



FINANCIAL SERVICES FEDERATION

23 August 2019

Phase 2 of the Reserve Bank Act Review
The Treasury
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**Safeguarding the future of our financial system: In-principle decisions and follow-up questions on: The role of the Reserve Bank and how it should be governed
Consultation Document 2A: Phase 2 of the Reserve Bank Act Review**

Thank you for the opportunity to submit on this Consultation Document. The Financial Services Federation (“FSF”) congratulates the writers on having developed such a comprehensive document for discussion. However, some FSF NBDT members are frustrated by the lack of direct outreach and consultation with them in relation to this review from RBNZ and Treasury despite requests to RBNZ for such engagement.

As outlined in the FSF’s response to Consultation Document 1 earlier this year, the FSF represents responsible and ethical finance, leasing and credit-related insurance providers. Of the FSF’s 60 members (a list of which is attached as Appendix A), only 3 still raise funds from depositors (Non-Bank Deposit Takers – “NBDTs”). Most of what follows in answer to the questions raised in the Consultation Document comes from the perspective of these 3 members rather than the wider membership of the FSF.

Questions for consultation

Chapter 1: Should prudential regulation remain with the Reserve Bank?

The FSF notes that no follow-up questions to those raised in Consultation Document 1 are raised in the consultation paper. In response to Consultation Document 1, FSF’s submission was that the status quo works well and that the RBNZ manages its monetary and prudential policy roles well in general. The FSF did not support the establishment of a New Zealand Prudential Regulation Authority or a New Zealand Financial Services Authority.

The FSF therefore notes favourably the in-principle decision by the Minister of Finance, the Hon Grant Robertson, not to separate the prudential regulation and supervision functions from the Reserve Bank and agrees with the rationale provided for this decision.

Chapter 2: What financial policy objectives should the Reserve Bank have?

2.A What other objectives should the Reserve Bank have?

- **Which of the objectives discussed in Chapter 2 should feature in the Reserve Bank Act, and why?**
- **Are there other objectives not covered in Chapter 2 that should be considered?**

Whilst the FSF argued to retain the Reserve Bank's existing "soundness" objective, it accepts the reasoning provided in the Consultation Paper as to why the Minister has taken the in-principle decision to replace this with the single high-level financial policy objective to: *"Protect and enhance the stability of New Zealand's financial system"*.

The FSF does not favour providing the Reserve Bank with too many detailed objectives because this would not allow them the flexibility they may require to deal with varying circumstances. The FSF believes the elements that make up financial stability as described in Figure 2B on page 19 of the Consultation Document are implied in the above high-level objective and therefore do not need to be spelled out and the Reserve Bank should be able to determine how it will achieve this high-level objective by using all the levers suggested as being elements of financial stability as it feels it needs to depending on the circumstances.

In its response to Consultation Document 1, the FSF supported the retention of "efficiency" as an objective of the Reserve Bank and therefore believes that including an objective to achieve financial system efficiency should continue. The FSF takes the view that requiring the RBNZ to minimise the regulatory burden on firms and use regulatory resources cost-effectively; facilitate effective competition in the financial sector; facilitate the development of New Zealand's capital markets; facilitate effective innovation in New Zealand's financial sector; and promote efficient credit allocation as part of an overall financial system efficiency objective is entirely for the RBNZ to be required to achieve.

The FSF submits that, taken together, the objectives of protecting and enhancing the stability of New Zealand's financial system and including a requirement to maintain financial system efficiency, are all the objectives that are required for the RBNZ to achieve. This is on the basis that the other objectives discussed under figure 2B of the Consultation Document are actually sub-objectives of one or other of these higher-level objectives.

For example, the objective to provide safeguards to protect particular groups in society is part of achieving financial stability and resilience of both the system and regulated entities as is the goal to share information and promote understanding which is part of maintaining confidence in the financial system. Likewise, the goal to co-ordinate policy with other regulatory agencies and support objectives of monetary policy are part of both the stability and efficiency

objectives and so too are the other objectives mentioned in the table such as supporting sustainable growth and supporting the economic objectives of government.

The FSF believes that maintaining higher-level objectives rather than getting into a more detailed set of objectives allows for more flexibility for the RBNZ to react as required depending on circumstances, and on government objectives.

2.B Should the Reserve Bank be given a more explicit climate change objective? If so, what would be your preferred mechanism for achieving this?

