RESERVE BANK OF NEW ZEALAND
TE PŪTEA MATUA

Consultation Document: Review of the Treatment of Charitable and Religious Organisations under the Non-bank Deposit Takers Regime

The Reserve Bank invites submissions on this consultation document by 5pm on 20 August 2013

Submissions and enquiries should be addressed to:

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Please note that a summary of the submissions may be published. If you consider that any part of your submissions should properly be withheld on the grounds of commercial sensitivity or for any other reason, you should indicate this clearly.

July 2013

Ref #5356776

INTRODUCTION

1. The purpose of this consultation document is to seek stakeholder views on the appropriate treatment of charitable and religious organisations under the Non-bank Deposit Takers (NBDT) regime.

2. In particular, it sets out our analysis of various options for the treatment of charitable and religious organisations, and our preliminary view on the preferred option. We are interested to receive stakeholders' feedback on the different options canvassed in the document and our preliminary conclusion on which option should be preferred.

3. In considering these matters, the Reserve Bank (the Bank) has also been conscious of the importance of taking into account various other relevant areas of work which are currently being progressed. Most importantly:

    - The implementation of a licensing regime for NBDTs under the Non-bank Deposit Takers Bill (NBDT Bill);
    - The review of the prudential regime for NBDTs;
    - The review of the existing Securities Act exemption applying to charitable and religious organisations being carried out by the Financial Markets Authority (FMA); and
    - The progress of the Financial Markets Conduct Bill, which will replace the existing Securities Act 1978.

4. The Bank also stresses that this document is concerned with the treatment of charitable or religious entities that meet the definition of NBDT. It does not address the question of whether any particular entity comes within the definition, as this will depend upon the specific circumstances of the entity in question. The Bank is currently aware of eleven charitable and religious organisations that are currently caught by the definition of NBDT.

5. The remainder of this paper is divided into the following sections:

    Section 1 discusses the current treatment of charitable and religious organisations under the NBDT regime;

    Section 2 discusses the reasons for reviewing the current treatment of charitable and religious organisations under the NBDT regime;

    Section 3 discusses options for the treatment of charitable and religious organisations under the NBDT regime, and the Bank's preferred option;

    Section 4 discusses which specific prudential requirements should apply to those charitable and religious organisations that would remain within the definition of NBDT under the Bank's preferred option; and

    Section 5 discusses the basic transitional arrangements being proposed for the proposals set out in this document.

6. The Bank invites submissions from interested parties on its proposals by 5pm on 20 August 2013

SECTION ONE: STATUS QUO

Current regulation of the NBDT sector

7. The prudential regulation of deposit takers is currently provided for under Part 5D of the Reserve Bank Act of New Zealand Act 1989 (Part 5D), which defines a deposit taker as an entity that:

    - offers debt securities to the public in New Zealand; and
    - carries on the business of borrowing and lending, or providing financial services, or both.

8. In summary, under Part 5D and associated regulations, a deposit taker must:

    - have a current credit rating;
    - have at least two independent directors and an independent chair;
    - have a risk management programme;
    - have a capital ratio of at least 8 percent (or 10 percent if the deposit taker is exempt from the requirement to have a credit rating);
    - ensure that its related party exposures do not exceed more than 15 percent of capital;
    - maintain liquidity policies in its trust deed, including at least one quantitative liquidity measure.

9. Part 5D also sets out offences and enforcement powers for the Bank.

10. The NBDT Bill, which is currently before Parliament, re-enacts the provisions of Part 5D and implements the remaining elements of the regulatory regime for NBDTs. These include licensing, suitability assessments for directors and senior officers, restrictions on changes of ownership and new powers for the Bank to detect and manage instances of distress or failure of NBDTs.

