New Zealand Banking Association
Te Rangapū Pēke

Submission

to the

Treasury - Te Tai Ōhanga

on the

Statement of Funding Approach – Funding Strategy for the Depositor Compensation Scheme

25 September 2023

NEW ZEALAND BANKING ASSOCIATION – TE RANGAPŪ PĒKE
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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 Treasury - Te Tai Ōhanga (**Treasury**) on its Statement of Funding Approach (**SoFA**) consultation (**Consultation**) as part of implementing the Depositor Compensation Scheme (**DCS**). NZBA commends the work that has gone into developing this consultation.

Contact details

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

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Support of overall approach to SoFA

4. NZBA supports Treasury's preference to adopt a target fund approach. This would ensure levies are predictable and charged on a fair and equitable basis while preventing unnecessary expenditure and liquidity risk for the Crown.

5. NZBA also supports Treasury's preferred approach to setting a target fund size based off the expected shortfall after recoveries have been made through the use of resolution tools. This metric accurately reflects the actual costs associated with a failure and reduces the risk of over levying deposit takers unnecessarily.

6. In our view:

   6.1. **The target fund approach gives deposit takers certainty about their expected levies and expenditure:** The use of ex-ante levies gives deposit takers predictability about future expected levies, resulting in increased certainty and stability for deposit takers. This aligns with the predictability principle set out in the Consultation. The alternative funding approaches fail to give certainty to deposit takers about costs. As discussed below, the insurance-based pricing model poses practical difficulties, and it would be difficult to accurately model future contributions. In addition, the nature of ex-post levies poses the same issues, while failing to provide equitable treatment to all deposit takers.

   6.2. **The target fund approach reduces liquidity risk to the Crown:** The use of ex-ante levies to build a target fund reduces financial risk to the Crown and reduces the likelihood the Crown backstop will have to be utilised in relation to a failure (especially in relation to the second and third failure scenarios set out in the Consultation). This aligns with the principle that the fund should be fully funded by industry over time, and be able to meet the cost of failures without the need for the Crown backstop. Ex-ante levies provide certainty that the fund will be able to meet the cost of failures and reduce the total risk of Crown intervention.

   6.3. **There are practical constraints with insurance-based pricing:** It is unclear how insurance-based pricing without a target cap would function in practice. The rate of resolutions and/or insolvencies of deposit takers has been largely infrequent in Aotearoa/New Zealand. This would make gauging the risk of collapse difficult.

   6.4. **General reliance on ex-post levies may be inequitable and increase liquidity risk to the Crown:** NZBA has previously expressed its support for the use of ex-ante levies over ex-post levies. NZBA agrees with Treasury's view that such a funding model would be inequitable as failed deposit takers would not bear any cost. Further, ex-post funding would require the Crown to incur the initial costs of a specified event notice. This poses a liquidity risk to the Crown and would require substantial levies to be paid by the remaining deposit takers in the years following a collapse. In a scenario where a deposit taker fails in tight economic conditions such levies could put substantial financial pressure on surviving deposit takers and potentially increase the overall likelihood of subsequent additional failures. These additional failures risk a cascading effect of failures throughout the sector, as levies would further increase in these circumstances.

6.5. **The target fund approach should account for anticipated recoveries following a failure:** As noted above, NZBA supports the approach of setting a target fund size based off the expected shortfall after recoveries have been made through the use of resolution tools. However, NZBA notes that further analysis is needed on, and clarity around, the approach that would be taken to rebuild the fund after a failure. In particular, if the approach was to rebuild the fund at a faster rate than the original build rate, through increased levies, then this could create issues for the remaining deposit takers, and potentially be contrary to the predictability principle set out in the Consultation.

Other Comments

7. NZBA has following comments in relation to the questions in sections 9, 10 and 12 of the Consultation:

7.1. **NZBA supports a longer period to build the levy**: Although we express no preference to the exact timeframe that should be selected to build the target fund, the timeframe should reflect the low incidences of default in the Aotearoa/New Zealand market. We note that building the fund over a shorter period may falsely indicate to the general public a concern with the stability of the sector. Further, the increased costs of building the fund over a short period will place significant financial pressure on deposit takers.

7.2. **The need for good public communication:** Public communication about the size of the fund, the Crown "backstop" and the speed at which the fund is being built will be vital when the DCS is implemented. It will be important that Treasury and the RBNZ (as the prudential regulator) strongly support deposit takers in explaining the structure of the fund to customers, so as to minimise the risk of the loss of any public confidence in the financial system which might arise if deposit takers are alone in communicating the framework. This will be particularly relevant in relation to providing comfort to customers about the resilience of the banking market in the context of the sizing of the fund relative to the overall protected deposit base covered by the DCS.

7.3. **Levies should be reduced/reassessed once the target fund size is met:** It is important that once the target fund size is reached levies are adjusted to account for this. NZBA agrees that levies could still be required to grow the size of the fund to take account of economic growth/inflation impacts on the aggregate level of protected deposits or an increased number of deposit takers, or to cover on-going costs of operating the fund. However, these should be wholly or largely met by earnings of the fund or require significantly lower levy contributions once the target fund size is achieved.

7.4. **Clarity is needed for future deposit takers entering the market:** NZBA notes the limited analysis in the Consultation of how a new deposit taker entering the Aotearoa/New Zealand market would affect the approach taken to the setting, funding requirements and size of the fund. The framework should be clear on how levies would be set for deposit takers entering the market (and any effect on existing deposit takers) to provide certainty and ensure an equitable approach for the market.

7.5. **Further consultation should outline management of the fund:** We understand that Treasury intends to consult further on the management of the fund, including the modelling of expected returns and investment focus. NZBA supports this further consultation and supports Treasury's desire to be open and transparent throughout this consultation. NZBA expects that the fund's investment priorities would be primarily low risk, fixed interest investments. While this approach should provide suitable levels of liquidity, given the low incidences of deposit taker default in Aotearoa/New Zealand, such an approach will need to be balanced against the ability of the fund to generate returns in line with economic growth/inflation.

7.6. **Further consultation should involve early, transparent, and open communication:** We understand Treasury intends to undertake another, more individually targeted, consultation in early 2024. With the implementation of the DCS scheduled for late 2024, NZBA sees early and open communication from Treasury and the RBNZ as key in order to avoid delays in meeting the proposed implementation timetable. NZBA also encourages Treasury to begin engaging about this consultation with industry as soon as possible.