PowerFinance

Submission on Deposit Takers Bill

February 2022

1. Information about PowerFinance

Response made on behalf of an organisation:

Organisation: Power Finance

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Who we are:
PowerFinance is a FinTech based in Auckland. Our mission is to help make finance a better version of itself. Through finance, we want to deliver better value, better experiences for people, their families, and their communities.

We are currently a non-licensed financial services company. We are in the process of applying to become a NBDT, as our business growth plan includes taking deposits to add to the investor and consumer product options in the market.

2. Introduction and General Comments

Why is PowerFinance making a submission?
PowerFinance has three reasons for making a submission:

1. We believe finance should support the wider community and that the financial sector should be robust and resilient in order to protect all that participate in it.
2. For finance to be the best version of itself (i.e., to provide products and services that are empowering, efficient, and accessible), the regulatory environment needs to facilitate innovation.
3. If we become an NBDT as noted above, we would be impacted under the proposed changes to the regime.

Overview and general comments
We welcome the review of New Zealand's deposit taking regime, since the prudential settings are significant in shaping a financial system that contributes positively to the well-being of New Zealanders. In particular, we commend the rigorous and transparent approach that has been brought to the Phase 2 review by the Reserve Bank and Treasury teams. The resulting legislative framework – comprising the 'institutional act' and the DTA – should provide the basis for a more innovative and inclusive financial system.

3. Transitional arrangements

The DTA is, in large part, enabling legislation, with further detailed development to occur through regulations and standards (now also to be secondary legislative instruments). So much of the positive impact of the legislation will depend on continuing momentum, drawing on the well-resourced and focused approach evident in the Phase 2 reform process leading to the exposure draft.

In this regard, we welcome the broad timetables set out on page 19 of the Explanatory Notes, but make two comments:

- In relation to the general standard-setting process for banks, it would be good to have this unpacked somewhat. Rightly, the initial focus is on the regulations for the Depositor Compensation Scheme, and the initiating a revised crisis management framework is likely also a high priority (in part because of its relationship to the DCS). Beyond that, there are many existing Handbook standards that can be grandfathered, or subject to minor changes pending deeper review, to speed the transition.

- It is not clear why there should need to be a 24-33 month transition period for transition of NBDTs into the new, inclusive, LDT category. The elimination of this confusing distinction was a key reform, so it would be unfortunate for it to continue for a protracted period.

In practice, there are material barriers to new full banking licenses (e.g. recent experience has been that these have primarily resulted from entry of subsidiaries of offshore banks or roll-ups of existing large finance

companies). As a result, for those seeking to introduce innovative business models and who wish to subject themselves to the additional responsibilities of being a regulated deposit taker, the current option is to inherit into an oversight regime whose shape is in a state of flux.

We submit that, in effect, postponing the finalised treatment of the smaller deposit-taker category (i.e. those who are currently NBDTs or who apply to be LDTs on the basis of standards tailored to their scale) should not be necessary as the sector is small, its business model is not complex, the entities are not systemically significant individually or as a group, and there are stakeholders (notably the trustee companies who act as supervisors) who have significant insight to help inform decisions. The result of these factors ought to mean that key design questions (e.g. the role of supervisors, disclosure, a modified liquidation option[1]) can be worked out relatively quickly. This would enable an implementation programme that should not soak up considerable resource in order to provide a superior set of outcomes than those prevailing at present, given the sector's scale and the proportionate approach adopted in the exposure draft.

4. Purposes and principles

We strongly support the stated purpose of the proposed Act to promote the prosperity and well-being of New Zealanders, consistent with the addition of this over-arching goal in the Phase 1 reform. In particular, we support the integration of the notion that the Act should contribute to a sustainable and productive economy. This principle embodies our kaupapa, the purpose driving our product and service offerings and the overall impact we want to have on finance in New Zealand.

