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Dear David,

ASB Bank Limited (**ASB**) **submission on the Exposure Draft of the Deposit Takers Bill** (**the Bill**)

ASB's purpose is to accelerate the financial progress of all New Zealanders. We therefore welcome legislative changes that aim to create a trusted and consistent regulatory framework for banks and other deposit taking institutions, promote financial stability, and support the economy. ASB supports the purpose of the Bill to promote public confidence in the financial system.

We have appreciated the open and constructive discussion with the Reserve Bank (**RBNZ**) policy team as we have reviewed the Bill and sought to understand how aspects of the Deposit Takers Act (**DTA**) will be implemented. We look forward to continuing to engage closely with you as the legislation is developed ahead of its introduction to Parliament.

We are concerned that the Deposit Takers Act will fail to deliver one of its key aims, of promoting public confidence in the financial system, if the new Deposit Compensation Scheme (**DCS**) is poorly designed or if deposit takers do not have enough time to meet the new DCS rules in a way that works best for our customers.

Our key requests, having reviewed the Bill within the tight timeframe, are that:

1. a further consultation round is undertaken prior to the Parliamentary introduction of the Deposit Takers Act, with additional detail available on how the DTA will operate in practice;

2. the RBNZ commits to a consultation schedule that allows time for industry to provide considered feedback on the extensive Regulations, Standards (subpart 2 of Part 3 of the Bill), the Statements

of Approach to Funding and Resolution (subpart 7 of Part 6 and s274 respectively) and any supporting guidance (the "**supporting documents**");

3. this consultation schedule ensures the supporting documents are finalised well in advance of implementation deadlines; and

4. deposit takers are given more time to implement the changes required by the DTA, once it is enacted.

These measures are required because:

1. The Bill does not provide information on how the DTA will operate in practice. This critical information will be provided in the supporting documents – which are not yet drafted. For example, the Bill requires that deposit takers pay a DCS levy, but we have no information on how the levies will differentiate between conservatively managed and riskier deposit takers, or what the target size of the DCS fund will be. And Part 7 of the Bill provides the RBNZ with a range of resolution powers, with detailed information still to follow on how and when resolution tools will be used, how these will interact with the existing Open Bank Resolution (**OBR**) mechanisms and how the DCS levy could be used to both fund resolution powers and pay out in the event of a liquidation. Without this information, consultation can be only partly effective.

2. Aspects of the Bill are operationally unworkable. There are fundamental aspects of the Bill that require amendment prior to Parliamentary introduction. These include multiple design aspects of the DCS, such as the proposed move to a 'single customer view' involving some complex look through requirements, the multiple eligibility carve outs in the Bill and the fact that depositors' eligibility for the DCS can change over time.

3. Even once unworkable aspects of the Bill are addressed, the changes will be highly complex and require large-scale implementation work. There are long lead times for us to make changes to core banking systems, even when we afford a very high priority to regulatory changes. System changes can only be made once all the relevant requirements – set out in the supporting documents – are finalised. And these changes will need to be implemented alongside the considerable volume of other significant regulatory change projects required in the sector, which are currently challenging to resource.

Our enclosed submission provides further detail on the above and includes recommendations as follows:

1. Set a later target date for implementation, to allow for informed consultation based on clear requirements and orderly, consistent industry implementation.
2. Simplify DCS eligibility.
3. Clarify the interplay between new and existing resolution tools (including OBR), use of the DCS, and Statutory Management.
4. Set risk-based levies to address moral hazard risks and maintain efficient markets.
5. Remove the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 from the definition of prudential obligation.
6. Consult on the investment of the DCS fund.
7. Launch a centrally run consumer education campaign on the DCS.
8. Design well-sequenced, logical transitional arrangements and share details well in advance.

We look forward to discussing this with you and continuing to work with you closely as you develop this important regulatory change.

In addition to the enclosed ASB submission, we have worked closely with the New Zealand Bankers' Association (**NZBA**) on their submission. Our submission intentionally focusses to a greater extent on operational, implementation-related feedback and we hope this is a useful complement to the NZBA submission.

If you require any further information in relation to this submission, please do not hesitate to contact Jennie Cade, Senior Manager, Government Relations and Regulatory Affairs (jennie.cade@asb.co.nz).

Yours sincerely,

Jon Raby
CFO
ASB Bank

Enc: ASB Submission

ASB submission – Exposure Draft of the Deposit Takers Bill

ASB Bank Limited (**ASB**) fully supports the intent set out in the Exposure Draft of the Deposit Takers Bill (the **Bill**) to promote the safety and soundness of deposit takers; to promote public confidence in the financial system; and to avoid or mitigate the adverse effects of both risks to the stability of the financial system and risks from the financial system that may damage the broader economy.

