FINANCIAL SERVICES FEDERATION

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Phase 2 of the Reserve Bank Act Review
The Treasury
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The Financial Services Federation (FSF) is grateful for the opportunity to submit on the further consultation on the prudential framework for deposit takers and depositor protection as part of Phase 2 of the Reserve Bank Act review.

By way of background, the FSF is the industry body representing the responsible and ethical finance, leasing and credit-related insurance providers of New Zealand. We have sixty members and affiliates providing these products to more than 1.5 million New Zealand consumers and businesses. Our affiliate members include internationally recognised legal and consulting partners. A current list of our members is attached as Appendix A. Data relating to the extent to which FSF members (excluding Affiliate members) contribute to New Zealand consumers, society and business is attached as Appendix B.

The FSF would like to start by congratulating the Treasury, particularly the officials who have written the Consultation Document in support of this phase of the Reserve Bank Act review, on the excellent quality of the writing of the document. The document is necessarily very extensive but the clarity of the explanations provided and the way in which the options are presented within it, makes the complexity of the content easier to follow than it might otherwise have been.

The FSF has some concern however with respect to some of the nomenclature and definitions being applied to various participants in the lending and deposit-taking sector. The FSF notes that in the previous 2 rounds of consultation there was clear distinction between what are registered banks, licensed Non-Bank Deposit Takers (NBDTs) which include credit unions and building societies as well as the seven other companies that still take deposits from the public, and Non-Deposit-Taking Lending Institutions (NDLIs) who are those companies that are not registered banks and who do not fund their operations via raising deposits from the public.

The FSF notes that the term “finance company” is not defined in the Glossary Document accompanying Consultation Document number 3 and the concern with respect to that is that,

because it is being applied to both NBDTs who are not credit unions or building societies and also to NDLIs who do not raise deposits from the public, there is a risk of confusion as to which entities the Institutional Act and the Deposit Takers Act will apply.

The FSF submits that, as part of this review, it would be timely to clearly define the participants within the regulatory perimeter and those who are outside of it. The use of the term "finance company" does not help with providing such clarity as it can be applied to any company that is not a bank, but which takes deposits, lends money or both. The FSF's suggestion is that the term "finance company" should be dropped entirely and that those companies within the scope of the regulatory perimeter should be described as being deposit-takers whether they are registered banks, credit unions, building societies or NBDTs and those companies that are not within the regulatory perimeter but which are non-bank lenders should be described as NDLIs. The FSF suggests that, the term "finance company" is obsolete, does not provide the necessary clarity as to which non-bank lenders it applies, and does not provide a helpful way of thinking about the players involved in the new universe of banks and other deposit-takers versus NDLIs.

The FSF further notes that on page 29 the Consultation Document raises the question of the treatment of lenders that are solely funded on wholesale markets (i.e. those that do not issue retail debt securities, instead solely issuing debt securities to wholesale investors such as high-net-worth persons and investment businesses). Further on in the document (note 12 on page 35), the statement is then made that wholesale-funded non-bank lenders are also sometimes referred to as finance companies and that they obtain funding on wholesale markets or from their parent companies). This just adds further to the confusion outlined above as to which entities are within the regulatory perimeter and which are outside it in the FSF's view and is further justification for the use of the term "finance company" being discontinued.

Although not referred to as such in the Consultation Document, the FSF also notes that the Reserve Bank's website refers to Non-Bank Lending Institutions (NBLIs) which includes NBDTs and non-deposit-taking finance companies (NDLIs) which are lenders that do not raise deposits from the public.

The FSF is concerned that the interchangeability of the acronyms NBLI and NDLI, has also become confusing. It would be clearer therefore if those companies that are NBDTs are described as such and those companies that are NDLIs are described as such and the use of the term Non-Bank Lending Institutions (NBLIs) could also usefully be discontinued.

Similarly, with the term "wholesale funded", there is not a definition of this in the Glossary but it would provide more clarity if it was defined as being those companies that obtain funding on wholesale markets or from their parent companies and who are therefore NDLIs.

In any event, the FSF's members feel that further consultation is required as to the development of better terminology for the non-bank sector that describes what they do rather than what they do not do whether that applies to those that are both deposit-takers and lenders or those that are lenders only. However, for the sake of clarity, the FSF will continue to

refer to those entities that are deposit-takers and lenders as NBDTs and those that are lenders funded in other ways as NDLIs.

One further point the FSF would like to make before moving to answer the questions posed in the Consultation Document, is that the current Reserve Bank purpose description as outlined in S1A of the Reserve Bank Act 1989, only talks about the Reserve Bank's role in managing risk factors. It does not talk about what action is needed from the Reserve Bank to support growth in New Zealand's economy and whether the financial system is doing what it needs to do to support this. This would seem to the FSF to be a significant omission in the post-COVID environment.

It is true that the current Government is encouraging the Reserve Bank to do what it can to stimulate economic growth but the FSF questions the effectiveness of some of these measures when credit channels other than those of the banks are not well understood or their potential role in supporting businesses to grow is not appreciated.

A prime example of this lack of understanding by Government, is the Business Finance Guarantee Scheme (BFGS) and the fact that it has still not been extended to the specialist lenders that are the NBDTs and NDLIs which provide finance to businesses of all sizes in sectors that banks are often reluctant to support or to SMEs or small traders and partnerships because they understand these types of businesses and sectors and are able to assess the inherent risk in lending to them, better than the banks do.

As you can see from the FSF's membership list as at 1 October 2020 provided as Appendix A to this submission, the FSF has only 3 NBDT members and the remainder of the members that are NDLIs or leasing companies do not raise deposits from the public. FSF members that are NBDTs or NDLIs provide finance or leasing products to consumers, businesses (from sole traders, SMEs through to large Corporates and Government) or both consumers and businesses. The following answers to the questions posed in the Consultation document will attempt to encompass the Dviews of the wider membership.

Chapter 2: Purposes of the Deposit Takers Act

2.A Do you agree with the proposed purposes? If not, what changes would you propose to the purposes? Are there any other purposes worth considering?

The FSF is generally supportive of the proposed purposes of the Deposit Takers Act but encourages consideration of aligning these with the purposes of the Institutional Act which will set out the Reserve Bank's objectives (among other things). The FSF believes that, aside from promoting financial stability, the Reserve Bank should also be expected to promote and stimulate the growth of the New Zealand economy, particularly in the post-COVID environment. The fact that the first purpose calls for the Reserve Bank to "promote" the safety and soundness of deposit takers seems to the FSF to be entirely sensible to avoid the

implication that the Reserve Bank should run a zero failure banking regime for deposit takers as the Consultation Document states.

The FSF is not so sure however about the purpose of promoting public confidence in the financial system. Whilst the FSF agrees that there is some validity in this objective in order to ensure that the sector can play its core role of intermediating society's collective wealth between lenders and borrowers, the FSF believes that this is something that could be achieved more at the margins rather than by being explicitly stated.

The FSF suggests that what would be more appropriate is that one of the purposes of the Deposit Takers Act should be to promote competition and diversity in the lending and deposit-taking sectors in order to stimulate economic growth. Again, the FSF notes that access to credit is critical to the nation's economy as we enter the rebuilding phase following the shock that has been caused to it by COVID-19 so it is imperative that the Reserve Bank be empowered to help facilitate this.

The FSF supports the final purpose of mitigating the risks that arise from the financial system in order to empower the regulatory regime to limit the build-up of systemic financial risks, such as those that may arise to the broader economy from the financial cycle. The FSF believes that this purpose also serves to achieve the public confidence objective.

The FSF has no further suggestions for other purposes worth considering for the Deposit Takers Act.

2.B Do you agree with the proposed decision-making principles? If not, what changes would you propose to the principles? Are there other principles that should be considered?

The FSF is satisfied that the proposed decision-making principles are appropriate and cannot suggest any other principles that should be considered.

The FSF is particularly supportive of the principles of the desirability of minimising unnecessary costs of regulatory actions, taking into account the benefits of the outcomes to be delivered and the desirability of taking a proportionate approach to regulation and supervision, and ensuring that similar institutions are treated consistently.

As the Consultation Document rightly points out, aside from the credit unions and building societies there are only 7 NBDTs remaining in operation in New Zealand. These are all small businesses incurring substantial compliance costs to be able to remain in business as an NBDT and thereby provide a highly valuable service to New Zealand investors by way of an alternative option to that of bank deposits. They will be incurring further cost to obtain both a conduct license when the Financial Markets (Conduct of Institutions) Amendment Bill is passed and comes into force and to be part of the proposed deposit insurance scheme.

The imposition of any suggested further costs must be balanced by a genuine cost benefit analysis that clearly demonstrates the additional benefits and protections to the New Zealand public arising out of these costs.

As has already been stated, the FSF submits that the Reserve Bank's purpose should also be to stimulate and support New Zealand's productivity and economic growth and therefore is supportive of the principle that sectors regulated by the Reserve Bank remain competitive. The FSF believes that, in order to achieve this, it is important that the Reserve Bank understands and promotes the diversity of bank and non-bank credit channels and the fact that this diversity exists because one size does not always fit all. The non-bank channels exist because there is demand that cannot be met by banks and the Reserve Bank's purpose and decision-making principles should encourage this for a richer competitive environment.