We similarly support the principles set out in section 4 of the exposure draft. These are important in setting the tone for prudential regulation and its implementation. In particular (and picking up the principles set out in the exposure draft), we emphasise the following as imperative in fostering innovation, dynamism and competitiveness in the New Zealand financial system:

- **Supporting new players**: Recognising the contribution that new market participants can make to fostering innovation and choice among consumers of financial products and services. As noted above, a key factor in this will be the attention given to transitioning quickly to a high-quality regime for NBDTs and smaller LDTs.
- **Transition**: The key factors relating to smaller LDTs are not their impact on financial stability, but the impact of their failure on public confidence and the reputation of the financial system. While the reforms that eventually became the NBDT Act, and associated changes to supervision, resulted in substantial improvement, the reality is that they have failed to underpin a thriving sector that can contribute positively to the overarching goals of the prudential legislation. This is now exacerbated by the protracted period of uncertainty that results from the length of the transitional period and the very high-level nature of the principles that are baked into the DTA with respect to this sector. There is an opportunity to refresh the settings in a way that will optimise both financial stability and the innovation, inclusiveness, and competitiveness of the financial system.
- **Proportional intervention**: Proportionality in terms of matching the standards to the scale and of the institution and nature of its business model, rather than a blanket 'one size fits all' approach.

5. Depositor Compensation Scheme

Overall position

We agree that the depositor compensation scheme will be a positive tool to support financial stability and consumer protection.

Deposit takers play a key role in the financial system, support economic growth, and provide a savings mechanism for depositors of all sizes. Given their vital role, it is important to ensure they are resilient, and depositors are protected and confident in the system. We agree that the introduction of the scheme will enhance trust in the financial system, improve the stability of the funding base for deposit takers, and support back-end crisis management.

[1] Noting that this makes only modest and targeted changes to the general liquidation regime. It does not seek to be a full crisis management framework outside of generally-applicable insolvency laws.

Implementation

We set out our thoughts on specific aspects in response to feedback requests in the Exposure Draft: Explanatory Notes:

- **Model and structure**: We support an asset management model similar to the Accident Compensation Corporation scheme. Levy moneys should be segregated from other public funds and be managed under a public insurance provider structure. This allows the pool of funds collected as levies to grow and support the liquidity and growth needs to ensure that funds are available to effect compensation under the scheme in the event of a triggering crisis event. This further supports growth of institutional markets by adding a well-capitalised investor for high quality assets.
- **Levy model**:
  - We generally agree with the proposed structure and the underlying principles as set out in the Exposure Draft. We believe that the best way to achieve these principles is by having a simple and transparent levy structure and one that is likely to provide fairly balanced outcomes consistent with the purposes and principles of the DTA.
  - In this regard, while we agree with the principle of risk-based pricing, which is the apparent intent of clause 227(b)(i) of the Bill, we have some questions about what how that would be determined. This is not necessarily straightforward. For example, if credit ratings could be adopted on the principle of simplicity, the impact of the underlying criteria (e.g. the BICRA methodology) should be assessed with regard to the purposes and principles of the DTA.
  - Further, the meaning of clause 227(b)(iii) is somewhat opaque, particularly if it is to be understood as a "principle" intended to drive the regulations. It is to the effect that the levy obligation must not be such as to impact "the financial stability of a deposit taker of that class". There are two issues with this. First, financial stability is a system concept, so is unclear in its meaning here. Second, if it is to be equated with the soundness of institutions of the relevant type/scale, then it suggests that the only limitation (e.g. for smaller LDTs) is that the levy amount does not impact their solvency. It would be useful to have this clarified as it will be of some significance in the preparation of the regulations.
- **Privacy**: With regard to the practicality of depositors amending their existing terms and conditions with depositors to enable information sharing, we support the Reserve Bank seeking an exemption under the Privacy Act 2020 to enable this information sharing.

6. Single regulatory regime and strengthening accountability

General position

We support the move to a single regulatory regime.

That the existing regime is confusing and suboptimal was clearly recognised in the first Phase 2 Consultation Papers and corresponding Cabinet decisions. Consumers cannot be expected to understand the nuances in these regulatory frameworks, and they hamper the ability of both prudential and conduct authorities to bring a coordinated and principles-based approach to the deposit-taking sector.

The new law recognises that regulatory distinctions should be based not on form but on the substance of activities, shaped to the circumstances of different classes of deposit-taker.

On that basis, standards and rules ought to be focused on current real-world factors such as scale, business model, funding model, and systemic impacts. This is true also of registered banks and is already recognised in existing banking supervision – for example, in the differential treatment of branches and for wholesale service providers which do not take deposits, and in the application of the OBR and outsourcing standards. Each 'NBDTs' and registered banks are each companies in the business of borrowing and lending and who take retail deposits. The distinctions in their treatment under existing law relate primarily to historical factors which we now have a chance to assess on a principled, forward-looking basis. The quicker the process is undertaken the better.

We support the unitary approach as delivering the following:

- Greater transparency – a system the public can understand and engage with.
- Greater regulatory efficiency and coherence by treating like-with-like.

