Submission

to the

Finance and Expenditure Committee

on the

Deposit Takers Bill

24 November 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 eighteen 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
   - KB Kookmin Bank Auckland Branch
   - MUFG Bank Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Introduction

3. NZBA welcomes the opportunity to provide a submission to the Finance and Expenditure Committee (the **Committee**) on the Deposit Takers Bill (the **Bill**). NZBA commends the work that has gone into the Reserve Bank Act review, of which the Bill is a key milestone.

Contact details

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

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Executive Summary

Key submission points

NZBA fully supports a modernisation of New Zealand's deposit taking regulation and the underlying principles of the Bill. Financial regulation has progressed substantially in the decades since the current regime was enacted.

The NZBA's key submission points are as follows.

- The depositor compensation scheme (**DCS**) provisions should come into force a minimum of 12 months after the key DCS regulations are developed (including (1) the core DCS scope regulations, referred to in the explanatory notes for the exposure draft of the Bill (**Exposure Draft**) as the "'relevant arrangements' regulation" and "entitlement regulation", (2) initial regulations deeming depositors and deposit takers to be excluded from the DCS, referred to in the Exposure Draft explanatory notes as "eligibility regulation" and "coverage regulation", and (3) DCS levy regulations), with appropriate guidance notes provided by the Reserve Bank of New Zealand – Te Pūtea Matua (**Reserve Bank**) (including in relation to development of the "single customer view standards").

  Other aspects of the Bill should have a backstop of 6 years after enactment to allow for transition and consultation on the large volume of subsequent regulation, standards and guidance which the Reserve Bank is required to consult on and develop.

- Further Reserve Bank engagement and work should be factored in to resolve core concerns, before the DCS comes into force. Inconsistencies between DCS and open bank resolution (**OBR**) have not been resolved, the proposed two stage implementation approach is inefficient, and Reserve Bank guidance for deposit takers and the public is required.

- The personal liability approach for bank directors should be amended and liability for non-compliance should be generally set at an entity level. Further, AML/CFT obligations should not be included in "prudential obligations".

- The risk of unintended consequences from rushing implementation remains high, as demonstrated by the further examples of unintended consequences discussed below.

It is critical that the reform delivers a robust, fit for purpose regime for customers which is effective and enduring and also workable for industry – and NZBA is fully supportive of this outcome. Adequate time should be taken at the design phase to ensure this occurs, otherwise the consumer protection objective (of the DCS in particular) could be materially compromised.

Additional key submission points (and defined terms used above) are as set out in the remainder of this document and the Appendices.

5. As indicated above, NZBA fully supports the modernisation of New Zealand's deposit taking regulation and the underlying principles of the Bill.

6. Updating the legislation with a broader, tailored range of regulatory and supervisory tools allows for an approach that is fit for purpose. NZBA also supports the introduction of a depositor compensation scheme to bring New Zealand into line with other OECD countries. We discuss this further in **Part 1** below.

7. However, we believe that a greater emphasis is needed on ensuring a smooth implementation for the benefit of customers and testing of the mechanics in the Bill. In the remainder of this submission we discuss:

   (a) **Part 2: Timing and additional submissions on depositor compensation scheme**:

      (i) As a priority, additional time should be factored in for the Bill to come into force in an orderly fashion. Rushing the DCS in particular will create customer confusion and uncertainty, while imposing unnecessary industry cost. This achieves the opposite of the DCS's intended effect.

      (ii) We ask the Committee to consider our further submissions on the proposals for the DCS, following NZBA's submissions on the Exposure Draft of the Bill and discussions with the Reserve Bank on these matters in particular.

   (b) **Part 3: Director due diligence requirements and liability regime require refinement**: We also ask the Committee to consider our further submissions on the proposals for director due diligence requirements and liability generally, as these provisions are a key concern of NZBA member banks with the current Bill.

   (c) **Part 4: Further indicative examples of unintended consequences arising from the Bill**: We have set out examples of some key unintended consequences that remain in the Bill, which help demonstrate the need for continuing a considered approach to developing the new legislation. This includes the risk that unexpected businesses become classed as "deposit takers", significant unintended impacts and costs on overseas banks operating in New Zealand, and the effects of the extremely broad Reserve Bank powers and limited built-in safeguards under the Bill.

   (d) **Part 5: Submissions on new matters in the Bill**: We provide our submissions on the limited set of new elements raised in the Bill that were not in the Exposure Draft. These should be considered in addition to the points raised in Parts 2 to 4 and in the Appendices.

   (e) **Appendices: Matters raised on the Exposure Draft**: Before the Bill was referred to the Committee, the Reserve Bank consulted on the Exposure Draft. The Exposure Draft was released in December 2021 and in response the NZBA provided:

      (i) a detailed written submission on the full Exposure Draft;

      (ii) an additional written submission on ex-post resolution levy proposals raised in the explanatory notes to the Exposure Draft; and

(iii) further input over a series of industry workshops with the Reserve Bank.

Despite these and other submissions, the Bill referred to the Committee largely repeats the Exposure Draft, with little amendment.

We therefore attach as Appendices the NZBA's submissions on the Exposure Draft.

The NZBA strongly reiterates the points raised in those Appendices. They represent a number of fundamental concerns with the approach in the Exposure Draft that have now been carried forward in the Bill.

Part 1: Support for the underlying principles of the Bill

8. Since existing bank legislation was enacted in 1989, global financial regulation and New Zealand's other financial and securities laws have generally been overhauled and updated, sometimes several times over. We agree it is important that our deposit taking laws are similarly revisited.

9. We support the general design and purpose of the Bill, including:

   (a) the increased range of tools and mechanics for tailored regulation and supervision of deposit takers, rather than (for instance) focusing on director attestation and personal liability as is the case in existing legislation;

   (b) the unified approach to regulation of deposit takers including banks and non-banks;

   (c) the introduction of depositor protection in the form of a DCS, bringing New Zealand into line with other OECD countries.

10. These are key focus points for the creation of a well-designed deposit-taking framework in New Zealand.

11. Looking beyond these underlying principles, a successful and lasting update requires an approach that:

   (a) responds to the features of the New Zealand environment, with a **tailored and scaled approach** to supervision and enforcement;

   (b) **supports public confidence** in the financial system; and

   (c) **provides certainty** to the industry, with a clear transition path known well in advance. Such certainty is also key to public confidence: allowing sufficient time to develop and settle the new regime, with well-formed and understood regulation, will allow deposit takers across the industry to deliver a clear and consistent message, and positive use experience, to customers.

12. These outcomes were encouraged before publication of the Exposure Draft and introduction of the Bill through the considered approach taken to the review of the Reserve Bank Act in high level Reserve Bank and Treasury consultations over a period of four years, from 2017 to 2020. It is important that this approach continues so that the best possible reform package is delivered.

