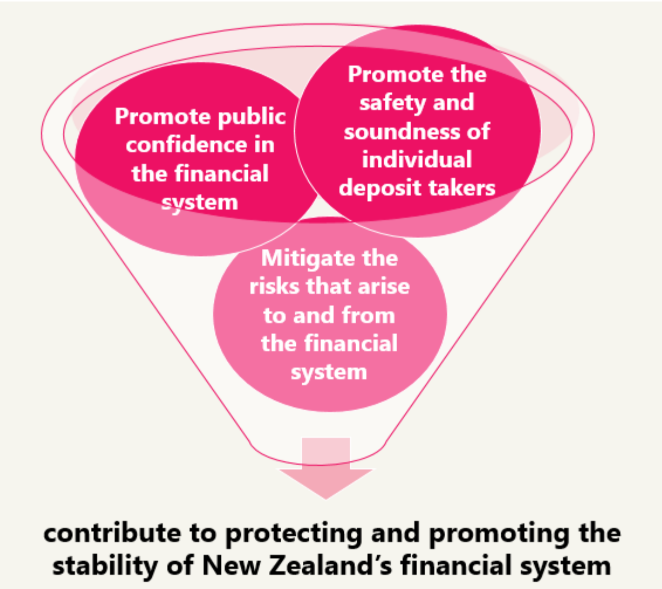
1 In 2019, Cabinet agreed to establish a deposit insurance scheme. The scheme is now called a 'compensation' scheme in the exposure draft, since it is not intended to involve the issue of "contracts of insurance" or the Reserve Bank (or the Crown) "carrying on insurance business in New Zealand". There are no direct contracts between depositors and the scheme, although eligible depositors will be compensated by the scheme in the event of liquidation of a failed deposit taker. Internationally, it is not uncommon for jurisdictions to use different names like "compensation", "protection", or "claim scheme" referring to a deposit insurance scheme.

2.1 Overview of Parts 1-5

Purposes and principles

Clauses 3 and 4 describe the purpose of the prudential regime, and principles that the Reserve Bank must take into account when exercising powers under the regime. The main purpose of the Bill is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system. This is in line with the purposes and objectives of the Reserve Bank of New Zealand Act 2021. The Bill also has three additional purposes that describe, in more detail, what this means in relation to the prudential regime for deposit takers (as shown in Figure 2).

Figure 2: Purposes of the Deposit Takers Bill

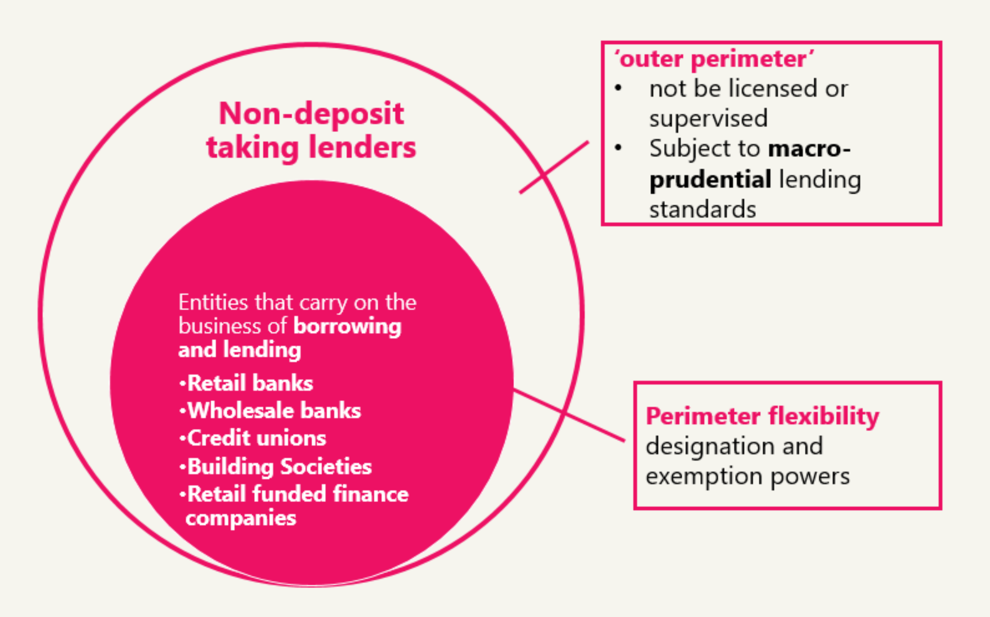


How the Reserve Bank should undertake its statutory mandate for financial stability is also provided for in the decision-making principles. The principles are designed to guide the exercise of powers under the DTA, and to ensure that a range of factors are taken into account by the Reserve Bank when pursuing the statutory objectives. This includes ensuring that considerations other than financial stability are taken into account (for example, efficiency-related considerations) and that longer term risks are well-managed (for example, the risks associated with climate change).