NBDTs also tend to be regionally based and therefore closer to their lending customers and their investors than larger deposit-takers such as the banks. They are regularly talking to their customers in person and are trying to help people to make more from their investments than they can from the banks. This return is then spent with businesses in their local community so the FSF firmly believes that, rather than trying to hinder their activity, the Reserve Bank should be actively encouraging them to grow and thrive, particularly in the post-COVID environment.

The FSF is therefore particularly pleased to note that the two principles mentioned above will ensure both regulatory efficiency and proportionality and looks forward to this being applied to ensure that regulation and supervision are tailored to reflect deposit takers' sizes, systemic importance, complexity and risk profiles.

Chapter 3: Regulatory Perimeter

3.A Do you agree with the proposed approach to defining the overall regulatory perimeter? If not, what approach would you suggest?

The FSF supports proposed approach 3.1 to defining the overall regulatory perimeter as capturing banks, credit unions, building societies and NBDTs but will make further comment about the treatment of NDLIs later in this submission.

The FSF points out however that the way proposed approach 3.1 defines "lending" as being the provision of credit under a credit contract as defined by the Credit Contracts and Consumer Finance Act 2003 (the CCCFA), could be misleading. The CCCFA regulates consumer lending only so therefore the CCCFA definitions of credit and credit contract pertain only to *consumer* credit and *consumer* credit contracts. Banks, credit unions, building societies and NBDTs also lend to businesses and this commercial lending is not covered by the provisions of the CCCFA. So, it would need to be made clear that the lending that is referred to as being part of the regulatory perimeter is both consumer and commercial lending.

3.B Do you support the proposed exclusion for wholesale-only funded lenders? If not, what approach would you suggest?

The FSF absolutely supports the proposed exclusion for wholesale-only funded lenders from the scope of the regulatory perimeter. The FSF disagrees with the statement in the last paragraph of page 29 of the Consultation Document that while such lenders could generate financial stability risks, these risks would typically be lower than those presented by deposit-takers that raise funds/take deposits from the general public and would go so far as to say that there are little or no financial stability risks attached to such lenders.

3.C Do you support a maximum size threshold for the wholesale exclusion? If so, what would be an appropriate measure of size?

As stated in the answer to question 3.B above, the FSF believes there are little or no financial stability risks associated with wholesale-only funded lenders. On that basis, setting a maximum size threshold would not seem to be logical or necessary

The question should be when would the Government ever be required to get out their cheque book to mitigate the financial stability risk associated with a wholesale-only funded lender and the answer to that question in the FSF's view is never. The risk associated with such lenders lies with their institutional investors and not the general public.

On this basis, the FSF does not support a maximum size threshold for the wholesale exclusion – the exclusion should be applied to all wholesale-only funded lenders regardless of size.

3.D Do you agree with the proposed territorial scope of the legislation? If not, what approach would you suggest?

The FSF agrees that the intended territorial scope of the perimeter which aims to capture entities that borrow money in New Zealand and that undertake the business of lending (regardless of whether the lending takes place in New Zealand) is appropriate.

3.E Do you have any comments on the application of the Deposit Takers Act to associated persons?

The FSF strongly suggests that it would be very much more appropriate if all the various pieces of legislation that regulate the activities of "associated persons" of lenders applied the same definition to what exactly is an "associated person". The Consultation Document notes that the Reserve Bank Act and the Insurance (Prudential Supervision) Act 2010 (IPSA) have different definitions of such persons.

The FSF also points out that the CCCFA as amended in 2019 by the Credit Contracts Legislation Amendment Bill also now has a requirement that all directors and senior managers of consumer credit providers must be certified as being fit and proper persons by the Commerce

Commission by 1 October 2021 in order for the lender to continue to operate. The definition of "senior manager" is as defined in the Financial Markets Conduct Act 2013 and is a person who is not a director but who occupies a position that allows that person to exercise significant influence over the management or administration of the entity so they could also be described as being an "associated person".

Whilst those lenders who already have a requirement to be licensed under another piece of legislation such as the Reserve Bank Act or the Non-Bank Deposit Takers Act, will not be required to have their directors and senior managers certified as being fit and proper persons under the CCCFA, the FSF believes that, for the sake of clarity and consistency, it would make sense for all legislative definitions of "associated person" to be aligned.

3.F Do you agree with retaining the restriction on the use of the words "bank", "banker" and "banking", but limiting it to persons providing "financial services"? If not, what approach would you suggest?

As the FSF pointed out in the introductory comments to this submission, there is considerable confusion over the use of nomenclature to describe the entities that will be included within the regulatory perimeter and those that will not and the proliferation of different terms to describe the same activity is largely to blame for this. The FSF is therefore very supportive of further consultation to determine how the different entities within the financial sector are described to provide the necessary clarity – particularly to the public of New Zealand as to with what type of entity they are dealing – that is currently lacking.

As has been pointed out already, more than one of the terms currently in use such as "bank", "registered bank", "NBDT", "NBLI" or "NDLI" can be applied to an individual institution and this review therefore seems an appropriate time to consider some more user-friendly nomenclature.

Given that this may well include an allowance for other deposit-taking entities to use words like "bank" in the way in which they are described, the FSF supports the proposed approach 3.2 of restricting words such as "bank", "banker" and "banking" to all those financial service providers that are licensed deposit takers but not exclusively to registered banks.

3.G Do you agree that the use of the words "deposit", "deposit taker" and "deposit-taking" should be restricted? What restrictions would you suggest?

The FSF supports the proposal that the words "deposit", "deposit taker" and "deposit-taking" should be restricted. As the Consultation Document quite rightly points out doing so would prevent uninsured financial products being marketed as deposits so that investors are not misled into thinking their investments are covered by the deposit insurance scheme when they are not which would undermine confidence in a downturn and exacerbate financial stability risks. The FSF also believes that these restrictions are helpful in preserving the bright line between deposit-taking lenders and non-deposit-taking lenders.

The FSF supports the proposal that the restrictions on the use of "bank", "deposit" and associated terms be no broader than necessary in order to comply with the Bill of Rights Act 1990 in relation to restrictions on free speech and that it would therefore only apply to persons that provide "financial services" as defined in the Financial Service Providers (Registration and Dispute Resolution) Act 2008. The FSF agrees with the assertion in the Consultation Document that this approach would provide limited scope for public confusion in relation to entities that do not provide financial services such as food banks etc.

3.H Do you support the proposed approach to foreign bank branches? If not, what approach would you suggest?

The FSF does not represent any banks foreign or otherwise so has no real opinion on this issue other than to say that the proposed approach to foreign bank branches as set out in the Consultation Document would seem to be appropriate.

3.I Do you agree that prudential regulation should be retained for finance companies funded via retail debt securities?

Notwithstanding the comments previously made by the FSF in this submission that the term "finance company" is outdated and should be dispensed with completely, the FSF agrees that prudential regulation should certainly be retained for those companies funded via retail debt securities.

As previously stated, the FSF membership includes three of the seven NBDTs that are not building societies or credit unions (Asset Finance, Gold Band Finance and Mutual Credit Finance) as well as a large number of lenders who would be described as being wholesale funded. In answering this question, the FSF will respond on behalf of its NBDT members first and then respond on behalf of its NDLI members.

With respect to the question of whether prudential regulation should be retained for companies funded via retail debt securities, the FSF's NBDT members are unanimous in the view that they wish to be included within the regulatory perimeter (and therefore any Deposit Insurance Scheme) regardless of whether they take on-call deposits or offer other types of debt securities to retail investors such as debentures or term deposits. The FSF also believes that deposit-takers should be seen as being prudentially regulated immediately the new Institutional Act comes into force.

FSF's NBDT members have all invested significantly since the introduction of the NBDT Act to ensure they meet the stringent compliance and operational requirements of the regime and they therefore wish to continue to be prudentially regulated institutions. They are also prepared to shoulder the cost of being participants within a Deposit Insurance Scheme (DIS) in order to ensure that they are able to continue to attract funds to grow their businesses.

Having said this, however, the FSF's NBDT members are also of the view that the costs of such prudential supervision should be minimised to the greatest possible extent and that supervisory costs should reflect the size of the institution being supervised. Smaller entities would seem to require less time to supervise than larger ones and the cost being imposed on these entities should reflect this. The FSF will comment further on the cost to belong to the DIS in the responses to the questions raised regarding this scheme in chapter 8 of the Consultation Document.

Further, NBDTs would appreciate the support of the Reserve Bank to the sector in the offering of a deposit facility for NBDTs at a reasonable rate to be agreed. This would ensure that NBDTs can hold sufficient levels of cash for their liquidity whilst being incentivised to do so and would alleviate any potential economic burden that would be imposed on NBDTs from a negative OCR, or more broadly in relation to any strict bank term deposit conditions that may create issues for them in building cash reserves in a viable or profitable manner.

