Regulatory Impact Statement: Depositor Compensation Scheme Regulations

Coversheet

Purpose of Document	
Decision sought:	Policy decisions for the regulations required for the operationalisation of the DCS under the new regime of the DTA.
Advising agencies:	Reserve Bank of New Zealand
Proposing Ministers:	Hon. Nicola Willis, Minister of Finance
Date finalised:	15 July 2024

Problem Definition

To meet obligations under the Deposit Takers Act 2023 (DTA), the Reserve Bank of New Zealand (Reserve Bank) is required to introduce the Depositor Compensation Scheme (DCS) to protect up to $100,000 per depositor per deposit taker in the event of a failure. Regulations are secondary legislation and are required for the commencement of the DCS. The aim of this proposal is to finalise the regulations required for the DCS.

Executive Summary

This Regulatory Impact Statement (RIS) outlines our advice on regulations necessary for the commencement of the Depositor Compensation Scheme (DCS). Regulations are secondary legislation which are made by Order in Council on the recommendation of the Minister of Finance. The Reserve Bank is responsible for providing advice to the Minister on these proposed regulations.

The DCS will support the Reserve Bank's financial stability objective and contribute to the well-being and prosperity of all New Zealanders, by facilitating a robust and trusted deposit taking sector. The DCS will give New Zealanders peace of mind that their eligible deposits are protected if their deposit taker fails.

The deposit-taking sector has been consulted and engaged with throughout the development of these regulations and has provided valuable input into how the DCS will be operationalised.

The proposals cover the following aspects of DCS regulations:

1. the methodology for calculating levies;
2. operational matters relating to the payment of levies;
3. specification of the scope and coverage of the DCS, including eligible products and entitlement conditions;
4. "relevant arrangements", in which funds are held by a depositor on behalf of someone else, for example, lawyers' trust accounts;
5. exempting branches of deposit takers from the DCS if they are only engaged in wholesale business.

Alternative options are considered for each proposal, and a preferred option is identified by the Reserve Bank in each case. The primary constraint on the development of these proposals was that they need to fit within the scope of the DTA. The DTA sets out a number of purposes and principles that direct the exercise of the Reserve Bank's prudential function. To deliver these requirements under the Act, the Reserve Bank is introducing the DCS. The DTA also sets out a number of principles that must be taken into account by the Reserve Bank when achieving the purposes, which guide the development of secondary legislation.

Beyond the general purposes and principles, regulations under the DTA will be guided by specific principles. This is particularly relevant for the levies proposals, which are required to be designed with reference to a number of principles in the DTA. Additionally, the levies are subject to further guidance provided in the Statement of Funding Approach (SoFA). This provides a relatively strict framework within which the Reserve Bank may develop the regulations.

Therefore, when analysing the impact of different regulations, we acknowledge there are fewer potential options to compare due to the requirement of these fulfilling the principles and purposes of the DTA and SoFA.

A summary of the significant proposals and preferred options is below.

Chapter 1: Levy Approach			
Levy Methodology			
	Option 1: Composite risk indicators	Option 2: Credit ratings	Option 3: Flat rate
Overall Assessment	**++**	**+**	**0**

Preferred option: Our preferred option is the composite risk-based method for calculating DCS levies. This option helps mitigate moral hazard risk, supports deposit taker soundness and is more predictable, as it is based off New Zealand's prudential framework, as compared to the other options.

Consultation: In general, submitters were comfortable with the preferred approach. Smaller deposit takers preferred the flat rate as it reduced the impact levies would have on those deposit takers least able to afford the levy.

Chapter 2: Operational aspects of levies				
<u>Interest</u>				
Options:	Not charging interest	Interest charged at OCR +4%	Interest charged at a fixed rate	Interest charged at an alternative benchmark rate
Overall Assessment	**-**	**++** **(Preferred option)**	**+**	**+**

<u>Relief and instalment arrangements</u>		
Options	No regulations for relief	Relief available
Overall Assessment	**-**	**+** **(Preferred option)**

Preferred option: Interest charged at OCR + 4%, with relief availability is our preferred option. This option compensates the DCS fund for the time value of money and incentivises deposit takers to pay the levies without delay. Relief provisions make the system fairer by reducing the likelihood of exceptional circumstances leading to additional interest being imposed.

