

In confidence

Office of the Minister of Finance

Chair, Cabinet Economic Development Committee

Reserve Bank of New Zealand Act Review – Deposit Takers Bill

Proposal

- 1 This paper seeks agreement to further policy decisions on the Deposit Takers Bill (the 'Bill'), following consultation on an exposure draft, and ahead of introduction of the Bill to the House in August 2022 (at the earliest).

Relation to government priorities

- 2 These proposals are part of a broader review of the Reserve Bank of New Zealand Act 1989, which was part of the previous Government's coalition agreement between the Labour Party and the New Zealand First Party. The overall objective of the Review is to modernise the Reserve Bank's legislation to support the development of a New Zealand economy that is productive, sustainable and inclusive.

Executive Summary

- 3 I am seeking Cabinet decisions to finalise details of a package of proposals agreed on by Cabinet in April (DEV-21-SUB-0076) and October (DEV-21-MIN-0204) 2021 which will support the introduction of a Deposit Takers Bill into the House. The Bill is the culmination of four substantive rounds of public consultation on Phase 2 of the Reserve Bank Act Review, including most recently, consultation on an exposure draft of the Bill which was published in December 2021. The Bill will support a prudential framework that will help protect society from the damage to New Zealand's financial system and wider economy that could be caused by unexpected external factors, excessive risk taking by the deposit taking sector, and/or the unmanaged failures of individual deposit takers.
- 4 I am seeking decisions on the following policy issues, principally relating to:
 - 4.1 **Privilege settings to allow the Reserve Bank to fulfil its supervisory function without restriction:** the privilege against self-incrimination will not be available to prevent the supply of information to the Reserve Bank, although any self-incriminatory information may not be used as evidence against a person in a prosecution, except in certain circumstances.
 - 4.2 **Various design features of the Depositor Compensation Scheme (DCS) including:**
 - 4.2.1 removing the large assessment criteria for non-financial corporate eligibility

- 4.2.2 providing the power to exempt certain deposit takers from the DCS
 - 4.2.3 adding additional duties for the liquidator to support the payout process
 - 4.2.4 allowing the Reserve Bank to share depositor information to support the functioning of the DCS including the payout process
 - 4.2.5 clarification of eligible depositor entitlement amounts to avoid 'double compensation'.
- 4.3 **A change to the design of the 'no creditor worse off' (NCWO) framework:** narrowing the scope of appeals for NCWO determinations by the Independent Valuer.

Background

- 5 In 2017, the Government announced a review of the Reserve Bank of New Zealand Act 1989. Phase 1 of the Review dealt with monetary policy arrangements, resulting in the introduction of the Monetary Policy Committee and the introduction of an economic objective of supporting maximum sustainable employment. Phase 2 of the Review, which began in June 2018, focusses on the institutional structure of the Reserve Bank, the framework for the prudential regulation and supervision of deposit takers, and new arrangements for depositor protection.
- 6 The overall objective of the Review is to modernise the Reserve Bank's legislation to support the development of a New Zealand economy that is productive, sustainable and inclusive. A modern and fit for purpose prudential regime will contribute to this overarching objective if it provides a credible pre-commitment to the long run goal of financial stability and protects the Reserve Bank's operational independence. This regulatory autonomy is complemented and supported by a robust accountability and transparency architecture that supports quality decision-making and public confidence in the legitimacy of the Reserve Bank as an institution.

Previous Cabinet decisions

- 7 In April 2021, Cabinet made policy decisions on a new prudential policy framework for deposit takers and the introduction of depositor protection [DEV-21-MIN-0076, DEV-21-MIN-0077, DEV-21-MIN-0078, and DEV-21-MIN-0079 refer].
- 8 These April decisions also recognised that further policy work would be required to finalise the Bill, with significant decisions requiring referral to Cabinet, others taken under ministerial delegation, and more minor and technical work managed by the Reserve Bank through drafting instructions to the Parliamentary Counsel Office (PCO).

- 9 In October 2021, the Cabinet Economic Development Committee, considered additional policy issues principally relating to the crisis management and resolution framework:
 - 9.1 purpose of the resolution function and role of the Minister
 - 9.2 bail-in
 - 9.3 the use of the Depositor Compensation Scheme fund in resolution
 - 9.4 no creditor worse off (NCWO) and appeal rights in resolution
 - 9.5 constraints on the ability of creditors to enforce rights against deposit takers in resolution.
- 10 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).

Exposure draft of the Deposit Takers Bill

- 11 Following the October Cabinet decisions I took additional decisions under delegation on various detailed aspects of the Bill to support the finalisation of an exposure draft for public consultation.
- 12 An exposure draft of the Bill was published by the Reserve Bank in early December 2021 with consultation open until late February 2022.