Part 2: Timing and additional submissions on depositor compensation scheme

Rushing the implementation stage will create unintended consequences and undermine the purpose of change

13. NZBA submits that the drafting and operational phase of the reform should be afforded the time for a similar level of careful consideration and engagement as the initial high level consultations up to introduction of the Bill. This is important both to ensure a smooth implementation and to minimise confusion and other unnecessary negative impacts for the public.

14. In our view:

    (a) **Additional time needed for implementation of DCS:** The DCS should come into force by Order in Council a minimum of 12 months after key DCS regulation has been passed,[1] to provide appropriate time for transition. This key regulation would be comprised of:

    (i) the core DCS scope regulations described in paragraph 26(a);

    (ii) initial regulations deeming depositors and deposit takers to be excluded from the DCS; and

    (iii) the DCS levy regulations,

    with appropriate guidance notes provided by the Reserve Bank (for industry, depositors and creditors) to provide certainty, and also to minimise inconsistent approaches, the need for subsequent fixes and confusion in the market including, for example, how quickly payouts under the DCS could be made when the DCS is first introduced. This should also include guidance on the "single customer view standards" as discussed further at the end of paragraph 26 (and potentially also the interaction between DCS and OBR, as discussed in paragraph 36(c) below).

    (b) **General back stop for remainder of the Bill coming into force:** The Bill should have a general backstop falling 6 years after enactment. There is a large amount of subsequent regulation, standards and guidance which the Reserve Bank is required to consult on and develop if the remainder of the Bill is to come into force in a smooth manner with sufficient time for deposit takers to transition across to the new prudential supervisory regime. A 6 year backstop would reduce the risk of a 'cliff edge' scenario, where consultation and transition time for aspects of the reform at the end of the work programme ultimately needs to be rushed because the backstop date is approaching.

15. The Bill (and the Exposure Draft that it largely repeats) is the first attempt to turn the high level consultations discussed above into practical and technical detail. At the same time the Bill also includes key structural elements that were not considered in the high level consultations and further changes in approach.

16. In an area as technical, inter-connected and systemically important as deposit taking and banking, the matters of detail are central to success – and they are at

[1] For instance, this may be achieved by providing for an Order in Council to be made only after the Reserve Bank has confirmed passage of the relevant regulations to the Minister.

least as difficult to get right as the conceptual framework that has been discussed over a period of years.

17. Rushing implementation of provisions that are not in final form will undo the work that has been done in the lead up to the Bill to achieve the outcomes mentioned above. As is consistently shown with financial legislation, accelerating implementation will create confusion, risk damaging public confidence, and cause significant unintended consequences, unnecessary costs and additional work to repair.

18. Since the original Exposure Draft was released only marginal changes have been made to the Bill. A large number of core submission points made on the Exposure Draft have not yet been responded to (see the Appendices for NZBA's submission points on the Exposure Draft), whether in the Bill or in explanatory materials. Initial workshops have been helpful as a way for industry to raise concerns, but further steps are now needed to address those matters. In particular, even where the Reserve Bank and market participants take a different view on points we believe it is important for those perspectives to be fully discussed to prevent unintended consequences in the future.

19. Further, despite its length and complexity, the Bill is ultimately a framework under which a wide range of secondary legislation, with both technical detail and strategic requirements, is needed. Many other processes outside legislation – including OBR – will also need to be significantly updated for the new laws. Implementing the reform will mean translating all of these elements into operational practice. For fundamental changes like the proposals here such changes can require months (or in some cases years) of development, testing and deployment, with a clear conservative approach taken to minimise the risk of negative impacts to customers. This work can only start in earnest when key secondary legislation is available.

20. We believe that a considered approach should be taken for this drafting and pre-implementation phase, continuing the positive approach taken to the high level consultations. This would mean:

    (a) discussing, addressing and resolving points raised in submissions before enactment of the Bill. If significant confusion and unaddressed points remain, as we believe is the case with the current Bill, then further time should be allowed to ensure that key risks have been considered and mitigated; and

    (b) providing an adequate transition period between enactment and the Bill coming into force for regulations to be developed and, after those regulations are developed, for accompanying guidance to be developed and industry to address their requirements and the public to be informed and educated about them.

DCS in particular needs careful consideration

21. **In particular, the DCS should not be rushed into effect before it is fully developed**. Taking a more urgent approach undermines the DCS's purpose of supporting public confidence and providing clear and quick access to compensation.

22. Depositor protection and bank resolution are acknowledged globally to be difficult to implement, requiring care and careful positioning. Not only must these matters provide a pathway for depositors to access their protected funds, but they must do

so quickly in the event of failure and provide confidence while removing the incentives for a ‘bank run’.

23. However, the Bill does not set out a pathway for achieving these outcomes, and secondary legislation addressing these matters has not yet been developed. The Bill:

(a) **does not** set out all the rules for what deposits are protected, how entitlements are determined across different accounts and what information needs to be collected;

(b) **does not** set out how a depositor would receive funds from the DCS – or how long this will take. These are complex questions particularly now that cheques have been discontinued. We understand the Reserve Bank is working on this separately, but it will not be ready by the proposed DCS implementation time;

(c) **does not** describe how the DCS would function in the case of a large bank failure. In such cases the Reserve Bank is likely to place the bank in resolution, but we understand may choose not to directly engage the DCS (by not issuing a notice under clause 193 of the Bill).

While we understand the Reserve Bank is working on an operational approach through OBR to provide for a DCS payout before it is legally required, ultimately it comes within the Reserve Bank’s discretion as to when and whether a DCS payout is made. Customers will need to be aware that the DCS does not guarantee them an immediate payout if a bank enters resolution; and

(d) **does not** describe how the DCS and OBR will operate together. This is an exceptionally complex matter and is fundamental to the implementation and public understanding of the Bill, as discussed in paragraphs 30 to 36 below.

24. The Bill notes that the DCS is expected to be implemented earlier than most other parts of the Bill. The explanatory notes to the Exposure Draft note an intention to bring the DCS into force six months after enactment of the Bill, at the same time that core related regulations are finalised (and potentially before the related levy regulations are finalised).

25. Preparing for the DCS is already a difficult task, particularly given the exceptions and variations to the way that customer entitlements are to be calculated (with the expectation of more variations to come through regulation). Deposit takers would need to start allocating and committing resources to implement the DCS shortly, to be able to meet the proposed timeline (particularly given current tight labour markets and the volume of other ongoing regulatory development work). However, as discussed above, without the underlying regulations being finalised deposit takers do not have the detail required to begin implementation activities and it is extremely difficult to scope and execute on the technology change projects which will be required to be undertaken by members – including for single-customer view, look through accounts and Reserve Bank reporting requirements. Certainty of

these matters, and the time to operationalise them, are vital for deposit takers to be able to assist with a successful implementation of the DCS.