The FSF does not favour an explicit climate change objective being given to the Reserve Bank. This is not to say that the FSF does not understand either the physical risks related to the effects of climate change or the risks associated with the transition to a lower-carbon economy. Quite the contrary, the FSF views these risks very seriously and can quite understand the potential they have to create risks to New Zealand's financial stability. The FSF believes that, in achieving the Reserve Bank's higher-level objectives, climate change issues would naturally be taken into account whilst doing so.

2.C Where in the legislative hierarchy should any additional objectives sit – as “secondary objectives”, or as “considerations” that the Reserve Bank must look at?

The FSF does not support adding any additional objectives other than the high-level ones of to protect and enhance the stability of New Zealand's financial system and to achieve financial system efficiency as the FSF believes they cover everything that could be required of the Reserve Bank whilst providing sufficient flexibility that the RBNZ can adjust its focus as required depending on changing circumstances.

The FSF believes that putting in place too many prescriptive objectives would bog the Reserve Bank down and make them less agile and able to adapt as required.

2.D How should the Reserve Bank's objectives be specified? Do you see a role for a “financial policy remit”? If so, what should it include?

The FSF believes it would be entirely appropriate for the Minister of Finance to issue formal guidance to the Reserve Bank from time to time via a financial policy remit to clarify Government policy as opposed to changing primary legislation as Governments and Government policy changes.

The FSF believes the higher level objectives as already described in this response of protecting and enhancing the stability of New Zealand's financial system and achieving financial system efficiency are sufficiently broad as to allow for financial policy remits on more specific matters of key Government policy to be clarified through such a remit.

2.E What is your view on creating a new “Deposit Takers Act” that combines material from the NBDT Act with the Reserve Bank Act’s banking regulation material?

As mentioned in the introduction to this submission, the FSF currently has only 3 members who raise funds by accepting deposits from the public and who are therefore covered under the NBDT Act. As also mentioned in the introduction, FSF NBDT members are frustrated by the lack of direct contact with them from the RBNZ.

The FSF strongly opposes the suggestion of creating a new “Deposit Takers Act” which would merge the Reserve Bank Act’s content on the banking sector with the NBDT Act’s content to unify the deposit-taking regime. There are many reasons why the FSF takes this position which are summarised as follows:

- NBDTs are not banks. Those that are FSF members who are simple Non-Bank Deposit Takers, as opposed to a building society or credit union, do not offer similar products to those of banks. They are considerably simpler in their operations than banks as they effectively have only two products on offer – the term deposit and the term loan. They do not offer transactional products or more complex lending products such as credit cards or mortgages. They therefore do not require the same supervisory regime as that which applies to banks;
- NBDTs are much smaller entities than banks – in the case of the FSF’s NBDT members considerably so. They do not have large in-house teams dedicated to regulatory compliance and have therefore built up a relationship based on trust with their current supervisor who understands their structure and complexities. There is a very real risk that applying the same supervisory regime as that which applies to banks could be too large a compliance burden for these small entities to handle;
- Although small, the NBDT sector is quite diverse and finance companies, building societies and credit unions differ considerably in the nature and scope of their activities, as well as in their size. A “one size fits all” model is not appropriate as the ability to engage closely and to tailor supervisory activity ensures timely identification of issues as well as being cost efficient.

2.F Looking at the example of the Reserve Bank’s objective set, which elements do you support and which would you change, and why?

As previously stated, the FSF favours keeping the Reserve Bank’s objective set at a higher level.

Chapter 3: How should the Reserve Bank be governed?

3.A What factors are most important for achieving the establishment of an effective governance board with responsibility for all the Reserve Bank’s decisions outside of monetary policy?

The FSF supports the Minister's in-principle decisions to establish a new governance board to replace the single decision-maker model, under which the Governor has this responsibility; not to establish a Financial Policy Committee (FPC); and to give the Treasury responsibility for assessing the Reserve Bank's performance. All of these decisions are in line with the FSF's views as outlined in the response to Consultation Document 1.

The establishment of an effective governance board to set the organisation's strategy and oversee the actions of management would definitely be an improvement on the existing governance model where governance and management roles are combined in one individual.

The most important factor for achieving the establishment of an effective governance board will be in the composition of the board and ensuring that those people who are appointed as board directors bring sufficient diversity of views, independent challenge, and accountability.