Regulatory perimeter

The current registered bank and NBDT regulatory regimes will be brought together into a single 'licensed deposit taker' framework. The perimeter for the regime (types of business that are required to become licensed deposit takers) is set by Schedule 2. This is intended to broadly capture firms that are in the business of borrowing and lending in New Zealand. Restrictions on the use of the word "bank" and other similar terms will be retained and may be limited to certain classes of deposit taker.

Figure 3 Regulatory Perimeter



An exception is that firms that wholly borrow from wholesale investors and do not borrow for very short terms (5 days or less) are not captured. This is intended to remove wholesale funded firms from the regime, as long as they are not able to effectively provide a 'transactional account' for wholesale investors. Firms that do provide 'transactional accounts' are intended to be captured even if the accounts are only for wholesale investors. There is no size threshold where wholesale funded lenders automatically become deposit takers, but the Reserve Bank has an ability to declare firms to be deposit takers. This is for cases where not doing so might cause risks to the stability of the financial system, especially when the wholesale funded lender is systemically important.

The Bill does not aim to capture firms that may do some incidental lending as part of a different business activity. The definition of 'lending' excludes offering deferred payment terms. Other incidental extensions of credit (e.g. money advanced to an employee to purchase tools) may not meet the 'business of lending' test. There is also scope to deem out certain persons or classes of entities by a notice issued by the Reserve Bank. The Reserve Bank's starting point will be to exclude firms currently deemed out of the NBDT Act using the power in the new Act, but more formal consultation on this point will follow after the DTA is passed.

Licensing

All deposit takers are required to have a licence. Part 2 provides that firms within the perimeter must be licensed, and the matters the Reserve Bank must consider in considering a licence application. The Reserve Bank will be able to use licence conditions to differentiate between deposit takers and take a proportionate approach to prudential regulation. Licence conditions may apply particular prudential standards to firms (see section below on standards), and make other firm-specific restrictions on the business of a deposit-taker.

Standards

Prudential requirements for all licensed deposit takers will be set out in standards – a secondary legislative instrument under the Legislation Act 2019 issued by the Reserve Bank. Part 3 sets out procedures for the issuance of standards. The scope of matters that can be addressed via standards is set out in some detail. However, the detail is generally intended to be illustrative rather than exhaustive. For example, a number of specific examples of possible capital rules are listed as being included, but the Bill makes it clear that the scope of capital rules is not limited to those examples. Standards may also provide for calibration of a standard via a licence condition as noted above. For example, a capital standard may say that a particular buffer may be up to 5% for deposit takers, and set out criteria for how the buffer should be set for particular firms. The Reserve Bank will apply the criteria, arrive at firm-specific buffers for each deposit taker, and apply them via licence conditions.

Supervision and Enforcement

Part 4 of the Bill provides supervisory powers to the Reserve Bank when dealing with licensed deposit takers. Notably, the Reserve Bank may:

- require information to be supplied;
- require a third party report; and
- undertake an 'on-site' inspection of licensed deposit takers (at a reasonable time and in a reasonable manner).

The power to require information goes beyond deposit takers themselves, to include:

- firms that may be financial services providers (to help determine if firms are inappropriately operating without license), and to monitor the 'outer perimeter' described above; and
- other entities that may have information about the business activities of a deposit taker.

There are also obligations on licensed deposit takers (Part 4, subpart 3) and their auditors to report suspected contraventions of prudential obligations and certain other matters to the Reserve Bank.

Reports of contraventions from licensed deposit takers cannot be used as evidence in a civil or criminal proceeding.

The Reserve Bank's investigation powers (Part 4, subpart 5) are available when a contravention of prudential obligations appears likely to have occurred, allowing the Reserve Bank to gather evidence for an enforcement action or other response.

The penalty regime for most contraventions in the Bill itself is criminal, with three key tiers of potential penalty (table below). Breaches of secondary legislation (i.e. prudential standards) are civil pecuniary (Part 5, subpart 2).

3-tier criminal penalties approach

Maximum Penalty Level	Body Corporate	Individual	Example Offences
1	Fine not exceeding $500,000	Fine not exceeding $50,000	Failure to supply information; Failure to disclose warning

Maximum Penalty Level	Body Corporate	Individual	Example Offences
2	Fine not exceeding $2,500,000	Fine not exceeding $100,000 or imprisonment for a term not exceeding 1 year (or both)	Failure to hold a current credit rating; Failure to comply with condition of license
3	Fine not exceeding $5,000,000	Fine not exceeding $500,000 or imprisonment for a term not exceeding 2 years (or both)	Failing to comply with a direction.

For certain minor offences (such as failure to notify the Reserve Bank if a new director is appointed to an overseas deposit taker), infringement offences (and associated fees) are provided for. The proposed levels of these fees is somewhat higher than is standard for infringement fees in some other regulatory regimes, given the large balance sheets of many deposit takers (we are proposing fees around the levels that apply in the Financial Markets Conduct Act 2013).

Issuing infringement notices offers a very simple process for formal enforcement for relatively minor offences where the evidence of the offence is likely to be clear, but the penalties are much smaller than those that apply to the other offences in the Bill. We are interested in feedback about the appropriate balance of the two sorts of offences. In some cases the offence may often be inadvertent or minor, but could sometimes be more deliberate or serious. In the case of information gathering powers, the Bill provides for an infringement notice if there is a complete failure to respond within the required time period (this is easy to verify and could often be inadvertent) while also allowing for criminal penalties for failure to comply more broadly.