11. Under Part 5D and the NBDT Bill, regulations may be made declaring a person or class of persons not to be a NBDT for the purposes of the NBDT regime, subject to the Minister and the Bank having regard to:

    - The nature of the business activities carried on by the person or class of persons and the extent to which those activities (i) are similar in substance to the activities of an NBDT; or (ii) involve activities as an NBDT;
    - The public interest; and
    - Any other matter the Minister or the Bank considers relevant.

Treatment of Charitable and Religious Organisations under the NBDT regime

12. Charitable and religious organisations that meet the definition of deposit taker can currently rely upon the Deposit Takers (Charitable and Religious Organisations) Exemption Notice 2010 (the Notice).

13. The exemptions in the Notice are primarily available to charitable and religious organisations that also rely upon the exemption in Clause 5 of the Securities Act (Charitable and Religious Purposes) Exemption Notice 2003 (the Securities Act Notice), or that are listed in the Schedule to the Notice. They include exemptions from the credit rating, governance, capital, related party exposure, and liquidity requirements under the NBDT regime. They do not include an exemption from the requirement to have a risk management programme.

14. In addition, to qualify for the exemptions in the notice, a deposit taker:

- must notify the Bank that it intends to operate on the basis of the exemptions granted in clause 5 of the Securities Act Notice;
- must not disclose an assessment of its creditworthiness that is in substance a credit rating issued by an agency that is not approved by the Bank; and
- must ensure that any information document relating to the securities it has issued includes a statement explaining the matters it is exempted from under Part 5D.

Securities Act (Charitable and Religious Purposes) Exemption Notice 2003

15. The Securities Act Notice covers charitable and religious organisations issuing debt securities under the Securities Act 1978 (Securities Act). It defines a charitable organisation as:

"a body corporate or unincorporated that is organised and subsisting, or carrying on business, exclusively for charitable, educational, religious, or recreational purposes; and includes a trade or professional union or association and a chamber of commerce."

16. For the purposes of the Securities Act Notice, a religious organisation is a type of charitable organisation, and is defined as:

"a charitable organisation that exists for religious purposes, whether or not it also exists for other purposes."

17. The Securities Act Notice provides comprehensive exemptions from the standard Securities Act requirements for issues of debt securities. These include exemptions from the requirements to:

- Have a trustee and trust deed;
- Prepare a prospectus and investment statement; and
- Prepare a signed directors certificate for an authorised advertisement.

18. The exemption applies to charitable organisations raising debt securities up to an aggregate outstanding amount that is no more than $2 million at any one time, and up to an allotment amount that is no more than $500,000 in any 12 month period. There are no restrictions applying to religious organisations raising funds for the purposes associated with the religious objectives of the organisation.

19. The exemption is subject to subscribers being given an information document with prescribed content prior to subscription. The information document includes a warning that the offer is not subject to normal offer document requirements and that risks may not be as fully disclosed as they would be in a standard offer document. Some limited additional information describing the debt securities and associated risks must also be provided in this document.

Characteristics of Charitable and Religious Organisations which meet the NBDT definition

20. The Bank is aware of eleven charitable and religious entities that currently meet the definition of NBDT, generally as a by-product of the fact that they carry on the business of borrowing and lending.

21. Charitable and religious organisations offering deposits to the public make a commitment to return the deposit. Consequently, investors in charitable and religious organisations have an expectation that their deposits will be available upon demand or at maturity, and may rely on at least some of their deposits for day-to-day transactions or for specific purposes. Some charitable and religious organisations offer a fund transfer or on-line service which enables depositors to transfer money from their deposit account with the charitable and religious organisation to their external bank account, possibly to manage payment of bills and other undertakings. Some charitable and religious organisations offer an array of deposit products such as a funeral plan or funeral account where the funds held in the account can be withdrawn to cover depositors' funeral expenses, or an educational plan where the funds held in the account can be withdrawn to pay for educational expenses.