Turning now to the way in which the regulatory perimeter might be applied to NDLIs, the FSF perceives there to still be a lack of trust in responsible non-bank lenders on the part of some officials and a lack of understanding that FSF member companies are well and prudently run. This may well be a result of the failures of some finance companies in New Zealand as discussed in the Consultation Document from page 35 and the $400 million ultimately paid out by the Crown under the Crown Retail Deposit Guarantee Scheme as a result of these failures. The FSF points out that the vast majority of the FSF's current non-bank lender membership traded through and survived the GFC because they did not have poor governance and management; did not indulge in criminal misconduct; did not have deficiencies in their disclosure, advice and investors' understanding; and did not require more adequate supervision.

The FSF believes that this has led to a lack of understanding of the very real and positive role that non-bank lenders play in areas that are not well served by the banks. Banks are not the only credit channel available in New Zealand and they are not good at providing credit to certain sectors of the economy, to SMEs, to self-employed business-people or to businesses based in small regional or rural areas. Non-bank lenders exist to serve these sectors because banks have not traditionally done so or have not done so well, and therefore non-bank lenders should be actively encouraged in order to preserve competitive neutrality and for the value they provide to New Zealand's economic growth which is needed now more than at any other time.

This lack of understanding of the importance of non-bank lenders to the New Zealand economy became more obvious when FSF has been discussing proposals with officials on the need for non-bank lenders to be included in the Business Finance Guarantee Scheme (BFGS) to help stimulate the New Zealand economy's post-COVID recovery.

The FSF has submitted on the previous 2 consultations as part of Phase 2 of the Reserve Bank Act review that the Federation does not support the extension of the regulatory perimeter to

include NDLIs on the basis that they do not need to be subject to prudential regulation as they are not systemically important to the financial system and do not take retail deposits.

Whilst the FSF still firmly holds this view, the FSF believes that as a result of the lack of oversight and therefore understanding of NDLIs by the Government, responsible non-bank lenders have been disadvantaged and more importantly opportunities have been not yet been taken up for specialised lenders such as FSF members to provide their expert assistance to New Zealand businesses were the BFGS to be extended to include responsible non-bank lenders.

On this basis the FSF has considered the matter of whether some form of overview of NDLIs by the Reserve Bank might be appropriate – even though this is not a question that has been asked in the Consultation Document. This could be along similar lines to the regime in place in Australia referred to on page 38 of the Consultation Document with respect to the distinction between those entities that are ADIs and those that are RFCs.

The FSF notes that some members already provide a Standard Statistical Return (SSR) to the Reserve Bank on a quarterly basis. This return captures data on the entity's liabilities; capital and reserves; assets held; New Zealand Dollar funding; New Zealand Dollar claims; specified loans on and off-balance sheet; securitisations; and residential loan analysis. Although the RBNZ website states that the institutions surveyed include all non-bank lenders (excluding small non-banks), the website does not give any indication as to the size of institutions being surveyed and what constitutes a "small non-bank".

It also appears that the data gathered in this Return is more weighted towards non-bank residential lending rather than the universe of non-bank lending which also includes consumer motor vehicle lending; other consumer lending both secured and unsecured; commercial motor vehicle lending; commercial asset lending; fleet and asset leasing; and commercial unsecured lending.

The FSF therefore suggests that consideration should be given to a requirement that large NDLIs (and the definition of a large company as being one with assets exceeding $60 million from the Financial Reporting Act 2013 could be applied here) provide similar quarterly reporting to the Reserve Bank on their activities as is currently required of those completing the SSR and that this could usefully be expanded to include all the various types of lending undertaken by NDLIs.

In fact there are some lenders within the FSF's membership of a size smaller than those with assets exceeding $60 million who would be willing to voluntarily provide such information which would also serve to provide regulators with a better understanding of the breadth and depth of the non-bank lending sector and its importance to the New Zealand economy.

The only caveat the FSF would apply to this suggestion is that FSF members take their compliance obligations across a number of different pieces of legislation very seriously and tend to view these in totality rather than taking each obligation on a piecemeal basis. The

revised CCCFA will require lenders to make an annual return to the Commerce Commission on various metrics which are yet to be decided upon. Reporting to various different regulators could well amount to reporting on the same information more than once and therefore it would seem to the FSF to make good sense for the regulators to sit down together with a representative group of non-bank lenders to consult on what information would be helpful and to whom, so any such reporting works for regulators as well as lenders and avoids duplication as much as possible.

3.J Would you support the approach of creating a restricted licence category for finance companies funded via retail debt securities (option 1)? What do you think would be the benefits and costs of this approach?

The FSF's NBDT members have carefully considered the two options for regulation discussed in the Consultation Document. This includes their having attended a very fruitful meeting with Treasury and RBNZ officials hosted by law firm Buddle Findlay in Wellington on 8 September.

The upshot of this meeting was that NBDT members wish to remain within the prudentially regulated framework including being participants in a Deposit Insurance Scheme (DIS) regardless of whether they take on-call deposits or offer other types of debt securities to retail investors such as debentures or term deposits so they do not support Option 1.

These members believe that Option 1 limits the ability of NBDTs to be flexible in the way in which they run their businesses and their ability to grow. Given the expressed desire of the officials present at the 8 September meeting to see the NBDT sector thrive and grow in order to provide for healthy competition, the FSF believes that Option 1 is therefore not the best option from the point of view of either the NBDTs themselves, the officials who will be regulating them or the investing public of New Zealand.

The FSF understands that this view is shared by the other two NBDTs who were present at this meeting and who are not members of the FSF, being Finance Direct and General Finance.

3.K Under option 1, what restrictions should be placed on the services that a licensed finance company could offer without becoming a full licensed deposit taker?

The FSF's NBDT members do not support Option 1 as already stated in the answer to question 3.J above.

3.L Should licensed financial market supervisors undertake the frontline supervision of finance companies under this model? If not, what approach would you suggest?

As has already been stated in this submission, FSF's NBDT members have invested significantly since the introduction of the NBDT Act in ensuring that they meet the stringent compliance and operational requirements of the Act. They have also built up constructive relationships of mutual understanding with their existing financial markets supervisors (FMS). FSF's NBDT

members certainly wish to remain within the prudentially regulated framework and also to be participants within a Deposit Insurance Scheme (DIS).

These members believe that by being part of the DIS they will achieve competitive neutrality as there are advantages in being part of such a scheme for attracting funds to provide for growth. Option 2 that requires companies to be licensed as deposit takers to issue any type of retail debt securities is therefore the preferred option for regulation for FSF NBDT members.

However, there is not consensus among FSF's NBDT members that the current operating structure where FMSs undertake the frontline supervision of NBDTs should be retained. There is a belief amongst some NBDT members that this model is currently working well and seems proportionate, so if it is already working well there is no need to replace it. But on the other hand there is also a belief that, if the Reserve Bank is going to be charged with the responsibility of prudential supervision of all deposit-takers under the Deposit Takers Act, then it is the Reserve Bank that should undertake the role of the FMS for NBDTs.

The concern with this is that the Reserve Bank does not currently have the resources or capability to do what the existing FMSs do as the supervisor of NBDTs and to have the same level of understanding of their businesses. A further concern is with the cost of this supervision and the need for this to be proportionate to the size of the entity being supervised, particularly as deposit-takers are going to incur the further cost of being part of the DIS.

The FSF therefore believes that further consultation is required with respect to the optimal supervisory model that achieves the purposes of providing New Zealand retail investors with the confidence to invest in secured term deposits through NBDTs whilst allowing these NBDTs to provide responsible lending to New Zealand consumers and businesses in markets the banks are failing to service but with a clear regard to keeping the cost of such a model as low as possible, particularly for small NBDTs.

3.M Alternatively, would you support requiring finance companies to have full deposit taking licenses to issue retail debt securities (option 2)? What do you think the benefits and costs of this approach would be?

As stated in the answer to question 3.L above, FSF's NBDT members support Option 2 as opposed to Option 1 but with the proviso that further opportunities be provided for consultation with respect to the optimal supervisory structure.

3.N Do you support the proposed approach to small deposit takers, under which the Reserve Bank would be expected to calibrate its regulatory approach in light of the proposed purposes, the decision-making principles, and the contents of the Remit? If not, what changes would you suggest?

The FSF does not represent any deposit takers that are mutual credit unions and building societies and notes that the proposed regulation of NBDTs discussed in section 3.2 of the

Consultation Document has been addressed in the answers already provided in this submission to questions 3.J, 3.K, 3.L and 3.M.

Having said that, however, the FSF does agree with the submissions made on Consultation Document 2A that small deposit takers could struggle to meet the costs of the compliance burden associated with a "bank-like" level of prudential regulation, and that prudential requirements for small deposit takers should reflect their less complex business models. NBDTs that are not building societies or credit unions also do not contribute to broader Government policy objectives, such as by promoting "financial inclusion".

