

Deposit Takers Act: What the purposes and principles mean for financial stability

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Introduction

The Deposit Takers Act 2023 (DTA) was passed last year and is intended to fully come into effect by no later than 6 July 2029. It will reform the law in a number of important ways:

- Repealing the Non-bank Deposit Takers Act 2013 (NBDT Act) and the Banking (Prudential Supervision) Act 1989 (BPS Act) and provides one legal framework for prudentially regulating all deposit takers.
- Establishing a depositor compensation scheme, protecting depositors of failed deposit takers in the amount of \$100,000 per depositor per institution.
- Changing the way deposit takers are licensed and regulated by:
 - Setting a new licensing test and fit and proper regime applying it to all deposit takers;
 - Providing that prudential rules are set by secondary legislation (standards) rather than conditions of registration and the Reserve Bank of New Zealand policies;
 - Reforming and making available a range of supervisory and enforcement powers (e.g. onsite inspections, warnings) and establishing a civil liability regime to respond to breaches; and
 - Setting a new duty on directors of deposit takers of due diligence.
- Designating the Reserve Bank as resolution authority with a range of new responsibilities and powers enabling it to protect the financial system when a deposit taker experiences financial difficulties.

Another important reform has been to reframe the statutory purposes for which the Reserve Bank carries out those functions listed above and introduce a new set of decision-making principles.

In this paper we describe how these purposes and principles have evolved from the existing law and how they will factor into the Reserve Bank's decision-making. Readers of the Reserve Bank's [Deposit Takers Core standards consultation paper](#) will have seen a great example of how these new purposes and principles are already being applied. Here we describe the legal framework in more detail and give a sense of what it means for financial stability.

The Reserve Bank is guided by a plethora of purposes across the legislation it works with. Let's start with the Reserve Bank of New Zealand Act 2021, its governing legislation.

The purpose of the RBNZ Act itself is

3 Purposes

The purposes of this Act are to—

- (a) provide for the continuation of the Reserve Bank of New Zealand; and
- (b) promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy.

These purposes apply to the Act. The RBNZ Act provides the Reserve Bank itself with the following objectives:

9 Bank's objectives

(1) The Bank's main objectives are—

Economic objective

- (a) the economic objective of achieving and maintaining stability in the general level of prices over the medium term; and

Financial stability objective

- (b) the financial stability objective of protecting and promoting the stability of New Zealand's financial system; and

Central bank objective

- (c) otherwise acting as New Zealand's central bank in a way that furthers the purposes of this Act.

(2) However, if an Order in Council is in force under section 125, the economic objective or objectives that apply under subsection (1)(a) are those that are specified in the order.

(3) When the Bank is performing or exercising a function or power that is conferred or imposed by other legislation, the Bank also has the objective of acting in a way that furthers the objectives or purposes of that other legislation.

While the RBNZ Act establishes the importance of financial stability as one of its objectives, it also refers to the DTA to provide the appropriate guidance for the Reserve Bank's actions under that legislation, and it is the DTA that best supports its pursuit of financial stability.

The financial stability purposes in the current law

Before we examine the purposes under the DTA, let's outline two definitions, and then look at the current law.

The financial system is not defined in any legislation, but it means the network of financial institutions, payment providers and infrastructures. The financial system produces investment credit and other financial services for society.

Also, when we refer to financial stability, it is shorthand for the stability of the financial system.

The purposes for prudential regulation of deposit takers are provided in the BPS Act as follows:

68 Exercise of powers under this Part

The powers conferred on the Governor-General, the Minister, and the Bank by this Part shall be exercised for the purposes of—

- (a) promoting the maintenance of a sound and efficient financial system; or
- (b) avoiding significant damage to the financial system that could result from the failure of a registered bank.

And the NBDT Act:

3 Purpose

The purpose of this Act is—

- (a) to promote the maintenance of a sound and efficient financial system; and
- (b) to avoid significant damage to the financial system that could result from the failure of an NBDT.

The use of “and” rather than “or” in the two Acts is curious. Either way, the purposes, para (a) in particular, are notably broad allowing for a wide range of strategies, provided those strategies are seen as necessary to promote the maintenance of a sound and efficient financial system.