22. Unlike corporate issuers, which used funds raised to finance the issuer's own business, some charitable and religious organisations lend money to third parties to fulfil their charitable or religious purpose. They may invest funds received in excess of loan requirements in properties or other forms of financial instruments. This gives them many of the basic characteristics of a typical NBDT, although these entities' depositors will often be strongly motivated by a desire to support the objectives of the entity, rather than solely by a desire to seek a financial return.

SECTION TWO: REASONS FOR REVIEWING THE TREATMENT OF CHARITABLE AND RELIGIOUS ORGANISATIONS UNDER THE NBDT REGIME

23. There are three key reasons why the Bank considers it is appropriate to review the treatment of charitable and religious organisations under the NBDT regime at this time.

24. Firstly, the forthcoming licensing of NBDTs under the NBDT Bill has prompted the Bank to review the treatment of entities that are exempt from all, or almost all, of the requirements of the regime, including charitable and religious organisations. The fact that an entity is exempt from most, or all, of the requirements of the regime is usually an indication that:

    - While the entity is technically caught by the definition of NBDT it is not carrying on traditional NBDT type functions; or

    - There are special policy considerations that justify the entity being treated differently from other NBDTs.

25. In these cases, the Bank is considering whether these entities should be covered by the licensing regime, or declared not to be NBDTs for the purposes of the NBDT Bill, thereby no longer being required to be licensed.

26. Secondly, the Financial Markets Authority (FMA) is currently undertaking a review of the Securities Act Notice. The FMA discussion document, *Charitable and Religious Purposes Exemption Review*, proposes to exempt charitable and religious entities from Securities Act requirements if they:

    - issue debt securities worth no more than $2 million per year; and
    - have outstanding debt securities of no more that $10 million at any one time.

27. The Bank considers that the fact that the Securities Act Notice is being reviewed also means that it is appropriate for the Bank to look again at whether the current scope of the exemption from the NBDT regime remains appropriate (given how it relies on the Securities Act Notice).

28. Thirdly, there is a broader set of potential risks arising out of the status quo. Specifically:

    - It exposes investors in NBDTs that are charitable and religious organisations to greater risks than investors in other NBDTs;
    - It results in inconsistencies in the treatment of different NBDTs, which can create a lack of clarity about the actual level of regulation different NBDTs are subject to;
    - It may give certain NBDTs that are charitable and religious organisations an advantage over other NBDTs, in those cases where they are carrying out genuinely analogous activities.

29. In the Bank's view, these potential risks, coupled with the time that has elapsed since the Notice originally came into force, means there is value in looking again at whether the treatment of charitable and religious organisations under the NBDT regime is appropriate.

Q1 Do you agree with the issues we have identified with retaining the status quo? Are there other issues that we should be considering?

SECTION THREE: ASSESSMENT OF POLICY OPTIONS

30. In considering the options for the treatment of charitable and religious organisations under the NBDT regime, the Bank sees the key trade off as being between addressing the issues that have been identified, and not imposing unnecessary compliance costs on charitable and religious organisations (which is a particular concern here given the public benefits they provide).

31. We consider three alternative options for regulating charitable and religious organisations:

    - Option 1 is to capture all charitable and religious organisations that meet the NBDT definition;
    - Option 2 is to declare all charitable and religious organisations out of the NBDT definition;

- Option 3 is to declare small charitable and religious organisations out of the NBDT definition.

32. In all of these options, the Bank is proposing to align the definition of charitable or religious entity with the definition of charitable entity currently being proposed by the FMA. This definition will either require that the entity be a registered charity, or meet the requirements for being registered, namely that it:

    - Has a charitable purpose that falls within one of the four purposes set out in section 5 of the Charities Act (relief of poverty, advancement of education, advancement of religion, or any other matter beneficial to the community); and
    - Provides a public benefit; and
    - Is not being carried on for the financial benefit or profit of an individual.

Q2 Do you agree with the options we have identified? Are there other options that we should be considering?

Q3 Do you agree with our proposed definition of charitable or religious organisation?

