

Initial Submission on the Exposure Draft of the Deposit Takers Bill

This is the initial submission of the non-bank deposit takers listed in the appendix to this letter (**NBDTs**) which sets out our high-level views on the Exposure Draft of the Deposit Takers Bill (**Bill**). We intend to make an additional submission by 11 March 2022 providing more detail on the specific parts of the Bill that are of concern to us and how we believe these concerns could be addressed. We acknowledge the very tight time pressures the Review Team is under and the large number of decisions that have needed to be made as part of the review – and how this has impacted the timeframes for meaningful consultation. We are grateful that you have acknowledged that this has presented challenges for us and approved the extended deadline for our full submission.

The NBDTs support the move to update New Zealand's prudential framework. We acknowledge the work of the Reserve Bank Act Review Team (**Review Team**) in identifying and developing policy options to deal with many complex issues associated with a once in a generation update of New Zealand's prudential regulation.

In recognition of the significance of the review to the NBDT sector and the potential benefits of a single prudential framework, the NBDTs have spent considerable time and money engaging with the Review Team on the development of a Deposit Takers Act (**DT Act**) since the consultation began in 2019. This has been done in the spirit of collaboration and genuine consultation – both assisting the Review Team to understand some of the particular challenges for NBDTs but also, in so doing, putting forward constructive suggestions on how a DT Act could be used to foster a more inclusive and diverse financial sector that ultimately would improve the wellbeing of all New Zealanders.

While it was pleasing to hear at the Hui on 3 February that the Reserve Bank of New Zealand (**Reserve Bank**) supports those goals and understands the importance of the NBDTs in a more inclusive, diverse and innovative financial sector, a number of our suggestions on how that could be reflected in a DT Act do not appear to have been picked up in the Bill. We appreciate that some specific areas of the Bill, such as the depositor compensation scheme and resolution, have required more urgent attention in the current economic setting. However, it is still of critical importance that the matters we raised previously are addressed to ensure the Bill enables the financial sector that we all want for New Zealand. In particular, it needs to be clear that the Bill is providing a setting in which smaller deposit takers have a model that is economically viable and the opportunity to be profitable. Without this, we will be unable to attract the capital required for growth and to protect against unforeseen events.

As was discussed at the Hui, the NBDTs' primary concern with the Bill is the level of regulatory uncertainty. Many matters the NBDTs had hoped would be in the Bill have instead been deferred to the standards. The Bill provides the Reserve Bank very wide discretion to develop these standards with almost no guidance on their content. The NBDTs had anticipated that the Bill would give direction on how proportionality would be applied by the Reserve Bank, how the Financial Policy Remit would be taken into account and the extent to which the existing prudential requirements applying to them would be grandfathered across in transition provisions. None of these matters have been addressed in the Bill.

The NBDTs anticipate that the changes in prudential supervision for them could be significant. While some are likely positive, such as the change to direct supervision, others could, if not carefully considered, affect the viability of the whole sector. The Bill gives almost no indication of what the regime will look like for us in practice. For banks, the strong working assumption is likely to be that there will be very little substantive change to prudential requirements applying to them. Presumably, all matters currently

covered by conditions of registration and supported by policies will simply be translated into standards which will now be legislative instruments (a process which seems to have already started with capital standards). The NBDTs, on the other hand, are operating in an environment of complete uncertainty. For example:

- **Restrictions:** NBDTs accept that many of the restrictions currently in their trust deeds will need to be converted into standards. However, neither the wording of the restrictions nor indeed the substance of the covenants is consistent across trust deeds. For example, the amount of security that can be given to non-deposit holders varies as does the calculation of related party exposures.
- **Liquidity and capital:** NBDTs operate on significantly simplified liquidity and capital rules. Again, while we are grateful to hear there is no intention to apply the old BS2A standards to NBDTs, we have no certainty on what capital ratios might apply, the composition of capital or whether the simpler capital adequacy calculations will change and, if so, how and even whether the terms of instruments that are permitted under existing regulations will continue to be accepted. As you will appreciate, this uncertainty will make it hard for some NBDT boards to make decisions to grow, attract capital from their shareholders and expand the support they give to their local communities.
- **Application of lending standards:** There is uncertainty around the power given to the Reserve Bank in the Bill to issue lending standards for all deposit takers. For example, lending standards that include matters relating to loan concentration would be a concern when a number of NBDTs operate in specific regions and don't have diversified portfolios.
- **Credit ratings:** The certainty relating to the rules on credit ratings for small deposit takers under the current regime has been replaced by delegating complete discretion to the Reserve Bank. For some NBDTs, a change of approach is likely to affect the viability of their businesses.
- **Levies:** There is significant uncertainty on how the deposit compensation scheme will be funded and the concerns we have raised on an approach to setting levies that risks largely defaulting to credit ratings (which simply do not affect the underlying risk of banks or the moral hazard associated with them) have not been addressed.