As well as court based enforcement and infringement fees, the Bill has (or will have) a number of non-court based ways to sanction entities that are non-compliant, or work to achieve compliance:

- A remedial notice (issued by the Reserve Bank) may require the firm to take specific actions, or prepare a remedial plan to address the contravention (Part 4, subpart 4).
- Enforceable undertakings – may be voluntarily made by a licensed deposit taker or other person and accepted by the Reserve Bank as an alternative to civil pecuniary penalties or criminal prosecution (Part 5, subpart 1).

The director accountability regime agreed by Cabinet is located in Part 3, subpart 3 (Directors' due diligence duty). As well as potential individual civil pecuniary penalties under that subpart, directors of licensed deposit takers may be involved in offences committed by the deposit taker itself. Part 5, subpart 5 provides for the Reserve Bank to apply to the District Court to ban people from being involved in deposit taking businesses in certain circumstances, if they have been a director of a deposit taker that has persistently or seriously breached its prudential obligations, for example.

2.2 Overview of Part 6

This section contains a summary of Part 6. An overview of the regulations and standards, together with some of the outstanding issues that will need to be worked through as part of implementing the DCS, are discussed in Annex A. We are interested in industry's view on those issues.

Coverage, eligibility, and compensation

The Bill introduces the DCS which protects eligible depositors up to NZ $100,000 per eligible depositor, per licensed deposit taker. Protected deposits under the DCS include New Zealand dollar deposits in transaction accounts, call accounts and saving accounts and term deposits (or equivalent products) issued by banks and NBDTs.

Eligible depositors under the DCS exclude sophisticated investors, such as large corporations, licensed deposit takers, licensed insurers, operators of financial market infrastructures, government agencies, and associated person of the deposit taker for which a DCS payout is triggered.

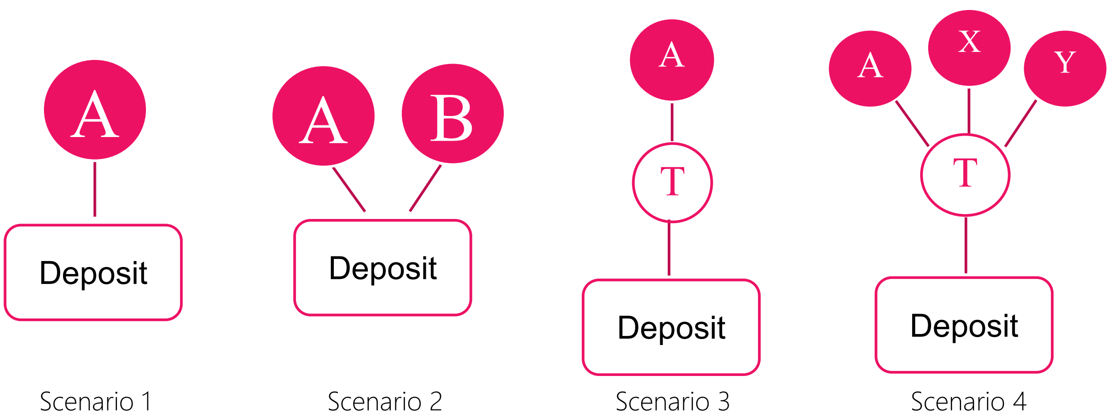
Deposit takers will need to collect information (e.g. whether a corporation is large, or whether a depositor is a government agency according to the definition/criteria listed in the DTA) in order to be able to report to the Reserve Bank about protected deposits covered by the DCS. This will be specified in the "single customer view" standards.

The DCS will provide compensation up to the $100,000 limit per eligible depositor in respect of protected deposits if a deposit taker is put into liquidation (initiated or agreed by the Reserve Bank), or when the Reserve Bank issues a specified event notice. A 'specified event notice' may be issued when the Reserve Bank uses resolution powers, but considers the most appropriate way of protecting eligible depositors is for the DCS to pay compensation. The $100,000 limit includes both the principal and the interest accrued on an eligible depositor's protected deposits up to the date a deposit taker is put into liquidation or a "specified event notice" is issued by the Reserve Bank.

Calculation of entitlement

Subpart 3, Part 6 provides for how compensation up to the $100,000 limit for eligible depositors is calculated. The calculation of entitlement of eligible depositors involves 4 different scenarios, as shown in Figure 4.

Figure 4 Different scenarios of deposits held by, or on behalf of eligible depositors



The DCS has different treatment for the 4 scenarios:

- Scenario 1: A holds the protected deposit for A's own right. The total amount of the protected deposit goes to A's compensation entitlement.