Option 1: capture all charitable and religious organisations which meet the NBDT definition

33. Charitable and religious organisations that meet the NBDT definition would be required to hold a licence and, consequently, would need to comply with a minimum set of prudential obligations under the NBDT Bill at the time of application, and on an ongoing basis.

34. Licensing charitable and religious organisations would have the following benefits:

    - It increases a potential investor's awareness that deposits in these charitable and religious organisations carry a range of risk and liquidity characteristics that are similar to those of other NBDTs;
    - It strengthens incentives for charitable and religious organisations to raise their risk management standards and to carry on their business in a prudent manner in order to compete for deposits with other NBDTs;
    - It creates a level playing field for persons carrying on the borrowing and lending of money; and
    - It enhances public confidence and participation in charitable and religious organisations through awareness that they are investing in a licensed NBDT that is prudentially regulated and is subject to the Bank's ongoing supervision.

35. Charitable and religious organisations, however, generally operate for the benefit of the public by making funds available to a wide group of loan beneficiaries, and by providing other services for the public benefit. Requiring all charitable and religious organisations to comply with prudential obligations similar to those that apply to other NBDTs could result in charitable and religious organisations being subject to

prohibitive costs, or being subject to obligations that are too difficult to administer. This may lead some charitable and religious organisations to cease issuing debt securities, which could be detrimental to their ability to support their charitable and religious purpose.

Option 2: declare all charitable and religious organisations out of the NBDT definition

36. This option would not impose additional prudential requirements (and associated compliance costs) on charitable and religious organisations. This has the benefit of avoiding any adverse impacts on the ability of all existing charitable and religious organisations to lend to borrowers that find it difficult to access commercial channels, and to fund their other charitable activities.

37. However, we think that retail depositors in charitable and religious organisations may not always be well placed to protect their interests because the business of borrowing and lending carried on by charitable and religious organisations raises risks that may not be easy to fully understand without having analysed detailed disclosures from those organisations.

38. In addition, this option would have the following disadvantages:

- It does not meet the principle of competitive neutrality where persons carrying on analogous activities should be regulated on the same basis; and

- It may result in a lack of clarity about the level of regulation these entities are subject to.

Option 3: declare small charitable and religious organisations out of the NBDT definition

39. Option 3 recognises that compliance with full prudential requirements would impose substantial compliance costs on charitable and religious organisations and accepts that a degree of differential treatment for those entities may be appropriate given the public benefits they provide.

40. For the purposes of this option, our preliminary view is that it would be appropriate to declare charitable and religious organisations out of the definition of NBDT where they have outstanding debt securities not exceeding $10 million and outstanding loans not exceeding $4 million. We consider that the benefits of using loans as a measure for the threshold are its simplicity and clarity, while using debt securities as a measure would align with the threshold being proposed by the FMA in granting exemptions from securities law requirements. Once an entity exceeded these proposed thresholds, it would remain within the regime permanently even if it at a later point it no longer had outstanding debt securities of over $10 million and outstanding loans of over $4 million.

41. Our preliminary assessment of the financial statements of the eleven charitable and religious organisations currently relying on the Notice shows that eight of these organisations would be declared out of the NBDT definition under the proposed threshold. We think that the remaining three charitable and religious organisations that would be captured by the regime report relatively higher earnings and, on that basis, would be better placed to move to compliance with the prudential requirements in the NBDT regime.

42. We consider that this option would have the following benefits:

- It preserves the ability of existing small charitable and religious organisations to continue to support niche markets;
- It reduces the compliance costs that would apply to new small charitable and religious organisations that carry on the business of borrowing and lending;
- Only large charitable and religious organisations, whose failure might have implications on the public's confidence in the broader NBDT sector, would move to compliance with prudential obligations; and
- Only large charitable and religious organisations that meet a minimum set of prudential requirements at the time of application, and on an ongoing basis, would be able to hold themselves out as licensed NBDTs.

Q4 Do you agree with our assessment of the costs and benefits of these three options for the treatment of charitable and religious organisations under the NBDT regime? Are there other costs and benefits associated with these options that we should be considering?

