NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Reserve Bank of New Zealand – Te Pūtea Matua

on the

Deposit Takers Bill Exposure Draft

21 February 2022

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About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following seventeen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - China Construction Bank
   - Citibank N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - Industrial and Commercial Bank of China (New Zealand) Limited
   - JPMorgan Chase Bank N.A.
   - Kiwibank Limited
   - MUFG Bank Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Introduction

3. NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand – Te Pūtea Matua (the **Reserve Bank**) on its exposure draft of the Deposit Takers Bill (the **Bill**). NZBA commends the work that has gone into developing the Bill under Phase 2 of the Reserve Bank Act review.

Contact details

4. If you would like to discuss any aspect of this submission, please contact:

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Need for ongoing consultation and overview of submissions

5. We thank the Reserve Bank for its active engagement with the industry on the Bill.

6. Given the short time available for consultation, spanning the December/January period, we have worked to review the Bill in as much as detail as possible and provide industry views on key matters.

7. Further, as the Reserve Bank has acknowledged in its Explanatory Notes to the Bill (**Explanatory Notes**), a number of key elements to the new regulatory landscape are not included in the Bill. These include detail of the content of proposed standards (as well as what standards are in fact proposed), key transition details and mechanics for the deposit compensation scheme, among others.

8. We appreciate the size of the Phase 2 review means that various elements need to be progressed before others. However, developing this regulation in stages will itself create risks to the stability of the financial system, undermining the purpose of the reform. And the introduction of a depositor compensation scheme will only support public confidence in the financial system if the scheme is well designed and can be rolled out smoothly and consistently. Managing these risks must be given equal priority to development of the law itself.

9. In particular, deposit takers must be given the time, information and opportunity necessary to build systems for compliance with the new rules. Investors and depositors must be given certainty of the direction and timing of regulatory changes in order to make investment decisions today. Leaving key detail to later stages, particularly without clear direction up-front, will place unnecessary pressure on an already resource-intensive compliance task, create market confusion and potentially increase the risk of unintended consequences (for instance, see our comments on the definition of "deposit taker" at paragraph 27(d)).

10. Certainty on progress, direction and timing (including transition) from an early stage, open engagement with stakeholders and appropriate safeguards in the initial framework are vital. We welcome industry workshops in particular as an effective mechanism to share feedback on the implementation practicalities of the reforms.

11. A desire to expedite regulatory reforms can in fact result in the legislative process taking longer. The Financial Markets (Conduct of Institutions) Amendment Bill (**CoFI**) was introduced to Parliament as a framework, with speed being prioritised over consultation and industry engagement. Significant ongoing work has since been required to amend and refine that Bill and two years later it is yet to be enacted.

12. Our feedback is necessarily high level in places given the timing and scope described above (and the specific examples provided should not be considered exhaustive). We have sought to make our feedback as useful as possible to the Reserve Bank in its further development of the Bill, but we strongly submit that the Reserve Bank continue to actively engage and consult with industry throughout the reform process, including on the further development of the Bill and the creation of standards, transitional provisions and other detail. It is also important that additional key details (including in relation to the deposit compensation scheme and related regulations) are made available as a priority to inform further consultation on the Bill. This ongoing engagement process is particularly relevant given the Reserve Bank's role as both regulator and drafter of the Bill – particularly active

engagement is appropriate to ensure that relevant safeguards, checks and balances are maintained throughout.

13. The remainder of our submission is divided into the following sections, broadly following the order of the Bill:

    (a) **Licensing, regulation and transition**: As discussed below, a clear transition path to the new regime (including clarifying in Schedule 1 that existing registered banks will be deemed licensed at transition) will be important to achieve the Bill's purposes. Additional safeguards and guidance are needed given the Reserve Bank's broad powers (including appropriately focusing the definition of "prudential obligations" on the Bill's framework of obligations). We have also provided input on a number of clauses below to assist with further development of key concepts, including the new proposed director due diligence obligation.

    (b) **Supervision and enforcement**: We strongly support the move to modernise the Reserve Bank's supervision and enforcement tools, and we believe that further work to refine the proposed tools at this stage would serve to greatly improve and focus their application. We have highlighted below a range of matters where we believe such further development would be beneficial to the scope and implementation of this new regime.

    (c) **Depositor compensation scheme**: We support the adoption of a depositor compensation scheme. Successful implementation will need to consider a range of operational challenges (and provide deposit takers with sufficient time and certainty to address those challenges). The scheme will need to be simplified (as far as practicable) to ensure it achieves the scheme's objectives of depositor confidence. NZBA also strongly believes that the levy regime must be risk-based.

    (d) **Crisis management**: Certainty and clarity, for both deposit takers and investors, will again be key to a successful reform of New Zealand's bank resolution tools. Any ongoing use of open bank resolution (**OBR**) needs to be carefully considered given the potential inconsistencies that may cause with depositor compensation and other resolution tools. Given the potential for usage of funds from the depositor compensation scheme, a clear line of responsibility for the Reserve Bank's implementation and resolution, and limits on usage of those funds, needs to be included to ensure they are appropriately applied.

Licensing, regulation and transition

14. As mentioned in previous Phase 2 submissions, NZBA supports the move to a modern regime for the regulation of deposit taking. The Bill takes a helpful, logical approach to setting out the requirements for licensing and ongoing regulation.

15. At a high level, there are three key general matters that need to be focused on and refined:

(a) **Transition**: A smooth transition to the new licensing and regulation regime will be key to the success of the Bill's purposes. Transition needs to be given priority in development (as described in paragraphs 8 to 11 above).

(b) **More guidance and safeguards on the Reserve Bank's powers must be included**: The Bill sets up a broad framework, with a wide range of tools at the Reserve Bank's disposal to achieve its purposes. However the key aspects of these tools are left for later determination by the Reserve Bank. We appreciate that this is effectively a necessary side effect of the size of reform and timetable. However, sufficient certainty must still be provided to maintain financial stability. That is, the trade off to providing such determination powers to the Reserve Bank is that robust safeguards must be included and clear guidance must be produced.

(c) **More detail and development of key concepts is needed**: We appreciate that the Bill is at an early stage and more refinements will be made. There are a number of matters which are key to the impact of the Bill on deposit takers (and their customers) which should be further reviewed with the industry as a priority. We have highlighted a number of key points below.

16. At the end of this section of the submission we have also provided our views on the **purposes and principles of the Bill** in clauses 3 and 4 and the **transaction restrictions** in Part 2, Subpart 5 of the Bill.

Transition

17. Details on the transition of existing banks and deposit takers to the new regime remain sparse (as acknowledged in the Explanatory Note). Even the short provision that is included in Schedule 1 to the Bill only refers to deeming existing registered banks to be "deposit takers". This should be clarified to refer to "licensed deposit takers" so that it is clear existing registered banks are not required to complete a fresh licence application. A clear statement should also be included that existing registered banks continue to be authorised to use restricted words under the new regime.

18. Details of any required actions for transition to a new licence, and timings, should also be provided as soon as possible so that this can be factored into timetables and resource allocations. Further detail would also be required on the scope of the FMA's role in the consultation described in clause 19 (and clause 51).

19. Please also see our submission at paragraph 55(c) below in relation to the DCS – to the extent that deposit takers are intended to transition into the new regime separately, the setting of risk-based levies needs to be considered so that first movers are not subsidising the remainder of the market.

More guidance and safeguards on the Reserve Bank's powers must be included

20. The Bill provides the Reserve Bank with a broad range of tools to set regulation via standards and conditions, allowing it to take a more tailored and appropriate approach to regulation than was previously possible under the Reserve Bank of New Zealand Act 1989 (the **1989 Act**).

21. The NZBA strongly supports this modernisation.

22. However, a side effect of this approach is that significant discretion to effectively set law is devolved to the Reserve Bank. The systematic protections built into the setting of primary legislation, and even the setting of regulation by Ministers, does not apply.

23. Appropriate safeguards and guidance must therefore be used to direct the Reserve Bank's powers and provide appropriate certainty to the market. This needs to include:

    (a) Ongoing, proactive engagement and consultation with the industry as standards and other provisions develop. The NZBA appreciates the Reserve Bank's recent approach to engagement on the Bill. We look forward to the continuation of this engagement as the Bill advances and standards are developed.

    (b) Publication of clear guidance and timelines by the Reserve Bank (with industry engagement as described above).

