

# Submission

to the

Reserve Bank of New Zealand - Te  
Pūtea Matua

on the

Levy Framework for the Depositor  
Compensation Scheme

25 September 2023



## About NZBA

1. The New Zealand Banking Association – Te Rangapū Pēke (**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.
  - KB Kookmin Bank Auckland Branch
  - Kiwibank Limited
  - MUFG Bank Ltd
  - Rabobank New Zealand Limited
  - SBS Bank
  - TSB Bank Limited
  - Westpac New Zealand Limited

## Introduction

NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand - Te Pūtea Matua (**Reserve Bank**) on its consultation paper "Levy Framework for the Depositor Compensation Scheme" (**DCS Levy Consultation**). NZBA commends the work that has gone into developing this document and the policies behind it.

## Contact details

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

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## DCS timeline needs to be lengthened

4. NZBA strongly supports the open engagement and industry workshops that the Reserve Bank (together with the Treasury) is providing in relation to the Consultation and other matters relating to the Depositor Compensation Scheme (DCS).
5. It is vital that this engagement continues as development of the DCS progresses, to ensure it is appropriately tailored to the New Zealand market and common banking products.
6. **However, NZBA strongly submits that the timeline for implementation of the DCS needs to be lengthened.** This should allow for at least 12 months between finalisation of the DCS regulations and commencement of the DCS.
7. We understand that the current intention is to:
  - 7.1. release draft DCS regulations for consultation in February or March 2024;
  - 7.2. implement final DCS regulations in July or August 2024; and
  - 7.3. commence the DCS in October 2024.
8. This timeline is extremely condensed. Although we acknowledge the Reserve Bank has previously delayed the timing for the DCS from early to late 2024, only limited implementation work can be done with any certainty ahead of advanced draft regulations being available.<sup>1</sup> The current timeline leaves very limited time for development for the draft regulations, and only two to three months to implement the DCS regulations once their final form is published. Although we understand that deposit takers will not be required to have established a Single Customer View (SCV) file when the DCS commences, considerable systems and communications work will still be required:
  - 8.1. Deposit takers will need to be able to clearly and accurately describe to customers which of their products are covered by the DCS, and the extent to which they are covered. Deposit takers may also be required to publish a list of their protected deposits on their website. This will require deposit takers to have analysed their products and established consistent communications messaging with their frontline staff.
  - 8.2. The Reserve Bank should also ensure that general public guidance is published well in advance of DCS commencement, to ensure that the public can be provided with consistent messaging regardless of the deposit taker of which they are a customer.
  - 8.3. Depending on the definitions included in the DCS, it may also be necessary to adjust product terms to more clearly fit within the DCS, so that customers have certainty.
  - 8.4. Deposit takers will need to create and implement systems in order to identify ineligible customers and consider relevant arrangements. This process is

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<sup>1</sup> We note that NZBA's submission on the exposure draft Deposit Takers Bill recommended 12 months for DCS implementation from the finalisation of key DCS regulations. The current timeline remains considerably shorter than this.



likely to require significant resources to implement and, in many cases, will require crucial technological upgrades. Implementing the DCS in such a condensed timeline will invariably cause major difficulties with the creation and implementation of these systems. This will be particularly so in relation to the time needed to implement any technological upgrades necessary to enable deposit takers to identify the deposits which will be covered by the DCS.

- 8.5. Deposit takers with overseas reporting requirements will generally need to be able to report on the extent to which the deposits they hold are protected.
  - 8.6. While the NZBA supports a delay to the requirement for a full SCV file, consideration should be given to ensuring that the DCS regulations and initial guidance provide sufficient clarity as well as sufficient time to allow those deposit takers to analyse and report with sufficient certainty.
9. Regardless of proactive engagement, NZBA strongly submits that the current timeline will place severe pressure on achieving a successful launch of the DCS, with considerable risk of customer confusion due to limited messaging and the potential for differing application among deposit takers.