- Scenario 2: A holds a joint account that is a protected deposit together with B. 50% of the deposit goes to A and another 50% goes to B's compensation entitlement unless the deposit taker has a record showing that the proportion of the joint account is not equal among the joint account holders.
- Scenario 3: T (as a trustee of a bare trust, or a client account holder under a relevant arrangement) holds the protected deposit on behalf of A (a beneficiary of a bare trust or a client of T under a relevant arrangement). The total amount of the protected deposit goes to A's compensation entitlement.
- Scenario 4: T (as a trustee of a bare trust, or a client account holder under a relevant arrangement) holds the protected deposit on behalf of A, X and Y (different beneficiaries of a bare trust, or different clients of T under relevant arrangements). For the purposes of compensation entitlement, the protected deposit is distributed among A, X and Y, according to the records provided by T—the account holder.

For Scenario 3 and 4, 'look-through' will apply when calculating the compensation entitlement. In other words, it is not the account holder, but the beneficiaries of a bare trust or clients of a client account, who will be entitled to compensation under the DCS. 'Relevant arrangements' for this 'look-through' treatment will be defined by regulations, but are expected to include lawyers and conveyancers' client account, real estate agent's client account, tax agent's client account, and bank-issued PIE funds exclusively invested in the issued deposit taker's New Zealand dollar deposits.

All scenarios are subject to the compensation limit of $100,000 per eligible depositor, per licensed deposit taker. The following Box provides an example of how the entitlements of eligible depositors are calculated.

Box A: Example of calculating the total entitlement of a person:

Anna deposits $10,000 for her own right at Bank M (Scenario 1). Anna has a joint account with her partner at Bank M with a balance of $20,000 (Scenario 2). Lawyer L holds $100,000 on behalf of Anna because Anna planned to purchase her first house and signed a contract with L and asks L to transfer the money to the seller. L also holds money on behalf of X ($500,000) and Y ($700,000) in the L's client account with which L holds money on behalf of Anna (Scenario 4).

If Bank M fails, Anna's total entitlement will be calculated by aggregating

Anna's deposit held for her own right	$10,000
Anna's proportion in her joint account with her partner	$20,000*50%
Anna's money held by L on behalf of Anna	$100,000

Since the total amount (in aggregate) is $120,000, which exceeds the limit of $100,000 per eligible depositor per licensed deposit taker, Anna will be reimbursed $100,000 by the DCS.

Subpart 3, Part 6 describes how deposits held by trusts and other corporate forms are treated. The trustee(s) of a trust (other than a bare trust) will be entitled to compensation under the DCS with each trust being subject to a $100,000 limit. A partnership will be treated as a person separate from each partner of the partnership (therefore being subject to a $100,000 limit), no matter whether the partnership is incorporated or not.

Funding of the DCS

Subparts 6, 7 and 8 of Part 6 set out the funding arrangements for the DCS. The DCS will be fully funded by levies collected from licensed deposit takers – by prefunding and maintaining a 'target' fund size.

The target size of the DCS fund, and the expected time to achieve the target, will be included in the Statement of Funding Approach, published by the Minister at least every 5 years. The DCS levy regulations will provide details about how levies are calculated. If the DCS fund is not sufficient to cover the payouts/costs, public money will be provided to the DCS fund on terms and conditions determined by the Minister. As a result of drawing on any public funds, the Reserve Bank may charge additional levies from industry to repay these funds.

Use of the DCS fund to support resolution

Subpart 5, Part 6 sets how the DCS fund can be used to support resolution in certain circumstances. Besides directly compensating eligible depositors, the DCS fund may also be used to contribute to resolution, including 'no creditor or shareholder worse off' (NCWO) compensation payments. Safeguards on the use of the fund in resolution require that the Reserve Bank must be satisfied that the resolution protects eligible depositors, and the contribution is no more than the DCS would have paid in a liquidation less expected recoveries (through the Reserve Bank's subrogation rights). An independent review of any contributions will be undertaken to ensure compliance with applicable safeguards.

These provisions recognise that the DCS can play a broader role in resolution outside of a liquidation and payout while still meeting the objectives of depositor protection. Resolution tools, such as a purchase and assumption (where a healthy deposit taker purchases assets and assumes liabilities, including protected deposits, of a failing 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), and may protect other creditors.

Temporary high balances

The Bill provides for the regulation-making power to extend the coverage of the DCS to temporary high balances (e.g. proceeds after selling a main residence, or compensation from an insurance policy). Considering the complexity of the rules related to identifying eligible circumstances that could be covered by the DCS, and the challenges of implementation, we do not envisage temporary high balances regulations will be in place when the DCS first comes into force.

2.3 Overview of Part 7

Part 7 of the Bill provides for the crisis management regime.

The key elements of the crisis management regime are based on decisions from the April 2021 Cabinet paper, which included decisions to carry over the substance of key statutory management powers from the 1989 Act, but place those powers (where practicable) directly in the hands of the Reserve Bank as resolution authority.

The Bill imposes an obligation on the Reserve Bank to plan for resolution (plans for each licensed deposit taker, and a public 'Statement of Approach to Resolution') (subpart 2).

A key pre-resolution power is the ability to direct licensed deposit takers and associated persons (subpart 3).

