

# Deposit Takers Bill: Legislative Statement - Second Reading

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## Introduction

The Deposit Takers Bill (the '**Bill**') is an omnibus Bill which modernises the legislative framework for prudential regulation and supervision of the deposit-taking sector. Deposit takers are financial firms that take deposits from the public and lend to individuals and businesses. Deposit takers include banks and non-bank deposit takers such as credit unions, building societies, and retail-funded finance companies. The Bill merges the previously separate frameworks for banks and non-bank deposit takers under a single regulatory regime, replacing the Banking (Prudential Supervision) Act 1989 and the Non-bank Deposit Takers Act 2013.

The main purpose of the Bill is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system. The Bill aims to protect society from the damage to New Zealand's financial system and wider economy that could potentially be caused by excessive risk taking by deposit-takers, the unmanaged failures of deposit takers, or unexpected external shocks to the deposit taking sector.

The Bill maintains the operational independence of the Reserve Bank within a prudential regulatory regime that seeks to promote transparency and public legitimacy, with appropriate safeguards, due process, and accountability arrangements.

## Background

In 2017, the Government announced it would undertake a Review of the Reserve Bank of New Zealand Act 1989 (renamed on 1 July 2022 as the Banking (Prudential Supervision) Act 1989), (the '**RBNZ Act 1989**'). The Review had the objective of modernising the RBNZ Act 1989 to support the development of a New Zealand economy that is productive, sustainable, and inclusive.

The Bill is companion legislation to the RBNZ Act 2021, which modernised the institutional design and accountability requirements of the Reserve Bank and introduced a new and clearer financial policy objective.. The Bill aims to address many recommendations made by the International Monetary Fund (in a 2016-17 review of NZ financial regulation) to update the broader framework for the regulation and supervision of deposit takers. In particular, the Bill:

- Elaborates the objectives for the new regime,
- modernises the licensing process,
- provides for a range of prudential standards,
- expands the suite of supervisory and enforcement tools,
- establishes the Depositor Compensation Scheme (the '**DCS**'), and
- improves the crisis management and resolution framework

## **The Bill elaborates the objectives for the Reserve Bank as the prudential regulator**

The Bill elaborates on what the RBNZ Act 2021's new financial policy objective of promoting financial stability means in the context of the sectoral regulation of deposit takers. To that end, the Bill has additional purposes to promote the safety and soundness of each deposit taker, to promote public confidence in the financial system, and to avoid or mitigate the adverse effects of risks to the financial system. There are also other part-specific purposes and objectives for DCS (Part 6) and crisis management and resolution (Part 7), which provide further clarity around Parliament's expected outcomes in those areas.

## **The Bill modernises the licensing process**

All deposit takers that carry on deposit taking activity (broadly speaking, carrying on the business of borrowing and lending) are required to have a licence, thereby defining the perimeter of prudential regulation for this sector. The Bill sets out the licensing requirements the Reserve Bank will use to evaluate potential applicants, and provides the Reserve Bank with the power to impose specific licence conditions on any deposit taker. The Reserve Bank will use licence conditions to differentiate between deposit takers and take a proportionate approach to prudential regulation. Licence conditions may impose particular prudential requirements on firms (for example, fixing a minimum capital ratio), and make other firm-specific restrictions on the nature of a deposit taker's business.

## **The Bill strengthens the range of prudential standards**

Prudential requirements for deposit takers will primarily be set out in 'standards', buttressed by licence conditions as appropriate, and subject to various process and procedural requirements. Standards are secondary legislation issued by the Reserve Bank under the Legislation Act 2019. The Reserve Bank must also satisfy certain statutory prerequisites before making standards (including consulting with any parties that may be substantially affected by the proposed standard). As secondary legislation, standards are subject to disallowance by Parliament.

The Bill provides greater clarity for the Reserve Bank, relative to the RBNZ Act 1989, over the areas it may set prudential requirements for deposit takers. Areas of prudential regulation the standards may relate to may include:

- governance,
- remuneration of directors and senior managers,
- capital, liquidity, security interests, and credit ratings,
- loan concentration and risk exposures,
- risk management, business continuity planning, and problem assets,
- disclosure, and
- internal controls and assurance.

The Bill also includes due diligence duties on directors of licenced deposit takers and New Zealand chief executive officers of overseas licensed deposit takers to ensure they comply with relevant prudential requirements.