Preferred option

43. Our default position is that if a charitable and religious organisation meets the definition of deposit taker or NBDT for the purposes of Part 5D or the NBDT Bill, then it should be captured by the NBDT regime.

44. Although option 1 (requiring all charitable and religious organisations to comply with a minimum set of prudential requirements) would be desirable in principle, we accept that the costs associated with complying with a minimum set of prudential requirements could have adverse effects on small charitable and religious organisations.

45. Option 2 (declaring all charitable and religious organisations out of the NBDT definition) could create inconsistencies in the treatment of entities carrying out NBDT type functions, which could be detrimental to the objectives of the regime.

46. For these reasons, our preferred option is option 3. We consider that declaring small charitable and religious organisations out of the NBDT definition would avoid the unnecessary costs of compliance which could otherwise diminish their ability to support their charitable purpose. In addition, the threshold of outstanding debt securities not exceeding $10 million and outstanding loans not exceeding $4 million in total would reduce the potential impacts that might result from the failure of this kind of entity.

47. Large charitable and religious organisations would move to compliance with the requirements in the NBDT regime under this option. This option also recognises the impact their failure could potentially have on the public's confidence of the broader NBDT sector, and ensures that only those entities that are able to meet a minimum set of prudential requirements would be licensed.

48. In summary, we propose that to be declared out of the definition of NBDT under this option, an entity would have to:

- Meet the same definition of chartable and religious organisation being proposed by the FMA;
- Have outstanding debt securities of $10 million or less; and
- Have outstanding loans of $4 million or less.

49. The NBDT Bill makes it an offence for an entity to hold themselves out as an NBDT or licenced NBDT if they are not actually an NBDT or licenced NBDT. As a result, we do not think that it is necessary for charitable or religious organisations that are declared not to be NBDTs to notify potential investors of that fact.

50. To prevent entities from avoiding the NBDT regime by splitting their business into two or more parts, all of which come under the $10 million debt securities / $4 million loans threshold being proposed here, we consider that entities with the same common owner should be treated collectively when considering whether they come above or below the threshold.

Q5 Do you agree with the Bank's preferred option of declaring smaller charitable and religious organisations out of the definition of NBDT, and requiring larger charitable and religious organisations to comply with the NBDT regime? If not, how do you consider charitable and religious organisations should be treated under the NBDT regime?

SECTION FIVE: ASSESSMENT OF PRUDENTIAL REQUIREMENTS

51. Under Part 5D, prudential requirements can be categorised into six areas, namely:

- Credit rating;
- Governance;
- Risk management programme;
- Capital ratio;
- Restrictions on related party exposures; and
- Liquidity.

52. The NBDT Bill also adds prudential requirements relating to:

- Changes of ownership; and
- Suitability assessments of directors and senior officers.

53. As a general rule, we think that charitable and religious organisations that are not declared out of the definition of NBDT should comply with the same prudential requirements as other NBDTs. However, there may occasionally be a need to exempt individual entities from certain requirements (either on a temporary or permanent basis).

54. In considering whether to exempt these charitable and religious organisations from certain prudential requirements, the Bank must have regard to the following matters under both Part 5D and the NBDT Bill:

    - Whether the exemption will be consistent with the maintenance of a sound and efficient financial system;

    - Whether compliance with the relevant provision or provisions would, in the circumstances, require the licensed NBDT, class of licensed NBDTs, or trustee to comply with requirements that are unduly onerous or burdensome; and

    - Whether the extent of exemption is not broader than is reasonably necessary to address the matters that gave rise to the exemption.

55. In the discussion that follows, we canvass our preliminary views on the application of specific prudential requirements to charitable and religious organisations that are not declared out of the definition of NBDT under our preferred option.

Credit rating

56. The purpose of the credit rating requirement is to provide investors with a measure of the likelihood of default by a particular entity, and to allow them to compare relative risks of institutions in a form that is easy to comprehend.