3.B What is the appropriate degree of delegation from the board to the Governor? Are there any decisions that should be reserved for the board?

The FSF agrees with the approach discussed in the rationale for the decision to establish a new governance board. This is that the board's role is to oversee the actions of management whilst the management has delegated day-to-day responsibility for running the institution with the parameters set by the board. The FSF believes that in an effective board structure, management has the obligation to report to the board on its activities, and to seek guidance as to how they should achieve the organisation's strategy and the board should be required to consult with management when setting the strategy rather than just handing it down from on high.

3.C What approach should the Treasury adopt in monitoring the Reserve Bank? What should the Treasury's monitoring responsibilities be? Should the Treasury's monitoring responsibilities be different for the MPC?

The FSF believes that the approach to the Treasury's monitoring role for the Reserve Bank has been adequately described in the Consultation Document as are their responsibilities. The Consultation Document also acknowledges the importance of distinguishing between the Treasury's role as monitor (on behalf of the Minister) and the Treasury observer on the MPC.

3.D Do you think there is merit in reclassifying the Reserve Bank as an independent Crown entity?

The FSF believes that there is merit in reclassifying the Reserve Bank as an independent Crown Entity. The description given in the Consultation Document to the role of the monitor provides a useful structure for the Treasury to adopt in its role as monitor of the Reserve Bank which is how it approaches its role for the other Crown Entities for which it acts as monitor. It would seem appropriate for the sake of consistency, for a similar approach to be taken to the monitor

role and, on that basis, it would simplify things if the Reserve Bank were to be made a Crown Entity.

3.E For the new governance board:

- **What should the split of executive and non-executive members be?**
- **What skills and expertise should non-executive members have? Is there merit in having representation from the FMA and/or the Treasury?**
- **How should members be appointed and removed? Should the board be able to appoint the Governor as CEO?**

The FSF believes that the new governance board should be made up entirely of non-executive members and agrees that a fully non-executive board boosts accountability by providing a clear split between governance and management decisions. It is also best practice for the governance model of any entity. Clearly management reports to the board and can provide advice to the board and be involved in discussions. The FSF believes that in appointing the members of the board, it is important to aim for a reasonable level of diversity – not just in terms of gender, ethnicity, and the like, but in age, experience and skills.

The FSF does not see the need for an FMA or Treasury representative to be appointed to the Board. Whilst there is a close connection between the FMA's and the Reserve Bank's responsibilities, the FSF feels that this connection can be achieved at CEO and management level. The option to invite Treasury or FMA involvement with the board as required would still exist.

However, the FSF submits that the board should include representatives of the sectors the Reserve Bank supervises, for example a representative from the FSF who could provide the perspective of NBDTs, NDILs and credit-related insurance providers.

3.F Are there any aspects of the board's operation that would benefit from legislative clarity or guidance?

The FSF cannot think of anything further to add in this regard.

Chapter 4: How should the regulatory perimeter be set?

4.A What is the appropriate definition of "deposit taker"? Do you agree that the definition should be framed around entities that take retail "deposits" and lend? If not, what approach do you consider would be preferable?

The FSF supports the definition of "deposit taker" being changed to lenders that "*take deposits from the public*" rather than those that "*offer debt securities*" as described in the last paragraph of page 75 of the Consultation Document and agrees with the rationale provided therein to do so. Certainly, this definition more realistically captures what it is that NBDTs do which is to take retail deposits and lend.

Having said this, however, the FSF notes that the in-principle decision has been made to bring the bank and NBDT regulatory regimes together into a single “licensed deposit taker” framework and refers to the answer provided to question 2.E above which provides the FSF’s concerns with respect to this proposal.

The FSF also strongly agrees with the suggestion made on page 77 of the Consultation Document that different rules between different types of firms should be allowed for under whatever the new regime looks like. The FSF absolutely supports the concept of proportionality to ensure that the burden of rules and their enforcement is proportional to the issues being addressed and the expected benefits of regulation. The FSF is extremely concerned that there is a genuine risk, as articulated, in the Consultation Document, that the creation of a single licensed deposit-taker framework could mean the application of requirements designed for larger and more complex firms apply to smaller firms such as existing NBDTs and new deposit takers.