The April Cabinet paper envisaged a statutory bail-in regime (a power in the Bill that could write down or convert certain liabilities without relying on contractual provisions in those liabilities). However, in October 2021, Cabinet decided that the initial resolution regime would rely on two other paths for imposing losses on creditors. Firstly, within resolution the broad transfer powers available to the Reserve Bank can be used to impose losses. Secondly, the Bill provides for a pre-resolution direction power that can be used to require deposit takers to exercise contractual rights to bail-in prepositioned bail-inable instruments.

This second approach is broadly similar to the tier-2 debt regime used in Australia. The prepositioning of bail-inable instruments is not expected for some time given the Reserve Bank's current focus on boosting common equity capital levels within the banking system. In the future, the prepositioning could occur via the introduction of standards mandating minimum levels of suitable liabilities. Also, a future review will consider whether statutory bail-in (as seen in the UK regime, for example) is necessary alongside the two paths provided for in the DTA.

The grounds for recommending entry into resolution are broadly that a material contravention of prudential obligations has occurred, and that there is no reasonable prospect of the contravention being resolved other than through resolution.

In the current draft of the Bill, all resolution powers are provided to the Reserve Bank, but the Reserve Bank is able to delegate them to a 'resolution manager'. This contrasts with the RBNZ Act 1989 statutory management regime where powers are assigned to the statutory manager (albeit with some key powers only able to be exercised by them with the permission of the Reserve Bank or the Minister, and some requiring an Order in Council).

In practice, it is likely to only be practical for the day-to-day management[2] of the entity in resolution to be conducted by a resolution manager – it would not be operationally practical for the Reserve Bank to do this directly. An uncomfortable result of the 'delegation' model is that the Reserve Bank could need to devote substantial time to monitoring this day-to-day management, given the responsibility of the Reserve Bank and its Board for matters that the Board delegates.

It may be more practicable for responsibility for this day-to-day management power to reside with the resolution manager. While the Reserve Bank would retain an ability to direct the resolution manager (and would be responsible for the outcomes resulting from those directions) on actions critical to its statutory purposes, the Reserve Bank would be more insulated from the day-to-day running of the failed entity. We are interested in any feedback on this issue.

Role of the Minister

The Bill provides for the Minister's involvement in some key steps in resolution (including entry to, and exit from, resolution). There is also a framework in subpart 2, Part 7 which is intended to ensure the Minister is adequately informed on the Reserve Bank's resolution approach (through consultation on the "Statement of Approach to Resolution").

As in the April Cabinet paper, this Statement will describe information flows prior to and during a resolution including: "the approach to collaborating with other agencies (e.g. the Treasury) in resolution planning; (and) how the Reserve Bank will inform and engage with the Minister of Finance and other agencies on the use of crisis management and resolution powers".

Cabinet decided in April that the Minister should also have a power to direct the Reserve Bank, as a residual lever where public funds are being used to support a resolution (e.g. government guarantees, loans or a temporary equity injection) and the Minister considers that there is a material risk to how these funds are being managed.

This power is contained in subpart 7, Part 7. The precise test for the use of this power and the relationship to the wider resolution purposes is still under consideration, and this could also lead to small changes to other powers of the Minister in Part 7. Feedback is welcome on potential concerns of the Minister in a resolution and whether the Minister has enough levers to respond

2 The day-to-day management of a failed deposit taker will include the administration of thousands of customers and other contracts, employment relations and health and safety obligations.

to them (either within the DTA or other regimes, or through imposing conditions on any public funds provided).

Moratoriums and Stays

The Bill provides that entities in resolution will be covered by a moratorium (Subpart 5, Part 7) based upon the existing moratorium in section 122 of the Reserve Bank of New Zealand Act 1989. However, there are some technical differences between that moratorium and the moratorium that has been included in the Bill. Most importantly:

- The moratorium in the Bill is time limited to 12 months, but may be extended for up to a further 12 months an indefinite number of times. This is intended to address concerns that are sometimes raised about the potentially indefinite duration or the moratorium, and it ensure that the moratorium applies for no longer than necessary. Feedback on this approach (including on any knock on impacts it may have for the rest of the resolution regime) is welcome.
- The moratorium also applies to “resolution termination rights” (e.g. the ability to deny an obligation owed to a deposit taker in resolution, or accelerate an obligation imposed by a deposit taker in resolution). However, this automatically applies for the duration of the resolution regardless of whether the rest of the moratorium ends sooner. This is designed to act as a form of “ipso facto” clause preventing the exercise of “resolution termination rights” solely on the basis that the deposit taker has been placed into resolution or been made subject to specific resolution powers. Any feedback on this approach would be welcome.

Finally, the Bill contains (as an exception to the moratorium) a short “stay” on the exercise of “resolution termination rights” in relation to derivatives. This stay applies until the close of the first day after the date on which the deposit taker is placed into resolution, but can also be shortened or (subject to certain conditions) extended.