Therefore, the FSF supports the proposed approach 3.4 that the Reserve Bank has the flexibility to calibrate its regulatory approach to small, less systemically significant deposit takers and that these decision-making principles should support a proportionate approach to minimise compliance costs and to take account of the role of these deposit-takers in facilitating competition.

An example where such flexibility already exists and where it has been effectively applied in the past is in the Reserve Bank's ability to provide an exemption for smaller NBDTs from the requirement to obtain a credit rating with some accompanying conditions.

3.O Alternatively, would you support creating a separate tier in legislation for small deposit takers? If so, how would you suggest drawing the distinction?

The FSF notes that in chapter 4 of the Consultation Document, with respect to the scope and setting of standards, proposed approaches 4.3, 4.4 and 4.5 suggest that the Reserve Bank should have the flexibility to calibrate appropriate standards for different deposit taker types or classes; that standards should provide for the calibration of specific prudential requirements to reflect the circumstances of an individual entity; and that the Deposit Takers Act should allow the Reserve Bank to set reporting and lending standards in relation to prescribed categories of non-deposit taking lenders. All of this flexibility is entirely appropriate in the FSF's view to allow the Reserve Bank to take an approach to small deposit takers that takes account of their size and activities.

Whilst it is true that having a separate tier in legislation for small deposit takers might create an arbitrary "cliff edge" in legislation that could inhibit the growth of small deposit takers, the FSF suggests that a way to avoid this might be to allow the Deposit Takers Act to have sufficient flexibility to be able to allow for a more proportionate approach depending upon the size of the entity. This is perhaps another area where more consultation would be helpful to ensure the balance between robust supervision and allowing for healthy competition in the market which is in the best interests of New Zealanders is maintained.

3.P Do you think the use of the words "bank", "banker" and "banking" should be restricted to a subset of deposit takers? If so, what criteria would be appropriate for their use?

The FSF is confused as to the purpose behind asking this question again when it appears to have been answered under question 3.F above and the FSF therefore refers back to the answer provided to that question.

3.Q Should current NBDTs have the same supervision, governance and disclosure exemptions from the FMC Act as banks? If not, what approach would you suggest?

The FSF's NBDT members support the retention of the current settings for their disclosure requirements on the basis of the simplicity of disclosure that provides most importantly for their customers. This is as compared to what appears to be the difficult to understand disclosure requirements for the banks.

The FSF also agrees that the new conduct licensing regime being introduced through the Financial Markets (Conduct of Institutions) Amendment Bill will provide the FMA with a greater degree of oversight over deposit takers and assurance that they are treating consumers fairly.

3.R Should current NBDTs be subject to a disclosure regime that is similar to that for banks? If not, what approach would you suggest?

Please refer to the answer provided to question 3.Q above.

3.S Do you support the proposed approach to perimeter monitoring? If not, what approach would you suggest?

The FSF supports the proposed approach to perimeter monitoring as outlined in proposed approach 3.6 of the Consultation Document to ensure that the Reserve Bank is empowered to monitor other lender types for financial stability risks and/or instances of unlicensed entities engaging in restricted activities or regulatory arbitrage.

The FSF refers to the answer provided to question 3.I of this submission where the FSF has suggested that some form of overview of NDLIs by the Reserve Bank might be appropriate and that this could take the form of a requirement that NDLIs of a certain size or above (perhaps using the definition of a large company as being one with assets exceeding $60 million from the Financial Reporting Act 2013) to provide some standard reporting to the Reserve Bank on their activities. The suggestion being that the existing quarterly SSR requirements could be extended to all NDLIs with assets exceeding the threshold amount so that the Reserve Bank is able to better monitor and understand the NDLI sector. The FSF notes that there are also some FSF members that are below this threshold who would be willing to provide data via an SSR process on a voluntary basis to assist increase the transparency of the non-bank lending sector to regulators.

This would also allow the Reserve Bank to monitor other lender types for financial stability risks and/or instances of unlicensed entities engaging in restricted activities or regulatory arbitrage.

However, the FSF notes that all consumer credit providers will be required to provide an annual report to the Commerce Commission under the CCCFA as it was amended last year. The form of this report and the information that will be required to be provided in it has not yet been determined but the FSF sounds a note of caution that it would be considerably more preferable to lenders who are NDLIs if any reporting requirements to both the Reserve Bank and to the Commerce Commission were aligned as much as possible to avoid duplication of effort and the cost of gathering the same information in different formats to satisfy the requirements of each regulatory body.

3.T Do you support the proposed designation power? If not, what approach would you suggest?

The FSF fully supports the proposed designation power as outlined in proposed approach 3.7 of the Consultation Document that the Reserve Bank should be empowered by the Deposit Takers Act to designate an entity as a deposit taker where the services it provides have the same economic substance as borrowing and lending. The FSF agrees that such designation power would discourage regulatory arbitrage and would encourage entities that are setting up just outside the perimeter to engage with the Reserve Bank to avoid confusion in the minds of the public regarding offerings that are or are not deposit offerings to the public

3.U Do you support the proposed exemption power? If not, what changes or alternative approaches would you suggest?

The FSF supports the proposed exemption power as outlined in proposed approach 3.8 of the Consultation Document with the safeguards proposed by Dr James Every-Palmer QC in his report on the prudential regulation of banks. Having such a power to exempt entities from the Deposit Takers Act will ensure that the costs of doing so do not outweigh the benefits of being part of the regime to ensure that these are proportional and that the requirements of the regime do not stifle competition.

The FSF agrees that providing that the power to grant exemptions must be exercised consistently with the purposes of the Reserve Bank Act and the Institutional Act once that has come into force, and the rest of the prudential framework; that the criteria to be applied by the Reserve Bank in determining whether to grant an exemption is clearly set out; requiring the Reserve Bank to give reasons for its decision to grant or decline an exemption; and providing that exemptions are subject to expiry dates to ensure regular review of the exemption is entirely appropriate.

The FSF notes that the Reserve Bank's current exemption power under the NBDT Act allows them to exempt small NBDTs from the requirement to have a credit rating as such a requirement would be unduly onerous or burdensome and that this is entirely appropriate.

3.V What should the criteria be for the Reserve Bank granting an exemption? What other limitations or safeguards should be placed on the power?

The FSF believes that the overarching principle of the Deposit Takers A ctshould be to ensure a regime exists to protect and promote the stability of New Zealand's financial system through the regulation and supervision of entities within the regulatory perimeter. The FSF believes that consideration also needs to be taken to the promotion of New Zealand's economic growth particularly in the post-COVID environment and the role that all lenders including non-banks, have to play in providing access to credit to stimulate this.

Exemptions to any regime have the potential to undermine the purpose for which the legislation is intended so the FSF sounds a note of caution by saying that any exemption-making power should be applied judiciously by the Reserve Bank.

When applying such power to respond to new and innovative business models that may not have been anticipated in the legislation, the FSF believes it is essential that the Reserve Bank seriously considers the harm that could be caused if such a business was to fail due to the lack of supervision an exemption might have afforded them. The FSF therefore supports the suggested safeguards contained in the report of Dr James Every-Palmer QC.

Chapter 4: Standards and Licensing

4.A Do you agree that the proposed scope of standards is appropriate? If not, what changes would you suggest?

The FSF agrees that the proposed scope of standards is appropriate and has no changes to suggest.

4.B Do you agree with the proposed power for the Reserve Bank to set lending standards (such as LVRs and DTIs) in relation to mortgages? If not, what changes to the scope or additional safeguards would you suggest?

The FSF does not agree with the proposed power for the Reserve Bank to set lending standards in relation to mortgages on the basis of proposed approach 4.2 of the Consultation Document for either NBDTs or NDLIs.

Non-bank lenders have, to date, not been subject to lending standards in relation to mortgages when they have previously been set, and they have continued to lend responsibly into this sector. They represent only a very small proportion of the mortgage lending that is done in New Zealand as compared to the banks and to include them would curtail the options and the point of difference they currently provide to the market. Applying these standards to non-bank lenders would also inhibit the competition and the ability to be innovative that these smaller entities are able to provide.

Not having included non-bank lenders in macro-prudential standards has allowed the market to continuing operating with flexibility without any adverse effect in any way.

The FSF also notes that all consumer lenders in New Zealand, whether supervised by the RBNZ or not, are subject to the obligations of the CCCFA which has been extensively amended as at the end of last year and the responsible lending compliance of all lenders is monitored and enforced by the Commerce Commission.

Non-bank lenders offer a valuable alternative to the banks to people with lower deposits but the means to service higher debt. These lenders price their offerings accordingly whilst still ensuring that their lending is being done responsibly in terms of the requirements of the CCCFA.

Therefore, the FSF submits that it should be made clear that macro-prudential powers such as LVRs and DTIs should be imposed only on banks as they are the entities that represent the vast majority of the mortgage market and which therefore exert the influence on the housing market that the imposition of these standards is seeking to provide.

4.C Do you agree that the Reserve Bank should be able to issue differing standards for different entity classes? If not, what approach would you suggest?

