Reserve Bank of New Zealand
Te Pūtea Matua

Depositor Compensation Scheme Regulations consultation

NBDT workshop – 21 March 2024

Indicative detailed timeline (current assumption)

March 2024

1. Deposit Takers Bill Passed — **Jul 2023**
2. Consultation on proportionality framework and DCS levy framework (RBNZ) and Statement of funding approach (Treasury) — **Aug/Sep 2023**
3. Consultation on DCS regulations — **Mar-May 2024**
4. Proportionality framework published — **by April 2024**
5. Consultation on core standards — **May/Jun 2024***
6. Consultation on non-core standards — **Jul/Aug 2024***
7. DCS regulations made — **End of 2024**
8. DCS commences — **mid 2025**
9. Consultation on exposure draft of core standards — **Oct/Dec 2025***
10. Consultation on exposure draft of non-core standards — **Feb/Apr 2026***
11. Core and non-core standards issued — **Jan 2027**
12. All remaining regulations made — **Jul 2027**
13. Licensing process — **Jan 2027 – Jul 2028**
14. All DTA standards including SCV commence — **Jul 2028**
15. Legislative backstop — **Jul 2029**

* Consultations will be released during this timeframe and run for 8 weeks

Legislation | Consultation | Operational | Licensing

DTA - Deposit Takers Act, DCS - Depositor Compensation Scheme, SCV - Single Customer View

← Communications and Engagement →

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DCS REGULATIONS

Second consultation - now open until 10 May

Regulation making power

Subpart 6 of Part 6, Deposit Takers Act

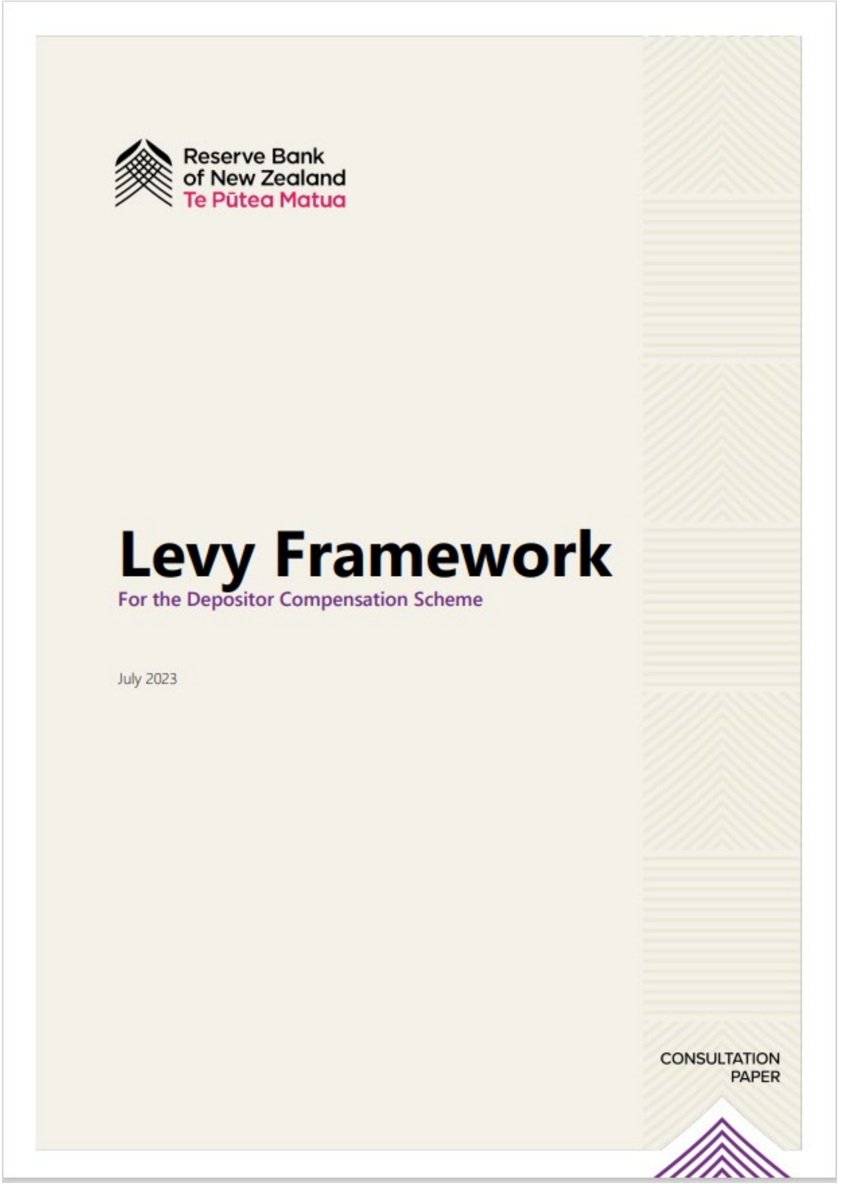
DCS regulation made by Minister of Finance on the advice of the Reserve Bank