We note that this stay is intended to replace the narrower stay on the enforcement of security interests in certain collateral that was included in the Reserve Bank of New Zealand Act 1989 in 2019[3] (i.e. is intended to cover both the enforcement of security interests in collateral posted in relation to derivatives, and the other matters that constitute “resolution termination rights” in the Bill). This has created the need for a variety of consequential amendments to preserve the effects of the amendments made in 2019 in other legislation (see for example, the consequential amendments in the Bill to the Corporations (Investigation and Management) Act 1989).

Liquidation, receivership and small deposit takers

There is a relationship between resolution powers and other ways of dealing with troubled deposit takers.

- Firstly, the Reserve Bank is able to commence resolution if it considers the grounds are met. This includes that there is no other satisfactory way to deal with the issues that have arisen with the deposit taker.
- If the Reserve Bank considers that (e.g. for a small firm) liquidation is a reasonable alternative to resolution, it may apply to the High Court seeking liquidation of the deposit taker (Subpart 11, Part 7).

3 See section 122(9A) of the Reserve Bank of New Zealand Act 1989 and related provisions.

- One issue is whether liquidation and resolution offer a sufficient toolkit to manage failing firms. Resolution powers are 'emergency' powers, and while the Act does not specifically restrict them to large firms, they may be seen as most appropriate for larger entities. Resolution is also likely to be resource intensive for the Reserve Bank to manage and it may not be practical to use it for smaller firms.

- Liquidation could take time to commence and this could be disruptive when an entity is already weak. Applying to court may cause delays (leading the Reserve Bank to prefer interim liquidation first) and can be contested by other parties, providing further delays. The resolution authority will lack control over a liquidation process and, in particular, there is a risk it will be disorderly. This also matters because liquidation is an important trigger for deposit compensation entitlements in the absence of a resolution.

- Some countries have liquidation regimes which are more specifically designed for smaller deposit takers, such as the UK Modified Liquidation regime. We are interested in views on whether the regime proposed by the exposure draft could be usefully augmented by that sort of regime, or some other change to facilitate small firm resolution, in future legislative development.

- In the last 15 years, a number of finance company failures were dealt with using receivership. Because the DTA and associated FMCA changes are likely to mean that trustees (with security over the assets of the firm) are not part of the steady-state regime for small deposit takers, normal receivership may not be an option for dealing with failing firms in the future, but a special regime for dealing with failing small deposit takers could potentially be based on the existing receivership model.

No creditor or shareholder worse off (NCWO)

Subpart 9 of Part 7 provides a mechanism to compensate shareholders and creditors of entities in resolution where such persons are worse off in a resolution when compared to their treatment in a liquidation ("NCWO"). The NCWO mechanism is grounded in the "Key Attributes of Effective Resolution Regimes for Financial Institutions" ("KAs") developed by the Financial Stability Board ("FSB"). FSB KA 5 provides:

- Resolution powers should respect the statutory hierarchy of claims, but provide resolution authorities with the flexibility to depart from the principle of treating creditors within the same class of claims equally where necessary to contain the systemic impacts of a bank's failure, or to maximise value for creditors as a whole; and

- Creditors should have a right to compensation where they do not receive at a minimum what they would have received in a liquidation of the firm under the applicable insolvency regime ("no creditor worse off than in liquidation" safeguard).

The NCWO mechanism should encourage decision makers to exercise resolution powers in a way that is at least as effective as the use of available tools in a normal insolvency process (such as liquidation). The NCWO mechanism in the Bill has the key features set out below.

- Eligible persons - persons who may be eligible for compensation are creditors and shareholders of a locally incorporated entity immediately before it entered into resolution (prescribed persons).

- NCWO obligation - any prescribed person who is worse off as a result of a resolution of an entity when compared to their position under a hypothetical liquidation of the entity shall be entitled to compensation.
- An independent valuer - a valuer is appointed by the Minister to determine whether compensation is payable. The valuer must be independent of the Reserve Bank, the Minister, the entity in resolution, and be suitably qualified to undertake the role.
- Calculation - 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 assumptions and principles prescribed in legislation and regulations. The valuer shall have access to a broad range of information to assist in making the calculation.
- Compensation determination – the valuer shall prepare a valuation report outlining its calculations and the entitlement to compensation, and give prescribed persons notice of its compensation determination.
- Appeals – appeals to the High Court shall be available to prescribed persons, the Reserve Bank, and the Crown in respect of compensation determinations by the valuer subject to appropriate limitation periods.

Box B: Appeal Rights for NCWO

The Bill provides for a merits review (allowing for a re-examination of the facts) on the basis that persons should generally be entitled to challenge decisions that affect significant rights and interests, and such rights should incentivise good decision making. However, resolutions themselves can be protracted, and a NCWO determination will generally only be made after a resolution has completed. Officials are concerned that broad NCWO appeal rights could result in significant costs, delays and uncertainty due to multiple appeals and protracted court proceedings. An alternative option to mitigate these issues, could be limiting appeal rights to assessing whether the NCWO valuer applied the law correctly, and focusing on providing greater certainty on the NCWO process through regulations.

- Payment obligation - the Crown shall satisfy any compensation that is not met in full by the DCS fund (noting the contributions by the DSC fund to NCWO payments are limited by applicable safeguards).