We cannot operate effectively with this level of uncertainty hanging over us. Our boards and shareholders are asking what the new regime means for our businesses and we are unable to give them any indication. We cannot plan for compliance costs and we cannot plan for growth as raising capital with this level of regulatory uncertainty poses significant challenges. On the other hand, if the regulatory regime will make our current models unviable then we need to have sufficient warning to be able to plan how we will approach this.

We have been encouraged by your assurances, and in particular statements made by the Governor, that the Reserve Bank sees value in the NBDT sector, and would like to see us thrive as part of developing a much more resilient, innovative and inclusive financial system. As kaitiaki we think it is important that you ensure the whole system flourish – both local institutions as well as the large foreign owned banks.

We make this submission with the same collaborative and constructive approach we have taken to date. We hope that the consultation on these matters will not end with our full submission, but that the Reserve Bank will, in the spirit of genuine consultation more akin to the principles of Te Ao Māori, continue to engage with a series of more focussed hui on areas of particular concern to our sector.

The focus of our full submission will be on the key matters that we think must be included in the Bill (rather than standards) to support a diverse and vibrant financial sector where smaller deposit takers can thrive. These matters are:

- **Purpose:** We are concerned that the purpose of the Bill has a singular focus on financial stability and gives undue weight to the safety and soundness of individual deposit takers. There is a risk that the purpose statement will be interpreted as a zero failure regime which could easily result in over regulation and a contraction of the financial sector (particularly NBDTs).
- **Proportionality:** We believe there needs to be clear guidance in the Bill about how the Reserve Bank must apply proportionality when exercising its functions and powers under the Bill, particularly those relating to supervision, licencing and standards. The same thing also applies in relation to fines, for example, where a, say, \$2.5 million fine for a bank will only have a minor impact on its profitability that year but could wipe out the entire capital of a smaller deposit taker or, at very least, a material part of it.
- **Transitional provisions:** We anticipate that the shift to the new regime will require a lot of work for the NBDTs which will require significant time and cost that we will need to plan for. Some of this could be mitigated if we were grandfathered into the new regime without having to reapply. Even then though at present, it is not clear which of our current regulatory framework will apply and how we will be expected to transition to new requirements.
- **Benefits of prudential regulation:** To create a diverse and competitive financial sector, prudential regulation must be attractive to new and existing business. Almost none of the benefits set out in our previous submission have been included and some that exist for us under the current regime have now been made uncertain.
- **Depositor compensation scheme:** We believe the Bill needs to refer to a government backstop or guarantee while the fund is being established and we are concerned the principles for setting levies will unfairly disadvantage smaller deposit takers. We also need to understand the potential compliance costs associated with it (e.g. on eligible customer identification) and would like to be actively consulted to ensure the scheme is as simple as possible and that a pragmatic approach is taken to any repositioning.
- **Crisis management and resolution:** Pre-planning resolution is likely to be a significant burden and should only apply to DSIBs. The statutory management regime is unlikely to be economic to apply to smaller deposit takers and an alternative to liquidation should be included. We have previously suggested the current receivership option be retained but this has not been included in the draft and we have no understanding of why that is.
- **Accountability:** The Bill proposes to grant the Reserve Bank significant levels of discretion to determine the rules applying to deposit takers outside of the legislation. To counterbalance this, we believe certain accountability measures should be included in the Bill similar to those found in comparable legislation in other jurisdictions.

We look forward to our ongoing engagement with the Reserve Bank.

Appendix

Christian Savings Limited

Credit Union Auckland Incorporated

Finance Direct Limited

Fisher & Paykel Credit Union Incorporated

General Finance Limited

Gold Band Finance Limited

Heretaunga Building Society

Mutual Credit Finance Limited

Nelson Building Society

Steelsands Credit Union Incorporated

Unity Credit Union

Wairarapa Building Society

Xceda Finance Limited