Stakeholder feedback on the exposure draft

- 13 The Reserve Bank received 21 submissions comprising industry bodies, individual banks, non-bank deposit takers (NBDTs) and other institutions. Industry were generally supportive of the Bill but highlighted a need for further policy work in several areas, and on-going consultation on parts of the Bill. Separately, the Reserve Bank also received substantive feedback from the Legislation Design and Advisory Committee (LDAC) following a meeting in December 2021 to discuss the Bill, and from experts at the IMF as part of the annual New Zealand Article IV process.
- 14 Submissions on Parts 1-5 of the Bill requested more detail on implementation (e.g. what standards the Reserve Bank would set for deposit takers, how 'proportionality' would be reflected in the rules for smaller deposit takers, and how actively certain powers would be used). Future policy development undertaken by the Reserve Bank (to give effect to the new legislative framework) is required before answers to these questions can be adequately provided.
- 15 Some stakeholders thought the Bill provides the Reserve Bank too much discretion around the use of its regulatory powers, and suggested more prescription in some areas. By contrast, my guiding principle for legislative design, and that of officials, has been to create a flexible and empowering statutory framework for the Reserve Bank as regulator, subject to appropriate

safeguards and clear process requirements. For its part, LDAC is broadly comfortable with the balance struck in the Bill between the authority delegated to the Reserve Bank to impose prudential requirements, and the protections in the Bill for stakeholders, including regulated entities. LDAC notes that the current framework (in the 1989 Act) already provides a significant degree of policy-making autonomy and discretion for the Reserve Bank.

- 16 The DCS received significant feedback especially regarding the coverage of the scheme and investor eligibility. The interaction between DCS and the Reserve Bank's existing Open Bank Resolution (OBR) framework was also a common theme.
- 17 Feedback on aspects of crisis management and resolution included the *Statement of Resolution Approach* and technical matters such as the derivative carve out for moratorium.

Analysis

Parts 1 to 5: Licensing, Regulation, Supervision, and Enforcement

Privilege settings

- 18 I propose that the privilege against self-incrimination not be available to prevent the supply of information to the Reserve Bank so as to allow prudential supervision to be conducted effectively through the unfettered supply of information. However, to retain protection for individuals, I propose that self-incriminating information may not be used as evidence against that person in prosecution except when the person provides evidence inconsistent to admission, refuses or fails to answer a question, or answers any question or supplies information in a way that is false or misleading in a material manner.
- 19 In the design of the supervisory powers agreed by Cabinet in April 2021 [DEV-21-MIN-0077], including the on-site inspection power, it was noted that the Reserve Bank will not be able to compel privileged, or self-incriminating information from individuals.
- 20 My officials report that the current privilege settings in 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.
- 21 Note, this proposal is aligned with the privilege settings currently in the RBNZ Act 1989 (sections 175 and 175B). The proposed override of privilege is confined to the privilege against self-incrimination only, rather than privilege more broadly conceived (e.g. legal privilege). This narrow override is also reflected in the information supply provisions found in other regulatory regimes such as the Commerce Act (section 106(4)), the CCCFA (section 113(l)).

- 22 Note, the Ministry of Justice's Bill of Rights Act (BORA) vetting will determine whether the scope of the override is appropriate and whether the protections are sufficient.
- 23 Note, this recommendation effectively means that Cabinet will amend decision #62 referred to in DEV-21-MIN-0077.

Part 6: Depositor Compensation Scheme

- 24 In April 2021 Cabinet took decisions to establish the foundations of a scheme to protect depositors from loss [DEV-21-MIN-0078], while in October further decisions were made by Cabinet with respect to the use of the scheme's fund in resolution and applicable safeguards [DEV-21-MIN-0204].
- 25 In addition, I took decisions under delegation on further technical matters including:
 - 25.1 September 2021: the name of the scheme, triggers for payout, funding strategy, levy setting, powers necessary for payout, operating budget, and eligibility requirement
 - 25.2 November 2021: the use of the DCS fund in resolution including when the fund may be used to contribute to resolutions, applicable safeguards, and the independent review of safeguards.
- 26 On the basis of these decisions, PCO drafted the relevant provisions of Part 6 of the Bill to establish a DCS to:
 - 26.1 provide compensation to eligible depositors when a deposit taker is put into liquidation or is otherwise subject to a 'specified event notice' under Part 6, and
 - 26.2 support a resolution measure undertaken in relation to a deposit taker.
- 27 In response to stakeholder feedback on the exposure draft and further analysis from officials, I have taken the following decisions under delegation, with respect to the design of the DCS:
 - 27.1 deposit takers licensed in another jurisdiction be explicitly added to the list of non-eligible depositors
 - 27.2 the identification and classification of covered (i.e. protected) and non-covered products
 - 27.3 disclosure requirements and accounting treatment for the DCS fund.
- 28 In addition to these decisions under delegation I am proposing that Cabinet make decisions in the following areas:
 - 28.1 the large assessment criteria for non-financial corporates