26. At a minimum, the key regulation for this work to be advanced will be:

(a) The core DCS scope regulations (referred to in the Exposure Draft explanatory notes as the "'relevant arrangements' regulation" and "entitlement regulation"). Deposit takers will need to amend their core systems to track and record which deposits are protected and which are not, and (particularly for more complex arrangements) how much of any deposit is ultimately protected.[2]

(b) The initial[3] regulations deeming depositors and deposit takers to be excluded from the DCS (referred to in the Exposure Draft explanatory notes as "eligibility regulation" and "coverage regulation"). For instance, under current Reserve Bank proposals for branch policy reform,[4] certain branches of international banks may be subject to the DCS for a short period, before being restricted to wholesale customers only with some indication that the DCS may not apply to such banks at that point.[5] If the Reserve Bank's branch proposals were to proceed, such banks may be required to implement the DCS for a brief period under the Bill, before being excluded shortly afterwards. While NZBA does not take a position on the branch reform proposals in this submission, the potential for a massive increase of compliance costs solely due to a timing mismatch needs to be addressed before deposit takers are expected to commit resources.

(c) The DCS levy regulations, with details of the calculation method and input data/factors. Given that levies will be risk-based and dependent on deposit bases, building up the resources to reflect and report to the Reserve Bank for levy calculations will be a significant task that should be aligned with the other system work above to prevent repetition. There is a risk of

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2 In relation to expected look-through requirements for 'relevant arrangements', we note from Reserve Bank workshops it is expected that deposit takers will only be required to identify the accounts that look-through treatment applies to, rather than maintaining the look-through information on an ongoing basis (i.e. the underlying clients under their entitlements). For example, where funds are held in an account by a custodian under a regulated client money or property service, the account and total balance would be identified but the deposit taker would not be expected to collect the identity of the custodian's clients and their entitlements. However, key amendments to core systems will still be required to ensure these 'relevant arrangements' accounts are able to be recorded and identified for DCS purposes.

3 The Exposure Draft explanatory notes refer to these regulations as being "develop[ed] when needed". In this submission we are referring to the initial scope of these regulations intended to have effect when the DCS is implemented.

4 https://www.rbnz.govt.nz/-/media/4d4f122724aa415fb899efe75e430208.ashx

5 The branch policy review notes that it and the implementation of the DCS are "separate but related policy questions".

unintended consequences if the DCS is implemented without first finalising levy regulations.

Appropriate guidance notes should also be provided by the Reserve Bank (for industry, depositors and creditors) to minimise inconsistent approaches, the need for subsequent fixes and confusion in the market including, for example, how quickly payouts under the DCS could be made when the DCS is first introduced. In addition to guidance on the above regulations this should also include:

(d) guidance in relation to the development of the "single customer view standards". These standards are expected to be complex, particularly as they interact with existing bank requirements (such as the liquidity requirements in BS13) so their final form is not expected in the initial set of key regulation. However it will be important to provide some guidance so that development and integration work can begin; and

(e) potentially, guidance on the interaction between DCS and OBR as discussed in paragraph 36(c) below, if the Bill does not include a formal consultation requirement as proposed in that paragraph.

27. Crucially, based on the current timetable (as NZBA understands it), deposit takers will also need to start explaining the effect of DCS to customers, without having any certainty about how it will function. In practice this is expected to:

(a) lead to depositors receiving incomplete or unclear information, which will likely lead to queries as to why the DCS has been rushed into effect before it is fully designed. This will create confusion and risk causing potential concern that the deposit taking industry is in crisis (requiring the accelerated timeline), decreasing public confidence and increasing the risk of a bank run in the early stages; and

(b) not prevent bank runs generally. In particular, if depositors are informed of the current proposals that triggering the DCS in a bank failure ultimately remains at the discretion of the Reserve Bank, and the timing and coverage of payout is at this stage uncertain, customers are still incentivised to withdraw their deposits at the first signs of trouble.

28. A hurried implementation without a clear message and pathway to a DCS payout would effectively negate much of the customer protection benefit intended from the DCS. It risks reducing customer confidence in the banking sector in the near term, without reducing contagion risk or providing for quick customer access to funds.

29. **NZBA therefore submits that:**

(a) The timeline for the implementation of the DCS should be revised to ensure there is sufficient time for the required regulations to be developed and details to be clearly communicated to customers. To achieve this, the DCS provisions should come into force a minimum of 12 months after the key DCS regulations (as described in paragraph 26 above) have been passed.[6]

(b) Other aspects of the Bill should have a backstop of 6 years after enactment. Based on progress developing the legislation so far, the fact that focus for the first year at least after enactment will necessarily be on the DCS, and the large volume of secondary legislation required, we believe a general 6 year transition period is appropriate.

(c) Further, if the Committee considers that the practical implementation of the provisions of the Bill is not sufficiently well understood at this stage (which we believe to be the case), then the timeline for enactment and implementation of the Bill should be adjusted to allow the Reserve Bank and Treasury progress their consideration of key issues, and assess if Bill amendments are needed.

Additional high priority submissions on depositor compensation scheme and open bank resolution

30. Related to the comments on the DCS above, we set out here additional submissions in relation to the DCS and its interplay with OBR. We believe this, and the following section discussing director due diligence and related requirements, require further consideration as a priority. These submissions should be considered in addition to the points raised in the Appendices.

31. The Reserve Bank's current primary resolution tool for large banks, OBR, largely exists outside of legislation. It has been developed by the Reserve Bank to make use of general 'statutory management' powers and was created to provide bank customers with potential ongoing access to their funds in the event of a bank failure.

32. NZBA understands that, after the Bill is enacted and the DCS is created, the Reserve Bank intends to maintain OBR as its primary resolution and depositor protection tool for large banks. Even if a deposit taker enters liquidation, receivership or resolution, DCS payouts are only triggered if the Reserve Bank determines to issue a notice under clause 193 of the Bill.

33. Under the Bill OBR continues to be built from legislated powers provided to the Reserve Bank (including inputs from the DCS), but will itself remain as an internal process of the Reserve Bank.

34. However, OBR is technical, not well understood by the public generally, and was created specifically to serve a system that did not provide a Government deposit

6 As mentioned in footnote 1, this may be achieved by providing for an Order in Council to be made only after the Reserve Bank has confirmed passage of the relevant regulations to the Minister.

guarantee or insurance scheme to depositors. OBR is also entirely unique to New Zealand. This means there are no examples of OBR and a deposit guarantee or insurance scheme successfully co-existing.

35. At a base level, therefore, meshing OBR and DCS (as well as the Reserve Bank's new general resolution powers under the Bill and the overlapping 'statutory management' powers under the Corporations (Investigation and Management) Act 1989 that we understand are proposed to remain) is an extremely complicated and novel issue.

36. **NZBA submits that** further Reserve Bank engagement and work should be factored in to resolve core concerns, before the DCS comes into force. In particular:

(a) **Inconsistencies between DCS and OBR not resolved**: Although there are surface-level similarities between DCS and OBR pre-positioning requirements, they have been designed separately and following different drivers. There are a number of inconsistencies between the approaches that mean any synergies to be gained from existing OBR work may be limited, and there is a far greater risk of existing OBR processes being disrupted by attempting to align the two regimes.