The NBDT market, which provides a viable alternative for small investors such as people wanting to supplement their pension income, has already shrunk significantly since the Global Financial Crisis came to an end. This is primarily because the regulatory hurdles put in the way of small businesses wanting to fund their lending activity in this way were considered too great and too costly to allow them to continue to raise funds via retail deposit. The FSF would not support any change to the current regime which further deterred existing NBDTs from carrying on their deposit-taking activity or from smaller new deposit takers entering the market.

4.B Should the Reserve Bank’s ability to monitor non-licensed entities be enhanced, for example through increased data reporting requirements? What do you consider would be the costs and benefits of such an approach?

The FSF did not support the suggestion that the Reserve Bank’s regulatory perimeter should be expanded to include such institutions as Non-Deposit-Taking Regulatory Institutions (NDLIs) when it was made in Consultation Document 1 and certainly does not do so now.

As they are not in the business of raising deposits from the public to fund their operations, they are clearly not “deposit takers” under either of the definitions discussed in the answer to question 4.A above. They are however lenders and as such they are regulated by the Credit Contracts and Consumer Finance Act 2003 (CCCFA) which is enforced by the Commerce Commission – as are deposit takers who are also lenders. It seems entirely sensible to the FSF that the deposit taking activity of a bank or NBDT should be regulated by the Reserve Bank but the FSF strongly submits that the lending activity of banks, NBDTs and NDLIs should be left to the Commerce Commission.

The CCCFA was significantly reviewed and improved in the wake of the Global Financial Crisis to the extent that clear Lender Responsibility Principles were written into the Act which came into force in June of 2015 together with the guidance for lenders as to how to meet these Principles that is contained in the Responsible Lending Code. The Commission has significantly increased

its enforcement activity against irresponsible lenders in recent times and the FSF believes they should be allowed to continue this work without interference from a second regulator.

The CCCFA is once again being reviewed with a view to strengthening a number of its provisions and to provide more prescription via regulation to ensure that all lenders do so responsibly. It is expected that the revised Act will be passed before the end of this year with it coming into force in 2020. The public is therefore amply protected (or will be) from poor lending practices under this regime.

4.C Should the Reserve Bank be given discretion to extend the perimeter within clearly specified parameters to avoid regulatory arbitrage (such as designating in entities with business models economically similar to deposit takers)? Do you agree that changes that are more significant may be more suited to legislative change, supported by pre-positioning?

Please see the answer provided to question 4.C above. The FSF believes there is more scope for regulatory arbitrage where there is a lack of clarity as to who is regulating what. Under the current model where the Reserve Bank regulates deposit takers and the Commerce Commission regulates lenders, it is absolutely clear who is the regulator responsible for what activity.

4.D Should tools that are not linked to licensing have a different perimeter? For example, it is common internationally for non-bank lending institutions to be subject to macro-prudential lending tools, even though they do not take deposits.

The FSF is not supportive of any proposal to bring NDIs into the scope of the Reserve Bank's regulatory perimeter for the reasons previously stated. Those lenders who were not subject to the Reserve Bank's LVR restrictions because they were outside of the regulatory perimeter at the time (for example) did so with a clear understanding of the risk they were taking on if they provided any credit that would have been outside of those restrictions and they have done so without incurring any further risk to their existing lending portfolio.

They provided a viable alternative to a small number of people who would otherwise not have been able to access finance because of the restrictions (who were primarily first home buyers) and have not suffered from any significant default or loss as a result.

Chapter 5: Should there be depositor protection in New Zealand?

5.A Are the interactions between depositor protection and the other parts of the financial safety net set out in Part 1 of Section 2 described appropriately?

The FSF notes that the in-principle decision to start developing a formal scheme to protect depositors in New Zealand has been made by the Minister and believes that the interactions

between depositor protection and the other parts of the financial safety net set out in Part 1 of Section 2 are described appropriately.

However, the FSF takes issue with the fact that the Consultation Document does not provide sufficient detail as to how the depositor protection would likely work in practice for the FSF to take a view as to whether or not the FSF is in support of its implementation. The FSF certainly agrees that the implementation of a depositor protection regime will increase costs for deposit-takers.

The FSF points out that it must be remembered that the NBDTs that are FSF members are all very small in size. Where table 5B of the Consultation Document talks about the value of insured deposits at \$58 billion should an insurance limit of \$10,000 (per depositor) be implemented, the FSF's NBDT members would represent approximately 0.1% of that amount. The FSF has serious concerns about the cost burden on such small deposit-takers.