Those purposes relate to the financial system, rather than to the registered banks or licensed NBDTs per se. So, the Reserve Bank is not responsible for maintaining the soundness and efficiency of individual banks or NBDTs, but rather of the financial system of which those entities form part. Nor are the Reserve Bank’s powers in respect of supervision to be exercised for the purposes of avoiding the failure of a bank or NBDT. Rather, it is the avoidance of damage to the financial system that could result if a failure occurred that is the Reserve Bank’s concern.

The soundness of individual banks and NBDTs is important though, because the system is made up of those institutions and there are many interconnections between them. However, the importance of those institutions, according to the current law, is because of their potential impact on the financial system.

Deposit Takers Act: the new purposes

3 Purposes

- (1) The **main purpose** of this Act 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.
- (2) **To that end**, this Act has the following additional purposes:
 - (a) to promote the safety and soundness of each deposit taker:
 - (b) to promote public confidence in the financial system:
 - (c) **to the extent not inconsistent with** subsection (1) and paragraphs (a), (b), and (d) to support New Zealanders having reasonable access to financial products and services provided by the deposit-taking sector:
 - (d) to avoid or mitigate the adverse effects of the following risks:
 - (i) risks to the stability of the financial system:
 - (ii) risks from the financial system that may damage the broader economy.

Background to the new purposes

The suitability of the statutory purposes for prudential regulation was a major focus of the Reserve Bank and Treasury team who, over the course of 2017 to 2021, reviewed the Reserve Bank of New Zealand Act 1989.¹

The review team asked the public which of the following should be included in the Reserve Bank's high level financial policy objectives:

- Soundness
- Efficiency
- Competition
- Consumer protection; and
- Public confidence.

It is notable that the review team did not consult on any purpose connected to financial inclusion or the accessibility of financial products and services provided by deposit takers to New Zealanders.

Section 3 of the DTA reflects the outcome of the review. Efficiency has been dropped from the existing high-level purposes. According to the review team, efficiency is hard to define. Competition and consumer protection were rejected. A place was found for both soundness and public confidence, although it is no longer the soundness of the system the Reserve Bank is concerned with, it is the soundness (and safety) of individual deposit takers.

Section 3 in detail

Breaking down this section, we note that it provides a main purpose. This purpose incorporates a high-level outcome (or "end"), i.e. what financial stability achieves for society, which is to enhance wellbeing and prosperity. Financial stability does not exist for its own sake but for these wider benefits. This is similar to section 3 of the RBNZ Act, e.g. monetary policy is not an objective for its own sake, but also to support wellbeing and prosperity.

Unlike the RBNZ Act, the DTA provides for "additional purposes" of the Act, rather than objectives for the Reserve Bank. These additional purposes provide more specific direction to the Reserve Bank as it carries out its functions and exercises its powers under the DTA. The phrase "to that end" in s 3(2) highlights that these additional purposes (with the exception of s 3(2)(c)) are the means to achieve the outcome/end.

¹ See [Safeguarding the future of our financial system: The role of the Reserve Bank and how it should be governed - November 2018 \(treasury.govt.nz\)](#)

Section 3(2)(a) Promote the safety and soundness of each deposit taker

Requiring the Reserve Bank to promote the safety and soundness of each deposit taker is a significant change of focus. No longer is the Reserve Bank's concern focused on the system alone. The safety and soundness of each licensed deposit taker is something the Reserve Bank must promote. This duty is not qualified by how important the deposit taker is to the system.

Promote public confidence in the financial system

Public confidence is a common objective for prudential regulators, such as the Australian Prudential Regulatory Authority (APRA) and the Bank of England. The link to stability of the financial system seems reasonably straightforward.

Avoid or mitigate risks to and from the financial system

Again, this additional purpose is consistent with the main purpose and the purposes of safety and soundness of deposit takers and public confidence. This purpose recognises that trends in the broader economy can threaten the financial system and that an unstable financial system poses risks to the broader economy. This is evident from such historical experience as property booms, credit crunches and banking crises.

Support New Zealanders having reasonable access to financial products and services provided by the deposit-taking sector

The phrase "to the extent not inconsistent" with the main and the other additional purposes clearly subordinates this purpose to the others in section 3. The Act permits the Reserve Bank to exercise powers and perform functions that might support the reasonable access of New Zealanders to financial products and services provided by the deposit taking sector. However, this is so long as there is no cost to the soundness and safety of any deposit taker, or to public confidence in the financial system, or if it increases, rather than avoids or mitigates, risks to and from the financial system to the broader economy.

