Explanatory note for introduction of the Deposit Takers Bill

Background

In 2017, the Government announced a review of the Reserve Bank of New Zealand Act 1989. Phase 1 of the Review dealt with monetary policy arrangements, resulting in the introduction of the Monetary Policy Committee and the introduction of an economic objective of supporting maximum sustainable employment.

A joint Review team comprising members from both the Reserve Bank and Treasury carried out the Phase 2 Review, supported by an Independent Expert Advisory Panel. While the joint-agency policy work underpinning the Review has largely been completed, work to enact the key outcomes of Phase 2 is ongoing and is being led by the Reserve Bank.

In April 2021, Cabinet considered four papers related to the foundational architecture of a new prudential regime for deposit takers and the introduction of depositor protection. The Cabinet Legislation Committee took decisions on these papers [DEV-21-MIN-0076, DEV-21-MIN-0077, DEV-21-MIN-0078, and DEV-21-MIN-0079] and these decisions were confirmed by Cabinet on 19 April 2021 [CAB-21-MIN-0128].

In October 2021, the Cabinet Economic Development Committee, considered additional policy issues principally relating to the crisis management and resolution framework. The Committee took decisions on this paper on 20 October [DEV-21-MIN-0204], and Cabinet confirmed these decisions on 26 October [CAB-21-MIN-0429].

Following the October 2021 Cabinet decisions the Minister of Finance took additional decisions under delegation (RBNZ #5853 and #5888) on various detailed aspects of the Bill to support the finalisation of an exposure draft for public consultation.

The exposure draft Deposit Takers Bill was released on 6 December 2021, with the deadline for submissions closing 21 February 2022. As part of the submission process, the Reserve Bank ran workshops with banks and non-bank deposit takers (**NBDTs**), and met bilaterally with several firms in order to address their queries on the Bill. A summary of submissions has been published on the Reserve Bank website. Separately, on the Reserve Bank website, we have published submissions in full with the exception of one submission where the submitter requested the submission be withheld.

Sets of decisions relating to a final set of policy issues for the Deposit Takers Bill were taken under delegation by the Minister of Finance and Cabinet in June 2022.

This document provides a summary of the significant changes to the Bill made since the exposure draft. The most notable changes are outlined in the main text with more minor changes described in annex table 1. Annex table 2 summarises feedback on the exposure draft that did not result in changes in the Bill.

Parts 1-5

These sections of the Bill include:

- **Part 1: Preliminary provisions** – including the statutory purposes of the Bill, and a set of decision-making principles the Reserve Bank must take into account when exercising its functions, powers and duties

- **Part 2**: **Licensing** – details requirements around the licensing of entities involved in the activity of borrowing and lending, and fit and proper requirements for directors and senior managers

- **Part 3**: **Regulation** – outlines the scope of prudential standards the Reserve Bank may impose on deposit takers, and the due diligence duty of directors requiring them to ensure their deposit taker complies with any prudential obligation

- **Part 4: Supervision** – details the powers of the Reserve Bank to gather information, undertake on-site inspections, investigations into non-compliance with prudential obligations, and to seek remedial action by the deposit taker

- **Part 5**: **Enforcement** – provides a range of powers to sanction deposit takers for non-compliance

Notable changes in these sections include changes to the Bill's penalty and offence settings based on feedback received from Legislation Design and Advisory Committee (**LDAC**) these were taken by the Minister of Finance under delegation. There was also a Cabinet decision that the privilege against self-incrimination will not be available to prevent the supply of information to the Reserve Bank, subject to safeguards. Further minor decisions are detailed in annex 1.

Privilege settings

Cabinet agreed, in April 2021 that the on-site inspection powers provided in the Bill would not serve as a 'search and seizure power' but rather for the purposes of 'business-as-usual' supervisory monitoring [DEV-21-MIN-0077]. The Reserve Bank would not be permitted under the Bill to compel privileged or self-incriminatory information from individuals when gathering information.

Further policy development indicated that the privilege settings in the exposure draft of the Bill may potentially undermine the ability for the Reserve Bank to adequately carry out its supervisory responsibilities, and achieve its statutory mandate of promoting financial stability. In June 2022, Cabinet agreed to revise privilege settings so that the privilege against self-incrimination will not be available to prevent the supply of information to the Reserve Bank, subject to safeguards.