This concern is compounded by the suggestion in Chapter 5 of Consultation Document 2B that industry-wide levies should also be imposed on deposit-takers to set up a deposit insurance scheme fund – again without any indication as to the cost to industry participants. Placing the burden of two deposit protection schemes or funds on small NBDTs such as the FSF's NBDT members would have the very likely outcome of putting them out of business so some very serious consultation would need to occur before the FSF could offer support to either of these proposals.

5.B What objectives should the depositor protection regime in New Zealand have? Should its objectives be:

- **To protect depositors from loss?**
- **To contribute to public confidence and financial stability?**
- **Both of these?**
- **Something else?**

The FSF understands that the objectives of protecting depositors from loss and contributing to public confidence and financial stability are the key objectives for a depositor protection regime. The key question for the FSF's NBDT members is what level of cost it will impose upon them and whether this will be so burdensome as to make continued deposit-taking activities unviable for them.

5.C The Minister has made an in-principle decision that the depositor protection regime should have a limit in the range of \$30,000-\$50,000. Given your answer to 5.B, what coverage level would be best within this range?

Given the small nature of the FSF's NBDT members' businesses, it is likely that a larger proportion of the deposits they hold will fall into this range than for larger institutions that attract larger deposits from a wider sector of the depositing public. It is therefore of concern to the FSF that they do not end up in the situation where a larger proportion of their deposit book

is covered by the depositor protection regime than those of larger institutions with a disproportionate cost falling to them as a result. The FSF believes that considerably more consultation as to the way in which a depositor protection regime might work and what it will cost would have to take place before the FSF could reasonably answer this and other questions about such a scheme. Coupled with this is also the need for further clarity on the proposed deposit insurance scheme fund as per the answer provided to question 5.A above.

5.D How would your preferred limit affect depositor wellbeing, public confidence, and depositors' responsibilities for their financial choices?

The FSF believes depositor wellbeing, public confidence and depositors' responsibilities for their financial choices are also served by the adherence to responsible lending obligations and enforcement of the CCCFA as well as a depositor protection regime.

5.E Do you think the New Zealand depositor protection regime should be supported by a preference for insured depositors? How would this affect the costs and benefits of a depositor protection regime in New Zealand?

The FSF supports the introduction of a depositor preference for the reasons outlined in Box 5A of the Consultation Document.

Thank you for the opportunity for the FSF to respond to the questions raised in the Consultation Document. Please do not hesitate to contact me if there is anything further you wish to discuss.



Lyn McMorran
EXECUTIVE DIRECTOR

Appendix A
FSF Membership List as at 31 May 2019

Debenture Issuers - (NBDT) Non-Bank Deposit Takers	Vehicle Lenders	Finance Company Diversified Lenders	Finance Company Diversified Lenders	Insurance	Affiliate Members
<u>Rated</u> Asset Finance (B)	BMW Financial Services ➤ Mini ➤ Alphaera Financial Services Branded Financial Services Community Financial Services European Financial Services Go Car Finance Ltd Honda Financial Services Mercedes-Benz Financial Motor Trade Finance Nissan Financial Services NZ Ltd ➤ Mitsubishi Motors Financial Services ➤ Skyline Car Finance Onyx Finance Limited Toyota Finance NZ Yamaha Motor Finance <u>Leasing Providers</u> Custom Fleet Fleet Partners NZ Ltd ORIX NZ SG Fleet Lease Plan	L & F Ltd ➤ Speirs Finance ➤ YooGo Avanti Finance Caterpillar Financial Services NZ Ltd CentraCorp Finance 2000 Finance Now ➤ The Warehouse Financial Services Flexi Cards Future Finance Geneva Finance Home Direct Instant Finance ➤ Fair City ➤ My Finance John Deere Financial Latitude Financial Pioneer Finance South Pacific Loans Thorn Group Financial Services Ltd Turners Automotive Group	Prospa NZ Ltd Personal Loan Corporation Metro Finance Credit Reporting Equifax (prev Veda) Centrix <u>Debt Collection Agencies</u> Baycorp (NZ) Illion (prev Dun & Bradstreet (NZ) Limited) Experian Intercoll Receivables Management	Autosure Protecta Insurance Provident Insurance Corporation Ltd Southsure Assurance	AML Solutions Buddle Findlay Chapman Tripp EY Finzsoft KPMG Paul Davies Law Ltd PWC Simpson Western FinTech NZ HPD Software Ltd Total : 61 members