- A consistent and principles-based approach for new entrants to the market which do not necessarily aspire to the scale or nature of entities regarded as "banks" – a distinction that will be maintained.

The questions relating to smaller LDTs are ones that must be addressed in any event in the new framework of standards that will be precipitated by the passing of the DTA Bill. Under sections 3 and 4, that is to be based on principles of proportionality and consistent treatment of similar institutions (recognising their diversity). Providing for a coherent treatment of new entrants will also help contribute to a sustainable and productive economy, particularly given the acceleration of technological and market developments.

Retention of NBDT regulations

We believe that all the current regulations such as the Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010 should not be altered in the transition to a unitary regime, which is predicted to take as much as three years. In that period, entities must have clarity on the rules that apply while the transition is occurring, and a holistic approach ought to be taken in the tailoring of appropriate standards that will apply going forward.

We agree with the strengthening of accountability for directors of deposit takers and in making this consistent with broader conduct regulation of the financial markets, most notably in the FMCA. To have a robust financial sector, it is important that individuals are held to account for outcomes over which they have significant influence.

Equally, this must also be fair and create correct incentives. In that regard, we support the integration of the due diligence framework based on the FMCA. This provides a foundation for financial institutions to build robust compliance and risk-management frameworks, tailored to their own circumstances and business model. It is clearly preferable to prevent harms before they occur than to deal with their consequences after they have. However, this should only be done to an extent, and such mechanisms should be established in a balanced way.

While the proposed new regime extends accountability of directors to all deposit takers, there are sensible limitations to their liability which we support:

- **Proportionality**: The sliding scale element of the duty with respect to the size and nature of the business of the deposit taker.
- **Director insurance:** The permission for directors to insure themselves for a breach.
- **Defences:** The imposition of defences for persons that contravene a prudential obligation.

These limitations to the liability are sensible and achieve greater accountability, whilst likely limiting any 'chilling effect' that would be caused by overly onerous responsibilities. It is imperative that the sensible limitations in the draft bill are kept.

7. Supervision and Enforcement

Supervision and enforcement are key pillars of any financial system. Effective supervision increases the likelihood that regulatory requirements will be met, and emerging risks can be identified early to save costs and shocks to the overall system. It also encourages good behaviour as effective enforcement deters improper behaviour from occurring.

We support regulators and supervisors having as many tools as possible. By providing more tools, it gives the Reserve Bank greater power to lay out a graduated set of actions to respond proportionally to issues. A robust environment that facilitates innovation is one in which improper actions are met in a predictable and reasoned way.

8. Crisis Management

Crisis management is important for dealing with events that seriously threaten a deposit taker's viability or financial stability generally. To effectively manage a crisis you need preparation, a deep toolbox, and coordination. Reforms around the world since the GFC have also recognised that the system should be transparent to both its participants and its users. As such, we commend the requirements for the Reserve Bank to prepare and publish a statement of approach to resolution and LDT-specific plans to facilitate orderly resolution.

PowerFinance supports the Reserve Bank being designated as the resolution manager as it would add clarity to crisis management. Most significantly, it recognises the primacy of financial stability.

In the Explanatory Notes, you asked for feedback on whether responsibility for day-to-day management of an entity in resolution to be conducted by a resolution manager – presumably by rule since the Reserve Bank as resolution authority already has clear power to delegate those functions.

Going back to first principles, the resolution regime is designed to promote financial stability and inevitably will apply in circumstances where that is most under threat – the failure of a bank, where there is no reasonable prospect that the failure can be adequately dealt with other than by formal resolution.[2] This will clearly be a significant focus of the Reserve Bank, and likely other government agencies, such that it is inevitable that there will need to be a substantial time devoted to monitoring the resolution. But this does not call for the Reserve Bank as resolution authority being down in the weeds, dealing with thousands of customers or making employment or health and safety decisions. The terms of the delegation ought to make it clear what are the respective responsibilities of the Reserve Bank and the resolution manager. But the line of accountability must be clear for financial stability to be placed at the centre of decision-making.

We support the moratorium on deposit takers during a crisis event, based on the existing moratorium in section 122 of the Reserve Bank Act 1989. We also support the time limit to 12 months as stated in clause 271(b) of the bill. This is an important signal encouraging swift resolution. It also helps effectively balance the interests of those who have a moratorium on exercising their rights against a deposit taker.

[2] Clause 266 of the Bill.