## **Proxy for Protected Deposit Amounts**

10. The comments below relate to questions 1 to 4 of the Consultation.
11. NZBA acknowledges the need for a proxy to calculate the total protected deposit amounts as an interim measure prior to the introduction of the SCV standards.<sup>2</sup> It is important that this proxy reflects the total protected deposit base, as accurately as practicable, in order for deposit takers to have confidence when calculating anticipated levies and to ensure levies are imposed on an equitable basis.
12. We emphasise the need for clarity about how the Reserve Bank has chosen its preferred model of using data from the Bank Balance Sheet Survey with an adjustment factor of 70%. NZBA understands that the 70% adjustment factor was chosen as an approximation of the percentage of deposited funds listed in the survey that would be fully insured under the DCS. Further, we understand the Reserve Bank will reconsider this figure once it has more information regarding “look-through” accounts. It is important that the Reserve Bank demonstrate clearly how it has reached this proxy, and engage further with industry on the calculations, given the impact that this adjustment factor has on the total amount of levies payable by deposit takers. This is needed to give confidence to deposit takers when calculating anticipated levies and will help them to understand what factors could affect any change in the adjustment factor during the proxy period.
13. In this context NZBA submits that the Reserve Bank should take a conservative approach to the calculation of any adjustment factor while a proxy is being used. This is to ensure that deposit takers do not pay levies at too high a rate during the interim

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<sup>2</sup> Further to our comments at paragraph 8.5, certain deposit takers may still need to build out an SCV approach with a degree of certainty for reporting purposes (and this should be factored into timing).



period, and effectively end up overpaying for the fund once the SCV data becomes available.

## Communication

14. When designing and implementing the proxy solutions – and generally throughout the implementation of the DCS – it is important that the Reserve Bank keeps in mind the need for clear and unambiguous communications at the customer level. Deposit takers will inevitably end up needing to engage with their customers on how the DCS operates, the size of the DCS fund and the role of levies in funding the DCS, including potentially what implications customers should take from the relative levels of levies paid by various deposit takers. This will need to sit alongside information on Open Bank Resolution (**OBR**) and how this operates separately from the DCS.
15. NZBA considers that this communication strategy needs to be driven by the prudential regulator in order to ensure consistency and clarity of messaging to the general public. Ensuring communication is clear and straightforward will be key to promoting public confidence in the financial system during the introduction of the DCS, particularly during the proxy period until the SCV standard is finalised.
16. NZBA understands that the Reserve Bank intends to set up a stand-alone website focused on providing the general public with information about the DCS. While NZBA supports this approach, it is important that the website contains sufficient information to be genuinely helpful to customers. In addition, the Reserve Bank will need to work alongside deposit takers to help them formulate a consistent, industry wide, communications strategy which is sufficiently detailed to be able to address the more focussed queries from customers about the DCS.

## DCS Levy Approach

### Support for risk-based approach

17. The comments below relate to questions 5 and 6 of the Consultation.
18. NZBA submits that a risk-based approach should be taken to formulate the DCS levy obligations. This will help to ensure levies are set on an equitable basis and lowers the likelihood of creating an incentive for additional risk taking by deposit takers, thereby contributing to greater financial stability.
19. In our view:
  - 19.1. **Taking a risk-based approach is preferred to ensure that levies are set on an equitable basis:** Taking a risk-based approach to formulating the levy framework is necessary to help ensure equitable treatment of all deposit takers. Deposit takers with elevated risk profiles should be subject to higher levies. All other things being equal, such elevated risk profiles lead to an increased likelihood of collapse and the subsequent need for the Reserve Bank to issue a specified event notice in relation to the deposit taker.



- 19.2. **Taking a flat rate approach could incentivise risk-taking behaviour:** The levy framework should not promote risk-taking behaviours, rather it should disincentivise them. Flat rate levies provide minimal incentive to limit risk taking behaviours as deposit takers will incur the same levy irrespective of risks they incur. Taking risk into account when creating the levy framework should seek to reduce risk-taking behaviour, as such behaviour would invariably result in higher levy payments. NZBA notes in this context that one of the additional purposes of the Act, is “to promote the safety and soundness of each deposit taker”. Recent instability in the United States banking sector including the collapse of Silicon Valley Bank, Signature Bank, and First Republic Bank reemphasizes the need to limit unnecessary risk-taking behaviours.

### **Levy contributions should not be subject to tax**

20. The Consultation assumes in Annex A that levies paid to the DCS fund may be subject to income tax. **NZBA strongly submits that an income tax exemption should be granted to the DCS fund:**
- 20.1. Assessing income tax on the DCS levies would be counterproductive to the economic purpose of the DCS fund. It may unnecessarily slow down the build up of the DCS fund.
- 20.2. Assessing income tax on the DCS levies would effectively mean that around a third of the amounts nominally paid by deposit takers for the purpose of ensuring customers are protected from a failure event, are instead available for general Crown expenditure through taxation. This would be inconsistent with the purpose and messaging of the DCS fund establishment.
- 20.3. NZBA understands that the DCS levies would not be subject to tax if the fund was held by the Reserve Bank directly.<sup>3</sup> There should be no policy reason to impose such a significant cost of the trust due to a separate structuring decision.
- 20.4. NZBA further understands that levies in international deposit insurance schemes are generally not subject to taxation. New Zealand would be an outlier in this regard.
21. In addition, NZBA strongly submits that levies should be considered a financial service for the purposes of the Goods and Services Tax Act 1985. For the same reasons outlined above, the imposition of Goods and Services Tax on levies would be inconsistent with the purpose and messaging of the DCS fund establishment.