While the capitalisation of New Zealand banks is on track to be amongst the highest in the world, it is nevertheless important that:

- depositors have confidence that there is a safety net in the event their deposits are held by an institution that finds itself in financial distress;
- the operation of this safety net is – from the outset – clear, well-understood and efficient;
- financial stability is not threatened by significant inflows of funds to deposit takers with less robust capital and liquidity management practices;
- regulation of deposit takers does not stifle innovation and progress in the industry; and
- there is appropriate alignment between New Zealand and comparable overseas jurisdictions, to facilitate continued support by investors in New Zealand's financial sector.

The following feedback begins in section A by highlighting instances in which these important outcomes may not be supported by the Bill and the proposed implementation of the Deposit Takers Act (**DTA**). In Sections B and C we provide feedback on changes to the Bill and considerations for implementation.

Section A: Focus areas for further urgent and detailed industry consultation

1. *Set a later target date for implementation, to allow for informed consultation based on clear requirements and orderly, consistent industry implementation*

Recommendation: Deposit takers must be given sufficient time both to understand and input into the design of these complex changes and to implement them. Many provisions in the Bill are not yet clear, either because definitions are unclear or because detail is lacking. Deposit takers need adequate implementation time following finalisation of secondary legislation, Standards, and any associated guidance, rather than roll-out timescales set with reference only to enactment of the DTA. Although ASB has and will continue to give high priority to work required to meet our regulatory obligations, the currently anticipated timescales would make it extremely challenging to implement and comply with these complex requirements.

Rationale: Without appropriate, considered consultation as to the design of the new regime and logically sequenced implementation requirements for deposit takers, the DTA is unlikely to achieve its stated purposes, particularly to promote public confidence in the financial system. If the DTA, secondary legislation, Standards and any associated guidance are not finalised in good time, then implementation will be put under pressure, potentially leading to inconsistent approaches across deposit takers. And if these documents are not drafted early enough to allow for considered consultation there is a risk that the law would not be drafted consistent with the intent of the Bill. The Directors' Due Diligence Duty under s88 applies in relation to 'prudential obligations', which seem

broad and will not be defined until the DTA, secondary legislation, Standards and any conditions of licence are known.

The design and implementation of the DTA will be a significant project, requiring changes to core and critical bank systems. These changes will need to be implemented alongside other significant regulatory change projects, the number and scale of which reflect the continued uptick in regulatory change in the sector and are resulting in critical banking platforms being subject to a high degree of change. For example, compliance with the BS11 (outsourcing) policy, potential upcoming changes to the Credit Contracts and Consumer Finance Act 2003 regulations and tax changes. Furthermore, specialist resources such as compliance professionals and technology specialists are already scarce, meaning it is currently unfeasible to meet tight implementation timescales by hiring additional staff. Implementation may also need to be managed alongside future COVID-related business impacts.

Suggested solution/drafting: We ask that the RBNZ revisit the currently stated timescales urgently. The operationally focussed industry working group the RBNZ Policy team has offered to facilitate will be able to help the RBNZ assess the timescales that will best support successful implementation and transition. Once we have a fuller understanding of the implementation task ahead, we will be able to advise of specific timescales.

2. Simplify Deposit Compensation Scheme eligibility

Recommendation: Eligibility of depositors and look through arrangements for calculation of entitlement for the Deposit Compensation Scheme (**DCS**) should be simplified substantially to support public confidence in the scheme. Depositors will need to be able to understand easily if their money is protected.

Rationale: The carve outs in the Bill, although reasonable in some cases, add significant complexity for both customers seeking to understand their eligibility for the DCS and for deposit takers implementing the SCV. It is not clear that the benefits of these carve outs outweigh the cost of the complexity. For example, the definition of eligible investor excludes certain 'large' persons, which appears unnecessary given the $100,000 limit on DCS payouts.

The Bill would also see 'large depositors' moving in and out of the definition of an eligible depositor, which could also undermine public understanding and confidence in the scheme and creates practical operational difficulties for deposit takers.

The move away from the current account-based view to an additional or replacement single customer view (**SCV**) will be particularly challenging, involving complex 'look through' requirements. Any legal structure in which asset ownership is not easily ascertainable will make establishing the look through arrangements for the SCV exceedingly time consuming for customers and deposit takers. There will be a wide range of entities in which asset ownership details are not readily available or easily ascertainable. A similar complexity was encountered with the implementation of the Liquidity Policy (BS13) customer aggregation reporting. The 2019 RBNZ Liquidity Thematic review identified discrepancies and interpretation results which highlighted the need for well-considered and precise definitions.