    (c) Statutory mechanics, to provide all parties with certainty of the robust consideration given to standards etc by the Reserve Bank.

24. By way of comparison, the 1989 Act currently provides the Reserve Bank with the power to consider registration applications and determine appropriate conditions. As a result, s75 of that Act provides for the Reserve Bank to publish the principles on which it acts to determination applications and conditions.

25. Given the considerably broader powers provided to the Reserve Bank in the Bill, stronger and clearer safeguards and guidelines are needed. This should include:

    (a) **Guidance on how the Reserve Bank intends to apply licensing requirements**: In addition to our comments further below on the drafting of licensing criteria, the Reserve Bank should be required to publish guidance on how it intends to apply those requirements (similar to current s75 of the 1989 Act).

    (b) **Clearer procedures when publishing standards**:

        (i) Although we note that consultation with substantially affected stakeholders is required when standards are published, and that standards must be necessary or desirable for the purposes of the Bill (clauses 67 and 70), there is little detail in how consultations

must be conducted. There should be clear requirements for draft standards to be published with reasoning as to how it meets the purposes of the Bill (ideally in the form of a draft Regulatory Impact Statement), with adequate consideration and submission time after that is produced.

(ii) As a priority the Reserve Bank should consider and be satisfied that new standards are not unduly or unnecessarily burdensome on affected deposit takers. For instance, the framework for standards relating to the depositor compensation scheme allow the Reserve Bank to require information to support their consideration of compensation entitlements (clause 81). As discussed below, the rules for determining entitlements are complex and may become more complex over time. Before any standards are created that require deposit takers to share information about holdings and beneficial entitlements etc, the Reserve Bank should be required to consult on what data is available (including what data can legally be shared with the Reserve Bank under privacy laws) and practical timelines for being able to collect further data.

(c) **Timetables, consultation and response periods**: As related points:

(i) We note that the Bill is often silent on consultation, notice and compliance timelines (or provision for the Reserve Bank to set deadlines for response, without any minimum periods). Where timelines are included, it is common for deposit takers to have 5 (calendar) days to respond, whereas the Reserve Bank is frequently provided with 20 working days. A response period of 5 calendar days will frequently be unreasonably short (particularly during the December/January period). The Bill should include explicit, reasonable timelines for all key compliance obligations (including compliance with any amended standards or licence conditions) and consultations.

(ii) Timing requirements for actions and responses need to be carefully considered. In many cases, non-compliance gives rise to an offence under the Bill. In such cases it becomes even more important that reasonable timeframes are legislated for compliance (such as for the provision of information) and that consequences are fully considered. For example, clause 25 requires Reserve Bank consent before a new senior manager of a locally incorporated bank is appointed. The Reserve Bank is provided 20 working days or more to consider a request for such appointment (clause 27), after a fit and proper certificate and all other relevant information is provided. This may leave deposit takers in a difficult position if a senior manager resigns unexpectedly – there is currently no provision allowing an interim senior manager to step in while a permanent replacement is found.

(d) **Review**: Further, clear mechanics should be included for the review and oversight of the Reserve Bank's actions under the Bill.[1] This could include (but should not be limited to) an internal review process at the Reserve Bank, such as a review committee addressing concerns with how powers have been exercised, set in legislation. We submit that such a review process would be particularly important when reviewing the Reserve Bank's use of DCS funds.

More detail and development of key concepts is needed

26. We understand that the Bill is at exposure draft stage and that it will be further refined before introduction to Parliament.

27. There are a number of key concepts for which broad definitions and descriptions are included. The lack of detail leaves significant uncertainty in how the concepts are intended to apply, as well as the potential for inconsistencies and overlaps. We have set out key drafting concerns below, however given the potential for further changes and uncertainty in some areas we consider it vital that there is ongoing industry engagement, as discussed in paragraph 12, as drafting development continues.

(a) **Prudential obligations definition:** We note that the definition of "prudential obligations" (used in the context of director's duties and a number of other areas) currently seeks to incorporate obligations under separate AML legislation. This is wholly inappropriate given the extensive existing framework for AML obligations, enforcement and supervision – already one of the most complex regulations in the financial (or any) sector (and currently the subject of their own standalone review). Incorporating AML obligations into the Bill as an additional layer imposed on deposit takers and their directors will create significant overlap and potential inconsistency between the two regimes, leading to confusion and uncertainty and additional cost, without any appreciable benefit.

(b) **Standards/conditions**:

(i) While we do not comment materially on the broad outline of subject matter of standards in clauses 72 to 85 (subject to our submissions above that appropriate safeguards, guidance and consultation is needed when standards are prepared), we note that there are some inclusions for which the intention is currently unclear. For example, the potential for bail-in standards is included as one of the first examples, in clause 74. However, the Reserve Bank's recent capital review expressly removed all contractual bail-in instruments from recognition as regulatory capital, setting New Zealand apart from international practice on the basis that instruments with contractual bail-in were not considered appropriate in the New Zealand context. Further

1 See also our comments in relation to appeal rights in relation to transaction approvals in paragraph 33(b).

guidance (and, given the cost to deposit takers already incurred to move away from contractual bail-in, consultation) is needed if bail-in instruments are being considered for reinstatement.[2] The Bill should also be clarified that any required contractual bail-in is not retrospective and will not affect existing instruments (either by deeming amendments to be made to the contractual terms or requiring issuers to change those terms). Without such clarification there is a risk of confusion and undue concern for existing investors.

(ii) As discussed in paragraphs 8 to 11, it is important that the market is given a clear idea of the expected content and direction of the standards (and related matters) as soon as possible, so that implementation work can begin and there can be productive consultation. Standards imposing additional obligations on branches of overseas banks should be carefully considered in that context and clearly signalled. Standards and requirements relating to directors and senior managers (such as fit and proper certifications under clause 75 and governance and remuneration restrictions under clause 72[3]) should be clear and signalled to the market in advance, and should not be used to unduly restrict individuals from entering the New Zealand market.

(iii) Similarly, the Reserve Bank is given the power to impose conditions on licenses in clause 23 of the Bill. This includes reference to a potential certification condition for deposit takers and/or directors (clause 23(f)). This reference should be deleted – as previously submitted (and reflected generally in the Bill), reliance on director certification is outdated and has been replaced by positive due diligence requirements. Allowing such requirements to be reinstated by conditions (and even extended, given the proposed reference to certification regarding other legislation) ignores the purpose of the reform and the addition of positive director duties.

(iv) We also note that a detailed definition of “related party” for the purpose of determining exposures is set out in clause 79 – although actual limits on exposures and related matters are left to be set by later standards, under clause 76. It would be helpful to discuss this further in the context of the expected standard, however we believe alignment of this concept with accounting

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[2] As a specific drafting point, we note that “bail-in instrument” is defined as including conversion to equity in the deposit taker or a subsidiary, but does not include conversion to equity of a parent (which is a common approach in practice). This should be amended to include parent equity.

[3] Any restrictions relating to governance and remuneration should also be reviewed and considered in the context of similar provisions proposed for CoFI, to ensure that deposit takers do not become subject to largely overlapping but differing requirements.

standards may be useful.[4] There are currently a number of unnecessary differences from the accounting approach, including:

(aa) The Bill refers to “substantial interest” in an entity, with quantitative thresholds for determining this interest. The accounting standards include more qualitative tests when determining related party relationships.

(bb) The Bill’s definition of relatives for this purpose includes parents and siblings of directors and senior managers of deposit takers or any of its associated persons, without considering the likelihood of any influence that those relatives may have over the dealings with the entities. By contrast the accounting standards definition is more tailored to those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity (NZIAS 24).

The use of different definitions has the potential to add complexity as well as creating differences in the way that exposures are measured and monitored for regulatory purposes, compared to the way they are reported for financial statements and disclosure statements.

(c) **Director due diligence**:

(i) Clarity is needed in the new director due diligence requirements in clause 88 of the Bill. The current drafting imposes a broad obligation on directors to exercise reasonable due diligence across a wide range of obligations (effectively all of the bank’s obligations under or related to the Bill – and see our comments below on the inclusion of AML obligations in the “prudential obligations” definition).

This director duty needs to be very carefully established, so that directors have sufficient certainty that they are able to sensibly and effectively perform their roles. Such duty must not be so intrusive as to effectively require directors to take on a management role, focusing on detailed day-to-day compliance. At a minimum, this duty should:

(aa) Clearly define what bank obligations are considered material for director focus. The current drafting may encourage Board-level focus on compliance with minor obligations, as well as those which are fundamental and which may reasonably be considered to have a greater impact on confidence in the bank or the financial system.