28.2 the power to exempt deposit takers from the DCS

28.3 the liquidator's obligations under the DCS

28.4 privacy issues related to payout

The 'large' assessment criteria for non-financial corporates

29 I propose that the 'large assessment' criteria for determining the eligibility of non-financial corporates under the DCS be removed. This will simplify the eligibility criteria for the scheme and reduce the compliance burden on deposit takers, without necessarily any commensurate reduction in the 'market discipline' exerted by large corporates.

30 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 of that decision is to mitigate potential moral hazard problems and motivate large and sophisticated corporates to monitor the risk profile of deposit takers (i.e. their ability to exert 'market discipline').

31 Several submitters, however, challenged the practicality of assessing whether a corporation is 'large' on an on-going basis. Industry also observed that the moral hazard issues supporting the exclusion may be overstated. Large corporates would typically have balances significantly higher than the \$100,000 coverage limit, and therefore maintain a strong incentive to monitor the risk-taking of their deposit taker.

32 In the international context it is common to exclude government agencies, financial institutions and related parties from deposit insurance coverage. However, it is less common to exclude non-financial corporates from protection based on a size criteria.

33 Note, this recommendation effectively means that the Cabinet will rescind decision #33 referred to in DEV-21-MIN-0078.

The power to exempt deposit takers from the DCS

34 I propose that the Bill provide for a regulation-making power to exempt certain types of licensed deposit takers from the DCS.

35 Furthermore, I propose that there is a statutory test attached to this proposed regulation-making power that will justify when the Minister of Finance may make a recommendation on the advice of the Reserve Bank. I propose that the Reserve Bank may give advice after considering certain criteria, including matters like the nature of the deposit taking business and customers of the deposit taker, and being satisfied proposed exemptions do not compromise the broad aims of the DCS. I propose that the Reserve Bank also be required to consult with the persons (or representatives of the persons) that the Reserve Bank considers will be substantially affected by the regulations.

- 36 Cabinet agreed in April 2021 that “membership of the scheme will be compulsory for all licensed deposit takers” (DEV-21-MIN-0078). This decision aligns the prudential perimeter for deposit taking with membership in the DCS.
- 37 However, some submitters, after reflecting on the potential costs of being covered under the DCS relative to the benefits, have requested a mechanism that enables some deposit takers to effectively opt out of the DCS scheme, where:
- 37.1 they would not need to contribute to the DCS levy, and
- 37.2 be subject to less stringent prudential requirements compared to other classes of licensed deposit takers given a lower level of moral hazard.
- 38 For example many branches of international banks that operate in New Zealand concentrate on products and services for wholesale investors. Some have suggested they would prefer to being excluded from the coverage of the DCS and are willing to be subject (in exchange) to the restriction of not taking retail deposits. There are also some firms (finance companies) that do take retail investments from members of the public, but currently focus on doing so using ‘debentures’ which will not be defined as insured products under the DCS.
- 39 The proposed regulation-making power and the associated regulation making test would provide the flexibility to exempt certain classes of licensed deposit takers from the DCS (potentially including the cases described above). It is also expected to serve as a viable future-proofing approach, should any new types of deposit taking institutions and products emerge in future.
- 40 This recommendation effectively means that the Cabinet will rescind decision #29 referred in DEV-21-MIN-0078.

Liquidator’s obligations under the DCS

- 41 I propose that the Bill include clauses about liquidator duties under the DCS (in addition to those in the Companies Act 1993):
- 41.1 providing the Reserve Bank with access to records of the failed deposit taker, and records of the liquidator, to facilitate the calculation of entitlement and payout; and
- 41.2 providing the Reserve Bank with assistance to facilitate the calculation of entitlement and payout.
- 42 Furthermore, I also propose to provide the Reserve Bank with the power to apply to Court for the enforcement of those liquidator duties in a manner similar to section 286 of the Companies Act.
- 43 The additional duties for liquidators are required to support the functioning of the DCS. The duties will ensure the liquidator cooperates with the Reserve Bank so that the necessary information is obtained to determine and calculate the eligible compensation amount and facilitate the payout process.

- 44 The proposal to extend section 286 of the Companies Act to the Reserve Bank is to provide for an effective mechanism to ensure cooperation by the liquidator.