Consultation: Submitters were generally supportive of the preferred proposals, proposing only minor amendments such as additional relief arrangements.

Chapter 3: DCS Scope		
<u>Protected deposits</u>		
Options	Regulation making credit balances on specific borrowing products protected deposits	No regulations making credit balances on specific borrowing products protected deposits
Overall Assessment	**++** **(Preferred option)**	**-**

Entitlement conditions

Options	Regulation making specified entitlement conditions	No regulations
Overall Assessment	**++** **(Preferred option)**	**-**

Preferred option: Our preferred option is to include credit balances of specific lending products as protected deposits and to narrow entitlement conditions. This offers the most equitable treatment of diverse deposit takers, while maintaining public confidence and financial stability. Specified entitlement conditions uphold the integrity of the DCS by ensuring depositors are not overcompensated in the event of a payout.

Consultation: Submitters were generally in agreement with the preferred option. Some deposit takers asked for adjustments regarding specific products their entity provides or clarification on certain accounts.

Chapter 4: Relevant Arrangements

Relevant arrangements

Options	Cover a specified list of arrangements	No further relevant arrangements
Overall Assessment	**++** **(Preferred option)**	**-**

Preferred option: Our preferred option is to cover the specified list of relevant arrangements provided as it promotes public confidence in the continued use of client money or property scenarios.

Consultation: Submitters broadly agreed with the proposed scope of coverage but provided feedback regarding the treatment of PIEs and unique relevant arrangement circumstances.

Chapter 5: Exempting Deposit Takers from the DCS

Branches

Options	No regulations making firms non-members of DCS	Regulation making wholesale only branches non-members
Overall Assessment	**-**	**++** **(Preferred option)**

Preferred option: Exempting wholesale-only branches from the commencement of the DCS is our preferred option. This option has significant net benefits as it reduces compliance costs and maintains competition for branches providing wholesale services.

Consultation: This proposal of exemption was generally supported by submitters, with some clarification requested on technical points.

The feedback received from stakeholders has been a valuable part of this policy process and has been taken into consideration in the final proposals. The Reserve Bank is confident with the decisions made on preferred options.

Limitations and Constraints on Analysis

The Reserve Bank has made assumptions regarding depositors' behaviour in response to the operationalisation of the DCS. Depositors may begin deposit splitting (depositing up to $100,000 in separate deposit takers) to receive more coverage if the value of their deposits is higher than $100,000, resulting in a greater proportion of all deposits being protected deposits. This would increase the quantity of levies required to build a sufficient fund for the protection of the additional eligible deposits. The Reserve Bank maintains the assumption that there will be some of this behaviour in the sector, however significant behavioural change will require a review and recalibration of the levy calculation.

The Reserve Bank's engagement with stakeholders throughout the policy process was thorough and offered good insight into the potential impacts of our proposals. Nevertheless, there remains a limitation in our understanding of the extent that deposit takers will pass on the cost of levies to their customers through deposit rates and other fees. While our estimations have indicated minimal economic incidence falling onto depositors, it will require a case-by-case analysis after commencement.

Data collected from the existing Bank Balance Sheet and NBDT surveys was used in the calculation of the DCS levy base. This data has offered a relatively accurate estimation before the DCS standard which will include a requirement for a Single Depositor View (SDV) comes into effect in mid-2028, however it will not be completely accurate due to the use of surveys as opposed to quantitative data. Evidence from international best practice was also used to develop the proposals. Assumptions were used to estimate the impact of these practices in the New Zealand context, although specific results cannot be forecasted.

Overall, the Reserve Bank feels confident with the accuracy of this regulatory impact statement. The necessity of certain assumptions throughout the policy process means we cannot completely forecast specific outcomes, however our public consultations and engagement with the deposit taking sector has given us certainty with our predictions.

