

# Submission

to the

# Reserve Bank of New Zealand

on the

# Open Bank Resolution – IT Pre-positioning consultation document

4 October 2011

# Submission by the New Zealand Bankers' Association to the Reserve Bank of New Zealand on the Open Bank – IT Pre-positioning consultation document

## Summary

1. The New Zealand Bankers' Association (**NZBA**) appreciates this opportunity to submit on the Open Bank Resolution – IT Pre-positioning consultation document.

## About NZBA

2. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a safe and successful banking system that benefits New Zealanders and the New Zealand economy.
3. The following twelve registered banks in New Zealand are members of NZBA:
  - ANZ National Bank Limited
  - ASB Bank Limited
  - Bank of New Zealand
  - Bank of Tokyo-Mitsubishi, UFJ
  - Citibank, N.A.
  - The Hongkong and Shanghai Banking Corporation Limited
  - JPMorgan Chase Bank, N.A.
  - Kiwibank Limited
  - Rabobank New Zealand Limited
  - SBS Bank
  - TSB Bank Limited
  - Westpac New Zealand Limited.
4. This submission is made on behalf of the following members of the NZBA:
  - ANZ National Bank Limited
  - ASB Bank Limited
  - Bank of New Zealand
  - Kiwibank Limited
  - Rabobank New Zealand Limited
  - SBS Bank
  - TSB Bank Limited
  - Westpac New Zealand Limited.

## Issues

5. NZBA invites the Reserve Bank of New Zealand (**RBNZ**) to engage with the industry on the detail of Open Bank Resolution (**OBR**) policy. NZBA suggests testing OBR with the industry to identify the strengths and weaknesses in responding to different situations of financial crisis. NZBA considers that further consultation with the

industry will assist both the public and industry understanding of OBR. The submission notes a number of areas where there is still uncertainty about the policy and on which the industry requires clarity.

6. NZBA notes the emphasis of the Financial Stability Board's report, *Effective Resolution of Systemically Important Financial Institutions* published in July 2011 (**FSB Report**), on the close cooperation and coordination between relevant home and host resolution authorities needed to facilitate the resolution of cross-border financial institutions in an orderly and cost effective manner. Cross border resolution can be impeded when there are major differences in jurisdictional resolution regimes, so effective pre-planning between the RBNZ and APRA is needed to reduce the likelihood that a required change is identified later in the IT implementation process, causing delayed implementation and introducing additional cost to the industry.
7. Given the ownership structure of the largest New Zealand banks and the complexity of cross-border resolution, implementation of OBR IT pre-positioning should not be undertaken in isolation. NZBA submits that there should be early and regular engagement between RBNZ and APRA, to ensure harmonisation of the Trans-Tasman approach, which would both reduce the risk of systemic contagion and the costs associated with the resolution of cross-border financial institutions.
8. Market perception of OBR is also an important consideration with the implementation of OBR IT pre-positioning. NZBA submits that it is vital that the market correctly understands the circumstances in which OBR might be used, and how it will be applied. Uncertainty as to the application of OBR may lead to misperceptions which could have a number of adverse impacts (such as increasing bank funding costs). Educating the market needs to be addressed throughout the IT pre-positioning process with coordinated communication from the RBNZ and banks.
9. In order to assist the market understanding of OBR, NZBA submits that the RBNZ should formalise 'principles of use' for the application of the haircut. This would allow losses to be apportioned to unsecured creditors in a fair and predictable manner, and consequently prevent panic or destabilisation of financial markets. This is a key feature of an effective resolution regime identified in the FSB Report.
10. To provide clarity and predictability to the market about how the haircut would be applied in practice, NZBA offers the following principles of use for consideration:
  - a. The haircut must only be applied to unsecured liabilities on appointment of a statutory manager, with unsecured liabilities valued as at the time the statutory manager is appointed.
  - b. The haircut must be applied to all unsecured creditors equally. To ensure consistency with the treatment of creditors, there should be no distinction between time-critical unsecured liabilities and other unsecured liabilities in this regard. The exception to this being payments or compromises with creditors under section 131 of the Reserve Bank of New Zealand Act 1989 (**RBNZ Act**) for

the purposes of carrying on the business of the registered bank. These are “going concern” payments usually made to suppliers and others who refuse to continue supply of services unless they are paid in full.