Minister must have regard to these principles

- DCS should be fully funded by licensed deposit takers
- Levy for each class of deposit takers should reflect:
  - likelihood and cost of a payout event (of being used to contribute to resolution)
  - the effect of levies on the soundness of a deposit taker of that class
- Desirability of predictability

Levies

- $= \mathit{Protected\ deposits} * \mathit{Levy\ rate}$
- Previously consulted (Q3 2023) on:
  - **Levy Base:** Estimating the total amount of covered deposits
  - **Levy Methodology:** The methodology for calculating how much deposit takers will pay in levies
- This consultation seeks feedback on our proposed final advice.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Levy Framework
For the Depositor Compensation Scheme

July 2023

CONSULTATION
PAPER

Levy base – estimating pre SCV

- An estimate is needed until Single Customer View requirements are introduced (2028). SCV will give a more accurate figure of the levy base.
- Proposed approach largely confirms the prior consultation approach:
  - Applies a sector specific adjustment factor to deposit account data.
  - Adjustment factor is designed to recognise the difference between account and customer-level data, as well as above cap deposits.

Total retail deposits, up to $100k ~$187b

X

Adjustment factor

=

Initial levy base ~$133b

Levy base – proposed solution

NBDT – estimating each NBDTs covered deposits

Step 1: Account level data (NBDT monthly survey)

- Get "2.1 Retail funding – debt securities issued to the public ($)"

Step 2: Apply adjustment factor

- Apply adjustment factor (based on average deposit size data and estimates of above-cap proportions)
  - For Credit unions: retail deposit amounts * 80%
  - For Building Societies: retail deposit amounts * 40%
  - For finance companies: retail deposit amounts * **40%**