Privacy issues related to payout

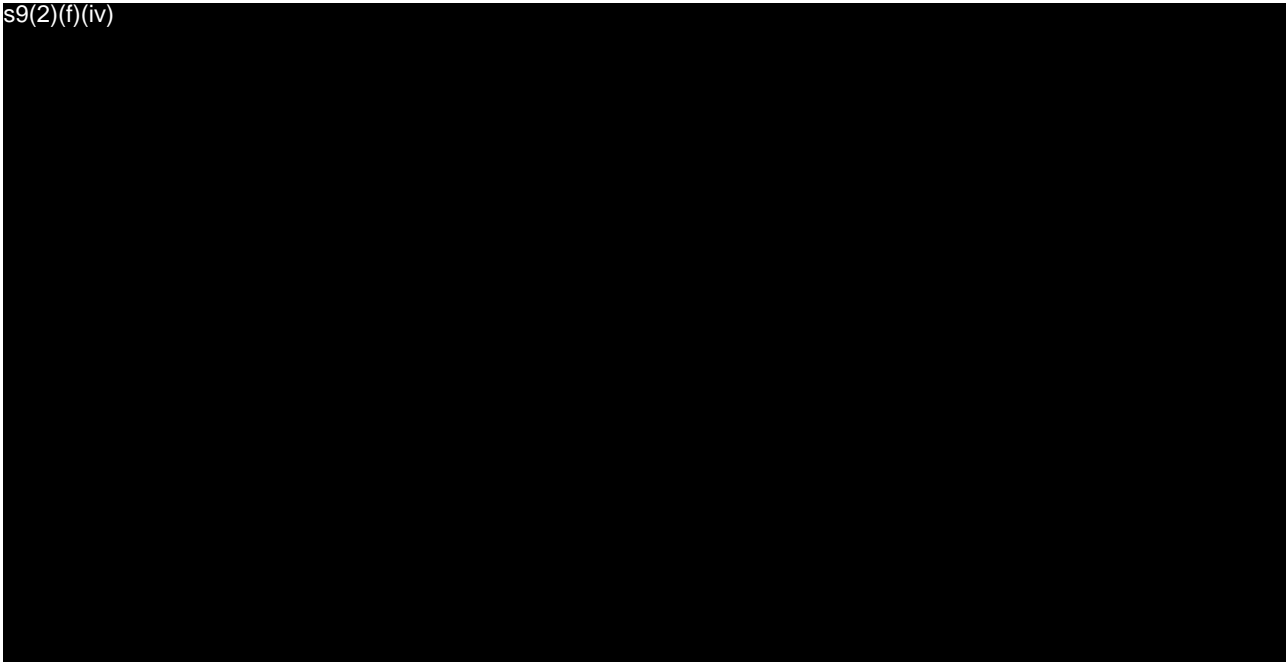
- 45 I propose that licensed deposit takers, account holders of 'bare trusts', and account holders of accounts held under 'relevant arrangement', will be provided with the power to disclose depositors' personal information with the Reserve Bank for DCS payout purposes, without requiring prior consent from depositors.
- 46 I also propose that the Reserve Bank will be provided with the power to pass necessary information (including personal information) to any other person if the Reserve Bank believes that the disclosure of the information is necessary to:
- 46.1 ascertain whether a person is an eligible investor who is entitled to compensation under the DCS
 - 46.2 calculate the person's entitlement to compensation under the DCS
 - 46.3 pay the compensation to, or on account of, the person.
- 47 To enable the payout process, relevant personal information of depositors will need to be provided by deposit takers to the Reserve Bank through a 'single customer view' file. This information may include full name, date of birth, address, alternative bank accounts, etc. For those accounts that will be treated by the 'look-through' approach to determine eligibility – account holders of bare trusts and accounts that are held under relevant arrangement (e.g. a lawyer's client account) – similar depositor information will also need to be shared with the Reserve Bank to identify eligible depositors and to determine the compensation entitlement under the DCS.
- 48 The Reserve Bank may need to subsequently share the information with another deposit taker, in the following scenarios:
- 48.1 having a deposit taker act as the paying agent on behalf of the Reserve Bank
 - 48.2 establishing a new account on behalf of eligible depositors with a viable deposit taker.
- 49 The power to disclose necessary personal information will override Information Privacy Principle 11 (IPP 11) in the Privacy Act, according to the interpretation of the Office of the Privacy Commissioner (OPC). The main purpose of this override is to ensure prompt payout under the DCS and to mitigate any potential risk to the DCS payout process due to licensed deposit takers or account holders of the aforementioned accounts failing to obtain consent from depositors before a payout event occurs.