57. Although some investors may be motivated to facilitate the charitable purpose of the organisation or some investors may not consider their deposit to be an "investment" (for example, where there is no expectation of a financial return), we think the availability of a credit rating would assist with an investor's decision on which charitable or religious organisation to place money with, and the corresponding level and maturity of deposit with that organisation. For example, an entity's credit rating may be an important factor to consider for investors placing funds on long maturities or saving for a specific purpose (e.g. through a funeral or education deposit account).

58. Although one approach could be to exempt charitable and religious organisations from the credit rating requirement on the condition that they disclose the nature of the persons they lend to and other purposes they carry out, this may not be sufficient. In particular, this disclosure would not cover all of the risks associated with investing in an entity, or disclose those risks in the most easily comprehensible manner.

59. As a result, we consider that charitable and religious organisations that are not declared out of the definition of NBDT should be required to comply with the credit rating requirement. However, these organisations would still be able to rely on the current exemption from this requirement available to NBDTs reporting consolidated liabilities of less than $20 million.

60. We are conscious of the potential high cost associated with complying with this requirement, and would be interested in feedback on the potential direct and indirect costs to charitable and religious organisations of obtaining a credit rating.

Q6 Do you agree that charitable and religious organisations that are not declared out of the definition of NBDT should be required to comply with the credit rating requirements? What level of direct and indirect costs would the requirement to have a credit rating place on a charitable or religious organisation?

Governance

61. The governance requirement in clause 24 of the NBDT Bill applies to a licensed NBDT that is a company, building society, or overseas company. It requires an NBDT's governing body to include at least two independent directors and the chairperson of the governing body not to be an employee of either the licensed NBDT or a related party.

62. Charitable and religious organisations are generally established under the Incorporated Societies Act 1908 or Charitable Trust Act 1957, or established as a corporation sole under the Roman Catholic Bishops Empowering Act 1997. Hence, we think that this requirement would generally not apply to charitable and religious organisations that are declared out of the definition of NBDT. However, we think that it should apply to any charitable or religious organisation that still comes within the definition of NBDT and which is a company, building society, or overseas company.

Q7 Do you agree that the governance requirement should apply to any charitable or religious organisations that are companies, building societies, or overseas companies, and are not declared out of the regime? What costs would be associated with complying with the governance requirement?

Risk management programme

63. Under the NBDT regime, licensed NBDTs are required to have a risk management programme, which includes procedures for effectively identifying and managing credit risk, liquidity risk, market risk and operational risk. The business of borrowing and lending money exposes charitable and religious organisations to all of these risks.

64. Charitable and religious organisations are not currently exempted from the risk management programme requirement. We think that charitable and religious organisations that are not declared out of the definition of NBDT should continue to be required to comply with the risk management programme requirement.

Q8 Do you agree that charitable and religious organisations that are not declared out of the definition of NBDT should have to comply with the risk management programme requirement? What costs are currently associated with complying with the risk management programme requirement?

Capital ratio

65. NBDTs are currently required to maintain a minimum capital ratio of not less than 8 percent where the NBDT has a credit rating, and not less than 10 percent where the NBDT does not have a credit rating. This is designed to ensure that an NBDT has sufficient assets to meet its obligations under a range of circumstances.

66. We are conscious of the fact that not all charitable and religious organisations remaining within the definition of NBDT under our preferred option are likely to be able to meet the capital ratio requirement within a short period of time. Our preliminary

assessment shows that capital of charitable and religious organisations generally consists of retained earnings, reserves or accumulated funds. Therefore, we think it would be unduly onerous to require these organisations to comply with the capital ratio requirement within a very short period of time, given that the capital raising activities available to them are not as wide-ranging as those available to other NBDTs.