Responsible Manager(s) (completed by relevant manager)	
Annette Crequer *Manager Regulatory and Policy Stewardship* *Prudential Policy* *Reserve Bank of New Zealand* 15 July 2024	
Quality Assurance (completed by QA panel)	
Reviewing Agency:	Reserve Bank of New Zealand
Panel Assessment & Comment:	The Regulatory Impact Statement prepared by the RBNZ meets the Quality Assurance Criteria.

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Section 1: The overall problem context

Problem: Regulations are necessary to bring the Depositor Compensation Scheme into force

This regulatory impact statement (RIS) provides an analysis of the decisions made for the development of the Depositor Compensation Scheme (DCS) regulations under the Deposit Takers Act 2023 (DTA). The DTA supports the Reserve Bank of New Zealand's (Reserve Bank) financial stability objective by facilitating a robust and trusted deposit taking sector. The DTA creates a new prudential regime by integrating the separate bank and non-bank deposit takers (NBDTs) regime and introduces the DCS.

The DCS will provide protection of up to $100,000 per eligible depositor, per deposit taker in the event of deposit taker failure. It will be funded through the DCS fund, which will be funded by levies charged to deposit takers. The introduction of the DCS brings New Zealand in line with our international peers and will give New Zealanders the confidence that their eligible deposits are protected. This confidence reduces the likelihood of bank runs and mitigates harm of deposit taker failures.

Regulations are necessary to bring the DCS into force. The DTA provides a broad outline of the DCS, including the level of protection. However, regulations are required to set clear boundaries on what deposits are covered, how entitlements are calculated and the amount of levies each deposit takers is required to pay.

Regulations are secondary legislation made by Order in Council on the recommendation of the Minister of Finance. The Reserve Bank is responsible for providing advice on proposed regulations to the Minister.

The DTA sets out a number of purposes that direct the exercise of the Reserve Bank's prudential function. Of particular relevance to the DCS, the Act seeks to:

- Promote the safety and soundness of each deposit taker,
- Promote public confidence in the financial system, and
- Mitigate risks to the stability of the financial system.

The DTA also sets out a number of principles that must be taken into account by the Reserve Bank when achieving the purposes. Those relevant to the DCS include:

- Taking a proportionate approach to regulation and supervision.
- Consistency in the treatment of similar institutions.
- Avoiding unnecessary compliance costs.

The DCS is subject to an additional purpose which specifies that it is intended to contribute to the stability of the financial system by protecting eligible depositors to the extent that they are covered by the DCS. Levies are also subject to multiple specific requirements under the DTA.

The DTA specifies that all of the costs of the fund are intended to be met by deposit takers in the form of levies. The cost recovery impact statement (CRIS) has been integrated into the levy analysis section within Section 2 of this RIS.

The status quo

The DCS is a legislative requirement of the DTA, and regulations are necessary for the DCS to operate. Therefore, there is no tenable status quo for comparison, so alternative options are considered.

Interaction with other regulations

The development of the DCS regulations is limited by the requirements of the DTA. A RIS was completed following key policy decisions[1] for the DTA in April 2021 and another following supplementary policy decisions[2] in October 2021. These provide a comprehensive analysis of DCS impacts which should be referred to in addition to this RIS for completeness. It should be noted the DCS is referred to as the Deposit Insurance Scheme (DIS) in the 2021 papers.

The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal, as the threshold for significance is not met.

Consultations

From July to September 2023, we consulted on the development of regulations for the DCS under the DTA. The consultation focused on the Levy Framework due to the significant amount of feedback we expected. In addition, we met with deposit takers through workshops on the implementation of the DCS, and informally tested some of the proposals. The Levy Framework consultation was complementary to the Statement of Funding Approach (SoFA) being consulted on by the Treasury.

From March to May 2024, we undertook a second consultation on the proposals assessed in this RIS, with workshops and bilateral meetings in addition. This overlapped with the Treasury's second round of consultation on the SoFA. The Treasury released the finalised SoFA document[3] in July 2024. The DTA requires the Minister of Finance to publish a SoFA for the DCS at least every five years, and sets out:

- Estimated costs
- A target size for the DCS fund (if any)
- A timeframe to reach this target
- Requirements for the investment of the fund, and
- A proposed approach to managing the Crown's financial position on the DCS.