- c. Access to the unfrozen portion of the unsecured liability occurs on the true maturity date of the unsecured liability – for instance, ‘time-critical liabilities’ are met and wholesale funders can also withdraw the unfrozen portion on the true maturity date of the liability. Contractual terms that trigger an acceleration of the maturity date on the appointment of the statutory manager may not apply, other than certain netting arrangements (as provided in sections 122 and 127 of the RBNZ Act).
  - d. All non-frozen funds remaining in the bank after the haircut has been applied, and all new unsecured liabilities, will be covered by a government guarantee for the term of the statutory management. This also applies to wholesale funders (not just retail customers and transactions).
  - e. The haircut will only be applied once. There will be no claw-back of unfrozen funds once they are released. Any loss due to the miscalculation of the appropriate level of haircut applied would not be assumed by unsecured creditors but become the responsibility of Government.
  - f. Portions of the frozen funds may be released to unsecured creditors (as the true net-asset deficiency is ascertained) during the period of statutory management or held in full until resolution of the insolvent bank.
11. NZBA notes the RBNZ comments at the 31 August 2011 workshop that conversion of these ‘principles of use’ into a section within a new banking standard (BS15) would be considered. Having a formal banking standard is important, as it would assist the industry in explaining the haircut and pre-positioning policy, particularly to international parties. It is crucial to correctly reflect the position under the policy with a view to limiting any potential risk of increased funding costs due to the initiative. The policy must not be perceived as a backdoor way of putting in place a retail depositor priority arrangement. Members are eager to be involved in consultation on a new BS15.
12. NZBA also alerts the RBNZ that the deadlines of 16 January 2012 for the submission of a detailed implementation plan, and the late 2012 deadline for full implementation of IT pre-positioning systems, are likely to need to be deferred - pending the outcome of discussions on the level of detail required for IT implementation plans, and the IT systems changes required to give effect to the pre-positioning policy.
13. The IT pre-positioning project is complex and requires significant IT resource for both planning and implementation. Our members are currently engaged in significant industry projects (including Settlement Before Interchange, Anti-Money Laundering and Counter Financing of Terrorism Act and Foreign Account Tax Compliance Act compliance) which are monopolising IT resources and will continue to do so until mid 2012 (and beyond in some cases). A number of outstanding issues also require

further clarification, through consultation between the RBNZ and the industry before detailed implementation plans can be submitted.

14. **Defined Terms:** Formal definition of key parameters will ensure everyone is clear on how OBR is intended to operate. It will also reduce the likelihood that systems and processes are implemented that do not operate as the RBNZ intended, and require costly adjustments later. For example, NZBA understands that the IT functionality to execute the haircut will apply on a 'per customer account' basis, and that multiple accounts held by an individual or a business will not be aggregated.
15. While the RBNZ has clarified which bank liabilities require IT pre-positioning (as outlined in Appendix A of this submission) NZBA submits that clear criteria for pre-positioning should also be formalised to ensure that banks have a clear and consistent understanding of which types of liabilities need to be pre-positioned both at present and when developing any new products in the future.
16. **Derivatives:** The process of applying the haircut to derivatives still remains to be clarified. NZBA understands that the RBNZ will set up a small group workshop to consider this issue.
17. **Term Deposits:** The banking industry still needs to determine whether they can agree on an industry protocol for applying a haircut to the interest component of a term deposit. If an industry protocol cannot be agreed, NZBA notes that the RBNZ is prepared to engage banks on a bilateral basis to confirm each bank's approach. Either way, the industry protocol or bilateral arrangements will need to be agreed before banks can submit their implementation plans.
18. The options currently suggested by RBNZ are illustrated in Table 1.2 below.

**Table 1.2 – Treatment of Term Deposits**

Option	Funds subject to haircut	Frozen principal	Frozen interest*	Released principal	Released interest	Payout on maturity	Total claim
1	10,600	2,500	150	7,350	600	7950	10,600
2	10,300	2,500	75	7,425	600	8025	10,600
3	10,000	2,500	0	7,500	600	8100	10,600

\* Shows the amount assumed frozen as part of the calculation.  
Table assumes full haircut is recorded as frozen principal.

