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Exposure draft of Deposit Takers Bill

Dear Mr Hargreaves

The International Capital Market Association (**ICMA**)[1] and the International Securities Lending Association (**ISLA**)[2] are grateful for the opportunity to make a submission on the exposure draft of this Bill.

Background

ICMA and ISLA are global industry associations that support participants in, and encourage the development of, the repo and securities lending markets, respectively.

ICMA's and ISLA's interest in the Bill stems from their commission of legal opinions, on behalf of their members, addressing among other things the enforceability of close-out netting and securities enforcement rights in the insolvency of New Zealand counterparties. Given that New Zealand registered banks are significant and active participants in the repo and securities lending markets, ICMA, ISLA and their members are naturally interested in any proposed legislation that will affect the enforceability of those rights. Changes to the perceived legal risk attaching to counterparty types,

1 ICMA is a membership association, headquartered in Switzerland, committed to serving the needs of its wide range of members. These include private and public sector issuers, financial intermediaries, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others worldwide. ICMA currently has more than 550 members located in over 60 countries. ICMA brings together members from all segments of the wholesale and retail debt securities market, through regional and sectoral member committees, and focuses on a comprehensive range of regulatory and market practice issues which impact all aspects of international market functioning. ICMA prioritises four core areas – primary markets, secondary markets, repo and collateral markets, and the green and social bond markets.

2 ISLA is a leading industry association, representing the common interests of securities lending and financing market participants. Its geographically diverse membership of over 150 members includes institutional investors, asset managers, custodial banks, prime brokers, and service providers.

Working closely with the global industry as well as regulators and policymakers, ISLA advocates the importance of securities lending in the context of broader capital markets. ISLA supports the development of a safe and efficient framework for the industry, by playing a pivotal role in promoting market best practice, amongst other things.

such as registered banks, are factored into the decision of whether to trade with such counterparties and, if so, on what terms.

ICMA and ISLA are aware the submission they make below has also been made by another global industry association — the International Swaps and Derivatives Association, Inc. (**ISDA**). That is understandable given the three associations share many of the same objectives and, indeed, many of the members of ISDA are also members of ICMA and ISLA. The three associations and their members are united in their view that the clarification sought in the submission below is essential for overseas entities to fully assess their legal position upon the insolvency of their New Zealand bank counterparties.

Submission

From the perspective of the repo and securities lending industry, clause 279 is a very significant provision. It provides for an exception to the moratoria in clauses 270(1) and 273(2) in the case of a "derivative" or a "relevant security interest". In the absence of this exception, a repo or securities lending counterparty may face a statutory stay on its ability to exercise its close-out netting and security enforcement rights in the resolution of a licensed deposit taker.

A key to obtaining the benefit of this exception is ensuring each transaction entered into between the parties (e.g., under a Global Master Repurchase Agreement (**GMRA**) or Global Master Securities Lending Agreement (**GMSLA**)) is a "derivative". In this regard, it is unclear whether repos and securities lending transactions are "derivatives".

ICMA and ISLA do not propose to delve into the legal analysis for and against this proposition, other than to note two things:

(a) First, in Australia, there are differing views within the legal profession as to whether repos and securities lending transactions are "derivatives" within the meaning of section 761D of the Corporations Act 2001. This is significant because the New Zealand definition (in section 8(4) of the Financial Markets Conduct Act 2013 (the **FMCA**)) is substantially based on that Australian definition. Therefore, it is reasonable to expect the uncertainty in Australia to exist in New Zealand also.

(b) Secondly, one (entirely plausible) interpretation of the "derivatives" definition produces a meaning that goes well beyond what was no doubt intended. For example, given the breadth of section 8(4)(a)(iii) of the FMCA, guarantees and indemnities should be "derivatives". That such an interpretation is plausible then raises the question of how the definition should be sensibly read down to give it its intended effect. That is not a question that should be left for lawyers to debate, at least in the context of high-value financial instruments such as repos and securities lending transactions that are a key part of the global financial markets.

Just as is the case for 'true' derivatives, it is critical to the effective operation of the GMRA, the GMSLA, and similar agreements that a non-defaulting party be able to exercise its close-out netting and security enforcement rights in the insolvency of its counterparty. That would be jeopardised if, in the case of a licensed deposit taker, there is an argument that rights in relation to repos and securities lending transactions do not qualify for the same protections as apply to 'true' derivatives. There is no policy reason for such a distinction to be drawn. Not extending the clause 279 exception to repos and securities lending transactions could have the same serious consequences for the financial markets that justify the exception for 'true' derivatives.

It would clearly be an undesirable outcome to allow this uncertainty to continue (or to suggest there should be a differential treatment among these financial market products). Accordingly, ICMA and ISLA submit clause 279 should apply to repos and securities lending transactions.

There are at least two ways this clarification could be made.

(a) Ideally, section 8(4)(b) of the FMCA would be amended to expressly include repos and securities lending transactions in the list of transactions that are "recurrently entered into in the financial markets in New Zealand or overseas". That approach would then have the ancillary effect of addressing the same issue that arises in the context of section 125 of the Financial Market Infrastructures Act 2021.

(b) If, for whatever reason, that approach was unpalatable, an alternative would be to make the same clarification (but in a more targeted way) in the definition of "derivative" in clause 279(4) of the Bill.

Further discussion

ICMA and ISLA would be happy to discuss further any of the matters raised in this submission. In particular, ICMA and ISLA would be happy to express a view on any drafting changes proposed to address the submission made above.

Contact information

We can be contacted in relation to this submission through our New Zealand legal counsel, Bell Gully, at:

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Yours sincerely

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