For instance, there is a fundamental mismatch between the account-based OBR approach and customer-based DCS entitlements that is not easily reconcilable. Some products are included in OBR but not in DCS (e.g. FX deposits) creating further mismatches. Utilising OBR processes for DCS would require a redesign of processes that have taken significant cost and time to build – while also effectively requiring the existing approach to remain in parallel, increasing workload further. Further time is required to work through and resolve these issues.

(b) **Proposed two stage implementation approach is inefficient**: Given the condensed timeline for implementation of the DCS that has been proposed, NZBA understands that the Reserve Bank intends to take a two-step approach to combining the DCS and OBR: an interim (or 'tactical') approach when the DCS comes into force; followed by a long-term (or 'strategic') approach.

Implementation of both tactical and strategic approaches will add significant time and cost to an already resource-intensive process. A two-step process is unnecessary – New Zealand's deposit taking industry is not understood to be in crisis. Taking a more direct approach here would be consistent with the principles of the Bill (which includes "the need to avoid unnecessary compliance costs" in clause 4(c)) and would be a better use of available resource (with the DCS remaining available for depositor protection while that solution is developed).

If the Reserve Bank continues to favour a two-stage process, then further guidance becomes even more important (as discussed in the following paragraph).

(c) **Reserve Bank guidance for deposit takers and the public is required**: If OBR is to be maintained, and the DCS is to be an input into

OBR, then it is important that the interaction between OBR and DCS is transparent for depositors and the industry. This could be achieved through inclusion in the Reserve Bank guidance notes discussed above (see paragraph 26 above), or a consultation requirement in the Bill (similar to the requirement to consult on the development of standards in clause 75 of the Bill[7]), under which in either case the Reserve Bank would:

(i) **engage and consult** with deposit takers on development and implementation of OBR approaches. This is necessary to ensure deposit takers have visibility on what is required of them, and to ensure that obligations placed on deposit takers to reflect or pre-position for OBR are reasonable in the circumstances; and

(ii) **educate** the public on its approach to OBR and DCS. This is particularly vital if (1) both tactical and strategic approaches to OBR are intended; and/or (2) the Reserve Bank expects to use OBR and not the DCS in a large bank failure. In these circumstances it would be extremely difficult for deposit takers to clearly explain such matters to depositors.

For instance, explaining the DCS to a customer may involve discussing:

(aa) that the DCS exists and may technically apply to the deposit (unless any exception applies based on the depositor, and subject to any current or future deeming or 'single customer view' rules);

(bb) but that the Reserve Bank may choose not to directly engage the DCS in the event of failure, by not issuing a notice under clause 193 of the Bill;

(cc) however in such case it is expected that the Reserve Bank would instead apply its internal OBR policy. The updated OBR policy is in the process of being developed by the Reserve Bank, and implementation may depend on whether an interim/tactical approach applies or a long-term/strategic approach.

Given the reliance on Reserve Bank policies, the complex overlay of those policies to the legislation, and the shortened timeline proposed, it would be vital for a successful transition that the Reserve Bank is able to provide a single clear source of guidance for these matters.

(d) **Clear application required to meet DCS purpose**: As a related point, we remain concerned that the above approach to OBR and DCS may defeat the purpose of the DCS. That is, it is important to the reform that depositors have clear, easily understood comfort that their deposits are

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7 In this regard, please also refer to paragraph 25(b) of Appendix 1 for further comments on clarifying the consultation procedures for standards development. These comments would equally apply to consultation on the DCS.

protected. If depositor protection under the DCS remains subject to Reserve Bank discretion and reliant on Reserve Bank policies, rather than providing clear and easily understood comfort, then depositors may remain at risk of withdrawing funds at sight of any perceived deposit taker weakness, rather than having the confidence to rely on the DCS. This would be an unfortunate outcome.

Part 3: Director due diligence requirements and related matters require refinement

37. We set out here additional priority submissions in relation to the director due diligence requirements and liability generally. As with our comments on the DCS, these submissions should be considered in addition to the points raised in the Appendices.

38. One of the key modernisation aspects of the Bill has been to shift focus away from the blunt and often counterproductive tool of personal liability (currently in place through frequent director attestations associated liability) to a more tailored set of provisions that apply to the corporate deposit taker in the first instance.

39. This is similar to the changes made when New Zealand's securities laws were updated in the Financial Markets Conduct Act 2013 (**FMCA**), which shifted away from personal liability for directors and promoters as a first step, to a more tailored set of penalties and enforcement that begin with the corporate issuer. With the exception of certain limited, specific obligations (primarily relating to production of Product Disclosure Statements and offences relating to defective disclosure and false statements which require knowing or reckless contravention), personal liability is reserved for persons who are "involved in a contravention". This is a common and relatively well understood test that requires some level of personal involvement with the relevant breach, rather than deeming directors to be personally liable for any breach at any time unless they can show active steps taken to prevent that particular breach.

40. Such an approach reflects a balance between consumer protection outcomes and the nature and size of regulated businesses, the wide range of technical obligations that apply to them (and that continue to change and evolve over time), the ability to otherwise impose adequate penalties, and the need to attract and retain quality personnel and strike a balance between compliance and assurance costs and providing fit for purpose products and good customer outcomes.

41. However, several key exceptions remain in the Bill that undermine its effectiveness, by not adequately recognising and balancing the broader contextual factors described in paragraph 40, which are widely recognised to have been appropriately reflected in the liability framework in the FMCA. More specifically, the provisions in the Bill set potentially punitive penalties and personal liability where it is not warranted and can be strongly counterproductive. These problematic provisions include personal director liability:

    (a) for any breach of a director's due diligence duty (clause 92 and clause 156(1)(d)), requiring processes to ensure all "prudential obligations" are complied with; and

(b) if a deposit taker or associated person is found to have provided a false or misleading declaration or representation to the Reserve Bank, or to have "otherwise publish[ed] or [made] available" information that the deposit taker knows that, or is reckless as to whether, the information is false or misleading (clauses 174 and 175). In practice this could extend to any information prepared for a marketing flier or made available on the deposit taker's website at any time.

42. These provisions are exceptionally broad. While certain defences are available in the Bill, they effectively require directors to have taken active steps to implement procedures to prevent breach in relation to any covered obligation – including any obligation (no matter how minor) in a standard and any information available anywhere on the bank's website. Directors will be encouraged to spend a majority of their time purely focused on compliance and management tasks, rather than on crucial governance activities (such as management of strategic priorities and business risk).

43. **NZBA submits that**:

(a) **Personal liability approach for bank directors should be amended**: The personal liability regime proposed for bank directors requires closer consideration – the rationale for imposing such punitive regimes is unclear, and contrary to the general modernisation approach that is a purpose of the Bill. As discussed above, liability for non-compliance should be generally set at an entity level. Personal liability should be reserved for deliberate or egregious breaches of prudential regulation.