The regulation-making power that would allow deposits in excess of $100,000 to be protected (if they are temporary high balances e.g., from an insurance payout or property sale) would introduce further complexity and it is not clear how this could be made to work.

Suggested solution/drafting: The drafting of the DCS eligibility provisions of the Bill should be reconsidered through the lens of implementation complexity and customer understanding. The definitions of protected deposit and eligible investor should be simplified, with carve outs included only as essential to the purpose of the DCS. A proportionate approach must be permitted e.g., deposit takers should not be required to undertake large-scale customer contact exercises to back fill information on existing accounts; and deposit takers should be able to make payments to named account holders rather than attempting to ascertain complex asset ownership details.

There are overseas schemes that appear to take a simpler approach to eligibility, and that the RBNZ may wish to consider. For example, under the Australian Financial Claims Scheme, eligible depositors are determined by reference to whether they meet the definition of an "account holder". This term includes categories, like an individual, a body corporate, a partnership, the trustees of a trust. And in Canada, deposit protection is determined with reference to a clear list of product types, such as savings and chequing accounts, term deposits and travellers' cheques.

3. *Clarify the interplay between new and existing resolution tools (including Open Bank Resolution), use of the Deposit Compensation Scheme, and Statutory Management*

Recommendation: For effective consultation on Parts 6 and 7 the Bill (Deposit Compensation Scheme and Crisis Management and Resolution respectively), the RBNZ must clarify how it expects to implement the resolution powers in the Bill and how they will work alongside existing resolution tools and the Statutory Management regime. It is essential stakeholders have a clear understanding of the RBNZ's rationale for expected continued use of Open Bank Resolution (**OBR**) and how this is expected to interact with the DCS, new resolution powers in the Bill and the statutory management regime under the Corporations (Investigation and Management) Act 1989 (**CIMA**). Without this, industry consultation cannot properly assist the RBNZ in identifying unintended consequences or potential poor outcomes for consumers and financial stability.

ASB recommends that the RBNZ provides information to deposit takers and other interested parties on the expected continued use of OBR after the DCS is established. The RBNZ should expect deposit takers, consumers, investors and others to require a reasonable level of detail in order to be able to (a) engage fully with the development of the Bill; and (b) begin appropriate preparations to comply with the Bill's provisions.

Rationale: There is not widespread awareness of how the RBNZ expects to implement the resolution powers in the Bill. We have several questions and concerns based on our current understanding, which we will continue to discuss with the policy team and at the planned industry workshops. These include whether a DCS payout to eligible investors could follow an OBR process; how OBR and DCS would be used for different types of deposit takers; how the SCV would be expected to work following an OBR process; and how the guarantee of unfrozen funds under OBR would interact with any DCS payout, where customers may have received guaranteed access to 'unfrozen' account balances under OBR, calculated on a different basis to what the DCS would provide.

The Bill allows for resolution tools to be used provided the RBNZ is satisfied the use of these tools will ensure the deposit taker will remain solvent and costs don't exceed those of a hypothetical liquidation (s218). However, the Bill does not deal explicitly with a scenario in which the use of resolution tools fails to achieve the continued solvency of a deposit taker. S221 suggests the DCS fund may allow for the DCS fund to pay out twice: once to fund the use of resolution tools and again to compensate eligible investors in the event the resolution tools are not effective and the deposit taker is placed in liquidation. It is not clear whether this reflects the intended operation of the DCS.

OBR is currently out of step with overseas jurisdictions because it bails in retail depositors prior to liquidation. The process of bail-in proposed in the Bill is very different to offshore jurisdictions like the UK and Canada. There, recapitalisation is scheduled over a weekend where certain 'known liabilities' are bailed in (excluding depositors) then, only if this is insufficient, is the bank then placed into liquidation. At this point, the overseas deposit compensation scheme pays out to insured depositors as a matter of priority. The overseas deposit compensation scheme then replaces the depositors as a creditor and losses are attributed to all creditors through the liquidation process.

New Zealand will deviate further from international practice if it intends to move to a system with a resolution tool (OBR) that bails in retail depositors and a subsequent DCS that then compensates them. It is not clear why New Zealand should depart from international practice and any unusual features of the New Zealand resolution landscape will need to be carefully managed by deposit takers with their investors.