67. We consider that there is a case for them to be allowed to come to compliance with the requirement over a period of two or three years from the date when any transition period commences. We would be particularly interested to receive information in respect of capital raising activities available to each charitable and religious organisation, and the reasonableness of providing a longer transitional period to comply with this requirement.

68. On the basis that this exemption is temporary, it would still be consistent with the maintenance of a sound and efficient financial system and is not broader than is reasonably necessary.

Q9 Do you agree that charitable and religious organisations which are not declared out of the definition of NBDT should be required to comply with the capital ratio requirement? What costs would be associated with complying with the capital ratio requirement?

Q10 If charitable and religious organisations are required to comply with the capital ratio requirement, do you agree that they should be provided with two to three years to move to compliance, given that they may have fewer capital raising options available to them?

Restrictions on related party exposures

69. The restriction on related party exposures is a limit, expressed as a ratio, on the exposures that an NBDT may have to related parties, relative to its capital. The current limit is no more than 15 percent of capital. This requirement ensures that related party exposures do not exceed a level that might put investors' interests at risk.

70. We think that there is a case to exclude lending to affiliated churches, schools, parishes and dioceses from the calculation of the limit on related party exposures where charitable or religious organisations are established for the purpose of supporting these organisations.

71. Under these circumstances, we consider that strictly applying the restrictions on related party exposures would be unduly onerous as it could constrain a charitable or religious organisation's ability to fulfil its charitable or religious purpose. The risk of charitable or religious organisation lending to, or investing in, other private sector bodies that have some link to individual members or senior officers of the charitable or religious organisation would continue to be identified and monitored. There would be scope to provide protection to depositors by requiring relevant charitable or religious organisations to disclose this limited exemption. Hence, the proposal would still be consistent with the maintenance of a sound and efficient financial system. This exemption is also not broader than is reasonably necessary since it will likely only apply to charitable and religious organisations.

72. In considering this matter, we would be particularly interested to receive information about the nature and level of any related party lending carried on by charitable and religious organisations.

Q11 Do you agree that charitable and religious organisations that are not declared out of the definition of NBDT should be required to comply with the related party exposure requirements? What costs would be associated with complying with the related party exposure requirements?

Q12 If these charitable and religious organisations are required to comply with the related party exposure requirements, do you agree that transactions with certain related parties should be exempt from these requirements, because including them might hinder the entity's ability to achieve its charitable or religious purpose?

Liquidity

73. A licensed NBDT is required to include liquidity requirements in its trust deed, including at least one quantitative liquidity requirement.

74. We think that charitable and religious organisations can come under liquidity pressure in cases where they borrow on short maturities and lend on long maturities. This could potentially be a threat to their solvency where there is an exceptionally high withdrawal of deposits, and they may not have access to bank facilities to allow them to make funds available to meet their financial obligations at short notice.

75. For these reasons, we think that charitable and religious organisations that are not declared out of the definition of NBDT should be required to comply with the liquidity requirement.

Q13 Do you agree that charitable and religious organisations that are not declared out of the definition of NBDT should be required to comply with the liquidity requirements? What costs would be associated with complying with these requirements?

Consent for changes of ownership

76. Clause 42 of the NBDT Bill requires licensed NBDTs to obtain the written consent of the Bank before giving effect to a transaction that would increase a person's level of influence over a licensed NBDT above a specified level, or above a higher level that had been previously authorised by the Bank. The purpose of this requirement is primarily to ensure that changes of ownership do not adversely affect an entity's ability to comply with the prudential regime (although the Bank would also want to be satisfied that the owners of the entity collectively have the necessary skills and incentives to effectively monitor the performance of the entity's management).

77. We think that charitable and religious organisations that are not declared out of the definition of NBDT should be required to comply with the consent for changes of ownership requirement.

78. However, we note that this requirement may not be relevant to certain types of charitable and religious entities because of their legal form and/or the fact that they are not owned by one or more other persons or corporate entities (for example, corporations sole and some charitable trusts do not have owners).