Penalty settings

LDAC provided feedback on the exposure draft recommending the removal of imprisonment for strict liability offences and reconsideration of certain penalties. LDAC advised against mixing *mens rea* and strict liability offences in a single provision as this can create enforcement uncertainty. LDAC also advised to remove imprisonment for strict liability offences. Both recommendations have been adopted in the relevant clauses (See Part 5, subpart 2, versions 8.0 DTB).

A number of offences in the Bill have been designated strict liability, with imprisonment removed as a potential penalty for those offences, and an offence for breach of an enforceable undertaking was introduced. LDAC also suggested the enforcement mechanisms for undertakings appeared

insufficient. These have been updated to include a tier one offence should the deposit taker breach an undertaking.

Part 6: Depositor Compensation Scheme

This section of the Bill establishes a Depositor Compensation Scheme (**DCS**) that will compensate eligible depositors up to $100,000 in a liquidation event. The DCS may also be used to compensate creditors or shareholders that may be made worse off as a result of a resolution action. Key changes in this section since the exposure draft relate to the eligibility of 'large' non-financial corporates and establishment of a power to exempt deposit takers from the scheme. Further minor decisions are detailed in annex 1.

The 'Large' assessment criteria for non-financial corporates

Cabinet agreed in April 2021 that deposits held by 'large' non-financial corporates should be excluded from the coverage of the DCS [DEV-21-MIN-0078]. The policy intent was to mitigate potential moral hazard problems and motivate large and sophisticated corporates to monitor the risk profile of deposit takers.

In response to the exposure draft, several submitters challenged the practicality of assessing whether a corporation is 'large'.[1] Such assessment would need to be conducted at least annually and would constitute a significant ongoing compliance burden for deposit takers. Additionally, the exclusion of 'large' depositors may reduce the small and medium size enterprises' confidence in the DCS, particularly if they are near the boundary for inclusion/exclusion in the scheme. In June 2022, Cabinet agreed to drop the restriction on coverage of large firms from the Deposit Takers Bill.

The power to exempt deposit takers from the DCS

Cabinet agreed in April 2021 that "membership of the scheme will be compulsory for all licensed deposit takers" [DEV-21-MIN-0078].

In response to the exposure draft, some finance companies and NBDTs challenged this decision and requested a 'restricted' class of licence that would be excluded from the DCS.[2] Feedback was also received from branches of international banks that operate in New Zealand suggesting that certain branches may prefer to be excluded from the coverage of the DCS and are willing to be subject, in exchange to the restriction of not taking retail deposits.

In June 2022, Cabinet agreed that the Bill provide for a regulation making power to exempt certain classes of licensed deposit takers from the DCS. A statutory test attached to this regulation-making power for determining the types of firms that can be exempt was also included in the Bill.

Part 7: Crisis management and resolution

This section provides the Reserve Bank with powers to address a deposit taker in financial distress, and to compensate creditors or shareholders that may be made worse off as a result of a resolution action relative to outcomes under liquidation the no creditor or shareholder worse off principal

[1] See Summary of Submissions paragraph 31
[2] See Summary of Submissions paragraph 37

(**NCWO**). Notable changes in this section include a decision by Cabinet to amend the NCWO framework in the Bill, with respect to appeal rights. The Bill also incorporates an ex post resolution levy. Further minor decisions are detailed in annex 1.

NCWO appeal rights

In April 2021, Cabinet agreed that an after-the-event compensation mechanism be established to compensate creditors if a resolution left them worse off than they would have been in an ordinary liquidation [DEV-21-MIN-0079]. The exposure draft Bill provided for appeals to be allowed based on points of law and points of fact, but a second subsequent round of appeal to the Court of Appeal would not be permitted. Further policy work has determined that allowing appeals based on points of fact may risk lengthy court proceedings eroding confidence in the NCWO appeal process. Additionally, limiting to only one round of appeal restricts the accountability of the process.

In June 2022, Cabinet agreed to limit appeal rights to points of law only and that appeals would be permitted from the High Court to the Court of Appeal (with permission of the Court of Appeal). The intent of these decisions is to enhance confidence in a timely NCWO payout and to provide for appropriate accountability for the NCWO valuation.