[4] These differences are illustrative of the more general point, that definitions in the Bill should be aligned with other existing legal and accounting concepts where relevant, to minimise the risk of unanticipated consequences and unnecessary costs.

It should also be clear that a deposit taker may consider the materiality of the obligation as well as the size of the business when considering what a "reasonable director" would do for the purposes of clause 88(2). This would recognise the broad range of obligations to be covered under the Bill and its associated standards and regulations, as well as the wide range of entities required to be licensed under the Bill.

(bb) Include clear rules and guidance on what is expected to be "reasonable" in the context of potentially very large, multi-service banks and overseas incorporated global banks. While we appreciate clause 88(2) and clause 89 include some high level descriptions of what factors to take into account and the meaning of due diligence, they do not go far enough to be helpful, including in the context of banks for which the New Zealand branch may only be a very small part of a global business.[5] The Commerce Commission guidance on director due diligence may be seen as a helpful precedent in this regard. While the scope of obligation differs, overall it provides clear, useful guidance and distinguishes between the role of management and directors. (As was the case with that guidance, a solid process of industry consultation – and refinement following such consultation to ensure it is helpful in practice - should also be adopted.)

Without such clarity, there is a risk of increased barriers to entry for highly skilled and experienced professionals wanting to take on directorships in New Zealand. It is important that directors are not expected to perform the role of management, and focus on compliance well beyond the point that is beneficial.

(ii) As discussed above in paragraph 27(a), the proposed definition of "prudential obligations" (which helps define the scope of director duties under the Bill) should be amended to remove reference to AML obligations. Including in the Bill such other obligations, which are already extensively regulated, creates significant additional uncertainty, overlap and potential inconsistencies.

(iii) We note that director indemnification provisions are similar to those in the FMCA and Companies Act, but effectively apply in addition to those regimes. This should be amended so that New Zealand incorporated companies are subject to the Companies Act requirements only (mirroring the equivalent provision in

[5] In the context of branches of overseas banks in particular, director obligations need to be carefully considered in the context of the size of the business that such directors are to manage. Requiring disproportionate focus on the New Zealand branch as a result of untailored legislation may be disadvantageous to the robustness of the bank as a whole.

section 526(3) of the FMCA), with the proviso that a relevant indemnity is ineffective to the extent it would otherwise cover a liability arising out of a failure to acting in good faith. The Companies Act provisions are otherwise already broad enough to cover such companies, and allowing both regimes to apply will lead to unnecessary overlap.

(iv) Lastly, we note for completeness that the Phase 2 review had previously sought input on the design of a director and executive accountability regime (and there is some indication this may still be under consideration for a future review). Our submissions on the director due diligence obligation are based on the obligation in the Bill as a stand-alone duty. If a separate accountability regime is later explored, this current due diligence duty would need to be reconsidered to ensure it does not introduce considerable overlaps, inconsistencies or overreach with a director and executive accountability regime.

(d) **Deposit taker definition:**

(i) We note that in Schedule 2 to the Bill the Reserve Bank has used a definition of deposit taker that appears to include (on the borrowing side of the equation) any entity that issues a 'call debt security' (regardless of whether the lender of that call debt security is wholesale or retail) which we believe has unintended consequences. We understand the intention is to capture 'transactional accounts' provided to wholesale investors, but this definition is not well targeted and requires considerable further thought. Many common financial products could be inadvertently captured as a 'call debt security', while bearing no resemblance or practical use as a transactional account. For instance;

(aa) Uncommitted debt facilities provided to a company by a bank are often repayable on demand. For example, a product as simple as an overdraft facility provided by a bank to a corporate, may be technically a 'call debt security' provided by the corporate to the bank. Any lending business that obtains such a bank overdraft facility may be deemed to be a deposit taker under this definition, even if they fund themselves solely through long term wholesale borrowing.

(bb) The definition may similarly also include intercompany loans within a corporate group, which are often repayable on demand. For instance, a corporate group may be structured so that long term wholesale funding is provided to a parent company, which on-lends amounts to a subsidiary with a lending business. The lending from the parent to subsidiary is likely to be technically repayable on demand, meaning that (as drafted) the subsidiary is a deposit taker.

It is not clear to us that businesses providing ‘wholesale transactional accounts’ represent a risk to the New Zealand financial system. Considerable infrastructure is required to provide functional transactional accounts to customers, and we are not aware of any current concerns in this area. If this was to become an issue in the future, it could be addressed by targeted regulation.

However, if despite the above comments it is thought necessary to capture ‘wholesale transactional accounts’ in the Bill, the definition needs to be targeted to address the purpose (e.g. limited to true wholesale deposits) and usage that the Reserve Bank is concerned with, and to exclude products otherwise used in the markets such as those described above.

(ii) The definition of deposit taker should also exclude the issue of retail bonds in the New Zealand market (as was considered in previous stages of the Phase 2 review). Bonds are a form of investment in a business and are not synonymous with deposits. Continuing to prevent companies that have a lending business (whether it is a principal or ancillary business for that company) from seeking any investment through retail bonds, where other businesses are permitted to do so regardless of credit risk, does not provide an even playing field and is outdated.

(iii) Given the scope of the definition (even with our submitted changes above), a clear process for exemption applications and consideration, and limited licensing requirements for certain deposit takers should be included in the Bill, so that there is a process to address any unintended results that arise in the future.

(e) **Definitions and concepts relevant to licensing:**

(i) Clause 14 provides that only bodies corporate may be licensed (a restriction not present in the 1989 Act). While we do not expect natural persons to need to be licensed, it would help to be clear that a person acting as trustee may be licensed.

(ii) The criteria to be considered for licensing is in some ways more helpful than the 1989 Act equivalent drafting, but it has introduced uncertainty in some cases. In clause 16, consideration of the “appropriateness” of the owner of the applicant is extremely broad and should be made clearer. Similarly, in clause 17(2) the reference to overseas regulation/supervision needing to be “at least as satisfactory” as New Zealand equivalents should be reconsidered, given that New Zealand has deliberately set itself apart from international practices on matters like capital adequacy – a clear meaning of “satisfactory” should be included, so that it is clear that overseas jurisdictions are not required to take the same approach to each element as New Zealand (and, for instance, do

not require the same high capital requirements for which New Zealand is a deliberate outlier).

(f) **Advertising, credit ratings etc:**

(i) Further consideration is needed of the restrictions on advertising and similar, particularly in relation to overseas banks that also operate in other jurisdictions. For instance, advertising by an overseas bank may (on an internet site generally focused at other jurisdictions but available in New Zealand) refer to a non-approved credit rating – this should not be inadvertently restricted.

(ii) The restrictions on the use of the word "bank" in advertising (such as business cards) should also be updated to permit authorisation in the same way as other uses of a restricted word, by an overseas bank that is not (and is not required to be) licensed in New Zealand (clause 410).

(iii) An obligation has been included for deposit takers to deliver to the Reserve Bank a dated rating agency 'certificate' within 20 working days of a relevant change in credit rating or credit watch[6] (clauses 61 and 62) and to provide credit ratings on deposit takers' websites (clause 63). It is unclear what purpose these clauses serve, given rating agency changes and notices are publicly available from the rating agency websites and additional bank disclosure is of limited benefit to depositors (particularly depositors of licensed banks). If a separate certificate addressed to the Reserve Bank is contemplated in clauses 61 and 62, this is not something that the deposit taker can control and rating agencies may refuse to provide such a separate certificate within the timeframe outlined. It should be sufficient for a deposit taker to notify the Reserve Bank of the change (which the Reserve Bank could verify from the rating agency websites). Any requirements relating to rating agencies and rating confirmations should also be socialised well in advance with the rating agencies.

28. As discussed above, the above examples are not exhaustive but are intended to highlight examples of key themes to be developed in drafting.

[6] As more technical points, we note that "current credit rating" is defined for the purpose of these clauses as a rating "given not earlier than 1 year before that date". Ratings are typically updated approximately (but not exactly) annually, so we would suggest amending the timeline to 15 months to allow for variations. Further, the definition of "credit watch" appears to be focused on what is typically labelled by credit rating agencies as credit watch, but it would be helpful if the legislation definition could make it clear that it does not include a change in outlook only.