The drafting of section 3(2) ensures the supremacy of the Act's financial stability purposes, while giving the Reserve Bank the permission to pursue this other "accessibility" purpose.

This additional purpose was added by the Finance and Expenditure Committee of Parliament during the final stages of its consideration of the Deposit Takers Bill. The Reserve Bank did not recommend this inclusion and advised that the Bill had not been designed with such a purpose in mind (as we have seen this purpose was not considered by the Treasury/Reserve Bank review team) and therefore powers and functions provided under the Act may not be effective to achieve it.

Nevertheless, Parliament felt the additional purpose was important to avoid the outcome of a "one-size-fits-all" prudential regime, geared towards the interests of the larger deposit takers and at the expense of smaller (typically New Zealand-owned) institutions. They also wanted to capture "financial inclusion" and the expression of this new purpose was determined to be the best way to define that concept.

Decision-making principles

In addition to the main and additional purposes in section 3, the DTA provides a list of decision-making principles in section 4 that the Reserve Bank must take into account as relevant to the performance or exercise of the functions, powers, and duties conferred or imposed on it.

Decision-making principles are reasonably common in legislation. A good example is [section 4 of the Building Act 2004](#). They first appeared in the Reserve Bank prudential legislation in section 157F of the RBNZ Act 1989, later replaced by the section 8 of the NBDT Act 2013. They do not appear in the BPS Act.

8 Principles to take into account when exercising powers

When performing its functions and exercising its powers under this Act, the Bank must take into account the following principles:

- (a) [the desirability of consistency in the treatment of similar institutions](#), regardless of matters such as their corporate form:
- (b) [the importance of recognising—](#)
 - (i) [that it is not the purpose of this Act to eliminate all risk in relation to the performance of NBDTs or to limit diversity among NBDTs; and](#)
 - (ii) [that depositors are responsible for assessing risk in relation to potential investments and for their own investment choices:](#)
- (c) [the desirability of providing to depositors adequate information to enable them to assess risk in relation to potential investments and to distinguish between high-risk and low-risk NBDTs:](#)
- (d) [the desirability of sound governance of NBDTs:](#)
- (e) the desirability of effective risk management by NBDTs:
- (f) [the need to avoid unnecessary compliance costs:](#)
- (g) [the need to maintain competition within the NBDT sector.](#)

The principles highlighted in [blue](#) are carried over to the DTA. The text in māwhero ([pink](#)) is highlighted because any equivalent principle is notably missing from the DTA. Section 8(b) would seem incompatible with the new additional purpose in section 3(2)(a) that requires the Reserve Bank to promote the soundness of individual deposit takers.

The updated list of decision-making principles is found in section 4 of the DTA:

4 Principles to be taken into account under this Act

In achieving the purposes of this Act, the Bank must take into account the following principles that are relevant to the performance or exercise of the functions, powers, and duties conferred or imposed on the Bank:

- (a) the desirability of—
 - (i) taking a proportionate approach to regulation and supervision; and
 - (ii) consistency in the treatment of similar institutions; and
 - (iii) the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders:
- (b) the need to maintain competition within the deposit-taking sector:
- (c) the need to avoid unnecessary compliance costs:
- (d) the desirability of maintaining awareness of, and responding to,—
 - (i) the practices of overseas supervisors that perform functions in relation to any licensed deposit taker or any holding company of any licensed deposit taker; and
 - (ii) guidance or standards of international organisations:
- (e) the desirability of ensuring that the risks referred to in section 3(2)(d) are managed (including long-term risks to the stability of the financial system):
- (f) the desirability of sound governance of deposit takers:
- (g) the desirability of deposit takers effectively managing their capital, liquidity, and risk:
- (h) the desirability of depositors having access to timely, accurate, and understandable information to assist them to make decisions relating to debt securities issued by deposit taker

Here we have marked in māwhero (pink) those clauses that are new and not reflected in the NBDT Act.

The legal nature of these principles is they are “mandatory considerations”. When performing a function and exercising a power, the Reserve Bank must ensure that each principle that is relevant is considered. However, the weight given to each principle is at the discretion of the Reserve Bank.