Ex post resolution levy

In October 2021 Cabinet agreed that it should be possible to recover public funds expended in support of deposit takers via an ex post resolution levy on deposit takers [DEV-21-MIN-0204] and that authority to develop the levy proposal would be delegated to the Minister of Finance.

In June 2022, the Minister of Finance took decisions providing for the ex post resolution levy. The ex post levy mechanism will allow the Crown to recoup from deposit takers; public funds expended either in resolution of a deposit taker or a pre-resolution action that stabilises the deposit taker.

Including an ex post levy mechanism in the Bill provides the ability to impose a levy to recover resolution costs without the need to explicitly legislate to do so at the time a stress event occurs. The levy mechanism may also provide deposit takers with greater incentives to prudently manage their risk taking (and that of their peers) given that contingent liability for costs incurred in resolution could be transferred from government to industry.

Annex 1 – further changes since the exposure draft[3]

Part	Subpart (clause numbers reference version 8.0 of the Bill)	Changes made	Rationale for the change
Preliminary provisions	Clause 6; meaning of current credit rating	Extended the current credit rating definition to fifteen from twelve months.	Submission noted that credit rating are updated approximately but not exactly annually. This change will align the current credit rating definition in the Bill to industry best practice.
	Clause 6; meaning of voting rights	Included a definition for voting securities to mean a security that confers voting rights (with the same meaning of section	This change aims to fill a gap in the Bill as voting securities had not been defined.

[3] Clause numbers are from version 8 of the Deposit Takers Bill

Part	Subpart (clause numbers reference version 8.0 of the Bill)	Changes made	Rationale for the change
		6(1) of the Financial Markets Conduct Act (FMCA) 2013). Previously this had not been defined, though voting rights was.	
	Clause 7; meaning of associated persons and holding entity	Extended bankruptcy remoteness to covered bond SPVs or an SPV that is involved in a securitisation prescribed by regulations, but not to other securitisation programmes.	Submissions requested certainty on the status of certain securitisation SPVs in the insolvency of deposit takers (i.e. not a subsidiary or an associated person). This change aims to provide the ability to extend bankruptcy remoteness to certain securitisation SPVs (prescribed by regulation).
Licensing	Clause 26; Licensed deposit taker must obtain the Bank's approval before new director or senior manager is appointed	Specified that fit and proper requirements in the Bill do not extend to interim appointments of new directors or senior managers.	This change aims to provide flexibility to enable interim appointments of new directors or senior managers. Absent of this flexibility, respondents noted that deposit takers may be left in a difficult position if a director or senior manager resigns unexpectedly. Pragmatically, the Bill needs a provision to allow an interim director or senior manager while a permanent replacement is found.
	Clause 40; Licensed deposit taker must obtain Bank's approval for changes in control and amalgamation	Replaced approval with a notification requirement for overseas banks to signal a change in control or amalgamation is taking effect.	This change aims to provide flexibility. Respondents noted that an approval requirement would be unsuitable to overseas and international banks in light of their size and level of activity outside of New Zealand. Should each change in control or amalgamation require the Reserve Bank's approval, this would become burdensome to the deposit taker.
Supervision	Clause 107; Disclosure of information to Bank by auditors	Extended the disclosure of information to Reserve Bank by auditors' clause to require auditors to report suspected breaches of any obligation or regulations under the Bill.	This change aims to fill a gap in the Bill for the auditor to report suspected breaches (by the deposit taker) to the Reserve Bank.
Enforcement	Clause 157; Maximum amount of pecuniary penalty	Clarified that the maximum pecuniary penalty (greater of $5million or 0.1% of consolidated assets) should be based on the balance sheet of the New Zealand business, rather than the consolidated balance sheet of the entire deposit taker.	This change aims to provide statutory clarity. Previously, there was confusion as to whether the maximum pecuniary penalty would apply to the balance sheet of the overseas' or international bank's or just the New Zealand portion.
	Clause 160; Defences for person that is involved in a contravention	Amended the general defences for a person involved in contravention. 'Reasonable and proper steps' changed to 'reasonable steps'. This change is consistent with sections 501 and 503 of the FMCA 2013.	This change aims to provide statutory consistency between the Bill and FMCA.
DCS	Clause 190; Definition of eligible investor	Deposit takers licensed in a jurisdiction other than new Zealand have been added to the list of non-eligible investors.	This reflects the policy intent that both licensed deposit takers in New Zealand and those registered overseas are not eligible investors under the DCS because they are expected to be sufficiently sophisticated to monitor the risk of institutions with which they deposit.
	Clause 191, Meaning of protected deposit and related terms	Amended the regulation making process to be aligned with the general regulation making process specified in clause 452(1) i.e. made by the Governor-General, by Order in Council, on the	"Recommendation of the Reserve Bank" appears appropriate considering the technical aspects involved in the regulation on the maximum amount calculation.