Amendment to purposes/principles

29. We generally support the purposes adopted in the Bill, and recognise these as considerably more fit for purpose than those in the 1989 Act. However, as submitted previously we believe that the Reserve Bank will be unnecessarily restricted unless it is acknowledged that it may take into account efficiency and innovation. We believe this could be addressed by a reference to efficiency in the purposes in clause 3 and/or in the principles in clause 4. As they stand, these purposes are effectively entirely defensive in approach, which may lead to a need to focus on short term maintenance of stability over long-term improvement (and greater overall stability and confidence).

Transaction restrictions

30. Several restrictions on transactions have been included in the Bill in relation to licensing (relating to change of control, significant transactions and amalgamations).

31. These restrictions should be carefully considered in relation to overseas banks, as their application would significantly increase compliance costs and where home jurisdiction regulators will be expected to have the primary role approving changes. Similar to the approach in the 1989 Act (and following the approach taken in the Bill to director appointments) these restrictions should be limited to a notice requirement to the Reserve Bank.

32. Further, given that these restrictions are to be set out in legislation, it is important to clearly define them and technical/immaterial changes should be expressly excluded for certainty. For instance, an amalgamation of a small bank subsidiary into the parent should not require Reserve Bank consent, the sale or transfer of assets to an SPV as part of a covered bond or securitisation (e.g. RMBS) arrangement should be expressly disregarded, and other transactions that are currently excluded under BS15 (Significant Acquisitions Policy) should be excluded as well. A clear process should also be included for additional exclusions to be adopted through standards or another defined process.

33. To the extent these restrictions do apply, the NZBA submits that:

    (a) Restrictions on the definition of “material” (for the purpose of considering significant transactions) should be included in the Bill (refer clause 39) – this is a key provision that may impact deposit taker activities and clarity on the lower bounds of what may be considered material should be set in legislation.

    (b) Reserve Bank decisions not to give consent should be considered to be ‘appealable’ under clause 53 (rather than being restricted under clause 54). This should be consistent with the approach to decisions whether to grant a licence, given the same criteria is intended to be applied.

Supervision and enforcement

34. The NZBA strongly agrees with Bill's approach of providing a broad range of supervision and enforcement powers, but we submit that as drafted these powers are too broadly applied. Rather than providing a blank slate for use by the Reserve Bank, they should be carefully considered in the context in which they are intended to be used. For example:

    (a) **Safeguards and further development of the Bill**: As a general point, our comments above regarding guidance, safeguards, and development of concepts apply equally in relation to the Bill's supervision and enforcement provisions. The Bill provides the Reserve Bank with very broad supervision and enforcement powers, but with very few safeguards or guidance to ensure they are exercised reasonably. By way of example only, under clause 133 the Reserve Bank may make an order requiring disclosure of a warning on only 3 working days' notice to the relevant deposit taker. Within this extremely short timeframe the deposit taker is expected to prepare and provide written submissions and be heard. While there may be situations where quick disclosure of a warning is required, in many instances it would be reasonable to allow deposit takers additional time to consider, respond and discuss with the Reserve Bank. Longer timeframes, with a potential exception allowing earlier disclosure where there is a pressing need (such as fraudulent operations), would be more appropriate.

    (b) **Information gathering power**: While the NZBA acknowledges that the Reserve Bank will need to obtain information from time to time, the current clause 95 provides an extremely broad power to require information from any person, with only minimal restrictions included in the Bill. This goes considerably further than necessary, and should be restricted to gathering information from, and in the custody or under the control of, the deposit taker and its associated persons (rather than "any person"), with a reasonable minimum time allowed for delivery and a requirement for the Reserve Bank to provide the reason for the request (i.e. why it is considered necessary or desirable for the purposes of performing or exercising its functions, powers, or duties under the Bill). Reasonable and clear limits and timings are particularly important given the offence provisions that apply for non-compliance.

    (c) **Report requirement**:

        (i) The Reserve Bank's power to require a report under clause 99 is not expressly linked to the purposes of the Bill. It should be clear that the Reserve Bank may only require reports where necessary or desirable for the purposes of performing or exercising its functions, powers, or duties under the Bill. Given the potential for such reports to incur significant cost and resource, the Bill should also address practical matters for such a report, including provision for the setting and agreement of terms of reference for the person preparing the report, and to consult with the relevant

deposit taker and the person preparing the report as to a reasonable period to produce the report.

(ii) Clause 101 provides for publication of reports, “whether in whole or in part”. However in some cases it may be more appropriate to publish a summary, as publication of part only of a report may be misleading in context.

(d) **On-site inspection power**: The on-site inspection power in clause 110 onwards has been based broadly on powers under the AML legislation, and in that regard reflects the particular requirements of that AML legislation. However, there is no need for such broad powers in relation to inspection of deposit taker records. In particular:

(i) While we support the proposal that the power is only exercised at a reasonable time and in a reasonable manner, the inspection power should require notice to the deposit taker (except in limited circumstances, such as reasonable suspicion of fraud) and should apply to business premises where records are held (for example, not to retail branches). This is particularly relevant given the increase in off-site working, where relevant employees may not have an opportunity to be at the premises if notice is not given in advance. The drafting should also be clear that a director or employee’s home address is not considered a place of business for this purpose merely as a result of ‘home office’ or flexible working arrangements.

(ii) Further detail should also be included so that it is clear that information gathered cannot be used for other purposes (or shared with other regulators) and that persons conducting the on-site inspection are appropriately trained and authorised.

(iii) Restrictions should be included so that the Reserve Bank does not have the right to access irrelevant personal information held by the deposit taker.

(iv) The inspection powers of the Reserve Bank should be aligned with those provided to the FMA. This is consistent with the principle of a ‘twin peaks’ model and to ensure consistency and clarity if a joint review is conducted onsite (such as a thematic review).

(v) Given the potential impact of the inspection powers on deposit taker employees, a clear requirement should be included for the Reserve Bank to inform employees etc of the scope of their powers under clause 111, including what information is required to be provided and who is required to provide it, so that staff can be comfortable complying requests made of them. For instance, a person who is not an employee, director or agent of the deposit

taker[7] (but happens to be on-site) should be provided enough information to understand whether they are required to comply (and consequentially whether they are protected by clause 112 if they do provide information).

(e) **Prudential obligations**:

(i) As discussed in paragraph 27(a) above, the current definition of "prudential obligation" should not include reference to AML obligations. The concept of "prudential obligation" is used repeatedly in relation to supervision and enforcement (including, for example, in the clause 95 inspection power and the clause 115 reporting duty). AML is subject to its own detailed regime that addresses such issues and incorporating it here as well only adds complexity, confusion and the potential for inconsistency and overreach without additional benefit.

(ii) Without limiting our concerns expressed above and elsewhere in this submission, including AML obligations here would permit overseas AML regulators to utilise the mechanics in subpart 8 to access information held by deposit takers about particular customers. Even if this was contemplated for legislation, it is inappropriate and the outside the scope of this Bill. It would need to be considered and the subject of consultation in connection with specific AML legislation.

(f) **Remedial actions**: Requirements placed on deposit takers to take action to prevent future breaches (such as for clause 118 remedial notices and clause 145 undertakings) should acknowledge that such actions are forward looking. In particular, requirements to "ensure" that future breaches do not occur should be amended to include a reasonableness or similar due diligence standard. Consistent with the remainder of the Bill, the focus should be on ensuring that deposit takers implement appropriate procedures to minimise the risk of future breach. It will typically be impossible to agree or implement procedures as part of a notice or undertaking that entirely removes any risk of future breach (particularly given the likely detailed and technical nature of many standards).

(g) **Investigations**: Given the scope of the investigator's powers (including broad information-gathering in clause 126), any investigator appointed should be an employee of the Reserve Bank. If (despite this submission) external advisers are used in these inspections, conflict of interest issues would need to be resolved noting most large firms may have existing mandates with the deposit takers. The Reserve Bank should in practice retain oversight and responsibility for such investigations, and management of any information requests in an investigation. Similar comments to those made in paragraph (d)(v) above, in relation to clause

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[7] For instance we note that, as drafted, the Reserve Bank's powers (and the protections in clause 112) only apply to employees etc of the deposit taker, and not of subsidiaries or other associated persons of the deposit taker.

111 of the Bill, also apply in relation to the investigator's information-gathering power in clause 125.