- 50 OPC has been consulted and supports the policy intent of compensating depositors under the DCS. While IPP 11 of the Privacy Act does provide a solution to the privacy problems officials have identified, OPC agree this solution would be administratively burdensome for the Reserve Bank and deposit takers, such that the legitimate policy intent of compensating depositors would be frustrated. In these circumstance, a limited override of IPP 11 is justifiable. Officials, including OPC, will continue to discuss the issue to ensure that the override is limited to IPP 11, and that on the operational side, all involved parties understand their other responsibilities under the Privacy Act.

Clarification about compensation entitlement

- 51 I propose that the Bill includes a clause to ensure that the entitlement of an eligible investor may be reduced by any amounts received by, or that remain or become available to, the eligible investor after the quantification date.
- 52 This is to clarify that if a payout is triggered in respect of a firm, but eligible investors are still able to access some or all of their funds, it is not necessary for the DCS to repay those funds. This will avoid a situation where the depositor is effectively compensated twice, which may otherwise arise under current arrangements under the Reserve Bank's Open Bank Resolution (OBR) and potential interactions with the payout process under the DCS.

s9(2)(f)(iv)



Part 7: Crisis Management and Resolution

- 56 Part 7 of the Bill provides powers for the Reserve Bank to: issue directions to a deposit taker; remove, replace and appoint a director, and; powers for the resolution of a licensed deposit taker (or an associated person) that is in financial distress. Part 7 also provides for compensation to be payable to creditors or shareholders made worse off as a result of resolution (relative to outcomes that would have occurred through liquidation).

- 57 To support the crisis management and resolution framework other decisions have been taken (including under the delegation to me). These include:
- 57.1 **Public Finance Act 1989 amendment:** this enables the government to incur expenditure or inject equity without an appropriation to support a Reserve Bank regulated entity in financial distress (i.e. a deposit taker, insurer or financial market infrastructure), exercisable subject to various conditions.
- 57.2 **Ministerial direction power:** the parameters of a ministerial lever to direct the Reserve Bank in the management of public funds have been finalised, where the use of this power must not be inconsistent with the primary purposes of the resolution regime as specified in Part 7. That is, where I disagree with the Reserve Bank on how fiscal risks are being managed and I subsequently decide to use the power, this must not conflict with the resolution objectives of avoiding significant damage to the financial system and protecting eligible investors under the DCS.
- 57.3 **Ex post resolution levy:** I have agreed to the specification of a pre-positioned mechanism in the Bill that would enable the government to recover the costs of any public funds expended to support a deposit taker. The Bill would not require the power is used, or that all costs should be recovered. The power will be given effect through a regulation requiring consultation with affected entities, and it would have to stipulate the method for calculating the levy.

Resolution manager

- 58 The Deposit Takers Bill establishes a 'resolution regime' which allows failing deposit takers to be managed using special powers. Cabinet has agreed that the Reserve Bank, as Resolution Authority, will be accountable for the overall conduct and outcomes of a resolution, but the Reserve Bank has noted that for practicality reasons it is likely to rely on an appointed 'resolution manager' to handle day-to-day management of the firm in resolution. The exposure draft makes the resolution manager a delegate of the Reserve Bank, which puts accountability for their detailed actions onto the Reserve Bank and its board.
- 59 While this model makes accountability for the resolution process very clear, the Reserve Bank has expressed concerns around the potential for it to create legal risk and require substantial resourcing and board time. I am proposing to retain the 'delegate' model at this time, but have asked the Reserve Bank and Treasury to undertake further detailed policy work on mechanisms that could address the concerns expressed above.

No creditor worse off (NCWO)

- 60 I propose that the following two changes be made to the 'no creditor worse off' (NCWO) framework with respect to appeal rights:
- 60.1 appeal rights be limited to points of law only, and

60.2 appeals be permitted from the High Court to the Court of Appeal (with the permission of the Court of Appeal).

- 61 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 resolution (e.g. liquidation) [DEV-21-MIN-0079]. Further, in October 2021 Cabinet agreed to seven proposals detailing specific features of the NCWO mechanism, including that appeal rights on points of fact and law be available to prescribed persons in respect of determinations made by the independent valuer, subject to appropriate limitation periods (proposal 6) [DEV-21-MIN-0204].
- 62 Limiting appeal rights to points of law only, mitigates the risk that the High Court will simply be asked to substitute the opinion of one expert over another, which the High Court may not be well placed to assess due to the technical nature of NCWO matters.
- 63 Permitting appeals from the High Court to the Court of Appeal enables a second round of appeal should the determination by the independent valuer be initially upheld by the High Court, and to focus on a particular matter, with more careful argument. Furthermore, it is noted that a right to a second appeal is an important safeguard.