Part	Subpart (clause numbers reference version 8.0 of the Bill)	Changes made	Rationale for the change
		advice of the Minister in accordance with a recommendation of the Reserve Bank.	
	Clause 221, Persons may disclose information to Bank to facilitate payment of compensation	Include provisions in the Deposit Takers' Bill such that: Licensed deposit takers, account holder of bare trust accounts and accounts held under relevant arrangement are provided with an exemption so they do not need to obtain customers consent before disclosing personal information to the Reserve Bank for the purpose of DCS payout.	According to Privacy Act 2020, an agency must obtain consent from an individual before disclosing any personal information of that individual with another agency. This may not be practical considering the goal of 'prompt payout' under the DCS, if a deposit taker fails to obtain the consent before a payout event occurs.
	Clause 222, Bank may disclose information to facilitate payment of compensation	The Reserve Bank be provided with the power to disclose necessary information (including personal information) to any other person for the purpose of facilitating a DCS payout. This could include a payment agent or an acquiring bank who is taking the customer on.	According to Privacy Act 2020, an agency must obtain consent from an individual before disclosing any personal information of that individual with another agency. This may not be practical considering the goal of 'prompt payout' under the DCS, if a deposit taker fails to obtain the consent before a payout event occurs.
	Clause 253, Financial information about fund consolidated into Bank's financial statements only if required by financial reporting standard	The relevant clauses are amended to ensure that the DCS fund is not to be consolidated with the Reserve Bank's balance sheet unless a Financial Reporting Standard requires such a consolidation.	Policy work undertaken by the accounting teams at the Reserve Bank and the Treasury have evaluated the nature of the DCS against the international accounting standard (GAAP). They have concluded that consolidating the DCS fund into the Reserve Bank's balance sheet may create unnecessary volatility and provide misleading information on the financial position of the Reserve Bank. The Reserve Bank's auditor has confirmed this judgement.
	Clause 254, liquidators obligations under the DCS	Liquidators are obligated to cooperate with the Reserve Bank in supplying access to necessary information to determine and calculate the eligible compensation amount and facilitate the payout process.	This change is made with the intention of facilitating a timely DCS payout which will require the Reserve Bank having access to records at a failed deposit taker. The exposure draft Bill does not require liquidators to provide all necessary information for a timely payout from the DCS.
	Clause 255, Offence to hold out that product is protected deposit	The Reserve Bank provided with the power to direct deposit takers about the interpretation of the eligible product regulations to ensure that licensed deposit takers properly classify covered/uncovered products under the DCS.	The policy intent is to provide clarity regarding DCS coverage in order to promote public confidence in the scheme.
Crisis Management and Resolution	Clause 290, Moratorium	The stay on close out rights in resolution widened to apply to specified instruments. Specified instruments will be further defined by regulations and are expected to cover repurchase agreements (repos) and securities lending transactions.	A number of submitters suggested that repos and securities lending transactions should be covered by the definition of derivative for the purposes of the stay on close out rights. We opted to have the stay explicitly apply to repos and securities rather than changing the definition of derivative to avoid unintended inferences about the meaning of derivative in other contexts (e.g. the definition of derivative in the FMC Act).
	Clause 324, Kind of security interest referred to in various sections	For the purposes of the stay on close out rights under derivatives, the requirement for collateral to be "transferred or otherwise dealt with" to be in the	Some submitters suggested that the requirement for the collateral to be "transferred or otherwise dealt with" to be in possession and control is problematic under some collateral management