Recovering public funds expended in a financial crisis or in support of a resolution

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 to maintain the stability of the financial system, or in support of a resolution, which ultimately leads to losses for the Government. Cabinet has approved amendments to the Public Finance Act allowing the Minister to approve expenditure in a financial crisis without an appropriation in a financial emergency subject to conditions aimed at ensuring that this power is only used as a last resort. The Government could commit funds prior to a resolution (in circumstances where financial stability concerns may be best met without putting an entity into resolution), or to support the resolution of a deposit taker.

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.

Cabinet has agreed that "the Bill may include a resolution levy to recover losses by the Crown in supporting an entity in resolution for financial stability reasons". Further decisions on how an ex-post resolution levy could operate will be taken having regard to feedback received from industry.

Provision for an ex-post levy could be provided for in the DTA, but it may also fit in other legislation (as it is a fiscal tool), and could go beyond the deposit taking sector and cover other financial firms like insurers. Any levy provisions would need to have design features to ensure that it is set and calibrated appropriately. 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). Provision will also need to be made to guide the Minister when setting levies and in deciding who should face levies and how quickly the costs should be recovered. Some potential features of an ex-post resolution levy are set out in Table 1.

Table 1: Potential features of an ex-post resolution levy

Feature	Description
What can be recovered	• Net costs of supporting a deposit taker after any recoveries • Funds spent in resolution and prior to a resolution • Minister may estimate likely net costs while recoveries still uncertain and discount (actual or anticipated) recoveries using an appropriate discount rate • Must set regulations within 5 years of initial expenditure
Who can be levied	• Either all deposit takers, or a subset (if the support was needed due to a particular subset)
How should levies be set (matters to have regard to)	These could include: • Financial stability – the desirability of recovering expenditure that was necessary or desirable to maintain the stability of the financial system and the continuity of critical financial services • Causality - the desirability of recovering the funds from the class of firms that caused the problem • Proportionality - setting levies that achieve recovery without placing sector under too much additional stress
Process for setting levies	Set by Order in Council on recommendation of Minister after consulting with Reserve Bank and affected entities.

We are interested in any feedback on an ex-post resolution levy.

2.4 Overview of Part 8

Part 8 deals with miscellaneous but also important content. This includes:

- Restricted words—unless authorised by the Reserve Bank, a financial service provider must not use 'bank', 'banker' or 'banking' in a name or title, otherwise it will be subject to a fine up to $2.5 million.
- Trans-Tasman cooperation—the Reserve Bank must consult with relevant Australian financial authorities if it believes that an action is likely to have a detrimental effect on financial stability in Australia.
- Confidentiality—how the Reserve Bank can disclose information it collects, or information related to the exercise of its powers under the Bill.
- Regulation-making power—Orders in Council, made by the Governor-General on the advice of the Minister in accordance with a recommendation the Reserve Bank, will be the main tool to make regulations under the Bill. The regulation making powers cover classes of lending and the DCS (as explained in Part 6).
- Exemption power—the Reserve Bank can exempt a person from complying with the credit rating requirements of the Bill.

3 Transitional arrangements and consequentials

There are no specific transitional provisions in the Bill at this time. Broadly, we anticipate that transitional arrangements can be managed through the power to bring provisions of the new Act (provisionally known as the Deposit Takers Act or the DTA) into force at different times via Orders in Council after enactment of the DTA (expected in late 2023). We expect this process to operate broadly as follows:

- 6 months following enactment of the DTA: essential DCS related regulations are completed and Part 6 of the DTA comes into force.
- Approximately 24 months following enactment: registered banks transition from prudential supervision under the 1989 Act to being licensed and supervised under the DTA. When this occurs, the 1989 Act will be fully repealed. In order for this to occur, the Reserve Bank will need to design proposed standards for these types of licensed deposit takers (which will involve consultation with industry).
- Approximately 24 months following enactment (or possibly 6-9 months later): licensed non-bank deposit takers transition from being licensed and regulated under the NBDT Act to being licensed and supervised under the DTA. When this occurs the NBDT Act will be repealed. In order for this to occur, the Reserve Bank will need to design proposed standards for these types of deposit takes (which, again, will involve consultation with industry).
- Regulatory policy formulation and transition can take a long time. For example, the Reserve Bank capital review completed in recent years is expected to be fully implemented on 1 July 2028. It will be a significant commitment over the initial period for the Reserve Bank board to examine regulatory settings on the basis of the modified objectives and principles contained

in the DTA. While in general objectives and principles have not changed dramatically, and some grandfathering of existing regulatory settings is likely, this process will take some time.

The Bill will also contain a set of consequential amendments to other Acts. A number of these are included in the exposure draft, but they are not complete. The introduction of deposit compensation and change of regulatory arrangements for the NBDT sector may lead to some further changes to the Financial Market Conduct Act. Decisions taken by Cabinet in April around spending public funds in financial emergencies are expected to be implemented via consequential amendments to the Public Finance Act.