By contrast, we note that:

(i) As discussed above, under similar financial laws in the FMCA, liability rests primarily with the corporate issuer, with personal liability of directors reserved for specific circumstances. When that Bill was prepared it was noted that such an approach would promote compliance with the securities law, deter conduct that undermines market integrity and confidence, and promote informed participation by investors through the provision of compensation and visible punishment of wrongdoers, but "not be so strict as to deter innovation or conduct that is beneficial for society".[8]

(ii) Looking at global approaches, in Australia both the existing bank executive accountability regime (**BEAR**) and proposals for a new financial accountability regime do not impose personal liability except in limited circumstances where the individual is "involved in a contravention". This is a more appropriate approach (and aligns with the FMCA position as discussed above; demonstrating that there is nothing inherent in deposit taker regulation that requires a different approach to be taken).

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8 2011 Cabinet Paper on "Securities Law Reform" from the Minister of Commerce, paragraph 187.

In our view, adopting an “involved in a contravention” approach to personal liability (similar to the FMCA and international approaches) would strike a more appropriate balance to encouraging technical compliance while ensuring ongoing focus on providing products and customer outcomes (and importantly is less likely to deter appropriately qualified individuals from taking on a director role).

(b) **AML/CFT obligations should not be defined as “prudential obligations”**: Under the Bill directors of deposit takers would effectively face the risk of personal liability for even the most technical of breaches under any banking standard or similar, as well as any breach under anti-money laundering (**AML**) legislation. This may effectively require directors to implement and monitor due diligence procedures for every single aspect of these requirements (or, at the very least, consider and periodically take external advice on the ‘importance’ of every such requirement and reasonableness standards). These requirements could potentially run to thousands of pages in total. Ultimately, the approach that has been proposed will require a disproportionate amount of resource to be devoted solely to ‘box checking’ compliance of day-to-day management tasks, impacting on time for governance and strategic decisions (including higher level ongoing consideration and re-evaluation of conduct standards).

Further, we reiterate that AML compliance is already subject to its own comprehensive regime, which includes a detailed liability regime – one that requires significant ongoing resource to manage. Adding a further layer of compliance through a separate, duplicated and overlapping liability regime will disproportionately increase costs and reduce efficiency.

(c) **Penalties are disproportionate; and a clearer approach should be taken to insurance and indemnities**: Lastly, we also note that:

(i) As was submitted on the Exposure Draft, the size of penalties imposed should be re-evaluated in the context of the above comments. The Bill proposes penalties that may be exceptionally high (particularly for large deposit takers, a penalty of 0.1% of total assets under clause 157 would be effectively disproportionate for any breach of the Bill, particularly when the availability of other remedies in the Bill is considered).

(ii) The approach in the Bill to limiting indemnities and insurance is unnecessarily convoluted. While we appreciate that similar provisions in the FMCA appear to have been used as a base, the range of entities to which those provisions of the FMCA apply is relatively limited. The Bill provides an opportunity to adopt a clearer position for all deposit takers in the New Zealand market. It should be redrafted to be clear that insurance and indemnities are permitted, without requiring unnecessary steps to reach that position (such as requiring constitution changes and interest register notices, which as discussed in paragraph 44(b) below are difficult to comply with for many entities in any event).

Part 4: Further examples of unintended consequences in the Bill

44. As discussed above, NZBA is concerned that moving quickly to implementation at this stage risks creating unintended consequences that may undermine the Bill's effectiveness. We have discussed some specific concerns in relation to the DCS (see paragraphs 17 to 28 above) but a range of other examples and concerns have been identified, including the below. We believe that further engagement and time should be factored in before the Bill comes into force to allow time to identify as many such concerns as possible, and resolve them.

(a) **Unintended entities captured as 'deposit takers'**:

(i) Under the current proposed definition of 'deposit taker' lending businesses are required to be licensed as deposit takers if they also issue a 'call debt security' to any person, even if they do not take any deposits from retail customers. This means that lending businesses with an uncommitted bank facility, as well as corporate treasury companies with on-demand inter-company loans, may technically be considered 'deposit takers'.

(ii) New Zealanders will often need to open a bank account in a different country for various reasons (such as when relocating or travelling for an extended period). As drafted, any bank in another country that allows a New Zealander to open an account may need to be licensed as a deposit taker here (clause 4 of Schedule 2 of the Bill). The practical effect of this would be to require banks operating outside New Zealand to prohibit any New Zealander from approaching them for an account.

(b) **Branches of overseas banks not fully considered**: A number of provisions in the Bill remain drafted on the effective assumption that the deposit taker is a locally incorporated company. These provisions include:

(i) director due diligence requirements, as discussed above (which would require the global board of an international bank operating in multiple jurisdictions around the world, and for which New Zealand may be a very small part, to devote a disproportionate amount of time to the operations of the New Zealand branch);

(ii) requirements to amend the overseas constitution of the bank to specifically address New Zealand legislation for the purpose of insurance and indemnities; and to keep an interests register with details of indemnities or insurance (clause 97) even if this is not a feature of the home jurisdiction's corporate law; and

(iii) the potential timing mismatch between the DCS implementation and the Reserve Bank branch review, as discussed in paragraph 26(b) above.

These provisions are disproportionately onerous and unnecessarily difficult for branches of overseas banks to comply with, and risk disincentivising overseas banks from entering or remaining in the New Zealand market.

(c) **Broad scope of Reserve Bank powers**: The Reserve Bank is afforded an extremely broad range of powers under the Bill, from accepting applications, to setting deposit taker standards, on-site inspections, enforcement, to setting and use of levies for resolution and other purposes, to resolution itself.

As discussed in the NZBA's submission on the Exposure Draft (see Appendix 1), processes and safeguards should be included to assist with transparency and certainty (similar to, for example, the requirements in section 75 of the 1989 Act for the Reserve Bank to publish the principles on which it acts to determine registration conditions, which does not appear in the Bill).

The Bill provides a significant change in the status quo, and the use of new powers always risks creating unintended costs and other consequences (which in the financial sector can itself impact financial stability). We believe it is important that clear safeguards, transparency, consultation and accountability are included to minimise these risks.

As an example (discussed at paragraph 25(d) of the NZBA's submission on the Exposure Draft), this could include an internal review process at the Reserve Bank, such as a review committee addressing concerns with how powers (such as use of DCS funds) have been exercised, set in legislation.

45. The above listed provides examples of the unintended consequences that have been identified so far. They demonstrate the risks of accelerating the process and the unintended damage this could cause.

Part 5: Submissions on new matters in the Bill

46. We set out below brief submissions on the limited set of new matters included in the Bill that were not included in the Exposure Draft (and therefore are not addressed in the Appendices).

	Clause reference/provision	Submission
(a)	Schedule 1 (transitional matters)	• Existing registered banks should not be required to reapply to become licensed deposit takers (clause 10 of Schedule 1) and should be grandfathered into the new licensing regime. Although clause 10 anticipates the potential for a different process for licensing existing banks, it would ultimately be disproportionate and unnecessary for a re-application process to apply. The Reserve Bank already has access to significant ongoing substantive information about registered banks.