(h) **Pecuniary penalties for breaches of standards/conditions**: Clause 152 provides a maximum pecuniary penalty for any breach of standard or condition of up to $5m (or 0.1% of consolidated assets if higher). We submit that:

(i) A test based on consolidated assets is inappropriate (unless used to reduce the overall penalty where a $5m cost would be inappropriately punitive – ie a penalty that is the lesser of $5m and a percentage of consolidated assets). A $5m penalty is already a significant deterrence. There is no need or justification to impose higher (and potentially many multiples higher) fees on a bank based on the size of its business.

(ii) To the extent that any penalty is included proportionate to consolidated asset size (or similar test), in the case of an overseas deposit taker it should be clearly based on the balance sheet of the New Zealand business (rather than the global bank), consistent with the approach to overseas banks in the Bill generally.

(iii) While the court is required to take into account the importance of the breach under clause 153, there are likely to be a number of requirements in the standards that do not warrant such a high potential penalty. Provision should be made for a lower penalty for 'administrative' aspects of the standards, with the standards setting out which aspects are considered administrative.

(i) **False or misleading representations**: Under clauses 168-170, deposit takers and their directors are generally liable for making false representations to the Reserve Bank. However, the clauses go considerably further than is needed or appropriate, and should be scaled back accordingly. As drafted:

(i) Matters that a person "ought reasonably to have known" are captured. The penalty (for an individual) of inadvertently making a statement that they "ought reasonably to have known" was false, but did not in fact know was false – perhaps due to a misunderstanding – includes imprisonment for up to 1 year. Such a broad and punitive obligation on deposit takers and their representatives is wholly inappropriate and unnecessary in the context. A better approach would be to follow that taken in the FMCA,[8] given the requirements for due diligence procedures elsewhere in the Bill. That is:

[8] We note that the FMCA does include an "ought reasonably to have known" test in the context of insider trading. However, that is not comparable to the matters addressed in the Bill – the insider trading provisions are far more limited in scope, and can be expected to be continuously controlled by listed companies as part of their public disclosure obligations.

(aa) reserving criminal liability for situations where representatives have knowingly or recklessly made a false statement; and

(bb) if thought necessary, providing civil liability for those "involved in a contravention" of making a false statement (subject to standard defences). This test is well understood and more appropriate in the circumstances (it currently applies in relation to fair dealing breaches under the FMCA, for instance).

(ii) Clause 170 provides additional deemed director liability for information etc provided to the Reserve Bank or an investigator. This clause is unnecessary and should be removed. Including such provision would compound the current concerns with reliance on director attestations (rendering directors potentially liable for any statement made by the bank as a whole), undermining the general modernisation in the Bill. Personal liability of directors is subject to its own specific regime (on which we have commented above).

(iii) Any information that is published by a deposit taker is captured (clause 168(d)), even if this is not provided to (or relevant to) the Reserve Bank. Websites and other collateral are produced and updated on a regular basis – potentially daily or hourly. While deposit takers may be expected to make reasonable efforts to ensure accuracy, penalties including imprisonment are out of proportion. Such other published information is already regulated as appropriate through the Fair Trading Act and the fair dealing rules in the FMCA. There is no need to impose further penalties in the Bill.

(iv) Clauses 168(b) and (c) capture any information or document provided to the Reserve Bank or an investigator, in any context. This would include information demanded as part of an investigation or on-site inspection – something which could conceivably require substantial documentation within a short period (or, in the case of an on-site inspection, effectively immediately). It would be effectively impossible for a deposit taker or its representatives to ensure that no information or document provided in such circumstances is false or misleading, whether due to time since preparation, the different context in which it was produced, or simple error. Such information should only be covered where there is shown to be a deliberate intent to deceive or mislead.

Depositor compensation scheme

35. The NZBA continues to support the introduction of a depositor compensation scheme (**DCS**) and broadly supports the overall approach described in the Bill.

36. Our general comment is that considerable further work is required, as a priority, to simplify, strengthen and build on the framework in the Bill.

37. While there are a number of other aspects of the Bill that will require significant work by the industry to implement (as reflected in our submissions above on the need for further transition and other guidance), the DCS has the potential to require the greatest range of core system and customer-facing operational changes. The implementation task is made larger still if deposit takers must have procedures to deal with a DCS payout post the application of resolution tools such as OBR.

38. Further, given the additional significant direct cost to the industry of levies, it is important that the money raised from those fees is put to effective use protecting depositors. NZBA also strongly believes that the levy regime must be risk-based (see paragraph 55(a) below in particular).

39. We have expanded below on a few key areas of concern where further refinement and clarification is required.

Further consultation needed

40. As is the case with other parts of the Bill, a number of key concepts have not yet been fleshed out and are left to Reserve Bank discretion and/or future regulations. This includes a number of the matters described in our submissions below (for example, further detail on who is an "eligible investor", further detail on what constitutes "protected deposits", what obligations are placed on deposit takers, and the structure of the risk-based levy to be paid by deposit takers). It also inevitably interacts with the proposals for crisis management and resolution, and the intended future place for OBR – for instance, if accounts are partially frozen, this would seem to inevitably delay any payment under the DCS until those accounts are unfrozen and written off.[9]

41. Given the substantial impact that these matters can have on deposit takers' business models and operations as well as customer impact/understanding as well as the significant work required from deposit takers to implement them, further ongoing consultation is **vital** as these concepts are developed. A failure to do so will inevitably lead to laws being enacted that are unworkable or unnecessarily complex to apply, and depositors will be left unsure of their protections. The look-through requirements to establish ultimate ownership under the proposed 'single customer view' will be particularly confusing for depositors and extremely challenging to implement. Public confidence in the DCS is critical to its success – if its operation and application is unclear, all the financial stability benefits of the DCS will be lost.

42. Furthermore, certain "fringe" aspects of the "protected deposits" and "eligible investor" definitions result in added complexity that is out of proportion to the benefit of covering such areas, ultimately risking the overall effectiveness of the DCS (see for example our comments on large persons in paragraph 48(c)).

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[9] The effect of any Crown guarantee provided in relation to OBR also needs to be clear, including in relation to DCS payouts and NCWO calculations. The DCS is not intended or designed for use in place of a Crown guarantee if the Reserve Bank pursues OBR, and it has the potential to introduce significant complexity.

Complexity and general operational challenges

43. The introduction of various ‘look through’ and single customer approaches when deciding entitlements under the DCS will lead to a number of operational challenges for deposit takers. As discussed above, public confidence that the DCS will work efficiently if triggered is crucial for the DCS to fulfil its function. It is therefore essential that these approaches are implemented in a manner that works in practice.

44. For instance:

    (a) It is highly likely that the back office systems and record keeping approaches of each existing deposit taker will vary significantly, within the bounds of current laws. The systems of large deposit takers often require significant testing and development time for changes to be made, to ensure no unintended consequences of those changes affect depositors. Smaller deposit takers may have less flexibility to implement their own changes, and may not hold as broad a range of customer data.

    (b) Deposit takers will need to undertake a detailed investigation of their existing data across all customers and identify potential gaps from what may be required to calculated DCS entitlements. Fulfilling such data sets will create substantial challenges in customer interaction which may result in further delays, which should be reflected in the implementation timeline.

    (c) Furthermore, both the liquidity provisions under BS13 and the requirements of the DCS require deposit takers to prepare substantial data sets in order to implement these policies. It would be preferable to align the requirements of BS13 and DCS information-gathering as far as practicable, to minimise complexity.

    (d) Accordingly, ongoing workshops or similar with existing deposit takers across the industry must be used to ensure that the requirements of the DCS (including the impact of clause 205 of the Bill) and the data collection requirements that deposit takers have to undertake to implement the DCS are implemented in a way that caters for such differences and challenges.

    (e) Complexity can lead to unintended consequences from a DCS management perspective as well. Workshops and consultations would also assist to ensure that any practical gaps are identified, so that investors are not able to achieve inappropriate windfall gains (or inadvertently excluded from compensation) if the DCS is triggered.

    (f) Where the rules to categorise investors and entitlements are complex (such as where there may not be an equal split of a joint account, or deposit takers may or may not be required to look through to underlying beneficial interests), any obligation placed on the deposit takers (including via standards) should acknowledge this. For instance, deposit takers should not be held liable for failing to positively confirm with each joint account whether a non-equal split should be applied, or for correctly analysing whether a trust arrangement is legally a bare trust. Such obligations would be administratively unworkable given the number of

depositor customers and the possibility for circumstance changes. We expect that depositors should also generally be permitted to provide additional information/evidence after a DCS event occurs (including in the case of joint accounts), reducing the need for absolute reliance on deposit taker records. For example, clause 197 (joint accounts) should be amended to permit further evidence in the same way as clauses 198 and 199 for accounts other than joint.