Other issues

Transitional issues

- 64 There will be a significant amount of work undertaken by the Reserve Bank to implement parts of the new prudential regime for deposit takers once the Bill has become law. A key feature of this implementation work is the development of standards and regulations, and the development of supervisory and enforcement models for deposit takers. Banks and NBDTs will not be required to comply with the full suite of new prudential requirements under the Deposit Takers Act until a future date after enactment (likely 2026). During this transition time, NBDTs will continue to operate under prudential requirements set under the NBDT Act 2013, and registered banks will continue to operate under the prudential regime under part 5 of the RBNZ Act 1989.
- 65 I have set an expectation for officials that the DCS should be up and running by late 2023 or early 2024 – roughly six months after the new Act is expected to be passed. This will mean that the DCS section of the legislation (Part 6 of the Bill) will come into effect no later than this point, before the Reserve Bank has developed all of the prudential requirements for the new deposit takers regime.
- 66 The Bill provides a degree of flexibility to determine when sections are commenced (through a commencement order made by the Governor-General acting on the advice and consent of the Executive Council). However, the Bill will also need to set out transitional provisions showing how licensed NBDTs

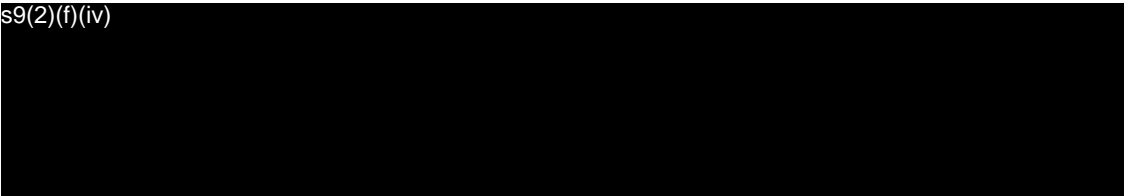
and registered banks will be transitioned to the new prudential regime under the new Act. In submissions on the exposure draft, banks and NBDTs expressed the need for a clear well-sequenced transition plan to the new regime.

- 67 I have agreed a preferred approach with the Reserve Bank on transitional issues. Firms will remain registered/licensed under existing legislation until the full suite of prudential standards are drafted (late 2026). From that point, all existing firms are treated as licensed under the new Act but only if they can demonstrate to the Reserve Bank that they meet certain core requirements associated with the new standards.
- 68 However, DCS coverage (Part 6 of the Bill) applies from the time the DCS is introduced and existing banks and NBDTs will be automatically part of the DCS. The power to exempt certain classes of firms from the scheme will also be available – subject to Cabinet agreement to the proposal in paragraphs 34-40 above. Prudential rules from current legislation apply until the full suite of new standards are brought into effect together. Supervision and enforcement powers from current legislation also apply, but with an option for new powers under the Deposit Takers Act to be brought into effect before the full suite of standards are in place. New applicants prior to the time the new Act is fully in force will need to initially license/register under current legislation, and must meet current rules and criteria. If a firm fails before the new Act is in force, the Reserve Bank will resolve the entity using current powers, unless Part 7 (Crisis management and resolution) is brought into effect earlier.
- 69 I consider that this approach provides simplicity and certainty for both industry and the Reserve Bank, and allows officials to focus efforts initially on DCS implementation.

Next steps

- 70 I will be seeking the Cabinet Legislation Committee's approval for the introduction of the Deposit Takers Bill, with the Bill implementing previous policy decisions made by Cabinet in April and October 2021, as well as the current set of decisions I am seeking from the Committee.
- 71 I anticipate that the Bill will be finalised for introduction in early August.
- 72 Based on that expected introduction date, I further anticipate that the Deposit Takers Bill will become law in or around July 2023. A further six months will then be required to implement the DCS (which I am prioritising for enactment) – including finalising relevant regulations, consulting and finalising the *Statement of Funding Approach*, consulting and finalising levy regulations, as well as the development of a public education campaign to support the Scheme. The Scheme is therefore planned to be operational around early 2024.