The FSF refers to the answer provided to question 3.O above. As stated, the FSF supports the notion of the Reserve Bank having the ability to issue differing standards for different entity classes to reflect the risks they present and to accommodate the broad range of deposit takers' business models. The FSF agrees that this would allow the RBNZ to take a proportionate approach to regulation and supervision and to ensure that similar institutions are treated consistently.

4.D Do you agree that the Reserve Bank should be able to make standards that enable it to exercise supervisory discretion on matters and within ranges specified in the standards? If not, what approach would you suggest?

Again, the FSF refers to the answer provided to question 3.O above. The FSF agrees that the Reserve Bank should be able to make standards that enable it to exercise supervisory discretion on matters and within ranges specified in the standards but also agrees with the assertion in the Consultation Document that the RBNZ should be required to give reasons to an affected entity and to consider its response before exercising its discretion.

The FSF also agrees that it is important that this power be supported by clear guidance on the circumstances in which the Reserve Bank would seek to use supervisory adjustments and that the RBNZ should be required to publish information about its regulatory approach.

4.E What procedural requirements and protections should apply to the Reserve Bank's use of supervisory adjustment?

As above, the FSF supports the fact that Cabinet has agreed that the Institutional Act will include a requirement for the Reserve Bank to publish information about its regulatory approach including a clear articulation of:

- The thresholds for the use of supervisory adjustments as opposed to formal enforcement tools so it is clear when either of these approaches would be appropriately used;
- The factors it considers in assessing risk and determining its response;
- Its approach to promoting transparency in the use of these adjustments.

4.F Do you support the proposed approach to allowing the Reserve Bank to set reporting standards and lending standards in relation to categories of non-deposit-taking lenders that have been prescribed via regulations? Why or why not?

The FSF refers to the suggestion made in the answer to question 3.I of this submission with respect to possible reporting requirements for NDLIs that might be helpful to increase the Reserve Bank's understanding of the non-bank lending sector and its importance to the New Zealand economy. However, the FSF does so with the caveat that this should be done on a more "joined-up" basis with the consultation and co-operation of the affected NDLIs and the co-ordination of the requirements of the different regulators to avoid a proliferation of disconnected regimes.

The FSF does not, however, support allowing the Reserve Bank to set lending standards in relation to non-bank lenders under any regulations in support of the Deposit Takers Act and refers to the answer provided to question 4.B above. The FSF does not believe that such lenders pose any systemic risk to New Zealand's financial stability, but they do provide a valuable and valid alternative to banks, particularly for people working in SMEs or who are self-employed. These lenders are closer to their customers and they have credit analysis capabilities and systems to enable them to properly understand their markets. They are also, like all lenders, subject to the responsible lending obligations of the CCCFA.

4.G Do you agree that the proposed procedural requirements for standards are appropriate? If not, why not? Should any other requirements be considered?

The FSF believes the proposed procedural requirements for standards are appropriate as they provide for adequate consultation both publicly and within Government on the introduction or amendment of a standard and also for a means to challenge a standard via the Regulations Review Committee where it contains matters more appropriate for parliamentary enactment, or appears to make some unusual or unexpected use of the standard-setting power or via judicial review to ensure the Reserve Bank acted within its powers and consistently with the legal framework.

4.H Do you support the proposed licensing test for deposit takers? If not, what approach would you suggest?

Firstly the FSF points out that section 4.5 of the Consultation Document with respect to licensing tests and the procedural requirements that would apply to licensing under the Deposit Takers Act once again uses the term "finance company" when explaining which entities under the proposed regulatory perimeter would need to obtain a license from the Reserve Bank. Given what the FSF has already said in this submission about the confusion that is caused when determining what is meant by the term "finance company" and therefore the need for its use to be discontinued, the FSF would prefer it if it was made clear that the licensing requirements apply only to those entities within the proposed regulatory perimeter and that these are those entities offering deposit-taking services (i.e. banks, credit unions, building societies and non-bank deposit takers) and that these requirements do not apply to NDLIs.

The FSF is however supportive of the licensing test for deposit-taking entities being that the entity would be able to comply with the requirements imposed on them and would be able to comply with applicable standards.

The FSF also notes however that under the CCCFA, all lenders will be required to complete a certification process through the Commerce Commission for their directors and senior managers by 1 October 2021. The FSF urges that wherever possible, the requirements for both the Deposit Takers Act licence and the CCCFA are aligned to the greatest possible extent in terms of the requirements of the certification process and the definition of what constitutes a senior manager.

4.I Are the proposed procedural requirements for licensing appropriate? If not, why not? Should any other requirements be considered?

The FSF is seriously concerned by the number of licences required to be held by deposit takers. Whilst the FSF accepts the need for a deposit takers licence to be held under the Deposit Takers Act, the FSF has questioned why the terms of a licence in relation to conduct matters could not be included in the terms of the deposit takers licence, rather than establishing a completely separate licencing regime as will be the result of the Financial Markets (Conduct of Institutions) Bill.

This is particularly so when most deposit takers will also require a further licence in relation to financial advice. Added to that is the requirement that they be a registered financial services provider and it seems to the FSF that the regulatory overlap is becoming excessive.

The FSF is strongly of the view that all licensed entities should be subject to one licensing regime for all their activities rather than being subject to a proliferation of disconnected regimes (as the FSF has already mentioned in the answer provided to question 4.F above) and believes that further work on the Conduct Bill should be halted whilst consideration is given to

how all the separate regimes to which each entity is currently subject could be achieved on a more consistent and "joined-up" basis.

4.J What scope of appeal rights should be provided for in relation to licensing decisions and why?

The FSF is comfortable with the appeal rights as outlined in the Consultation Document in relation to licensing decisions.

4.K Do you agree with the proposed approach to de-licensing? If not, what changes would you suggest?

The FSG agrees with the proposed approach to de-licensing.

4.L Do you agree with the proposed use of the register to record and apply standards and other requirements on deposit takers? If not, what approach would you suggest?

The FSF agrees that the proposed use of the register to record and apply standards and other requirements on deposit takers is appropriate to promote transparency of the requirements applying to each deposit taker.

Chapter 5: Liability and accountability

5.A Do you agree with the general categorisation of the contraventions that should give rise to criminal and civil liability in the Deposit Takers Act?

The FSF agrees with the proposed approach taken by the Review that deposit-takers should be subject to both criminal liability as well as civil liability because of the fact that there is a very high threshold for action for criminal liability.

The FSF also agrees with the general categorisations of the contraventions that should give rise to criminal and civil liability in the Deposit Takers Act as proposed in the Consultation Document.

5.B Do you agree with the specification of the new positive duties for directors of deposit takers? If not, why not?

Whilst the FSF preferred the enhanced status quo option in response to Consultation Document 2B because it built on the existing regime that is already well understood by regulated entities, the FSF accepts that Cabinet has taken the in-principle decision to increase the accountability of deposit takers' directors by imposing various positive duties upon them.

Given the direction in which the Government wishes to take the regime for deposit takers therefore, the FSF believes that the new positive duties for directors of deposit takers are

appropriate. The FSF also supports the proposal that these duties will be supported by clarification and guidance from the Reserve Bank in order to provide clarity to directors as to what is required of them to carry out these duties.

5.C Do you agree that directors should not be indemnified or insured against loss in the performance of their duties?

The FSF agrees that directors should not be indemnified or insured against loss in the performance of their duties where they are liable for personal financial losses arising from breaching (or unsuccessfully defending proceedings tied to) the new positive duties or unsuccessful defences of criminal proceedings generally.

The FSF does however agree with the proposed approach taken in the Consultation Document where deposit taker directors can be insured or indemnified for their costs where they have been successfully defended in criminal proceedings generally; where they have been successfully defended in criminal and civil proceedings tied to the new positive duties; and where they have been either successfully or unsuccessfully defended in civil proceedings not tied to the new positive duties.

5.D Do you see any specific issues with the relationship between the existing director duties in the Companies Act, and the new duties being proposed here?

The FSF is strongly of the opinion that any new duties of directors should be complementary to existing director duties and not contradictory or likely to cause confusion as to the duties required of directors. On that basis the FSF is pleased to note that attention has been paid in the Consultation Document to the relationship between the new obligations being proposed here and the duties that directors owe to their institutions and their owners under the Companies Act 1993.

Whilst the FSF notes that the existing director duties in the Companies Act are owed primarily to a company and its shareholders, rather than to the public at large and the new duties being proposed are obligations owed to society, the FSF agrees that the proposed additional positive duties for directors will address any misalignment between commercial incentives and the pursuit of private benefits by a deposit taker and the outcomes society would like to achieve from the financial system.

5.E Do you agree that deemed liability should be retained for false and misleading disclosure? If not, what approach would you suggest?

The FSF agrees with proposed approach 5.5 as set out in the Consultation Document that directors should have deemed civil liability for false or misleading disclosure and that this approach would be limited to knowing or reckless breaches. The FSF agrees that this would emphasise the ongoing importance of accurate disclosures in promoting self- and market discipline and align with the FMC Act's approach to deemed liability for disclosure breaches.