45. As a further operational challenge, we note that the Bill anticipates (and goes some way to clear the path for) another deposit taker assisting in the case a payout from the DCS is required, with the Reserve Bank being permitted to establish accounts with that other deposit taker in the name of depositors entitled to compensation (clause 212). While NZBA supports this concept, we note that further exemptions relating to matters such as AML and privacy are likely to be needed for a deposit taker to be in position to take on such a role.

46. Finally, if the Reserve Bank does intend to retain OBR under the new DTA regime, it should be clear that deposit takers are not required to retain records based on both an account-based and single customer view for use prior to any liquidation.

Lack of clarity in core definitions

47. The definitions of "protected deposits" and "eligible investor" are fundamental to the operation of the DCS regime and any uncertainty in them needs to be limited.

48. We have the following comments on the current definitions in clauses 185 and 186:

(a) **Debt Security**: While it appears the intended focus of the DCS is to protect standard savings accounts, chequing accounts and term deposits, the term "debt security" as used under the FMCA is very broad and could, e.g., include positive balances on credit cards or revolving mortgages in credit. It would also create unnecessary compliance costs for licensed deposit takers that do not offer traditional deposits or transactional accounts, and for which customers would have no expectation of DCS coverage.[10] We would welcome further clarity on whether the intention is that all liabilities that fulfil the FMCA definition of debt security are caught by the DCS as this will have impact on system build, customer certainty and may go against the nature of some of these products (for instance, if deposits held as security are captured, then payment of them under the DCS may lead to (i) the DCS payments not being subject to security, and (ii) the secured amount being deemed to be reduced, effectively removing the secured party's security). As described above it would also unnecessarily increase compliance costs for certain banks. The 'no creditor worse off' (**NCWO**) assessment may also be impacted.

(b) **Excluded instruments**: The exclusion of various traded securities (bonds etc) from coverage is achieved based on references to such products in

[10] For instance, some branches of overseas banks may transact with wholesale clients only and may only provide settlement services or similar to such clients, rather than transactional accounts. Including all 'debt securities' as protected deposits will significantly increase compliance costs for such banks without material benefit.

the market. While we appreciate this is the approach taken for derivatives under the FMCA (on the basis that derivatives are extremely difficult to categorically define), we do not see a need to take such an approach here – it may lead to confusion where products are referred to by various names, or where similar products have different names, or where new products are developed that should be covered but use existing, excluded names. A definition of excluded instruments based on a legal trait (such as the ability to freely trade such instruments), or alternatively an amended definition of what is protected based on a legal trait, should be considered for clarity.

(c) **Large Persons**: With the current drafting, it is not entirely clear whether this definition intends to only catch large corporates or all large persons. The latter interpretation could also, e.g., catch individual customers, trusts, community organisations and schools. It is also unclear why large corporates should not benefit from coverage under the DCS. Carving them out will also inevitably cause concerns for SMEs, as there will be a lack of certainty whether their deposits are protected as they get close to satisfying the relevant asset/turnover tests.

The reference to net asset value approach could further also lead to persons having substantial assets but low deposits being excluded from the DCS. The reliance on financial statements also leaves uncertainty as to whether a person is "large" in the period between the end of their financial year and the publication of their accounts for that year. We would welcome further clarity on these points.

Separately, the distinction between large and other persons could lead to additional operational challenges for deposit takers which we would be keen to discuss with the Reserve Bank. For instance, as currently drafted a deposit held by a wholly-owned subsidiary of a large corporate may be included, but a deposit held by the large corporate itself would be excluded.

In the context of the FMCA, investors are incentivised to promptly provide their financial statements (to allow continued participation in wholesale offers), and wholesale investor 'safe harbour' certificates can be relied on where there is a lack of clarity. However, such an approach may be less practical for the DCS, where there is no incentive for investors to provide such information.

Identifying large persons would also require deposit takers to conduct a full review of their customer data base which requires considerable time and resources.

Ultimately, it is not clear that excluding 'large' persons from coverage, with the additional ongoing complexity that brings, is necessary or helpful in the context of the purpose of the DCS.

(d) **Associated Persons**: As previously submitted,[11] excluding associated persons of a deposit taker is likely to lead to practical difficulties for deposit takers with little practical gain.

(e) **Foreign Currencies/Governing Law**: As previously submitted, the limitation of protected deposits to NZ dollars (clause 186(a)(i)) could adversely affect small and medium sized exporters which require foreign currency-denominated deposits in their daily operations.

It would also be helpful to clarify that a New Zealand governing law clause in the contractual terms is sufficient to satisfy the requirement in clause 186(1)(a)(ii).

(f) **Offshore deposit takers**: We previously submitted that nostro/vostro balances of offshore deposit takers should not benefit from the protections of the DCS. Clause 185(b)(i) of the Bill currently only refers to "licensed deposit takers" but does not address offshore deposit takers.

(g) **Amount protected**: Under clause 186(2)(a), the amount protected "at a particular time" includes "the principal to be repaid". We assume this is intended to include all principal repayable at any time, rather than just amounts that are due and owing at that particular time (particularly as the latter approach would create confusion as to whether and at what stage particular investments are protected). This should be clarified in the drafting.

49. As a related point, the restriction on 'holding out' relating to protected deposits and eligible investors (clause 244) should be refined to acknowledge that circumstances beyond the deposit taker's control may determine this – for instance any deposit offered by a deposit taker may not be covered by the DCS if the depositor is or becomes large.

Management of the fund and use in resolution action

50. We agree with the DCS' funds being used to cover reasonable costs of the DCS and, with proper safeguards, reasonable costs of the Reserve Bank in administering the DCS. However we are concerned that the Reserve Bank's proposed powers to manage and use the DCS are very broad, with limited transparency and oversight. For instance:

(a) The Reserve Bank is given broad powers to charge expenses to the fund and determine apportionment of expenses (clauses 192 and 193). There is no review process or appeal process in the DTA for this (beyond publication of financial statements, which are not focused on such matters).

(b) The Reserve Bank is also given broad freedom to invest the fund under clause 194 (with the Reserve Bank of New Zealand Act 2021 restriction on using the fund to obtain a controlling interest through share purchases,

[11] See paragraph 74 of NZBA's submission on Consultation Document 3 of the Phase 2 review.

being specifically disapplied). It is not clear if the intention is for the fund to be invested in high risk/high return products – and if so, on what basis that is considered necessary or appropriate.

(c) When making depositor payouts, the Reserve Bank is given the freedom under clause 216(2) to determine the 'waterfall' of payment to a customer when they have multiple protected deposits (that is, to determine which deposits are treated as paid through compensation and which are not).[12] This should be subject to clear rules set out in advance, to provide certainty to investors and to ensure that the Reserve Bank's right of subrogation is maximised, such as by paying out secured deposits first (which in turn minimises the cost to the fund of a DCS payout).[13] This could be developed through industry workshops or similar.

51. In addition, a key concern in the current draft Bill is the possibility that the Reserve Bank may use the fund for resolution actions (see Part 6, Subpart 5). This has the potential to significantly deplete the fund (and even lead to double payments, where a resolution is not successful and depositor compensation is still required). Such a feature is arguably inappropriate, and if included should only be used subject to very strong safeguards:[14]

(a) As previously submitted, the DCS is a crucial aspect of the wider crisis management framework and must be carefully aligned with and integrated into wider resolution actions. The Bill currently only contains limited details of how this would occur in practice and we would welcome an opportunity to discuss this point further with the Reserve Bank, in particular the interplay between the DCS and OBR.

(b) In the event funds are used for resolution, the funds will have been largely provided by the other non-failing deposit takers through the risk-based levy, which ultimately should not bear the costs incurred of keeping another, failing deposit taker afloat. Accordingly, the surviving deposit takers should not have to bear the costs of replenishing the fund for any

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[12] We do note that clause 211(a) refers to making payment in the manner prescribed by regulation, but this appears to be intended to address manner of payment rather than apportionment. However we would welcome clarification on this.