		Requiring a re-application is likely to be a large piece of additional work and would divert resource away from the DCS (and other workstreams described earlier in this submission). • Clause 3 of Schedule 1 provides for existing registered banks "to be treated as being a licensed deposit taker" for the purpose of Part 6 (the DCS provisions) and "any other provision of this Act relating to the enforcement, application, or effect of Part 6". This clause should set out clearly what "other provisions" apply. As a particular example, it needs to be clear that clause 93 of the Bill (introducing a director due diligence duty) is **not** intended to be such a provision, given that the director due diligence duty is part of the set of amendments due to come into force at a later stage.
(b)	Clause 88(2) (setting of standards relating to pre-positioning for a potentially wide range of resolution approaches)	The potential requirements to pre-position for the wide range of resolution mechanisms proposed by the Reserve Bank risks creating a very significant implementation and ongoing compliance cost that is out of proportion with the risk of failure. Large registered banks are already expected to pre-position for a bank separation. All registered banks are required to pre-position for OBR. Pre-positioning for the DCS is also expected. Implementing and updating these pre-positioning requirements (and potential combinations of them) is already expected to require significant resource. Pre-positioning standards should be expressly limited to the requirements mentioned in this paragraph – bank separation (as applicable), OBR and DCS. Trying to pre-position for other proposed forms of resolution is unlikely to be appropriate and should not be contemplated in the Bill (or, if it is, that it is subject to a bespoke consultation regime and demonstrable benefit before implementation). In particular: • Additional pre-positioning would involve significant additional cost and impacts on senior resource, while potentially creating unintended incentives to change business structure. • Pre-positioning for statutory management (other than OBR) and liquidation resolution would be extremely complex, given the broad powers and potential approaches that a manager or liquidator may take and the potential events in play. • The new example given (segmentation of loan books) is unlikely to be achievable in practice given overlaps of customer bases (eg owner occupiers with an additional

		rental property; small businesses that secure business lending against residential property).
(c)	Clause 107 (auditor disclosure requirements)	When compared to the Exposure Draft, the Bill has expanded the proposed requirements for auditor disclosure to the Reserve Bank. Whereas the Exposure Draft proposed disclosure where a suspected breach of financial-related obligations has occurred, the Bill goes further to require auditors to disclose suspected breach of **any** prudential obligation. Many prudential obligations will be outside auditors' expertise and they would not be in a position to determine whether a breach had occurred. Requiring a legal duty on them to do so may create confusion and potentially reduce transparency and openness in deposit taker/auditor relationships. Additionally, it is unclear how this obligation fits with deposit takers' own breach reporting regime (Part 3, Subpart 3 of the Bill). A deposit taker would conduct a preliminary investigation to identify whether an event (or suspected event) qualifies for disclosure under the regime, and must disclose as soon as practical after it forms the belief that breach **in a material respect** has occurred. However, the proposed obligation on auditors to report provides limited or no opportunity for the deposit taker to investigate whether disclosure is required at all. Such reporting (without any opportunity for investigation) will also only cause confusion.
(d)	Clause 111 (on-site inspection powers)	• The proposed permitted purposes for the Reserve Bank to conduct on-site inspection powers are broad, and should be limited to specific relevant reasons. The proposed ability for the Reserve Bank to conduct an inspection to "examin[e] any matter relating to the business, operation or management of a licensed deposit taker in order to understand and identify risks in connection with those matters" or to "verif[y] the reliability of information supplied" to the Reserve Bank would allow an unannounced inspection to be used for almost any reason, and in many cases where less invasive and disruptive approaches (such as requesting information from the deposit taker) would be far more appropriate. • It is not clear why the obligation on the Reserve Bank to explain the effect of its inspection powers has been removed from the Bill. Given that the Reserve Bank may question any employee or agent at any time, it is vital that those persons are informed of the Reserve Bank's powers and that person's rights and obligations. • In relation to the above matters, the Reserve Bank has noted in the explanatory note to the Bill that it may only

		exercise its inspection power "in a reasonable manner". It has also noted that it expects to be able to use this power to access the private houses of employees and directors to the extent they work from home. This approach provides very little clarity to deposit takers and employees (or the Reserve Bank) as to what may be considered "reasonable", and poses an unnecessary threat to individuals that their home may be subject to inspection without notice. The Bill should contain clearer guidance and safeguards as to what is reasonable, rather than leaving this to the broad determination of the Reserve Bank. Inspection of private homes should be entirely prohibited from inspection under this power.
(e)	Clauses 144 and 145 (no privilege against self-incrimination)	The Bill has notionally reinstated the position on privilege from the 1989 Act, changing position from the Exposure Draft position (and the position recommended by Treasury in the June 2022 regulatory impact statement) where a privilege against self-incrimination was included. However, the 1989 Act position is not a directly comparable position here and it is not clear that there would be situations where compelling an employee or director to provide self-incriminate would provide access to relevant information that would not otherwise be accessible to the Reserve Bank. We understand from the explanatory note to the Bill that Cabinet agreed to this change in approach in June 2022 (the same month as the contrary Treasury regulatory impact statement). While we maintain that the self-incrimination privilege should be reinstated, it would be helpful to understand the reasons for the change in approach in order to provide further information on our position (and we believe this is a matter the Committee may wish to consider).
(f)	Clause 154 (restrictions on proceedings where undertaking is in place)	Where an undertaking is provided by a deposit taker, the Bill provides that proceedings cannot be brought against the deposit taker, but only for so long as there is no breach of the undertaking. By contrast, the Exposure Draft prevented criminal proceedings and pecuniary penalties from the point that an undertaking is entered into. The effect of the change is to discourage deposit takers from providing undertakings for (for example) remedial actions. Where undertakings have been provided, any enforcement action should be taken under the terms of those undertakings - rather than re-opening the possibility of other consequences from the original breach.
(g)	Clause 192 (publication of list of protected deposits)	The Bill includes a requirement for licensed deposit takers to publish a list of "all debt securities issued by the deposit taker that are protected deposits". It should be clarified that

		this requires a high level list of the product types/categories to be published, rather than requiring the list to include all customer variations or rates, or (reading the current drafting literally) the deposits of all customers. A high level list is likely to be the most useful for customers, as something that can be quickly reviewed rather than requiring the customer to step through all the different variations to understand their own product.
(h)	Clause 224 (protected deposits not subject to security interest)	Clause 224 provides that, if a customer has a deposit secured in favour of the licensed deposit taker, any DCS compensation paid to the customer is not subject to the security interest. This provision effectively undermines the general laws around security and should be carefully considered. For instance, if a customer has a liability to a bank that is secured by a deposit with the bank, a DCS payout would mean that the customer receives their deposit back, and the bank becomes an unsecured creditor for the full liability. This ultimately places more strain on resolution and places the bank (and potentially its other creditors) in a worse financial position.
(i)	Clauses 289 and 291 (derivatives protection rules - application of stay)	Clause 284 of the Bill generally prohibits contracts with a licensed deposit taker from being terminated or similar on the basis of: • the licensed deposit taker entering into resolution; or • the exercise of various resolution functions, powers, or duties under subparts 4 to 8 of Part 7 of the Bill. This prohibition is subject to clause 291, which allows certain derivatives and other arrangements to be terminated in such cases, but only after the end of a stay that may be imposed by the Reserve Bank (by specifying a later time under clause 291(1)(b)). This stay needs to be strictly time limited to meet the requirements of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions (*Key Attributes*),[9] which form the basis of the relevant eligibility rules in a number of key international jurisdictions including the United States. Non-compliance with these Key Attributes may make it more difficult for New Zealand banks to enter derivatives and similar arrangements with international counterparties.