Financial Implications

- 73 The proposals in this paper build on the package of decisions made by the Cabinet Economic Development Committee in April and October 2021 on the Reserve Bank’s prudential and supervisory framework [DEV-21-MIN-0076, DEV-21-MIN-0077, DEV-21-MIN-0078, DEV-21-MIN-0079, and DEV-21-MIN-0204]. These decisions will have direct financial implications for the Reserve Bank since the new legislative framework underpins a more resource intensive approach to prudential regulation.
- 74 Cabinet has previously taken a decision to amend the Public Finance Act 1989 to provide for an authority to incur expenditure without an appropriation, under limited circumstances. This enables the Crown to provide public support to deposit takers, both prior to, and during resolution actions undertaken by the Reserve Bank. Any significant outlay of public funds – equity, loans or crystallisation of guarantees – may be subsequently recouped from the deposit taking sector via a pre-positioned *ex post* resolution levy in the Deposit Takers Bill. The outlay of public funds, if used at all, will be situation-specific, while the Minister of Finance will have discretion to determine whether some or all of the public expenditure will be recovered from the sector.
- 75 The DCS will also have indirect financial implications for the Crown. For example, a Government backstop for the scheme will create an explicit contingent liability. The backstop – a permanent legislative authority sitting in the Bill – supports a payout in the event the target fund size determined by the Minister of Finance’s *Statement of Funding Approach* has not been met with industry levies. This contingent liability can be quantified by the gap between the amount of levies collected from industry and the target fund size. The backstop may also be called upon when the DCS is used to support a resolution of a deposit taker, and where existing funds are insufficient.
- 76 s9(2)(f)(iv) 
- 77 A compensation obligation arising under the NCWO mechanism compensates creditors and shareholders of a deposit taker who are worse off in resolution, relative to a liquidation process. Compensation payments could have financial implications for the Crown, although in general, there will be an incentive for the resolution process to be conducted in a way that is not detrimental to the interests of creditors and shareholders. In the event they are made worse off, compensation may be met by the DCS fund, subject to safeguards. If these safeguards imply that the scheme’s funds are insufficient to cover all or part of the NCWO compensation payment, such payments will be met by the Crown through a permanent legislative authority situated in the Bill.

Legislative Implications

- 78 The recommendations in this Cabinet paper will be given effect by the Deposit Takers Bill. The Bill has a priority 4 in the 2022 Legislation Programme (to be referred to select committee in 2022).
- 79 The Deposit Takers Act will bind the Crown.

Regulatory Impact Statement

- 80 A Regulatory Impact Statement (RIS) for these decisions has been prepared by the Reserve Bank, and reviewed by an independent assessor from within the Reserve Bank. The assessor considers that it meets the Quality Assurance criteria.

Human Rights

- 81 My officials will be working with the Ministry of Justice in relation to the Bill to ensure that any concerns relating to the New Zealand Bill of Rights Act are addressed. For example, the BORA vetting will consider whether the proposed override for privilege is appropriate.

Population Implications

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

Consultation

- 83 An exposure draft of the 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 consultative Hui with banks and NBDTs, and met individually with several firms, in order to help support the sector's subsequent formal written feedback. Following the close of the consultation period the Reserve Bank undertook a number of workshops with industry to discuss their written submissions.
- 84 The following agencies were consulted on the contents of this paper: the Ministry of Business, Innovation and Employment; the Financial Markets Authority; Parliamentary Counsel Office; Ministry of Justice; and the Office of the Privacy Commissioner.

Communications

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

Proactive Release

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

Recommendations

The Minister for Finance recommends that the Committee:

- 1 **note** that Cabinet has previously agreed to proposals for a new framework for regulating and supervising deposit takers, and the introduction of a scheme to protect depositors from loss, for inclusion in a Deposit Takers Act [DEV-21-MIN-0076, DEV-21-MIN-0077, DEV-21-MIN-0078, DEV-21-0079, and DEV-21-MIN-0204].
- 2 **note** that an exposure draft of a Deposit Takers Bill was released for public consultation in December, with the Reserve Bank receiving 21 formal written submissions.
- 3 **note** that the Reserve Bank has been engaging with stakeholders on the substance of their feedback and detailed design issues for the new prudential framework and depositor compensation scheme, in the form of industry workshops and bilateral discussion.

Privilege settings

- 4 **note** that Cabinet [DEV-21-SUB-0077] noted the Reserve Bank's on-site inspection power would not function as a 'search and seizure power' but rather for the purposes of 'business-as-usual' supervisory monitoring.
- 5 **note** that Cabinet [DEV-21-SUB-0077] also noted that the Bill would not allow the Reserve Bank to compel privileged or self-incriminatory information from individuals.
- 6 **agree** that (contrary to the earlier position outlined in recommendation 5) the Bill should provide for the privilege against self-incrimination not be available to prevent the supply of information from individuals but this information may not be used as evidence against that person in prosecution except in cases when (subject to drafting):
 - 6.1 the person provides evidence inconsistent to an admission, refuses or fails to answer a question, or answers any question or supplies information in a way that is false or misleading in a material manner.
- 7 **note** that recommendation 6 overrides privilege against self-incrimination only, rather than privilege more broadly.

The 'large' assessment criteria for non-financial corporates

- 8 **note** that in April 2021, Cabinet agreed that that deposits held by large non-financial corporates should be excluded from the coverage of the DCS [DEV-21-MIN-0078].

- 9 **agree** to recommend that Cabinet rescind the decision referred to in recommendation 8, and instead agree that the 'large assessment' criteria for determining the eligibility of non-financial corporates under the DCS be removed.