[13] As a related point, we have not identified any clear requirement on the Reserve Bank to pay amounts recovered through subrogation back to the fund. This is implied in various parts of the Bill (including clause 191(1)(d)), but should be made explicit – as well as a clear requirement to pursue such subrogation claims (subject to assessment of expected return against costs of doing so) and amounts paid out in error.

[14] While we note that an independent review is required if a fund amount is used for resolution purposes rather than for a DCS payout (clause 223), that review is limited to the Reserve Bank's determination of the maximum amount that could be paid, and does not address the circumstances of payment or any other matter. It also does not clarify the consequences should the independent review of use of the DCS fund in resolution find that resolution activity was not efficient, e.g, a recourse for remaining deposit-takers against the Reserve Bank. Furthermore, it legally requires the reviewer to "take into account" the Reserve Bank's comments on the report (going well beyond the usual consultation wording elsewhere in the Bill), which may limit the review's independence.

shortfall arising due to the Reserve Bank spending fund assets on resolution actions.

(c) This is especially important if funds are used for payments due to violations of the NCWO principle. If the valuer subsequently finds that the Reserve Bank has not properly applied the NCWO principles the DCS should have the possibility to recoup any losses of the DCS that arose from such misapplication, rather than obliging remaining deposit takers to shoulder that cost. In addition, any use of DCS funds for NCWO purposes should be subject to an independent assessment before any shortfall arising from such use is charged to other deposit takers.

52. We reiterate the importance of adequate safeguards for such uses of the fund, including transparency of the Reserve Bank and the technical ability for action to be taken against it for mismanagement or misapplication of funds.

Funding of the DCS

53. As has been previously submitted, NZBA strongly believes that the levy should be risk-based, and this concept should be expressly recognised in the Act or supporting regulations.

54. The risk-based levy for the DCS has the potential to seriously affect deposit takers' business decisions. Accordingly, it is important that the levy is properly designed to achieve its goals. The Bill currently leaves a number of important points open or subject to regulations. We would welcome an opportunity to be consulted on draft regulations detailing the risk-based levy.

55. A number of elements are important when designing the levy:

(a) **Risk-based Levy derived from a number of key variables**: Risk-based pricing should be based on a number of key variables such as equity/regulatory capital/loss absorption and other credit support (such as a parent company guarantee or similar), liquidity & funding, asset quality, business model & profitability, management metrics, credit ratings and the extent of protected deposits held by the deposit taker. In this regard, we encourage the Reserve Bank to engage further with industry to consider the approaches adopted in jurisdictions with mature DCS regimes, including the United States, Canada and the European Union.[15] These regimes generally use fairly consistent approaches, and any arbitrage between them and New Zealand's approach should be avoided.

(b) **Different type of deposit takers**: We agree with the suggestion in clause 226(3) of the Bill for the regulations to provide for different risk-based levies for different classes of deposit taker. This allows the tailoring of the risk-based levy to the different business models used by deposit takers and systemic importance, and enables fair and balanced outcomes across the industry.

[15] See for example the 'Guidelines on Methods of Calculating Contributions to Deposit Guarantee Schemes' published by the European Banking Authority and various resources available from the International Association of Deposit Insurers.

(c) **Transition timelines**: In general, the sooner the details of the risk-based levies are known the better can deposit takers plan for and manage the DCS costs. In addition, if banks and other deposit takers become subject to the DCS requirements at different stages this should be taken into account when setting the risk-based levy – those who transition at an earlier stage should not be required to build up the fund for those that transition later.

56. The setting of risk-based levies should involve industry consultation at all stages. For example, the statement of funding approach (clauses 233 onwards) should include explicit provision for consultation with industry as well as members of the public. The levy regulations and statement of funding approach should be required to address the target size of the fund, as well as how levies will be reduced once such target size is reached (while maintaining fairness between new entrants to the market and those that provided the initial funding for the DCS) as well as the approach to ex-post levies.

57. Finally, as previously submitted, any support by the Minister to cover deficiencies in the fund should be provided by the Minister at cost. Requiring the payment of interest on such funds would ultimately punish the remaining deposit takers for another deposit taker's failure. The cost of any deficiency caused by the Reserve Bank's use of DCS funds for resolution (leaving inadequate funds available for a subsequent failure of the deposit taker) should not be borne by licensed deposit takers – i.e. costs of borrowing should not be charged by the Minister in that case.

Crisis Management

58. NZBA supports the modernisation of New Zealand's crisis management framework for deposit takers, including implementation of NCWO.

59. As discussed in relation to other parts of the Bill, we believe that ongoing engagement is needed to further develop and strengthen the provisions in the Bill, including appropriate safeguards to provide transparency and so that both deposit takers and creditors have sufficient certainty of approach (particularly offshore investors that are vital to prevent a significant funding deficit to support lending, given the finite amount of deposits in New Zealand's low saving economy).

60. In the area of crisis management, early and clear guidance is particularly important when new rules are developed. Uncertainty and unnecessary complexity can discourage investors from participating in debt instruments and financial products issued by New Zealand deposit takers. This would have direct impacts on the stability of New Zealand's financial sector, counter to the purpose of the DTA.

61. In particular, and as discussed further below:

(a) We are concerned that there is a lack of clarity as to how various elements of the crisis management framework (in particular open bank resolution or **OBR**, DCS and the general resolution powers of the Reserve Bank) are intended to work together. This has the potential to undermine the purpose of the DCS, by removing any comfort and public confidence it is intended to provide, as well as creating additional uncertainty for investors considering now whether to invest in a New Zealand deposit taker business and potentially impacting rating agency assessments, when New

Zealand legislation is already unusual in some respects compared to international jurisdictions.

In addition, maintaining the statutory management regime under the Corporations (Investigation and Management) Act 1989 (**CIMA**), when the tools provided by that regime are replicated and tailored for resolution under the Bill, creates further unnecessary complexity without clear advantage.

(b) We are concerned that funds of the DCS, which are funded by deposit takers (and that would need to be subsequently topped up by deposit takers), may be used to support resolution actions without strong safeguards, including in relation to any compensation payments that are needed.

(c) Lack of clarity around the potential for future statutory bail-in in New Zealand may create significant uncertainty for investors and impact rating agency assessments.

62. We also set out some further general comments (including relating to close-out netting protections) in paragraph 73 below.

Coordination between DTA resolution, DCS, OBR and CIMA statutory management

63. As previously submitted, it is crucial that the crisis management regime for deposit takers forms a single, cohesive framework, with each part being aligned with the others. The different timelines for certain elements of the new regime (with the DCS being prioritised and lack of clarity around potential statutory bail-in) unnecessarily detract from the potential for a coordinated approach, creating gaps and confusion.

64. The focus on contractual bail-in discussed further in this submission also does not seem aligned with the Reserve Bank's very recent actions to adjust the requirements for regulatory capital instruments. We would welcome some more clarity on the rationale for this apparent change in approach.

65. It is further unclear how the Reserve Bank's policy of OBR fits into the crisis management framework provided for in the Bill. For example:

(a) The Bill does not specify whether OBR is one of the resolution actions that the Reserve Bank can take under clause 285 of the Bill or whether it stands as a separate resolution tool outside of the framework provided by the DTA. While we expect that it would sit under clause 285, there has been no guidance to clarify even this point. This uncertainty will be a concern for all creditors (and particularly offshore investors) as well as rating agencies that rate deposit takers. We also note that deposit takers subject to OBR have invested substantial resources over the past years in implementing OBR (as well as related policies such as BS11 Outsourcing) which should be integrated into any further resolution planning deposit takers are asked to undertake.

(b) It is further unclear how OBR and the DCS would interact. If OBR is triggered a portion of the deposit taker's liabilities (including deposits)

would be frozen for, potentially, a considerable time. The key purpose of the DCS is to ensure that, in the event of liquidation of a deposit taker, depositors would effectively retain access up to $100,000 of their deposits, providing comfort and mitigating the potential for a ‘bank run’. A separate resolution policy that freezes deposits before liquidation would mean that depositors are not in fact protected by the DCS. They could be provided access to only a small portion of their deposits, or none at all, for an indefinite period, the risk of which reinstates the factors that may lead to a bank run.