Q14 Do you agree that charitable and religious organisations that are not declared out of the definition of NBDT should be required to comply with the change of ownership requirements? What costs would be associated with complying with these requirements?

Suitability assessments of directors and senior officers

79. The Bank intends to prescribe matters, circumstances or conditions that are suitability concerns for the purposes of the NBDT Bill.

80. Where an actual or potential director or senior officer of an NBDT raises a suitability concern, the Bank must be notified and must make a suitability assessment of that person. The Bank may, as a result of the suitability assessment, prevent a person from acting, or continuing to act, as a director or senior officer of an NBDT.

81. Depositors hold directors and senior officers accountable for ensuring that the charitable and religious goals of the organisation are observed, and that potential for fraud and conflicts of interest, which could affect directors and senior officers' performance of their duties, are mitigated.

82. As a result, we think that the directors and senior officers of charitable and religious organisations that meet the definition of NBDT should be subject to the suitability assessment regime

Q15 Do you agree that the directors and senior officers of charitable and religious organisations that are not declared out of the definition of NBDT should be subject to the suitability assessment process? What costs would be associated with complying with this process?

Trust Deed and Trustee Requirement

83. All NBDTs are issuers of debt securities to the public under securities law, which requires them to have a trust deed and trustee, unless they are covered by an exemption under securities law. The NBDT regime leverages off these trustee and trust deed requirements by requiring certain prudential requirements to be placed in trust deeds and requiring trustees to monitor compliance with those requirements. The specific prudential requirements that must be contained in a trust deed are the NBDT's capital ratio, liquidity policy, and limit on related party exposures. Trustees must also approve the risk management programme of NBDTs.

84. The Securities Act Notice currently provides a comprehensive exemption for charitable and religious organisations from the usual securities law requirements, including the requirement to have a trustee and a trust deed. The nature of the current NBDT regime means that it is very difficult to apply the full set of prudential requirements to an entity that does not have a trustee or trust deed.

85. As noted earlier, the FMA is currently consulting on a proposal to require charitable and religious organisations seeking to raise significant funds from the public to move to compliance with the standard securities law regime. As a result, the charitable and religious organisations that we propose to cover in the NBDT regime would likely move to compliance with the standard securities law regime and accordingly would be required to have a trust deed and a trustee.

86. However, we are interested in feedback on the likely costs associated with having trustees to monitor prudential requirements in trust deeds.

87. We also note that the review of the prudential regime for NBDTs currently being undertaken is considering a number of options for supervision of NBDTs, including direct supervision by the Bank. If the current supervisory arrangements for NBDTs are changed as a result of this review, we consider that it should be possible to apply these new arrangements to larger charitable and religious organisations at the same time as they are applied to other NBDTs.

Q16 What additional cost would be associated with having a trustee also monitor compliance with prudential obligations in the trust deed?

SECTION SIX: TRANSITIONAL ARRANGEMENT

88. In considering the appropriate transitional arrangements for charitable and religious organisations under the NBDT regime, we are conscious of a number of factors. Most importantly:

- The likely timing of any changes to the Securities Act Notice;
- The timing of the Financial Markets Conduct Bill (FMC Bill), which will replace the Securities Act;
- The implementation of NBDT licensing; and
- The review of the prudential regime for NBDTs which is currently underway.

89. These factors make it difficult to design precise transitional arrangements at this time. However, we would expect that:

- The Bank's final policy position on the treatment of charitable and religious organisations would be decided and communicated to stakeholders by November 2013;
- Any transitional arrangements for charitable and religious organisation would commence no earlier than mid-2014; and
- The transitional arrangements would provide a reasonable period (e.g. one year or more) for affected organisations to move to compliance with the licensing and other relevant prudential obligations in the NBDT Bill.

90. We expect that the Bank will be able to provide greater detail on any transitional arrangement when informing stakeholders of its final policy in November 2013.

Q17 Do you have any comments on the likely timing of the transitional arrangements that we are suggesting?