Decision-making principles are distinct from purposes. None of the principles in section 4 are equivalent to objectives or purposes. They are all considerations that exert influence on the Reserve Bank as it pursues the actual statutory purposes in section 3, but the level of influence each principle has to a particular decision is determined by the Reserve Bank and can never supplant the purpose itself.

The decision-making principles in more detail

Of the principles, (e), (f) and (g) are not likely to be influential on the Reserve Bank's decision-making. They are consistent and aligned with the purpose of the Act itself and entirely conventional for prudential regulation. For example, there is not much debate that deposit takers should have good governance and effectively manage their capital, liquidity and risk. Pointing this out is unlikely by itself to influence the Reserve Bank's proposed capital or governance standards.

We therefore focus on the more substantial principles.

Proportionate approach to regulation and supervision (the proportionality principle) section 4(a)(i)

This principle covers similar ground to the principle of avoiding unnecessary compliance costs. Essentially the prudential requirement under consideration by the Reserve Bank should match the risk to be addressed, otherwise regulatory and compliance and costs will result.

The proportionality principle has a special status, being the only principle for which its own published frameworks is required. Section 77 requires the Reserve Bank to prepare, keep up to date and publish a proportionality framework. This framework must set out how the Reserve Bank will take into account the proportionality principle when it develops prudential standards.

When preparing the proportionality framework the Reserve Bank must have regard to:

- a. The size and nature of the business of different deposit takers;
- b. The extent to which a range of different requirements are necessary or desirable to promote the safety and soundness of each deposit taker; and
- c. The relative importance of different deposit takers to the stability of the financial system.

While section 77 recognises that different deposit takers have different risk profiles to the financial system, the proportionality framework is ultimately concerned with ensuring that the extent to which this results in differentiated prudential requirements, the focus remains on the safety and soundness of each deposit taker (section 3(2)(a)).

The Reserve Bank has published its proportionality framework [here](#).

The deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders (the diversity principle) section 4(a)(iii)

This principle was modified late during the Parliamentary process of the DTA to include reference to access to financial products and services to a diverse range of New Zealanders.

This reflected both submitters' and the Select Committee's concern to avoid "one-size-fits-all" regulation that favoured larger deposit takers, and also the "financial inclusion" concept. The principle covers the same ground as the purpose in section 3(2)(c). However, here it is a principle that must be taken into account by the Reserve Bank in the course of its activities (undertaken for any purpose), rather than a purpose that can only be pursued if there is no cost to the other financial stability and soundness purposes.

The need to maintain competition within the deposit-taking sector (section 4(b))

Regulation and licensing can create barriers to entry and can reduce competitive dynamics and therefore efficiency and consumer choice. Conversely an absence of financial stability can also hamper competition and reduce consumer outcomes. This principle encourages the Reserve Bank to be aware of these effects in pursuit of the overall financial stability purpose. To some extent the principle now has greater importance, because the efficiency concept has been dropped from the Reserve Bank's purposes.

A recommendation from the Commerce Commission as part of its [market study into retail banking](#) was that the competition principle should be amended to refer to the need to "promote" rather than maintain competition. This would place a greater weight on the importance of competition as something to be promoted, rather than merely maintained, but would not alter the status of the principle vis-à-vis other principles and the main and additional purposes of the DTA.

Maintaining awareness of and responding to the practice of overseas supervisors who perform functions in relation to any licensed deposit taker or its holding company; and guidance and international standards, section 4(d)

This principle requires the Reserve Bank to take into account the prudential requirements of the home regulator of any overseas incorporated deposit takers doing business in New Zealand. It also requires consideration of the practices of regulators in other jurisdictions where a New Zealand incorporated deposit taker does business. In practice, this means the Reserve Bank pays particular attention to the practices of APRA.

There are a number of sources of relevant guidance and international standards. The Basel Committee on Banking Supervision is an obvious one. Others are the Financial Stability Institute, the Financial Stability Board and the International Monetary Fund. While the principle requires consideration of any of their relevant guidance, it is still left to the Reserve Bank to determine how it should pursue its purposes.