A related issue concerns the unfrozen part of any deposits of a deposit taker subject to OBR. Such deposits, like all unfrozen obligations of that deposit taker, are expected to benefit from a government guarantee under OBR. We have assumed that the DCS would not be used to back such a government guarantee:

(i) it would be inappropriate to do so, effectively treating the DCS as a broad fund for the Reserve Bank rather than a tool to protect depositors in liquidation (or to prevent a liquidation from being necessary); and

(ii) it would substantially increase the level of protection that depositors are provided (i.e. both the ‘unfrozen’ amounts, which are protected by government guarantee, and up to $100,000 of the ‘frozen’ amounts under the DCS at liquidation).

66. We also question why statutory management of deposit takers pursuant to CIMA remains an additional option, in parallel to the resolution actions under the Bill. We would welcome further clarification on what the potential scenarios under which a CIMA liquidation of a deposit taker could become relevant.

67. The numerous options under which resolution can be triggered lead to additional unnecessary costs for deposit takers as they regularly have to explain these regimes to offshore (and domestic) investors, as well as rating agencies, that are crucial for their funding needs. A New Zealand regime that is not aligned to other major central bank policies can lead to pricing distortions and limit funding capacity for deposit takers in offshore markets. A number of the options available in New Zealand are unfamiliar to offshore investors. The DTA provides a prime opportunity to streamline these options further and align them closer with international standards.

Funding of resolution measures

68. To the extent that the DCS is to be used to fund resolution actions taken by the Reserve Bank, there must be transparency and clear safeguards. The Bill currently focuses on the protection of public money in this regard, which we support, but it does not adequately provide for the protection of the DCS fund. The funds accumulated in DCS represent a valuable asset to the Government to protect financial stability; there must be protections in place to ensure they are used for a proper defined purpose. In particular:

(a) As previously discussed in our submission on the DCS, we have serious concerns about the DCS fund being used to make payments due to a violation of the NCWO principle. The DCS fund will have been largely filled by deposit takers that are not in resolution, and it would be their contribution that is used to make such payments, potentially with an obligation on them to also subsequently replenish the DCS fund. It is not appropriate for the remaining viable deposit takers to bear the cost of Reserve Bank actions that lead to NCWO compensation claims (that is, actions which effectively leave creditors in a worse position).

(b) The DCS fund serving as a broad source of funding for NCWO compensation payments, with limited accountability, also weakens the overall policy intent discussed for NCWO. NCWO has previously been discussed as incentivising the Reserve Bank as resolution authority to be conscious of additional costs, and to give rise to additional legal checks and balances.[16] Sourcing NCWO compensation payments from the DCS fund would negate both of those policy points without additional accountability measures.

(c) There should be a clear right and mechanics for deposit takers, and other stakeholders, to monitor the Reserve Bank's use of funds from the DCS for resolution purposes.

(d) Separately, clause 353 and 354 require the valuer to submit a draft report to the Reserve Bank and the Minister. Under clause 355, the Minister and the Reserve Bank may then require the valuer to reconsider its report. This potentially raises serious conflicts of interest issues with regard to the Reserve Bank and, potentially, the Minister that may impact on investor and depositor confidence in the regime.

Lack of clarity around statutory bail in

69. The lack of a clear direction in relation to statutory bail-in, with the indication that it may be potentially introduced a few years after the Bill is enacted, results in significant uncertainty for banks and investors.

70. While additional work may be required to determine if statutory bail-in should be implemented in the New Zealand regulatory framework (and if so, how),[17] leaving this as an open question may significantly undermine the new crisis management framework, given that a statutory bail-in regime would fundamentally change the landscape of any crisis management framework. We encourage the Reserve Bank

16 Refer to page 20 of *Safeguarding the future of our financial system: Background paper on bank crisis management and resolution* dated June 2019, prepared by The Treasury and the Reserve Bank: https://www.treasury.govt.nz/sites/default/files/2019-06/rbnz-safeguarding-future-financial-system-background-paper-p2.pdf

17 For instance, omitting any statutory bail-in is out of step with the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions and risks leading to conflicts with the home regulators of offshore parent banks of NZ subsidiaries, reducing the degree to which NZ subsidiaries can be integrated into a cross border resolution plan and creating additional costs.

to include consultation with the industry on the appropriateness (or otherwise) of statutory bail-in within its current timeline for the Bill.

71. The Bill further contains a number of references to contractual bail-in clauses (e.g., in clause 74 and, potentially, clause 253). These suggest that the concept of contractual bail-in is one of the Reserve Bank's resolution tools. This goes against recent developments in the New Zealand regulatory capital space, where contractual bail-in clauses were removed from regulatory capital instruments (in contrast to international approaches) and banks had to adapt their products accordingly. We would welcome further details on whether providing for contractual bail in options signals the Reserve Bank moving away from its current approach of not allowing them in regulatory capital instruments.

72. In any event, any decision to implement any form of bail-in (whether contractual or statutory) should involve significant industry consultation.

General comments on resolution powers

73. As noted elsewhere, we consider that ongoing engagement through development of the Bill, regulations and guidance will be key to the success of the new crisis management regime. By way of example:

(a) We strongly support the principle of the desirability of taking a proportionate approach to regulation and supervision (set out in clause 4(a)(i)) applying to all resolution actions taken by the Reserve Bank. Any resolution action taken by the Reserve Bank has the potential to significantly affect the deposit taker and it is thus crucial that such actions are proportionate to the failures of the deposit taker to which such actions relate.

(b) We also strongly support the inclusion of clauses protecting derivatives and similar matters from the effects of a moratorium, as such protection is effectively required to recognise close out netting for Reserve Bank capital and credit requirements, and to enter into derivatives in international markets. However:

(i) Extreme care needs to be taken with any limits to these protections, as such limits can easily undermine the certainty required and the ultimate drivers for including the protections. In the context of a legislation rewrite, for all such limits (whether an equivalent currently exists or not) a clear confirmation should be included (in the legislation or the relevant standards) that they will not impact the Reserve Bank's domestic legal certainty requirements, and they should also be reviewed and checked to ensure that international legal certainty requirements can continue to be met and that the New Zealand approach is consistent with the prevailing approach in overseas regulatory regimes, so that New Zealand counterparties will not be precluded from trading with international counterparties who are subject to those regimes. For example, clause 279(1)(b) could be read as restricting a

counterparty from closing out a derivative when a deposit taker enters resolution, until a "later time" specified by the Reserve Bank under clause 280.[18] Although clause 281 sets out various factors that must be met before a "later time" can be specified, the inclusion of this mechanic may significantly reduce close-out certainty and may jeopardise the necessary legal certainty and ability of New Zealand counterparties to enter into derivatives in international markets, discussed above.

(ii) The scope of products for which coverage is required needs to be carefully considered against the FMCA definition of "derivative" used. For instance, there may be some uncertainty whether certain sale and repurchase or stock-lending arrangements are captured by this definition. Such products should be explicitly included in the definition in the Bill to ensure legal certainty. Excluding such products could result in different rights applying to transactions under the same master agreement (to the extent the agreement covered both FMCA "derivatives" and sale and repurchase or stock-lending transactions, which is common practice in both the New Zealand market and overseas) and interfere with close-out netting and enforcement of security under those arrangements.

(c) Care is needed where the Reserve Bank is given the power to direct the issue of shares (by way of direction) or to issue further securities (as a resolution power), given the need to provide all material information to investors. This is particularly the case in relation to a direction, where the direction itself is not made public. It should also be made clear that the directors of the deposit taker (who are following Reserve Bank direction or, in the context of resolution, prohibited from taking any action) do not face deemed liability under the FMCA or other securities laws for any such securities issuance.

(d) The Reserve Bank's direction power under clause 253(1)(k) (to exercise contractual bail-in rights) is broadly drafted and could be used to allow the Reserve Bank to require bail-in outside resolution and based on subjective considerations supporting the decision. To provide investor certainty this power of direction needs to be subject to clear and objective criteria that can be reflected in the contractual terms of the relevant bail-in instrument.

(e) Clause 253(1)(a) regarding the direction to consult with the Reserve Bank currently refers to "any difficulties facing the deposit taker". While we appreciate that equivalent wording appears in the 1989 Act, this could be read as providing a very broad power in the Reserve Bank's new toolkit. This should be clearly directed at breaches or potential breaches of standards and other statutory obligations.

[18] As a separate grammatical point, the use of the word "or" between clauses 279(1)(a) and (b) is unclear and may imply that either (a) or (b) may be applied by the counterparty – in which case the counterparty would be able to enforce at the default time under (a), regardless of whether a later time is specified under clause 280. It would help to clarify the intended application here (taking into account our substantive comments above).