Suggested solution/drafting: RBNZ to clarify how it expects to implement the resolution powers in the Bill and how they will work alongside existing resolution tools and the Statutory Management regime. Once the RBNZ has set out these details to deposit takers and other interested parties such as investors and law firms, they will be able to comment on the RBNZ's proposed interplay between these resolution tools. This dialogue will help inform whether the drafting of the Bill requires amendment and/or if secondary legislation and guidance is needed to assist deposit takers' implementation preparations. We would also welcome a discussion on the RBNZ's consideration of how their resolution approach would differ from comparable overseas jurisdictions and the rationale for any differences.

4. *Set risk-based levies to address moral hazard risks and maintain efficient markets*

Recommendation: In preparing the levy advice to the Minister, RBNZ should ensure the range of levies payable by different deposit takers will be wide enough to reflect the full range of risk profiles. The basis point range for levies should align with other mature markets internationally. The RBNZ should also in their levy advice consider a broad set of factors and metrics to inform levies and *"ensure there is a meaningful distinction between premium categories to act as an incentive for banks to improve their risk profile"*[1]. For example, creditworthiness, capital, liquidity and funding, asset quality, business model and strategy, and governance. ASB recommends RBNZ and industry together consider the 'Guidelines on Methods of Calculating Contributions to Deposit Guarantee Schemes' published by the European Banking Authority[2] and various resources available from the International Association of Deposit Insurers.

Rationale: As submitted previously, a well-designed, risk-based levy system mitigates the financial stability and moral hazard risks associated with deposit compensation. We therefore welcome the provisions in the Bill that set out the principle that levies will be based on the likelihood of a deposit taker of each class being put into liquidation or entering resolution. Although the RBNZ has clearly articulated the levy should be risk-based, industry will have no information as to how the levy will be calculated, changed, and collected until the Statement of Funding Approach is consulted on.

Suggested solution/drafting: ASB would be happy to work with the RBNZ ahead of and during the levy advice consultation work and assist with any input required for the Minister's Statement of Funding Approach.

[1] International Association of Deposit Insurers (IADI) Differential Premium Paper, 31 October 2011
[2] EBA-GL-2015-10 GL on methods for calculating contributions to DGS.pdf (europa.eu)

Section B: Changes to the Bill

5. Remove the Anti-Money Laundering (AML) and Countering Financing of Terrorism (CFT) Act 2009 from the definition of prudential obligation

Recommendation: The definition of prudential obligations should be amended to remove AML/CFT.

Rationale: Including the AML/CFT in the definition of prudential obligation creates unnecessary dual legislative obligations in relation to the same matters. For example, the Bill as drafted would duplicate the on-site inspection powers in the AML/CFT Act. The definition of prudential obligations drives the scope of the Directors' Due Diligence Duty under s88.

Suggested solution/redrafting: Delete part (e) of the definition of 'prudential obligation' in s6 (Interpretation)

6. Management of the DCS fund

Recommendation: To provide confidence in the resolution regime, the requirements for the investment of the DCS fund should be consulted on.

Rationale: Public confidence in the DCS would be damaged were the investment of the part of the DCS fund not immediately required for expenditure to perform poorly.

Suggested solution/drafting: The Statement of Funding Approach should have regard to the risk of a poorly performing DCS fund when setting the requirements for the investment of the fund. The consultation on the Statement of Funding Approach should include the investment proposals.

Section C: Considerations for implementation

7. Consumer education campaign on the DCS

Recommendation: In the run up to launch of the DCS, we suggest the RBNZ and industry run a centralised campaign to educate Kiwis on the changes and what the DCS means for them.

Rationale: A sound public awareness of the DCS will help support the legislative intent of increased public confidence.

Suggested solution: RBNZ liaise with deposit takers and industry bodies to agree the key success measures of any education campaign and work together on design.

8. Well-sequenced, logical transitional arrangements need to be set out well in advance

Recommendation: We understand the RBNZ's intention to manage transitional arrangements through the power to bring provisions of the DTA into force at different times via Orders in Council

following enactment. While we support phased implementation, changes should not be introduced in a piecemeal way that would require costly and unnecessary rework. We submit that implementation dates should not be tied to the passing of the Bill, but to the publication of secondary legislation, guidance, and Statements of Approach.

Rationale: Given the substantial implementation task ahead, we support a 'do it well, do it once' approach to transition. Implementation should be timed in relation to the finalisation of secondary legislation, guidance, and Statements of Approach because these, not the DTA, provide the vital information deposit takers will need to ensure compliance.

Suggested solution: RBNZ to provide more information on proposed transitional arrangements to inform banks' implementation planning and facilitate future consultation.