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		possession and control of the non-defaulting counterparty, be changed to a requirement for the collateral to be "delivered, transferred, held, registered, or otherwise designated" to be in the possession and control of the non-defaulting counterparty.	scenarios, and that it would be preferable to use the wording "delivered, transferred, held, registered, or otherwise designated" (as in the European Union's Financial Collateral Directive). It is important to maintain consistency across the amendments made in 2019. An equivalent change was made to the Corporations (Investigation and Management) Act 1989 (CIMA). We note that this will then automatically flow through to the other Acts amended in 2019, as they will cross refer to the relevant provisions in CIMA.
	Clause 348, Procedural requirements	The use of the direction power must not be inconsistent with the primary purpose of the resolution regime as specified in Part 7 of the Bill.	The 'not acting inconsistent' test (vis-à-vis the Bill's resolution purposes) narrows the permitted scope of the power to the extent that it does not allow the Minister of Finance to issue a direction in response to wider social, economic or trans-Tasman considerations, except if such a direction were to address the risk to public funds involved in a resolution.
Miscellaneous	Clause 425; Bank may authorise class of persons to use restricted words in name or title	Included a clear transitional statement for the Reserve Bank to authorise a class of persons to use restricted words in name or title. At the time that subpart 1 of Part 8 comes into effect, deposit takers are treated as though they were authorised to use restricted words.	This change aims to provide statutory clarity. Previously, there was confusion as to whether deposit takers would still be able to use restricted words, after the DCS is activated, but before the remaining parts of the Bill are phased in.
Schedule 3	Local Government Borrowing Act 2011	Amended the Bill to make clear the New Zealand Local Government Funding Agency (**LGFA**) are not a deposit taker and be treated as a local authority.	This change aims to provide statutory clarity that LGFA will be treated as a local authority. Previously, the wording of the Bill implied that LGFA could be a deposit taker.

Annex 2 - Feedback on the exposure draft not incorporated into the Bill

Part	Subpart (clause numbers reference version 8.0 of the Bill)	Submission	Rational for no change
Preliminary provisions	Clause 6; Definition of prudential obligation	Request AML/CFT obligations should be removed from the definition of prudential obligation. Feedback noted given the extensive framework for AML/CFT obligations under the AML/CFT Act 2009, including AML/CFT as a prudential obligation 'create significant overlap and potential inconsistency between the two regimes, leading to confusion and uncertainty and additional cost, without any appreciable benefit.'	We believe the Bill and the AML/CFT Act 2009 can work in a complimentary way to address AML/CFT risk management and compliance issues. Our policy view is that the AML/CFT Act 2009 establishes an enforcement-based regime while the Bill will provide for corrective approaches to be taken through such as the powers for the early identification and remediation of problems.
Regulation	Clause 94; Directors' indemnities and insurance	Submitters suggest it would be unsuitable for the Reserve Bank to impose restrictions on directors'	We saw no need to restrict the operation of the prohibition on indemnities or insurance to the

Part	Subpart (clause numbers reference version 8.0 of the Bill)	Submission	Rational for no change
		indemnities and insurance that apply to overseas deposit takers. The submission notes that should restrictions apply the result would be disproportionate because they would apply to all the board's activities in every jurisdiction that the deposit taker is active.	New Zealand activities of an overseas deposit taker. Reserve Bank considers that prohibition is already restricted to New Zealand as it relates to breaches of the directors duty relating to "prudential obligations" which are obligations that are imposed under New Zealand law and directed at NZ based activities.
Supervision	Clause 112; On-site inspection	Request the Reserve Bank to define 'relevant place' as any place of business of the deposit taker. The submitters consider this necessary to limit on-site inspections to business premises only and does not apply to a directors' or employee's home or retail branches.	We did not see a need to restrict the definition of 'relevant place' in the way the submitter suggested. In our opinion, whether a place is a 'place of business' should be determined according to the circumstances of the case, with the Reserve Bank required to exercise the power in a reasonable manner.
DCS	Clause 202, Calculation of entitlement	Some finance companies requested DCS coverage to be increased to NZ $250,000 per eligible investor. The submitters argued that this is to be aligned with Australian and Singapore regimes and to prevent deposit outflows to those countries in time of uncertainties.	The $100,000 limit can cover approximately 92% of depositors in New Zealand and is sufficient to meet the goal of contributing to financial stability by protecting eligible investors. A further increase may unduly increase the cost of the Scheme (e.g. higher levies to be collected from licensed deposit takers) and may dampen the motivation for those depositors that are not covered by the scheme to continue to monitor risks thus mitigate moral hazard problems associated with the Scheme.
DCS	Clause 192(1) Meaning of protected deposit and related terms	Some finance companies requested to include 'debentures' in the eligible products of the DCS. The submitters argued that the transferability of debentures are limited only to those agreed by the finance companies that issue the debentures and the change of ownership being traceable.	We regard debentures as different from term deposit from the perspective of economic substance. Debentures share more common features with bonds. We saw no need to change the list of excluded products under the DCS.
DCS	Clause 191 (1) Meaning of protected deposit and related terms	Request to include foreign currency deposits in the DCS, since it will especially affect companies doing business in international trade.	The decision to not include foreign currency deposits under the DCS reflects the fact that the level of foreign currency deposits held by New Zealand registered banks is not significant, unlike in some other countries. It also reflects a desire to simplify, to some extent, the operation of the DCS. According to guidance published by the International Association of Deposit Insurers, deposit insurance in a jurisdiction should cover foreign currency deposits, but only if foreign currency deposits are "widely used". In the New Zealand context, foreign currency deposits account for about 2.7% of total deposits. Furthermore, many of these deposits are likely to be above the insurance limit (NZ $100,000), especially once NZD deposits held by the same depositors are taken into account.