5.F Do you agree with the proposed approach to maximum civil penalties on bodies corporate, including the use of maximum penalties based on the size of the institution or any benefit gained (or loss avoided)? If so, what specific metrics or amounts should be considered for these penalties?

The FSF agrees with the proposed approach to maximum civil penalties on bodies corporate as outlined in proposed approach 5.6 of the Consultation Document.

With respect to the specific highest metrics or amounts that should be considered for these penalties on bodies corporate, the FSF believes these should be:

- A maximum of $5 million (in line with the FMC Act);
- 10% of annual turnover (in line with the Commerce Act);
- Three times any benefit or loss avoided (in line with the FMC Act and the Banking Act (Australia).

5.G Should a lower tier of civil penalties be established for some contraventions, for example, those that do not adversely affect the deposit taker's prudential standing?

As noted above, the metrics suggested are the maximum penalties that could be imposed on bodies corporate if found to be in breach of or non-compliant with their requirements. There is therefore scope below that maximum level for lower civil penalties to be imposed that are reflective of those contraventions that do not adversely affect the deposit taker's prudential standing. Therefore, the FSF does not see the need to establish a lower tier of civil penalties for such contraventions.

5.H What maximum level of individual civil penalty should be provided for and why?

The FSF agrees with the proposed approach to provide for lower maximum civil pecuniary penalties for individuals, up to a specified dollar amount as outlined in proposed approach 5.7 of the Consultation Document.

With respect to the specific highest metrics or amounts that should be considered for these penalties on individuals, the FSF believes these should be:

- A maximum of $1 million or three times any benefit (in line with the FMC Act).

5.I Should criminal offences relating to the obstruction of routine supervisory powers be subject to monetary penalties, but not imprisonment terms for an individual? If so, what level of maximum penalty would be appropriate and why?

The FSF agrees with the proposed approach to provide for moderate monetary penalties for criminal offences relating to the obstruction of more routine supervisory powers such as

information-gathering and on-site inspection powers as outlined in proposed approach 5.8 of the Consultation Document.

The FSF believes that the maximum level of penalty that would be appropriate in these circumstances would be $300,000 for a body corporate and $30,00 for an individual for these sorts of breaches in line with the FMC Act. The FSF believes that such penalties would be sufficient deterrent to prevent this type of behaviour.

5.J What monetary and imprisonment penalties should be considered for more serious criminal offences and why?

The FSF agrees with the proposed approach to provide for more significant monetary penalties and for potential imprisonment for criminal offences relating to more serious breaches of the Deposit Takers Act as outlined in proposed approach 5.9 of the Consultation Document.

These more serious criminal offences such as operating a deposit-taking business without a licence, failing to comply with a direction or knowing or reckless breaches of prudential standards should certainly include a term of imprisonment for individuals who are party to the offences in line with the provision in the Crimes Act 1961 that any persons who are party to an offence are also guilty of that offence in the FSF's view.

Chapter 6: Supervision and enforcement powers

6.A Do you agree that the on-site power for the AML/CFT regime is an appropriate comparator for a similar power for the Reserve Bank's prudential functions?

The FSF agrees that the on-site power for the AML/CFT regime is an appropriate domestic comparator for a similar power for the Reserve Bank's prudential functions as it is one to which New Zealand deposit-takers are already subject so they are therefore familiar with the way in which it functions. The FSF also notes the observation in the Consultation Document that on-site powers in New Zealand legislation must be specified in ways consistent with New Zealand's legal and constitutional principles and that they typically require strong justification and careful design to ensure they balance rights and freedoms, which is entirely appropriate in the FSF's view.

6.B Should this power be a generic power in the new Institutional Act, or specified in the Deposit Takers Act?

The FSF notes that the suggestion in the Consultation Document is that the on-site power be a generic power in the new Institutional Act because it is an efficient and elegant way of enabling the power to be applied to the various industry sectors the Reserve Bank regulates and because it consolidates related supervisory tools and powers such as information gathering and sharing and investigatory powers in the Institutional Act. The FSF agrees that this is a better alternative than providing for these powers separately in the relevant sectoral Acts.

6.C Do you think any additional safeguards are necessary for the on-site power?

The FSF accepts the assertion in the Consultation Document that, in practice, most on-site inspections will be a regular and routine part of the supervisory cycle, but that there may be occasions when the on-site power needs to be used proactively or pre-emptively to ensure that the regulator has sufficient flexibility to turn up and inspect where urgency may be required or where advance notice may tip off the entity.

Given this need for inspections to be undertaken without warrants or the consent of the entities concerned, the FSF agrees that there needs to be safeguards to protect the rights and freedoms of regulated entities. The FSF is, however, unable to think of any additional safeguards that may be necessary to achieve this other than those proposed in the Consultation Document. That is, the scope being limited to accessing business premises at a reasonable time; the authorisation or approval of persons carrying out inspections (and that these persons have had appropriate training and have the requisite expertise); and confidentiality protections for information gained from the inspection.

6.D Do you think the FMA's on-site inspection power should be expanded in the same way that is proposed for the Reserve Bank?

The FSF notes that the FMA's on-site inspection power generally relies on the consent of the entity and that this is appropriate for those inspections that are a regular and routine part of the supervisory cycle. However, the FSF agrees that there may be times when aligning the FMA's on-site inspection powers with what is proposed for the Reserve Bank might be desirable. Therefore, the FSF would be comfortable with the FMA's on-site inspection power being expanded in the same way that is proposed for the Reserve Bank with the same safeguards as proposed in the answer to question 6.C above applying that power.

6.E Should an expanded FMA on-site inspection power apply in all circumstances and to all FMA-regulated entities or only some (e.g. in high-risk circumstances or for dual prudential-conduct regulated entities)?

On the basis that any expanded on-site power for the FMA is subject to the same safeguards as would be applied to the Reserve Bank's power, the FSF believes that the FMA's power should apply in all circumstances and to all FMA-regulated entities.

6.F Do you have any comment on the appropriate legislative location of supervisory powers such as information gathering and sharing, on-site inspections, and other related powers? Do you see merit in consolidating similar powers from sectoral Acts into the Institutional Act?

The FSF is comfortable with the suggestion in the Consultation Document that the Institutional Act is the appropriate legislative location of supervisory powers and the FSF also sees merit in consolidating similar powers from sectoral Acts into this Act.

6.G Should a breach-reporting requirement be directly provided for in legislation? Should this be provided for in the Deposit Takers Act, or located in the Institutional Act as a requirement for all entities regulated by the Reserve Bank?

The FSF notes that the Consultation Document refers to "banks" and "registered banks" consistently from the beginning of section 6.3 rather than "deposit takers" which would also include NBDTs in the breach-reporting requirement. Proposed approach 6.3 says that the Deposit Takers Act should require all breaches to be reported to the Reserve Bank but is not clear as to whether these are breaches by registered banks only or whether they are breaches by all deposit-takers. The FSF is therefore unsure as to whether or not the breach-reporting requirement would be applied to all deposit takers or just to banks.

On the basis that such a requirement was to apply to all deposit takers, the FSF believes that the requirement should be directly provided for in legislation and that this should be located in the Institutional Act as a requirement for all entities regulated by the Reserve Bank which, as noted in the Consultation Document, would be consistent with locating a number of other generic supervisory powers such as information-gathering and on-site inspection in that Act.

6.H Do you agree that the Deposit Takers Act should provide for the Reserve Bank to accept a voluntary undertaking from a deposit taker that is enforceable in court?

The FSF agrees that the Deposit Takers Act should provide for the Reserve Bank to accept such an undertaking from a deposit taker that is enforceable in court. Such enforceable undertakings would allow the Reserve Bank to agree certain outcomes with a deposit taker such as particular remedial actions to address non-compliance or an area of emerging concern.

6.I Should the Deposit Takers Act provide a statutory basis for the Reserve Bank to issue a formal notice to a deposit taker?

The FSF agrees with the assertion in the Consultation Document that the Reserve Bank already has the ability to issue warnings and notices informally and therefore there may be limited practical value in adding this tool to primary legislation. Given that the Reserve Bank's ability to issue an informal public notice or warning to signal to the public that an entity may have breached a prudential requirement, but that the Reserve Bank does not consider it appropriate to take further formal action at the time, does create a very real reputational consequence for the entity, the FSF agrees that this does prompt swift remediation.

On that basis, the FSF does not believe it is necessary for the Deposit Takers Act to provide a statutory basis for the Reserve Bank to issue a formal notice to a deposit taker.

6.J Do you see any role for infringement notices in the Deposit Takers Act?

The FSF agrees that infringement notices can offer a relatively efficient way to incentivise compliance where breaches have minor impacts, are frequent and are relatively unambiguous

and that by including an infringement offence in the Institutional Act for such minor infractions, there is therefore no need for an infringement notice power in the Deposit Takers Act.

The FSF does however have a question as to the scope of such an infringement notice power were the decision to be made to extend a requirement for a similar data-gathering exercise to the Standard Statistical Return (SSR) currently being completed on a quarterly basis by some NDLIs to all larger NDLIs. That is whether the infringement notice power would therefore be applied to those NDLIs over the agreed threshold who did not complete their SSR within agreed timeframes.