Levy base – proposed solution

Bank – estimating each bank's covered deposits

Step 1: Aggregating the following account level data

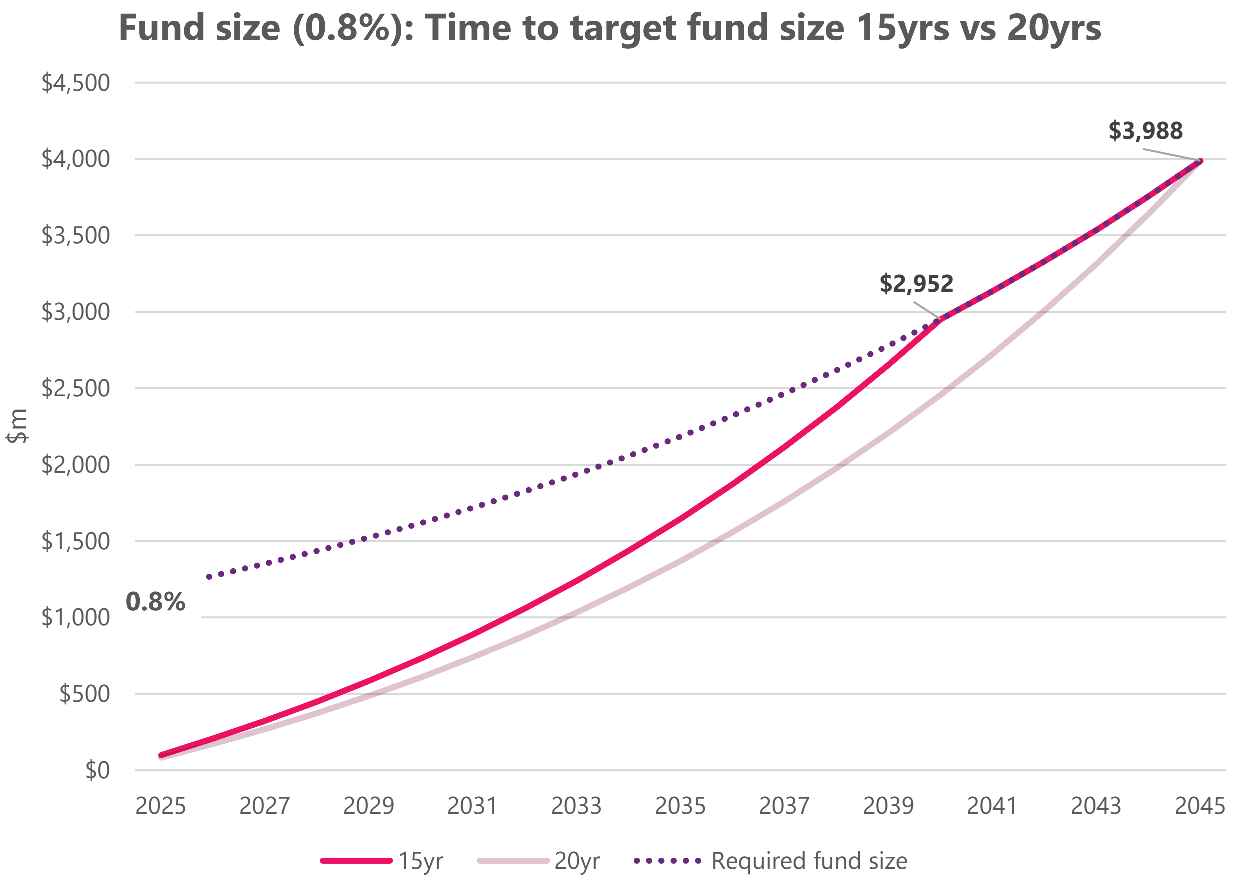
- for account values less than $100,000, use the value as reported in the BBS; and
- for account values of equal to or larger than $100,000, use $100,000 multiplied by the number of accounts

Step 2: Applying an adjustment factor to the aggregate number

- Aggregate amount * 70% [based on estimate of impact of people holding multiple accounts]

Levies – Statement of Funding Approach

- Statement of Funding Approach (SoFA) sets the total amount of levies that should be collected by specifying the:
  - **target fund size**: what proportion of insured deposits the fund should build up to (0.5 – 1.3%)
  - **timeframe**: how quickly should the target fund size be met.
- The Treasury is leading this advice - expect a second round of consultation in April/May.



Levies – Methodology options

Previously consulted on three methodology options for how much deposit takers will be required to pay in levies:

- **Flat rate -** preferred by Group 3 deposit takers
- **Credit rating** - risk-based
- **Composite risk indicators** – risk-based (preferred by Group 1 and 2 deposit takers)

Proposed approach: **Composite risk indicators**

- The proposed approach mitigates **'moral hazard' risks**; where deposit takers are incentivised to attract deposits by taking on additional risk.
- DTA requires that the levy method have regard to the **likelihood of a deposit taker failing**.
- As compared to credit rating approach, it supports **transparency**.

Levies – Composite risk indicators

Risk indicators for NBDTs

Indicator (and weighting)	Measure (sub-weighting within category)	Formula	Boundary
Capital adequacy (33.3%)	Total capital ratio	$\frac{Total\ Capital}{Risk\ Weighted\ Assets}$	9 – 20%
Liquidity (33.3%)	Simple Coverage Ratio	$\frac{Liquid\ Assets}{Total\ Assets}$	8 – 50%
Business model and management (33.3%)	Return on equity	$\frac{Profit\ after\ tax}{Average\ Equity}$	0 – 15%

Levies – Composite risk indicators

Risk indicators for banks

Indicator (and weighting)	Measure (sub-weighting within category)	Formula	Boundary
Capital adequacy (33.3%)	Total capital ratio	$\frac{\textit{Total Capital}}{\textit{Risk Weighted Assets}}$	9 – 18%
Liquidity (33.3%)	One month mismatch ratio (50%)	$\frac{\textit{1 month Mismatch}}{\textit{Total Funding}}$	0 – 10%
	Core Funding ratio (50%)	$\frac{\textit{One year Core Funding}}{\textit{Loans and Advances}}$	75 – 100%
Business model and management (33.3%)	Return on equity	$\frac{\textit{Profit after tax}}{\textit{Average Equity}}$	0 – 20%

Levies – Composite risk indicators

Of particular interest is:

1. **Focus on Capital, Liquidity and Business Model**

   As outlined in the consultation document, we plan on reviewing the factors in the lead-up to the updated standards in 2028.