Part	Subpart (clause numbers reference version 8.0 of the Bill)	Submission	Rational for no change
			We propose to retain with the original decision to exclude foreign currency deposits from the scheme.
DCS	Clause 198, 193. Payments out of fund	Request to limit the Reserve Bank's power to charge expenses to the DCS fund and of determining apportionment of expenses. The submitters suggested a review process or appeal process for this matter.	We believe that the accountability provisions (Subpart 9 of Part 6) provide the mechanism to ensure that the Reserve Bank's charge on the DCS fund is transparent and reasonable. Specifically, the accountability is to be achieved through the publication of a financial statement of the fund, which is to be audited by the Auditor-General.
DCS	Clause 190(1)(b)(iv) Eligible investor	Request to include directors of a licensed deposit taker in relation to a payout event as 'eligible investor' under the DCS. The submitters, mainly from credit unions and building societies, argued that directors of CUBS are required to hold deposits with the CUBS they serve as a membership policy.	We investigated this issue and found that although directors of CUBS are required to hold deposits with the firm they serve for, the minimum amount that they are required to hold is trivial (differing from 1-1000 NZ dollars) compared to the coverage of the DCS ($100k). Therefore, directors still have, in fact, the freedom to choose where to deposit their money. We suggest keeping the wording in this clause to mitigate, to some extent, the moral hazard problem associated with the DCS.
DCS	Clause 238, levy regulations principles	Request to include a cap of annual levy on licensed deposit takers similar to UK (not exceeding 0.5% of protected deposits). The submitters argued that this is mainly to avoid any significant burden to industry after a payout event happens.	We believe that the current draft already provides the mechanism to avoid significant burden to industry. Clause 227 in the exposure draft lists out the principles that the Minister must have regard to before making levy regulation recommendations. One of the principles is "the effect that obligation to pay a levy under this subpart is likely to have on the soundness of a deposit taker of that class". Therefore, we saw no need to include a numerical cap on the maximum amount of levy.
Crisis Management and Resolution	Clause 292, Bank may reduce or extend the stay	Request to remove the power to extend the stay since this is a departure from the Financial Stability Board's 2014, *'Key Attributes of Effective Resolution Regime for Financial institutions'* and the prevailing approach in major overseas jurisdictions.	The power to extend the stay is consistent with current New Zealand and Australian legislation (in New Zealand the RBNZ Act 1989 and the FMI Act 2021, and in Australia the Payment Systems and Netting Act 1998). We acknowledge the feedback and will continue to discuss this with stakeholders and consider, it may be raised again during the select committee process.

Part	Subpart (clause numbers reference version 8.0 of the Bill)	Submission	Rational for no change
Schedule 2	Part 6; Bank may make declarations for purposes of this schedule	Request the Reserve Bank to embed specific exclusions for wholesale and overseas banks. The submitters consider this group to provide non-consumer lending and borrowing. Extending the Bill to this group would raise their compliance burden.	While we acknowledge feedback, we however saw no need to make adjustments to the Bill. Part 6 of Schedule 2 provides the Reserve Bank the powers to make exemptions without making changes.