6.K Do you see a useful role for remedial notices and/or action plans in the Deposit Takers Act?

On the basis that a remedial notice and/or an action plan could relate to any breach and that they more clearly signal that these tools are part of the BAU enforcement toolkit rather than crisis management powers and most of the current criteria for issuing directions in the Reserve Bank Act are related to crisis situations, the FSF sees a useful role for such remedial notices and action plans in the Deposit Takers Act.

Chapter 7: Resolution and crisis management

7.A What are your views on the proposed triggers for placing a deposit taker into resolution and exercising resolution powers?

The FSF supports the proposed triggers for placing a deposit taker into resolution and exercising resolution powers as outlined in the Consultation Document. Applying both a non-viability test and a necessity test before taking such action would seem to the FSF seems to strike an appropriate balance between placing the deposit taker into resolution before all realistic alternative options have been exhausted on the one hand and the need to act swiftly and decisively to minimise losses and damage to the financial system and economy on the other.

7.B What should be the scope of statutory bail-in in New Zealand? What liabilities should be expressly included or expressly excluded? How should deposits be treated?

On the basis that bail-in as a resolution strategy would not generally be expected to be used in the failure of a smaller, largely deposit-funded institution where liquidation and an insurance pay-out of insured deposits may be more suitable, and the fact that the FSF's three NBDT members would fall into that category, the FSF has no comment to make on the scope of statutory bail-in in New Zealand.

7.C Should statutory bail-in have retrospective application?

Please see the answer provided to question 7.B above.

7.D Is there still a role for a ministerially appointed advisory committee to a statutory manager? If so, should legislation be more specific about the purpose and the composition of that committee?

The FSF does not believe there is still a need for a ministerially appointed advisory committee to a statutory manager. As noted in the Consultation Document, the Reserve Bank will be formally designated as the resolution authority for licensed deposit takers and will therefore be responsible for exercising crisis management powers.

With respect to the representation of creditors to the statutory manager, the FSF notes that the availability of NCWO compensation makes this redundant as it provides an adequate protection of creditor interests.

7.E Should the Reserve Bank have the power to demutualise a building society or credit union that meets the criteria for being placed into resolution?

Given that the FSF does not represent any building societies or credit unions within its membership, the FSF has no comment to make with respect to this question.

7.F Do you agree that deposit takers should only be subject to one statutory management and resolution regime?

The FSF believes that deposit takers should only be subject to one statutory management and resolution regime and that this should be the same as that for registered banks – i.e. the statutory management regime that currently exists in the Reserve Bank Act.

The FSF agrees with the assertions in the Consultation Document that statutory management under CIMA lacks crucial resolution tools that are recommended in the FSB Attributes of Effective Resolution Regimes for Financial Institutions and that the statutory management and resolution of deposit takers are essentially prudential issues.

7.G Do you favour option 1, option 2, or some other approach (including the status quo)?

The FSF's NBDT members favour Option 2 for creating a single statutory management and resolution regime for deposit takers under the Reserve Bank. However, FSF's NBDT members also point out that under their current Trust Deed arrangements, the Trustees have the power to appoint a receiver and undertake a review process which the FSF believes to be a good mechanism which should be retained for NBDTs.

The question raised in 3.L with regard to the continuing role of Trustees (or FMSs) notwithstanding, the FSF believes that the power to appoint a receiver or to undertake a review could remain with the FMS or be transferred to the Reserve Bank, depending on the outcome of the consultation with respect to question 3.L.

The FSF believes that the powers of a receiver should include exercising the right to declare all deposits due and payable; exercising any rights in law in relation to secured property; and doing anything with the secured property that the charging entity could do.

Having the ability to undertake a review process would allow the supervisor to determine whether the deposit-taker is in a sound position or not and therefore whether there is any possibility of default. Once the review is completed the supervisor would have the power to instruct the deposit-taker not to borrow money, lend money or accept new deposits which would also seem to the FSF to be a power that would be appropriate for the supervisor.

Chapter 8: Depositor protection

8.A What are your views on the benefits and costs of a preference for insured depositors compared to no preference?

The FSF does not believe that insured deposits should have any preference. In the case of failure of a deposit-taker, insured deposits would be repaid by the insurer who would then rank equally with all uninsured depositors. This was the way in which the Crown Retail Guarantee Scheme was set up during the GFC and it seems entirely reasonable to FSF's NBDT members that the DIS should be set up in the same way this time.

8.B If a preference for depositors is introduced, do you agree it should only cover insured deposits (not all deposits)?

Please see the answer provided for question 8.A above.

8.C Do you agree with the proposed prescribed product approach for coverage under the new scheme? If not, what approach would you suggest?

As previously stated, FSF's NBDT members strongly believe that all retail deposits should be covered by the DIS. Therefore bonds, debentures and capital notes should also be eligible for coverage under the scheme.

8.D Do you agree that both retail and wholesale investors in insured deposit products should be covered up to the $50,000 coverage limit? If not, what approach would you suggest?

As stated in the answer to question 8.C above, the FSF's NBDT members believe that all retail deposits should be covered by the DIS. This would include transactional accounts, on-call savings accounts, term deposits and redeemable shares offered by financial co-operatives as well as bonds, debentures and capital notes.

The FSF agrees that it is not easy for deposit takers to identify wholesale depositors and that a simple and comprehensive treatment would be the preferred course of action. Therefore, the FSF supports the proposal that both wholesale and retail investors would be able to access

insurance coverage by investing in the prescribed deposit products that are eligible for insurance.

Whilst the FSF is aware that the in-principle decision to limit the DIS to a maximum $50,000 coverage limit has already been made, the FSF would be keen to discuss a possible increase in this limit if this was at all possible and, if so, what that limit should be.

A higher coverage limit would provide cover for the total deposit book of many deposit takers and also provide for coverage based on the spread of deposits within that deposit book. This would be more in line with similar schemes in overseas jurisdictions. It would also serve to avoid the real possibility that depositors will split their deposits into amounts of $50,000 and deposit them across a range of deposit-takers in order to gain the protection of the DIS with each deposit-taker.

8.E Is the list of excluded deposit products appropriate? If not, what approach would you suggest?

The FSF believes that the proposed excluded products as outlined in the Consultation Document: foreign currency deposits, deposits held by related parties or connected persons and interbank deposits and deposits from other financial institutions, are appropriately excluded from the insurance scheme.

8.F Do you agree with the proposed narrow mandate for the deposit insurer?

The FSF agrees with the assertion in the Consultation Document that the deposit insurer should have powers commensurate with the scope of its mandate and that this should focus on protecting depositors in the event of a failure. On that basis, the FSF supports the deposit insurer powers and functions as set out in Table 8.2 of the Consultation Document.

8.G Do you agree that the deposit insurer should be able to provide funding for resolutions other than a liquidation?

On the basis that ensuring the deposit insurer has the ability to use funds to support resolution tools other than liquidation is one of IADI's Core Principles for Effective Deposit Insurance Systems, and that it is suggested that appropriate safeguards be implemented to ensure that the use of these funds is consistent with the protection of insured depositors and enhancing market discipline, the FSF agrees that the deposit insurer should be able to provide funding for resolutions other than a liquidation.

8.H If yes, do you agree with the limit on the amount of funds that can be used? What are your views on the appropriate safeguards?

The FSF agrees with the proposed safeguards that could be introduced by the deposit insurance scheme as per IADI's Core Principles and as outlined in the Consultation Document in addition

to giving the resolution authority an explicit objective to protect depositors and to use insurance funds in the most efficient way to also strengthen these safeguards.

8.I What are your views on the appropriate decision authority for the coverage limit?

The FSF refers to the comments made with respect to the maximum coverage limit in the answer provided to question 8.D above. The FSF agrees that the coverage limit is a key feature of the scheme and that it has significant impacts on protected depositors, uninsured creditors, and the Crown balance sheet. The FSF therefore agrees that any proposed changes to the coverage should be placed in legislation to create a more thorough process for changing the coverage limit, thus supporting the government to make a credible and durable commitment to protect depositors up to the prescribed level.

8.J If a deposit insurance fund is established, should changes to the target size and the levies be made by ministers via regulations or by the deposit insurer itself?

The FSF supports the suggestion in the Consultation Document that changes to the target size and the levies should be set in regulations using a similar approach to that used for funding the Earthquake Commission. The FSF agrees that this would provide more certainty for industry around future premiums and that the legislation should set out the criteria that should guide these decisions whilst directing the minister to have regard to the advice of the deposit insurer.

8.K Should there be a legislated requirement to review the deposit insurance scheme? If so, how often should it be reviewed (e.g., every five years)?

The FSF believes it is best practice for such a scheme to have a robust process for review to ensure it continues to achieve its objective and to support the durability of the scheme. The FSF believes that the timeframe for such regular review should be every five years to ensure transparency of the review process and any possible changes in the coverage limit.