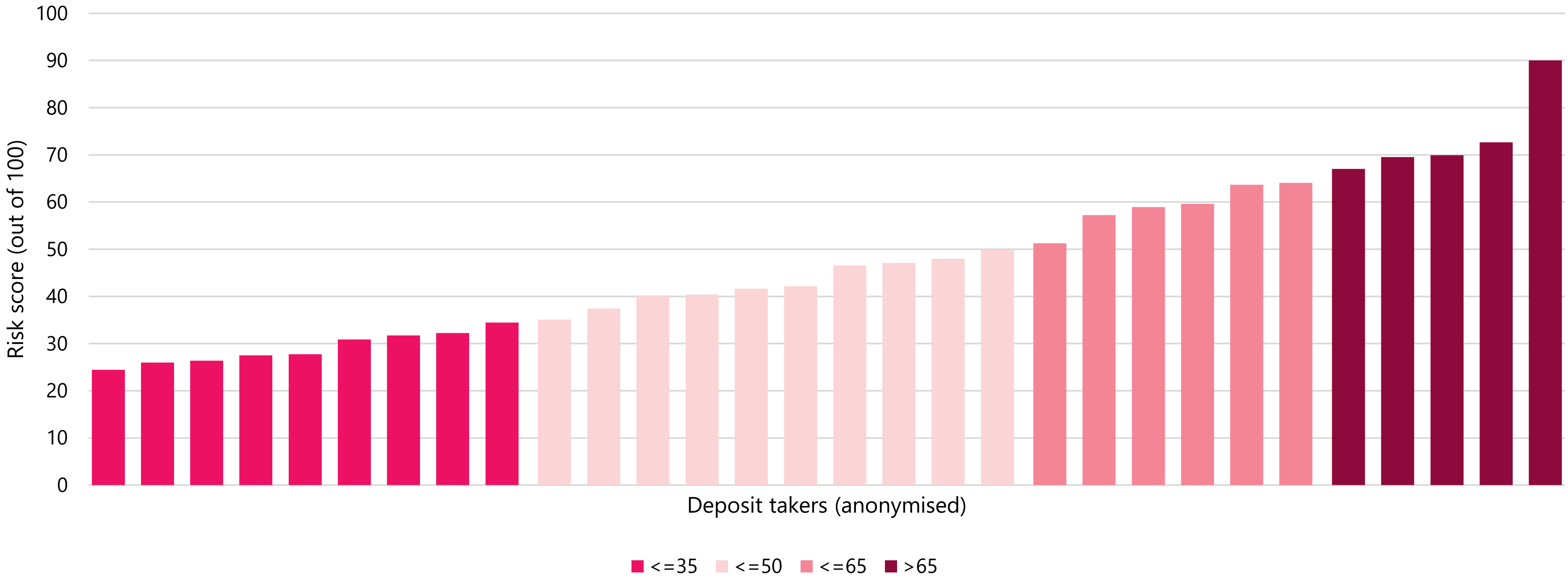
2. **Changes to the Return to equity (ROE) and removal of Non-Performing Loans (NPL)**

   Following the consultation release, we are continuing to consider whether both these changes create too much of a moral hazard risk. In particular, to take on undue risks that may result in high profitability in the short term. Furthermore, we have reservations regarding the procyclicality of including ROE and giving it this much weight.

   We will review further, including feedback in submissions received.

Levies methodology

Proposed Composite Aggregate Risk Scores



We are able to provide deposit taker's individual 'risk scores' on request. Noting it is subject to change.