19. Discussions during the 31 August 2011 workshop suggested a level of support for Option 2 - with interest accrued up to the date of statutory management subject to the haircut, but interest accruing after the date of statutory management not subject to the haircut. However, our member banks will need further collective discussions through the NZBA on this issue if they are to agree an industry protocol. NZBA will confirm the outcome once discussions are complete.
20. **Payments System:** Outstanding issues on pre-positioning the payment system will be provided by Payments NZ Limited in their submission.

21. **Implementation Plan:** The RBNZ is seeking the submission of implementation plans from banks which are expected to detail the feasibility, costs and timing associated with implementing OBR IT pre-positioning. However, members are uncertain about the content and level of detail the RBNZ expects them to report on. NZBA invites the RBNZ to engage with the industry through the NZBA in order to clarify the content and detail which banks are expected to present in their implementation plans.
22. **RBNZ outstanding materials:** NZBA has not yet received information on certain issues from the RBNZ as agreed at the 31 August 2011 workshop (eg. clarification of the RBNZ view on term deposits – the maturity date of deposits and when the haircut is applied to interest on deposits). This information is still required, and members seek further engagement with the RBNZ on those and other issues which may arise.

## Final Notes

23. NZBA submits that there are a number of outstanding issues which require clarity before banks can supply detailed implementation plans to the RBNZ. These issues need to be resolved to ensure that IT implementation plans are not designed with flaws as a result of incomplete information. Clarity on the outstanding issues will also provide certainty for the financial industry regarding when and how OBR might be applied.
24. In order to ensure that bank IT systems are adequately planned and implemented, the pre-positioning process should not be rushed. Flexibility in re-scheduling deadlines, if needed, would provide the necessary time for banks to thoroughly design and implement robust IT systems. As such, NZBA submits that at this stage, the 16 January 2012 deadline should be delayed, and full implementation should be planned for no sooner than 12 months after that date.
25. NZBA welcomes the level of industry consultation the RBNZ has undertaken to date on OBR IT Pre-positioning. We encourage continued engagement with the industry to assist with the development of a robust resolution framework to deal with bank failure.
26. Please do not hesitate to contact me if you have any queries on 04 802 3355 or Matthew Herbert, Policy Adviser on 04 802 3350.

Sarah Mehrtens  
**Chief Executive**

# Appendix A

## Compendium of Liabilities

Deposits and Borrowing	Pre-positioning
1. Transaction accounts	Yes
a. Interest calculated on minimum monthly balance progressive tiered structure	Yes
b. Interest calculated on whole balance – tiered structure	Yes
2. Solicitor trust accounts with multiple sub-accounts	Yes
3. Savings accounts	Yes
a. Internet savings accounts	Yes
4. Term deposits	Yes
a. Internet term deposits	Yes
5. PIR holding accounts	Yes
6. Derivative flows	No
7. Credit balances on credit cards / travel cards / mortgages / investment loans	Yes
8. Foreign currency accounts	Yes
9. Revolving credit facilities	Yes
10. Overdraft facilities	Yes
11. Insurance	No
12. Letter of credit	No
13. Medium term notes	No
14. Debentures	No
15. Bonds	No
Due to other financial institutions	Pre-positioning
16. Deposits	Yes
17. Term investments	Yes
18. Vostro balances	Yes
19. Settlement accounts	No
a. Government bond purchases	No
b. Foreign exchange settlements	No
Money market	Pre-positioning
20. Certificates of deposit	No

21. Commercial paper	No
22. Call accounts	Yes
23. Term deposits	Yes
24. Yield enhanced deposits	Yes
<b>Derivative financial instruments</b>	<b>Pre-positioning</b>
25. Foreign exchange contracts	No
26. Forward rate agreements	No
27. Futures	No
28. Options	No
29. Interest rate swaps	No
30. Currency swaps	No
31. Credit support agreements	No
32. Margin calls	No
<b>Due to controlled entities and associates</b>	<b>Pre-positioning</b>
33. Due to parent company	No
34. Due to subsidiary company	No
35. Interest payable on amounts due to parent	No
<b>Other liabilities</b>	<b>Pre-positioning</b>
36. Accrual of interest coupons	No
37. Open market positions	No
38. KiwiSaver accounts	No
39. Charity accounts / Child accounts	Yes
<b>Operating expenses</b>	<b>Pre-positioning</b>
40. Utilities	No
41. Suppliers	No
42. Employee benefits	No
43. IRD payments	No
a. Interest taxes	No
b. Payroll taxes	No