[9] The FSB Key FSB Key Attributes of Effective Resolution Regimes for Financial Institutions are available here: http://www.financialstabilityboard.org/2014/10/r_141015/. Refer to paragraph 4 and Annex IV in particular.

		Although the starting point in paragraph 4.2 of the Key Attributes is that resolution should not trigger termination, this should be subject to adequate safeguards, and only apply where substantive obligations under the contract continue to be performed. Under paragraph 4.3 and Annex IV, to protect the integrity of financial contracts and provide certainty to counterparties, any stay on termination rights that arises by reason only of entry into resolution or in connection with the use of resolution powers should be strictly limited in time (eg a period not exceeding two business days), and should only apply where there is no breach of substantive obligations under the contract. Therefore: • Clause 289(1)(b) should be amended to refer to clause 284 (as well as clause 281(1)). Given the title and purpose of the clause (and the explicit reference to "(including entering resolution)"), the omission of reference to clause 284 here appears to be an error. • Clause 289(2) should be deleted. This currently states that "Subsection 1(b) is subject to section 291". It is unclear what this reference refers to. On one reading, it could be suggesting that the exceptions to the moratorium in section 281(1) which are provided by section 289(1)(b) only apply if the relevant transactions are derivatives or relevant security interests. This however would defeat the purpose of including the words "(including entering resolution)" in clause 289(1)(b)(1) which appear to suggest that the fact of entry into resolution is not a bar to terminating and calculating a net balance due. • Clause 291 should be amended to make it clear that the clause 284 restriction on a resolution trigger does not apply at any time to a derivative or other relevant arrangement if the substantive obligations provided for in the contract (including payment and delivery obligations and provision of collateral) are not performed. • Clause 291(1)(b) and clause 292(2(b) should also be amended to remove the ability for the Reserve Bank to specify a later time for the stay to end.
(j)	Clauses 289 - 291 (derivatives protection rules –	Sale and repurchase (repo) and stock-lending arrangements play an important role in efficient operation of the financial markets. The Bill as currently drafted creates market uncertainty as to the netting treatment of such transactions as they don't necessarily fit within the definition of

	application to stock lending)	"derivatives" as defined. In order for rights under a netting agreement to be exempted from the restrictions in clause 284 and to take the benefit of clause 289, they must be derivatives or 'specified instruments' for the purposes of clause 291. We understand from the explanatory note to the Bill that the intention is to address this issue in regulations and provide for repos, stock-lending transactions and other similar transactions to be 'specified instruments' as defined in clause 290. While this approach would eventually achieve the same result, for continued certainty and clear operation in the markets it would be preferable to include this directly in the Bill before it is enacted.
(k)	Subpart 6 of Part 9 (ex-post levy)	We generally refer to the NZBA's previous submission on the ex-post levy in Appendix 2. We note in particular here that (as further discussed in that previous submission) the levy proposed does not include clear caps or limitations to ensure that the levy is only appropriately used and called on.

Appendices: Points previously raised in relation to the Exposure Draft

47. The Appendices to this submission set out:

(a) **Appendix 1**: NZBA submission to the Reserve Bank on the Exposure Draft, dated 21 February 2022 (annotated as applicable where amendments made in the Bill relating to points in that submission).

(b) **Appendix 2**: NZBA submission to the Reserve Bank on the ex-post resolution levy, dated 9 May 2022.

APPENDIX 1

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

Updated 21 November 2022 with annotations for matters addressed in the Bill

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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.[1] A clear statement should also be included that existing registered banks continue to be authorised to use restricted words under the new regime.[2]

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.

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1 ***Update 21 November 2022***: Amended by clause 3 to Schedule 1 of the Bill (although see paragraph 46(a) of submission on the Bill relating to transitional matters).

2 ***Update 21 November 2022***: Amended by clause 18 to Schedule 1 of the Bill.

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.[3]

(d) **Review**: Further, clear mechanics should be included for the review and oversight of the Reserve Bank's actions under the Bill.[4] 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

3 ***Update 21 November 2022***: Amended by clause 26(3)(a) of the Bill.

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

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 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.[5] 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[6]) 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

5 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.

6 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.

be set by later standards, under clause 76.[7] It would be helpful to discuss this further in the context of the expected standard, however we believe alignment of this concept with accounting standards may be useful.[8] 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

7 ***Update 21 November 2022***: "Related party" definition has been deleted from the Bill.

8 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.

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. 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.[9] 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

9 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.

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 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.[10]

(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[11] (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

10 ***Update 21 November 2022***: Amended by clause 66(1)(b) of the Bill.

11 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.

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.

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.[12]

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.

[12] ***Update 21 November 2022***: Amended by clauses 40 and 43 of the Bill.

(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[13] (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

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13 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.

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 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.[14]

(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

14 ***Update 21 November 2022***: Amended by clause 157(2) of the Bill.

FMCA,[15] given the requirements for due diligence procedures elsewhere in the Bill. That is:

(aa) reserving criminal liability for situations where representatives have knowingly or recklessly made a false statement[16]; 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

15 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.

16 ***Update 21 November 2022***: Amended by clause 174(1)(a) of the Bill.

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.[17]

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

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17 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.

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)).

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.[18] 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

[18] 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.

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 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**[19]: 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.

19 ***Update 21 November 2022***: "Large" persons test removed from the Bill.

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,[20] 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.[21]

(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.[22]

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

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

21 ***Update 21 November 2022***: Amended by clause 190 of the Bill; however see paragraph 46(g) of our submission on the Bill.

22 ***Update 21 November 2022***: Amended by clause 255 of the Bill.

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, 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).[23] 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).[24] 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:[25]

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23 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.

24 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.

25 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.

(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 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.[26] 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.

(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).

[26] 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.

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.[27] 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.

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27 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

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),[28] 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 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

28 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.

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.[29] 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

29 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).

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.

APPENDIX 2

NEW ZEALAND
BANKERS ASSOCIATION

Supplemental Submission

to the

Reserve Bank of New Zealand – Te Pūtea Matua

on the

Deposit Takers Bill Exposure Draft

9 May 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 further 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**). This submission is in addition to our written submissions dated 21 February 2022 (**Primary Submission**) and relates specifically to the potential ex-post resolution levy (**Ex-post Levy**) referred to in the explanatory notes to the Bill.