A good example of this principle in practice relates to the development of the proportionality framework. The Reserve Bank made sure to consider the recently released Basel Committee ["High-level considerations on proportionality"](#).

More additional DTA purposes

For completeness, we acknowledge two further purpose clauses within the Reserve Bank, although their effect and substantive content are not discussed.

Part 6 of the DTA establishes the Depositor Compensation Fund and the rules for when money may be paid out of the Fund.

It has its own purpose as follows:

Part 6

Depositor compensation scheme

Subpart 1—Preliminary provisions

190 Additional purpose of this Part

- (1) The purpose of this Part is to contribute towards protecting and promoting the stability of New Zealand's financial system by—
 - (a) protecting eligible depositors to the extent that they are covered by the depositor compensation scheme; and
 - (b) allowing the Depositor Compensation Fund to be used to support a resolution measure undertaken in relation to a licensed deposit taker.
- (2) This section does not limit [section 3](#).

Part 7 provides for the Reserve Bank to be resolution authority and with a range of functions and powers to deal with deposit takers in financial difficulty.

Part 7

Crisis management and resolution

Subpart 1—Preliminary provisions

259 Additional purposes of this Part

- (1) This Part has the following purposes (in addition to those set out in section 3):
 - (a) to avoid significant damage to the financial system that could result from a licensed deposit taker being in financial distress or other difficulties, including—
 - (i) by maintaining the continuity of systemically important activities undertaken by licensed deposit takers in New Zealand; and
 - (ii) by mitigating, or otherwise managing, any loss of confidence in the financial system resulting from a licensed deposit taker being in financial distress or other difficulties; and
 - (b) to enable a licensed deposit taker that is in resolution to be dealt with in an orderly manner; and
 - (c) to support the purpose of [Part 6](#); and
 - (d) **to the extent not inconsistent with any of paragraphs (a), (b), and (c)**, to minimise the costs of dealing with, or costs or losses otherwise incurred in connection with, a licensed deposit taker that is in financial distress or other difficulties by—
 - (i) preserving the interests of creditors and maintaining the ranking of claims of creditors; and

- (ii) dealing with the financial distress or other difficulties as quickly as is reasonably practicable; and
 - (e) to the extent not inconsistent with any of paragraphs (a), (b), and (c), to support the effective and efficient management of public financial resources by avoiding or minimising, and otherwise managing, the need to rely on public money to deal with a licensed deposit taker that is in financial distress or other difficulties.
- (2) In this Part, public money has the same meaning as in section 2(1) of the Public Finance Act 1989.
- (3) This section does not limit section 3.

We note above in māwhero (pink) text the subordination of the purposes in paras (1) (d) and (e) to the other purposes in section (1)(a)-(c). This is the same formulation used in the section 3(2)(c) accessibility purpose.

Conclusions for financial stability

The DTA maintains the Reserve Bank's focus on the financial system. However, the Reserve Bank is now directed under section 3 to promote the safety and soundness of individual deposit takers. This is a change from the current law's focus on the financial system: the soundness of an individual deposit taker being relevant only to the extent it promotes or detracts from the maintenance of a sound and efficient financial system.

In addition, the Act breaks down elements of financial stability, such as public confidence in the system and the mitigation of risks to and from the system. This provides more clarity and direction to the Reserve Bank as to the meaning of financial stability.

"Efficiency" is dropped from the high-level purposes. Instead, the Reserve Bank is directed to take into account relevant decision-making principles in section 4. Some of those principles may substitute for a focus on efficiency, such as the need to avoid unnecessary compliance costs and the desirability to maintain competition.

The decision-making principles introduce a range of other policy factors into the Reserve Bank's decision-making. These are weighed up by the Reserve Bank as it pursues its main and additional purposes. These considerations will influence the choices the RBNZ makes as to how it pursues its financial stability objective.

There is a new purpose permitting the Reserve Bank to perform its functions and exercise its powers to support New Zealanders' reasonable access to a range of financial products and services. This purpose is subordinated to the financial stability purposes and lacks supportive regulatory powers. This means its influence may be less than the similar decision-making principle (section 4(a)(iii)), which at least must be taken into account (as relevant) whenever the Reserve Bank makes a decision.

In any case, financial stability itself is a precondition that supports New Zealanders having access to a range of financial products and services provided by deposit takers.