The power to exempt deposit takers from the DCS

- 10 **note** that in April 2021, Cabinet agreed that membership of the DCS will be compulsory for all licensed deposit takers [DEV-21-MIN-0078].
- 11 **agree** to recommend that Cabinet rescind the decision referred to in recommendation 10, and instead agree that the Bill provides for a regulation-making power to exempt certain types of licensed deposit takers from the DCS on the advice of the Reserve Bank.
- 12 **agree** that there is a statutory test attached to the proposed regulation-making power, requiring consultation and suitable criteria relating to such matters as the nature of the deposit taking business and customers of the deposit taker, so that exemptions do not compromise the broad aims of the DCS.

Liquidator's obligations under the DCS

- 13 **agree** that the Bill include relevant clauses about the duties for liquidators under the DCS:
- 13.1 providing the Reserve Bank with access to records of the failed deposit taker, and relevant records of the liquidator, to facilitate the calculation of entitlement and payout; and
 - 13.2 providing the Reserve Bank with assistance to facilitate the calculation of entitlement and payout.
- 14 **agree** to provide the Reserve Bank with the power to apply to the Court for the enforcement of liquidator duties similar to section 286 of the Companies Act.

Privacy issue related to payout

- 15 **agree** that licensed deposit takers, account holders of 'bare trusts', and account holders of accounts held under 'relevant arrangement', will be provided with the power to disclose depositors' personal information with the Reserve Bank for DCS payout purposes, without requiring prior consent from depositors.
- 16 **agree** that the Reserve Bank will be provided with the power to pass necessary information (including personal information) to any other person if the Reserve Bank believes that the disclosure of the information is necessary to:
- 16.1 ascertain whether a person is an eligible investor who is entitled to compensation under the DCS

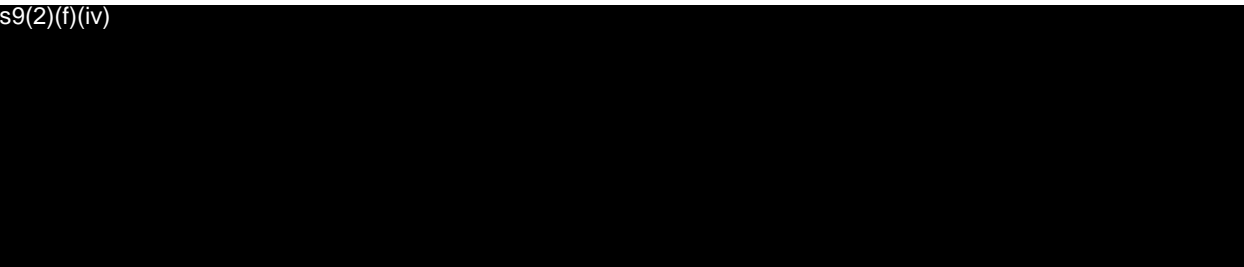
16.2 calculate the person's entitlement to compensation under the DCS

16.3 pay the compensation to, or on account of, the person.

Clarification about compensation entitlement

17 **agree** that the Bill include a clause that the entitlement of an eligible investor may be reduced by any amounts received by, or that remain or become available to, the eligible investor after the quantification date.

s9(2)(f)(iv)



Resolution manager

19 **note** that the Reserve Bank and Treasury will undertake further detailed policy work on the resolution manager issue to consider what mechanisms could address Reserve Bank concerns around the resolution manager acting purely as a delegate of the Reserve Bank.

No creditor worse off (NCWO)

20 **note** that the Bill includes an NCWO mechanism built on previous decisions by Cabinet (DEV-21-MIN-0204), which included a decision that appeal rights on points of fact and law shall be available.

21 **agree** to recommend that Cabinet rescind the decision referred to in recommendation 20, and instead agree that appeal rights with respect to NCWO determinations made by the independent valuer be limited to points of law only.

22 **agree** that appeals on NCWO determinations from the High Court to the Court of Appeal be permitted (with the permission of the Court of Appeal).

Transitional issues

23 **note** that banks and NBDTs will not be required to comply with the full suite of new prudential requirements under the new Deposit Takers Act until 2026, except those tied to the DCS which I expect to be operational around six months after the passage of the new Act.

24 **note** that banks and NBDTs will remain registered/licensed under existing legislation until the full suite of prudential standards come into force, and from that point all firms will be treated as licensed under the new Act if they can demonstrate they can meet certain core new requirements.

Other matters

IN CONFIDENCE

- 25 **invite** the Minister of Finance to issue further drafting instructions to the Parliamentary Counsel Office to give effect to the proposals in this paper.
- 26 **agree** that Cabinet's decisions and this paper be publicly released.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance