

21 February 2022

**To**

David Hargreaves  
Reserve Bank of New Zealand

**From**

General Finance Limited  
Gold Band Finance Limited  
Finance Direct Limited  
Mutual Credit Finance Limited  
Xceda Finance Limited  
(together, the **RBNZ Regulated Fincos**)

**By Email**

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Dear David

**Deposit Takers Exposure Draft - submission on matters relevant to RBNZ Regulated Finance Companies**

This letter supplements the joint initial submission made on behalf of CUBS NZ members and the RBNZ Regulated Fincos. It is intended to raise and submit on issues in the Exposure Draft of the Deposit Takers Bill (**Bill**) that specifically affect the RBNZ Regulated Fincos, or to expand on the matters where this group feels that the RBNZ Regulated Fincos can provide additional context and experiences.

**VALUE OF THE DEPOSIT TAKING FINANCE COMPANY SECTOR**

*RBNZ Regulated Fincos v banks*

We note that the Governor of the Reserve Bank of New Zealand (**RBNZ**) acknowledged during the Hui on 3 February 2022 that the approach of many banks to certain regulation (such as macro-prudential policies and the recent CCCFA changes) has been an approach of "de-risking by de-banking" which is a fundamental threat to core objectives of the RBNZ such as promoting the prosperity and wellbeing of New Zealanders and contributing to a sustainable and productive economy.

In contrast, the RBNZ Regulated Fincos serve specific market niches as specialist lenders. Our view is that Paul McBeth's comment in his article *Jumping the loan shark* on 21 January 2022 articulates the value we add as specialist lenders in improving core objectives of the RBNZ such as financial inclusion when he wrote (about the characterisation of certain elements of our sector as "loan sharks"):

*"It's an unfair generalisation because there is a group of lenders who cater for the thousands of people the banks won't touch ... they often provide much better budgeting support to people who have nowhere else to turn, including an often unforgiving welfare system."*

We believe that it is beneficial to both the soundness *and* the efficiency of the financial system to have a regulatory landscape that facilitates specialist lenders. This enables the sector to benefit from their detailed knowledge and understanding of the risk profile of certain market niches and ability to cater to

those customers. Specialist lenders are in a better position to carefully manage specific types of risk without resorting to de-banking people. Larger banks are not incentivised to develop this specialist expertise because they have sufficient demand from other customers and less agility in their systems to cater to specific market niches.

Facilitation of specialist lenders is consistent with both the goal of facilitating financial inclusion and promoting diversity in the financial sector because it enables specialist lenders to offer innovative products to cater to a range of market niches and reduces the risk of the whole financial sector supplying a homogenous product set that does not meet the needs of all New Zealanders.

#### *Retail v wholesale deposit taking finance companies*

We have concerns about a comment made during the Hui that incumbent non-bank deposit takers (**NBDTs**) have the option of "consolidating or moving to wholesale funding" if the new standards are "too intense". We would like to emphasise that there is value in a retail funded finance company sector. In particular, our view is that taking an approach to standards that the RBNZ acknowledges may force incumbent NBDTs to move to a wholesale funded model does not achieve good outcomes for a number of reasons:

- (a) the only thing it achieves is shifting all existing risk to unit trusts and warehousing arrangements, which shifts any risk away from the RBNZ as regulator but does nothing to manage or mitigate any underlying risk to financial stability;
- (b) it essentially locks out any new entrants – if standards are so high that incumbents cannot sustain the resources needed to meet them, what hope is there for new entrants – which undermines the RBNZ's stated goal to facilitate a rich, colourful, diverse and competitive financial sector; and
- (c) there are systemic risks associated with an exclusively wholesale funded model which was demonstrated during the Global Financial Crisis (**GFC**). It is crucial during counter-cycles that lenders demonstrate a willingness to lend to the real economy in order for the economy to recover – but in order to lend, a source of funding is needed. In the case of wholesale funded lenders, there is a significant risk that funding will dry up overnight during a counter-cycle, leaving them unable to lend (or at least to the level needed during a counter-cycle). During the GFC, the government was forced to introduce the wholesale funding guarantee facility because of fears of a cash dry-up as overseas investors stayed clear of any lender that did not have a government guarantee. While there is certainly a place for wholesale funded finance companies in a rich, colourful, diverse and competitive financial sector, our view is that there are risks in essentially forcing all finance companies to be wholesale funded and that a truly rich, colourful, diverse and competitive financial sector would enable both retail and wholesale funded finance companies to thrive.

On the basis of the clear benefits of having retail funded specialist lenders, we wish to emphasise that we can only continue to operate if the regulatory regime enables economically viable and profitable business models. While some tweaks may be warranted, the existing prudential standards contained in the NBDT Regulations and our trust deeds are appropriate and broadly fit for purpose for this sector and should not

be changed in any manner that increases our regulatory burden. In particular, our strong view is that the Bill should:

- (a) expressly provide that the existing prudential obligations of NBDTs will be converted into standards and only changed via the legislative process of amending standards (and we are happy to work with the RBNZ in converting the contents of our trust deeds, which differ in some respects, into an acceptable common standard); and
- (b) expressly prohibit the RBNZ from imposing lending standards, macro-prudential policy standards, loan concentration or lending exposure requirements on our sector (or on deposit takers of our size or market share) on the basis that any lending standards that could essentially prohibit businesses from specialising in certain market niches directly conflicts with the principles of competition and recognition of diversity and could have the unintended consequence of financial exclusion.

### **GFC to now**

We acknowledge and appreciate the comments made by the Governor that the RBNZ does value our sector and sees it as an integral component of a rich, colourful, diverse and competitive financial sector. It remains a concern to us that we are associated with the events of the GFC. The RBNZ Regulated Fincos are prudentially regulated by the RBNZ and do not resemble the finance companies pre-GFC. The remaining retail deposit taking finance companies all existed during, and withstood the impacts of, the GFC and are those that proved their ability to appropriately balance their business objectives with sound and prudent financial management – both before being prudentially regulated and during the NBDT Act era. We have proven ourselves to be entirely capable of operating in an efficient but also prudent and trustworthy manner during the last two significant counter-cycles (GFC and Covid), all with less regulatory support than was given to larger banks.

We take the RBNZ's note during the Hui that it is important that the deposit taking sector earns the trust of the public, and we feel that this sector has done what was needed to earn that trust and should be recognised for their own actions over the past ten years, not the actions of failed finance companies of the past.

We believe that, while it was understandable and probably appropriate for our sector to become prudentially regulated, it is possible that the events of the GFC might have resulted in a bit of an "overcorrection" in the regulatory burden imposed on our sector, relative to our size. Our view is that this is evidenced by the lack of new entrants into the NBDT sector since the NBDT Act was passed. We wish to re-iterate our submission that the Bill should be used as an opportunity to remedy this overcorrection, not exacerbate it.

### **RESTRICTED DEPOSIT TAKER REGIME**

In our submission dated 22 October 2020 (**2020 Submission**), we suggested that the Bill create a Restricted Deposit Taker category based on Australia's RDI regime. We would be interested in receiving from the RBNZ a detailed rationale as to why this suggestion was not implemented in the Bill. Particularly in light of a comment made at the Hui that the RBNZ would be reluctant to use the exemption power in

Schedule 2 of the Bill to exempt incumbent NBDTs on the basis that it would represent a full exemption from all prudential obligations.

The issue the RBNZ has raised with exempting an incumbent NBDT in full could be eliminated by creating a Restricted Deposit Taker category, which would not involve that deposit taker being completely removed from the regime – instead it could involve imposing lesser standards for a period of time accompanied by lesser benefits (for example, being excluded from depositor compensation or not being permitted to use restricted words).

## **UNPROTECTED DEBT SECURITIES**

We suggested in our 2020 Submission that deposit takers be given the option to offer "unprotected" debt securities – that is, debt securities that resemble protected deposits with the main difference being that this specific class of debt security will not be compensated by the fund in the event of failure (likely with some form of financial premium offered to the customer for accepting the additional risks associated with this product).

We understand that we would need to very clearly advertise to our customers the difference between a "protected deposit" and an "unprotected" debt security and ensure that our customers understand the implications of accepting the "unprotected" debt security. We are prepared to do that and work with the RBNZ on an appropriate framework to facilitate this. Given the significant uncertainty regarding the cost that will be imposed on this sector by the fund levies, our view is that we should have an option to offer "unprotected" debt securities. This would reduce the overall amount that would need to be paid out to our customers in the event of a failure and therefore, we expect, reduce the levies that should be charged to us.

## **REBRAND**

We have previously indicated that we might consider rebranding our sector. Our view is that it would be appropriate to enable us to rebrand our sector using a restricted term. We note that the Review Team appeared to be reasonably comfortable with this and that Cabinet supported restricted terms being used by all licenced deposit takers. However, this is not reflected in the Bill. We request that the RBNZ revert to the policy position that we understood was agreed to by Treasury and Cabinet to enable all licensed deposit takers to use restricted terms, which would enable us to rebrand in the manner previously discussed, if we choose.

Yours faithfully

**RBNZ Regulated Fincos**