### **Operational costs should be reassessed**

22. NZBA also notes that the assumptions used for the flat rate levy calculation in Annex A of the Consultation includes expected operational costs of 1% per annum of the fund. NZBA assumes this would apply equally to the assumptions used for the calculation of a risk-based levy. NZBA considers that this seems to be a high-cost percentage for a fund that is expected to be invested in relatively low risk investments only. We

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<sup>3</sup> Refer section CW 38 of the Income Tax Act 2007.



consider that further analysis should be undertaken by the Reserve Bank as to the appropriate cost assumption for the fund, given that this directly impacts on the overall size of the fund, and the level of levies payable by deposit takers.

23. It also needs to be clear how the operational costs are broken down, for example what proportion relates to the fund management costs as compared with the day to day operating costs of the DCS and the public communication costs.

## Other matters

24. NZBA also encourages the Reserve Bank to continue engaging (bilaterally and/or through working groups) on other matters raised at industry workshops, including:
- 24.1. **Treatment of branches of overseas banks (Branches).** The NZBA supports high priority bilateral engagement with relevant members in respect of the Reserve Bank's indicated intention to consider exemptions for Branches from the DCS and welcomes clarity on the Reserve Bank's timing to finalise its Branch policy review. At this stage, any decision to capture Branches within scope of the DCS would leave those Branches with an even more condensed timeline for implementation readiness.
- 24.2. **The mechanics for payout.** The NZBA supports high priority bilateral engagement with members to explore the pros and cons of each option (and in particular option 1, as the Reserve Bank's preferred approach) in greater detail. This includes:
- (a) Interaction with OBR, and therefore whether the payout mechanisms discussed are likely to be relevant only for smaller deposit takers. This will help inform discussions on the workability of option 1 presented at workshops.
  - (b) Application of customer due diligence (**CDD**) requirements in relation to onboarding of potentially thousands of customers. A solution to manage such CDD requirements in a cost-effective and smooth manner would be needed well in advance of any payout option implementation. The practical constraints with opening potentially thousands of new accounts presents a significant logistical and technological challenge for deposit takers, NZBA sees early engagement as key to ensuring deposit takers have the information necessary to able to meet these challenges.
  - (c) Potential impact on the staff and infrastructure of any deposit taker that steps into a payout role (particularly as customers of a failed deposit taker will be in a stressful scenario). This also feeds into the importance of communication generally, as discussed above.



- 24.3. **Development of updated liquidity requirements**, which NZBA submits should take account of the lower expected run off rate for protected deposits.<sup>4</sup>

Further, once SCV reporting is in place there should be consistency between (1) the SCV data and (2) data used for liquidity ratio purposes to reflect deposits and run-off rates (ideally, one data set to serve both purposes). We submit this should be a focal point of the Reserve Bank so that banks are clear about how liquidity and the DCS data can be aligned and work together.

- 24.4. **Timing for development of standards.** NZBA notes that, even where no substantive changes are intended to current policy, redrafted standards will require time to review and make any adjustments to existing assurance processes, and time to ensure there are no unintended consequences from the amendments.
- 24.5. **Sharing of customer data.** NZBA notes that sharing customer data on the scale required to implement the DCS levy framework has the potential to raise significant privacy concerns. The Reserve Bank needs to ensure sufficient protections will be in place to ensure all data that is transferred and held is done so in an appropriate manner, and appropriate protections are in place to prevent misuse. Further, the Reserve Bank must ensure appropriate protections are in place to minimise cyber risk.
- 24.6. **Definitions related to protected deposits.** This should also include detail on the 'waterfall' of payment/attribution where DCS payments are made in respect of multiple protected deposits held by a customer. This is a required input for deposit takers that need to comply with offshore reporting requirements.

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<sup>4</sup> We understand that the Reserve Bank intends to align future Liquidity Policy Review consultation papers, and their timing, with the Reserve Bank's broader consultation on DTA core standards.