Contact details

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

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Any Ex-post Levy needs to be considered with, and (if applicable) developed alongside, New Zealand’s long-term approach to resolution and bail-in

5. We thank the Reserve Bank for its active engagement with the industry on the Bill and for discussing the Ex-post Levy with the industry. We have set out our overarching views below. Some specific additional comments are set out at the end of this submission.

6. We understand that proposals for an Ex-post Levy are at a relatively early stage of development (reflected in the fact the levy was not incorporated into the exposure draft of the Bill).

7. We strongly submit that useful engagement and further development of an Ex-post Levy will require consideration of New Zealand’s long-term resolution and bail-in policies. Implementing an Ex-post Levy in advance of such policies will lead to unfairness and unintended consequences.

8. In particular:

   (a) **Ability to meaningfully consult**. At this stage, NZBA does not have a clear picture on what resolution is expected to look like in the long term, following the enactment of the Bill. The situations in which a deposit taker is expected to end up in a resolution utilising the Ex-post Levy (particularly given the need for increased capital requirements for large banks) are not well defined, and the likely amount and type of expenditures is also unclear. It is difficult to provide meaningful feedback on the design of a measure to recover costs when the strategies and policies that may lead to those costs have been left for a later review. Matters such as how to measure loss to be recovered, when it may be fair to recover amounts from industry, and the type of resolution that may give rise to an Ex-post Levy cannot be considered in detail without having defined how and when resolution is likely to occur.

   (b) **Fairness to the remainder of the industry**. Many amounts spent on resolution of a deposit taker will benefit that deposit taker (as well as the public and the market as a whole). Any Ex-post Resolution Levy to recover such spending from the industry will need to be clearly limited so that only appropriate amounts are recovered. This is particularly concerning in New Zealand as we do not (currently) have a statutory or contractual bail-in regime, so that there is no direct method to ensure shareholders bear losses before the Ex-post Levy is imposed.[1]

   (c) **Need for other safeguards**. Related to the above, it is important that use of any Ex-post Levy (and incurring costs that may give rise to the use of such a levy) be subject to clear safeguards, and that there are appropriate

[1] We appreciate that OBR is typically expected to ensure that creditors bear first loss. However, this is not enshrined in legislation and may change over time or in the specific circumstances of a bank resolution. There is no direct mechanic or requirement for shareholders to bear first loss in the Bill and, as discussed elsewhere in this submission, the position may change further when statutory bail-in is further considered.

incentives on the Minister and Reserve Bank to minimise spending. The comments made in paragraph 68 of the Primary Submission around use of the DCS fund apply equally in this regard. In the case of an Ex-post Levy, safeguards should be set to align with proper use of resolution and bail-in mechanics. For instance:

(i) There should be strong protections in place to ensure costs are for a proper defined purpose, with clear accountability that incentivises decision-makers to be conscious of incurring unnecessary costs.

(ii) There should be a clear right and mechanics for deposit takers, and other stakeholders, to monitor the use of funds that may be recovered through an Ex-post Levy.

(iii) Before an Ex-post Levy is imposed, costs should be reviewed in an independent report.

(d) **Avoiding 'too big to fail'**. Without such appropriate and visible safeguards as discussed above, the availability of an Ex-post Levy may also be seen as an indication that the Reserve Bank would not let a large bank fail. By comparison, the use of DCS funds for resolution under the Bill is subject to the limit that (effectively) costs must be less than would otherwise be expected under a liquidation scenario. While we believe that further safeguards are needed for use of the DCS fund (as described in the Primary Submission), the Ex-post Levy as proposed would inevitably have even fewer safeguards than DCS fund use.

9. Comparison to international examples in large markets shows the importance given to aligning levies with settled resolution policies.[2] For instance, we understand that:

(a) The European Union has implemented a Single Resolution Fund (**SRF**) for use to resolve failing banks, which will include backstop funding by ex-post levies from this year. The SRF is only for use as a last-resort, and requires that bail-in must first be exhausted (with limited exceptions) and cannot be used to absorb losses of an institution or recapitalise it.

(b) In the United States, the 'orderly liquidation' process in Title II of the Dodd-Frank Act allows for funding to be drawn from the U.S. Treasury, and for unrecovered amounts to then be assessed on the industry. However, the Title II process effectively requires that shareholders and creditors bear first loss and that bank management be removed.[3] To limit the risk of loss to the U.S. Treasury (and so to the industry), use of the Treasury's Orderly

2 We note that some jurisdictions (such as the United Kingdom) impose broader 'bank levies'. However, as these are not directly used to fund resolution we do not consider them directly comparable to the proposed Ex-post Levy.

3 See also the U.S. Treasury's 2018 report "Orderly Liquidation Authority and Bankruptcy Reform" that considered strong safeguards to be vital to such a regime, noting that Title II as initially enacted "create[d] a resolution authority that confers far too much unchecked administrative discretion, could be misused to bail out creditors, and runs the risk of weakening market discipline."

Liquidation Fund is initially limited to 10% of pre-resolution consolidated assets of the failed bank as most recently reported in financial statements, and then 90% of the fair value of consolidated assets available for repayment.

10. The NZBA submits that any Ex-post Levy implemented in New Zealand should similarly tie into, and be considered alongside, the design of New Zealand's long term resolution and bail-in strategy.

Additional specific comments

11. We also make the following specific comments. As discussed above, given the ongoing development of resolution/bail-in approaches these comments should not be taken as exhaustive.

    (a) **Use of Ex-post Levy**: Any Ex-post Levy imposed on deposit takers should be limited to resolution action in relation to a deposit taker (and not, for instance, an insurer), and to situations where a deposit taker is expected to go into liquidation in the absence of resolution (i.e. not for broader resolution activities).

    (b) **Timing of use of Ex-post Levy:** In the broad circumstances where an Ex-post Levy may be used (e.g. a large bank requiring resolution), it is likely that other deposit takers will also be experiencing losses and other difficulties. It would need to be very clear that the use of any Ex-post Levy would take account of impacts on financial stability as a fundamental criteria. Imposing a levy that itself impacts on financial stability (and increases the risk of further resolution action being needed) should be avoided as a priority.

    (c) **Ranking of requirement to pay**: As a related point to the above, the Reserve Bank should also consider how the payment of an Ex-post Levy would rank. In particular, payment should not rank above other creditors, as this may effectively mean that creditors of remaining banks are being subordinated in addition to the creditors of the bank in resolution.

    (d) **Capital treatment**: Depending on its usage and action taken to support a bank in resolution, an Ex-post Levy could conceivably effectively represent an equity investment in the resolved bank. The Reserve Bank should be clear that deposit takers would not need to hold capital in respect of such an equity investment. The Reserve Bank should also be clear on whether deposit takers may benefit from any gain made in such a resolution of a deposit taker (for instance, on ultimate sale of the equity by the Government or increase in value of that deposit taker).