Levies – estimate levy rate

Risk bands	Estimated levy % of covered deposits
1	0.05%
2	0.10%
3	0.15%
4	0.20%

Proposed method

- A flat levy rate is calculated to meet the annual required levy amount ($)
  - Based on SoFA median proposals: 0.066%
- The flat rate is multiplied by the Risk Band's Aggregate Risk Component (ARC)
  - First band = **1** x 0.066%
  - Second band = **2** x 0.066%
  - Third band = **3** x 0.066%
  - Fourth band = **4** x 0.066%
- Each band's levy is scaled in order to collect the total levy required (~75%)

Levies – key factors determining a deposit taker’s levy

- The Statement of Funding Approach (SoFA) determines what the flat rate is, by setting the expected **fund size (0.5 – 1.1%)** and **timeframe to meet the fund size (10 – 20yrs).**

- The **deposit taker’s risk score** determines the deposit taker's risk band. Each risk band's multiplier (aka ARC) will be applied to the flat rate.

- This rate will then be applied to each deposit taker's **estimated levy base**.

- The **distribution of risk scores** then determines the **scalar** used to meet the required levy amount.

Deposit taker A’s levy = [Estimated protected deposits] * flat rate * ARC * scalar

[note the tax exemption should reduce the amount of levies required to be collected annually]

Questions - Levy approach

1. Do you agree with the **revised composite approach** with respect to the quantitative risk **indicators, boundaries**, and **weights** for each input?

2. Do you agree that the composite risk indicators and weights should be **reviewed in 2028** to better reflect updated standards?

3. Do you have any **other comments** about the proposed DCS levy approach?

Operational aspects of levies

Frequency of calculation and payment, we propose:

- Levies are calculated on an annual basis, starting once the DCS commences in 2025
- Levies are invoiced annual in arrears (first invoice made in mid-2026)

Other proposed regulations:

- The deposit taker would be able to submit information for reassessment, within four years of the original levy payment
- Interest to be charged at OCR + 4% on unpaid levies
- Provide relief in exceptional circumstances, if it would be inequitable for a deposit taker to pay a levy

Protected Deposits

- Regulations will determine **protected deposits** eligible for DCS compensation.
- Under the Act protected deposits will include normal banking products such as **current accounts**, **savings accounts**, and **term deposits**, and similar products offered by non-banks.
- Investments will not be eligible for DCS compensation, including fixed-income securities such as debentures, bonds and notes.
- Through the use of regulation we propose the protected deposit definition include credit balances on **revolving home loans**, **revolving credit facilities**, and **credit cards**.

Debentures, and subordinated securities

- Traditional debentures with terms and conditions describing a 'sale to new owner' process, like bonds, are not expected to be covered. We understand some issuers are already changing terms and conditions to remove these clauses and are happy to take any related feedback.

- Any subordinated products (ranked below the main tranche of deposit-like products) will not be covered.

Relevant Arrangements

- **Relevant arrangements** relate to client money arrangements, where an amount is held in the name of a depositor on behalf of another person.

- Relevant arrangements enable the use of **look-through treatment**, with the DCS compensation entitlement being calculated at the level of the underlying client, not at the depositor level.

(This will be a slower and more complex payout process – need to identify remaining entitlements of underlying depositor by contacting relevant arrangement provider)

Relevant Arrangements

Under the Act, relevant arrangements will include **custodial services**.

Through the use of regulation, we propose certain **client accounts** would be specified as relevant arrangements:

- Conveyancers
- Lawyers
- Accountants
- Real estate agents
- Retirement village deposits

We also propose including holdings in **bank-sponsored PIE funds** as relevant arrangements.

Branches

- Recent RBNZ "Review of Policy for Branches of Overseas Banks" means branches of overseas deposit takers operating in New Zealand will no longer be able to interact with retail customers. This makes DCS much less relevant for them.

- All deposit takers are required to pay the levy, unless the debt securities they are offering are declared by regulations to not be protected deposits (i.e. unless they are exempted).

- We propose to exempt branches from DCS membership.

In-flight payments

- DCS entitlements are calculated on the basis of protected deposit balances at the quantification time.
- Rules are required to clarify whether these balances should reflect transactions that have been initiated but not fully processed at the quantification time (i.e. in-flight payments).
- Rules will cover a variety of different categorises of payments, but are expected to be similar in most respects to the treatment of in-flight payments in Open Bank Resolution.
- We are interested what impact these different rules may have on both direct and indirect participants in the payment system.

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www.rbnz.govt.nz

consultations.rbnz.govt.nz (DCS Regulations open until 10 May)

Email dta@rbnz.govt.nz