Annex A: Implementation of depositor compensation scheme

This Annex lists the regulations and standards to be developed to implement the DCS. We are particularly interested in industry's views on some practical matters related to implementation, and welcome feedback.

Regulations and standards to support the implementation of the DCS

To facilitate the implementation of the DCS, a set of regulations and standards are provided for in the Bill. These include:

Table 2: Regulations and standards to be made to implement the DCS

Regulation/standard	Description	Timing
'relevant arrangements' regulations	Providing for arrangements (other than bare trustee arrangements) to which look through is applied. These arrangements are generally called 'client accounts' in practice.	On implementation of the DCS
eligibility regulation	Providing for persons in addition to those specified in the Bill that are NOT 'eligible investors'.	Develop when needed
coverage regulation	Providing for debt securities in addition to those specified in the Bill that are NOT 'protected deposits'.	Develop when needed
entitlement regulation	Providing for rules to calculate entitlements, esp. for protected deposits with complex ownership structures.	On implementation of the DCS
conditions for payout	Providing for conditions under which the Reserve Bank will compensate (e.g. the Reserve Bank will not compensate if the name and amount of money owned by each client under a client account is not available).	On implementation of the DCS
levy regulation	Providing for the methodology of determining the of levy amount for different classes licensed deposit takers.	To be developed based on Statement of Funding Approach (to be published by the Minister of Finance after the Bill is passed)
single customer view standards	Providing for the methodology and infrastructure required to be established and maintained by deposit takers to enable prompt identification of eligible depositors' entitlement.	To be developed and consulted on after enactment of the Bill and providing a reasonable timeframe for implementation

To implement the DCS, the Reserve Bank will effectively be relying on the information held by deposit takers (and in some cases, account holders) to determine the entitlement of most eligible depositors. This means that deposit takers will be required to collect further information and upgrade their systems. For example, the single customer view (SCV) standards may require licensed deposit takers to mark the account type for each deposit, and have some form of a unique identifier to allow the Reserve Bank to aggregate the entitlement of a person.

The standards may also specify the requirements of reporting and testing to ensure the information is reliable for payout purposes. With the full establishment of SCV infrastructures among licensed deposit takers, the Reserve Bank will be able to reimburse most eligible depositors relatively quickly if a payout is triggered. For those deposits with complex ownership structures, the payout period is expected to be longer (up to several months) as the Reserve Bank will need to obtain information from the account holders (e.g. names of clients and the amount of money belonging to each client).

Before the SCV infrastructure is established, the DCS will be running in a simpler way which means manual operations would be needed to identify eligible depositors and calculate entitlement, should a payout event happen. This may require the Reserve Bank to run an application process for eligible depositors (verifying applications against the records of the failed deposit taker), so payout will take substantially longer in this early phase.

Practical matters for implementation of the DCS

Information collection

To operationalise the eligibility rules and implement the SCV standards, deposit takers will be required to collect and maintain data on a number of customer characteristics. We would be interested in submitters' views on the practicality of collecting such information, including:

- information regarding 'large' assessment and the implications of such information is missing, considering the size of a depositor is dynamic and need frequent updates to ensure they are eligible for compensation under the DCS; and
- information regarding whether an account is open/held for several partners of an unincorporated partnership.

Privacy issues

To enable the Reserve Bank to determine the entitlement of eligible depositors and payout, licensed deposit takers will be required to share necessary information on their customers with the Reserve Bank, including name, address (and other contact details), the balance of account, IRD number, withholding tax rate, etc. This is in line with the Bill which empowers the Reserve Bank to "rely on licensed deposit taker's records and information from eligible investors and other persons" when calculating and paying compensation under the Scheme.

The private information collected by the Reserve Bank will be only used for the purposes of calculating entitlement and making reimbursement. In case the information of an eligible depositor's alternative bank account not being available, the Reserve Bank may need to share the private information with another deposit taker to establish a new account on behalf of the depositor. In addition, if the Reserve Bank chooses to make reimbursement through a paying agent (likely to be a deposit taker with the capability of carrying out the payments and subject to a mutual agreement between the Reserve Bank and the paying agent), the Reserve Bank may need to share the private information it collects with the paying agent (e.g. about the alternative bank account, contact details, etc.)

We are interested in the practicality of deposit takers amending their existing terms & conditions with depositors to enable such information sharing. A possible alternative would be for the Reserve Bank to seek an exemption to the Privacy Act 2020 to legitimise this information sharing.

Obligations and powers of liquidators

In addition to requirements on licensed deposit takers, assistance from liquidators of failed deposit takers may also be required to facilitate the implementation of the DCS. Requirements on liquidators could include:

- providing the Reserve Bank with access to records at the failed deposit taker to facilitate the calculation of entitlement and payout; and
- providing the Reserve Bank with assistance to facilitate the calculation of entitlement and payout.

Liquidators of failed deposit takers may require additional powers in connection with their duties, particularly in relation to the Reserve Bank's rights of subrogation.

We are interested in submitters' views on the obligations and powers of liquidators regarding the implementation of DCS, and whether any additional obligations and powers of liquidators not mentioned above should be added to the Bill.