8.L Has the Review identified the appropriate criteria for assessing the best organisational form of the insurer?

The FSF believes the Review has identified the appropriate criteria for assessing the best organisational form of the insurer.

8.M Do you agree that the insurer should be located within the Reserve Bank? If not, what approach would you suggest?

The FSF agrees with the advantages outlined in the Consultation Document to housing the deposit insurance scheme within the Reserve Bank. Specifically, the synergies that may be achieved with technical design such as ensuring that banks (in fact all deposit takers, not just the registered banks) have the necessary systems in place to protect depositors; that the model can be activated relatively quickly given the Reserve Bank's existing relationships with the

deposit-taking sector; and that the Reserve Bank will be designated as the resolution authority so co-location would support strong information flows to the deposit insurer in a crisis.

The FSF notes that, under this model, the Reserve Bank Board would be required to ensure that there are sufficient safeguards in place to manage any potential conflicts of interest between deposit insurance and the Reserve Bank's other functions.

8.N Do you agree that the insurer should build a deposit insurance fund ahead of a failure? If not, what approach would you suggest?

The FSF agrees that resources that would be used for a deposit insurance payout should be collected in advance of a deposit taker failure through the establishment of ex ante funding as opposed to obtaining the resources after a failure has occurred.

The FSF agrees with the assertion in the Consultation Document that, under the ex-ante funding model, scheme members that ultimately fail and require deposit insurance payouts would have partially contributed to the cost of these payouts, whereas under the ex post funding model, only the surviving deposit takers would incur the payout costs of a failed deposit taker.

8.O What are your views on the appropriate size of any deposit insurance fund?

The FSF agrees that a "target size" should be established for the deposit insurance fund, and that the appropriate target size be subject to further consultation as this is a matter that would require further consideration by FSF's deposit taker members. The Consultation Document rightly points out that the funds held in the deposit insurance fund could otherwise be used by deposit takers themselves for more productive purposes, such as lending to the economy. This is of course of particular relevance given the necessity of access to credit with relative ease in the country's economic recovery post-COVID.

8.P Should the insurer charge higher levies to higher risk deposit takers? What are your views on how risk should be assessed?

The FSF does not support the concept of a differential premiums system (DPS) based on the different levels of payout risk applicable to individual deposit insurers but instead believes that premiums should be spread across the industry based solely upon the amount of the deposits guaranteed for each deposit-taker.

8.Q What are your views on how the Government funding backstop should be designed?

The FSF supports the concept that the scheme should have the legislated ability to borrow additional funding from the Crown if needed. The FSF also agrees that this borrowing would become an obligation of the scheme and would be repaid by scheme members with interest over time and that this Government funding backstop would ensure that the scheme has

adequate resources to fulfil its obligation to insured depositors. The FSF understands however the practical limitations as to how much the Crown can provide to the scheme in a short time frame due to issues such as the other stresses the economy could be facing at that time, particularly as the economy is already facing such stress in the current COVID environment and is likely to be doing so for some time to come.

The FSF would be keen to engage with officials on behalf of its deposit taker members, over the design of an operational approach to the backstop.

Please do not hesitate to contact the FSF if there is any further assistance that could be provided on this Review.

Lyn McMorran
EXECUTIVE DIRECTOR

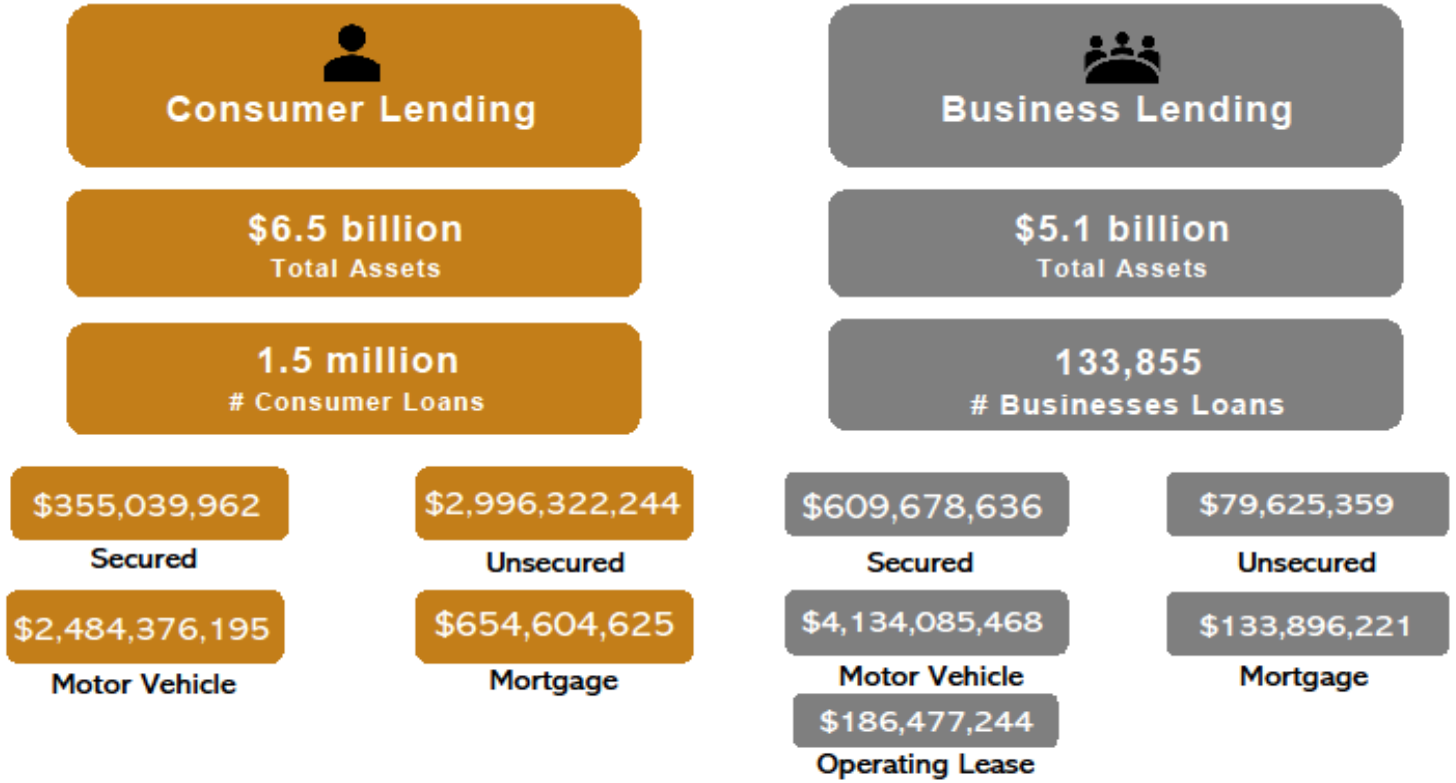
Appendix A- FSF Membership List as at 1 October 2020

Non-Bank Deposit Takers Leasing Providers	Vehicle Lenders	Finance Company Diversified Lenders	Finance Company Diversified Lenders	Credit-related Insurance Providers	Affiliate Members
<u>Rated</u> Asset Finance (B) <u>Non-Rated</u> Mutual Credit Finance Gold Band Finance ➢ Loan Co <u>Leasing Providers</u> Custom Fleet Fleet Partners NZ Ltd Lease Plan ORIX NZ SG Fleet	AA Finance Limited Auto Finance Direct Limited BMW Financial Services ➢ Mini ➢ Alphera 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	Avanti Finance ➢ Branded Financial Caterpillar Financial Services NZ Ltd CentraCorp Finance 2000 Finance Now ➢ The Warehouse Financial Services Flexi Group (NZ) Limited Future Finance Geneva Finance Home Direct Instant Finance ➢ Fair City ➢ My Finance John Deere Financial Latitude Financial Metro Finance Pepper NZ Limited Personal Loan Corporation Pioneer Finance Prospa NZ Ltd South Pacific Loans	Speirs Finance Group ➢ Speirs Finance ➢ Speirs Corporate & Leasing ➢ Yogo Fleet Thorn Group Financial Services Ltd Turners Automotive Group ➢ Autosure UDC Finance Limited <u>Credit Reporting & Debt Collection Agencies</u> Baycorp (NZ) ➢ Credit Corp Centrix Collection House Equifax (prev Veda) Illion (prev Dun & Bradstreet (NZ) Limited Intercoll Quadrant Group (NZ) Limited	Protecta Insurance Provident Insurance Corporation Ltd Southsure Assurance	255 Finance Limited Buddle Findlay Chapman Tripp Experian EY FinTech NZ Happy Prime Consultancy Limited HPD Software Ltd KPMG PWC Simpson Western Total: 63 members

Appendix B

FINANCIAL SERVICES FEDERATION

The Financial Services Federation (FSF) is the association for responsible finance and leasing companies operating in New Zealand. This infographic is a snapshot of our 40 lending members, the membership list can be found at our website www.fsf.org.nz



FSF lending members data survey period as at 29 February 2020 . Data collected and aggregated by KPMG. Values in NZ$.