### **The Bill expands the Reserve Bank's supervision and enforcement powers**

Supervision and enforcement are key components of the prudential regulatory framework. Effective supervision increases the likelihood that regulatory requirements will be met and emerging risks will be identified. Effective enforcement helps to deter or punish improper behaviour by sanctioning either the entity or specific individuals, who violate regulatory requirements.

The Bill provides for a range of new Reserve Bank enforcement powers to sanction deposit takers for non-compliance. The penalty regime for contraventions in the Bill includes criminal offences, civil pecuniary penalty liability, and infringement offences. Enforcement provisions include the power to accept undertakings. The Bill further criminalises the making of false or misleading declarations or provision of false or misleading information.

### **The Bill establishes the Depositor Compensation Scheme**

The absence of a depositor protection scheme makes New Zealand an outlier among other countries (one of only two OECD countries without depositor protection). The Bill addresses this longstanding gap, and establishes the DCS as a major element of the legislative reforms.

The DCS aims to promote the stability of New Zealand's financial system, providing each eligible depositor with \$100,000 of compensation protection for their protected deposits at each deposit taker. This is estimated to cover more than 90% of depositors. Broadly speaking, compensation will be payable when a deposit taker is in difficulty that causes disruption to the ability of eligible depositors to access their protected deposits.

The Bill sets up a DCS fund, which will be funded by charging levies to deposit takers. The fund is backed up by public funds should the balance of the DCS fund be insufficient to meet its compensation obligations. The DCS is a significant new function of the Reserve Bank, as the Reserve Bank has the role of collecting levies, managing the DCS fund, determining entitlements, and making compensation payments. The Reserve Bank can also use the DCS fund to support resolution measures when certain conditions are met, including protecting eligible depositors.

### **The Bill provides for crisis management and resolution powers**

Crisis management refers to the use of powers and supporting arrangements to deal with events that seriously threaten a deposit taker's viability. Placing a failed deposit taker into ordinary insolvency can have damaging consequences for its customers, the rest of the financial system, and the wider real economy. The Bill introduces an enhanced framework to enable the Reserve Bank to address a deposit taker in financial distress. These powers enable resolution to be dealt with in an orderly manner, avoiding significant damage to the financial system.

The Reserve Bank must be mindful of the interests of all parties in a resolution scenario, not just the interests of eligible depositors, as any creditors made worse off because of a Reserve Bank resolution action will also be entitled to compensation. This 'No Creditor Worse Off' (NCWO) mechanism is a safeguard which should encourage the Reserve Bank to exercise resolution powers in a way that is at least as effective as a normal insolvency process. Such creditor safeguards in a resolution are now international best practice and a common expectation among creditors internationally.

### **Key changes to the Bill recommended by the Finance and Expenditure Committee**

The Committee recommended changes to the statutory purpose and principles of the Bill to reflect the importance of financial inclusion in the deposit-taking sector. The Committee recommended an additional purpose to support New Zealanders having reasonable access to financial products and services. The Committee also recommended a new statutory principle that would require the Reserve Bank to take into account the desirability of diversity within the deposit-taking sector in achieving the purposes of the Bill.

In line with the financial inclusion theme, the Committee also recommended inserting a new clause to require the Reserve Bank to prepare and publish a proportionality framework to guide the development of standards. The proportionality framework would seek to avoid a one-size-fits-all approach and overly burdensome regulation. Smaller deposit takers, such as credit unions or building societies, would have the opportunity to engage on the framework through the statutory consultation process.

Related to the proportionality issue, the Committee recognised obtaining a credit rating could involve significant costs for smaller deposit takers. Therefore, the Committee recommended an amendment to require the Reserve Bank to consider additional matters when deciding whether to grant a credit rating exemption. These additional matters include the size and nature of the deposit taker's business.

The Committee recommended a number of changes to the design of the due diligence duty for directors of deposit takers. These changes included removing obligations tied to the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 and addressing the implications of the duty for overseas deposit takers who operate in New Zealand as branches. Furthermore, the Committee recommended amending the Bill to require the Reserve Bank to prepare and publish guidance on the due diligence duties. This guidance would clarify what a reasonable director and senior manager should do in the performance of their respective roles.

Finally, the Committee recommended a number of changes with regard to the DCS, including:

- improving certainty on what constitutes a protected deposit,
- providing clarity around what "carrying on business in New Zealand" means,
- future-proofing the Bill to allow for the possible coverage of foreign currency deposits,
- how the requirement to publish a list of protected deposits is specified in the Bill, and the conditions under which a shortfall in the DCS would be covered by public funds