Submissions generally supported the Reserve Bank's proposals in the consultation paper; however, some feedback was taken into account when adjusting the final policy decisions.

What is the policy problem or opportunity?

Regulations are necessary to provide for the DCS to operate through:

- Ensuring that the fund is established (and therefore that the DCS is credible).
- Ensuring that entitlements are clear so depositors can have confidence about their level of protection.

[1] Regulatory Impact Statement Reserve Bank Act Review - Deposit Takers Act - Regulatory Impact Statement: A New Prudential Framework for the regulation and supervision of deposit takers and the introduction of deposit insurance - 14 April 2021 - Reserve Bank Act Review - Deposit Takers Bill Information Release - The Treasury
[2] Regulatory Impact Statement: Deposit Takers Bill (Supplementary decisions) - 13 October 2021 - Regulatory Impact Statement - Reserve Bank of New Zealand (treasury.govt.nz)
[3] Statement of Funding Approach for the Depositor Compensation Scheme 2024 | The Treasury New Zealand

- To provide certainty about how the DCS will operate.

While the DCS directly or indirectly affects all New Zealanders, various requirements are placed on banks and NBDTs. As of March 2024, there are 15 licensed[4] non-bank deposit takers (NBDTs) operating in New Zealand with total assets being valued at $3.12 billion NZD[5]. These deposit takers comprise a range of entities including building societies, credit unions and finance companies. Comparatively, there are 27 registered banks, with four large Australian-owned banks (ANZ, ASB, BNZ and Westpac) responsible for just over 85% of bank lending. As of May 2024, banks had total assets of just over $708 billion NZD[6]. The deposit taking sector is made up of deposit takers with different business structures (banks, finance companies, building societies, credit unions) and size. This provides both an opportunity and a problem when trying to create simple but effective regulations that work for all deposit takers. The proposed regulations attempt to respect this diversity while being cognisant of not creating regulations that restrict deposit takers' ability to grow or change.

Section 2: detailed problem definitions and assessment of options

Section 2 is divided into the five broad policies. Regulations are required for all five policies, but each have their policy problem and considerations. Each subpart:

i. identifies the relevant policy problem;
ii. identifies possible options; and
iii. outlines our analysis and preferred option.

2.1 Levy Calculation Methodology

DIAGNOSING THE POLICY PROBLEM

What is the problem?

Levy regulations are required to specify the amount or method that deposit takers are required to pay into the DCS fund.

The DTA requires the Reserve Bank to provide the Minister of Finance advice about the proposed levy regulations. The levy regulations may specify the method of calculating the amount of levies each deposit taker is required to pay. Broadly, the SoFA sets the total amount of levies that are required to be collected, then the levy rules determine how much each deposit taker is required to pay to meet this total amount.

The DTA sets out principles that the Minister must have regard to when determining the levy method:

- the **likelihood of a deposit taker failing**;
- the **estimated costs** (including recoveries) to the fund of particular deposit takers failing;

[4] Register of non-bank deposit takers in New Zealand - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)
[5] Non-bank and other financial institutions - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)
[6] Banks: Balance sheet (S10) - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)

- the effect paying the levy is likely to have on the **soundness of a deposit taker** of that class; and
- the desirability of **predictable** levies.

The policy problem requires weighing up the mitigation of moral hazard risk (likelihood of deposit taker failure) with the desirability of predictable levies and the effect the levy requirement will have on the soundness of deposit takers.

The principle relating to estimated costs largely guides the overall amount of levies collected. The target fund size has already been determined by the SoFA. Levies will also cover operational costs, but these are not yet known with certainty as the DCS operating model is still being developed.

The DCS levy is considered a type of cost recovery. Cost recovery analysis has been integrated into the levy analysis throughout. Consistent with Treasury's 'Guidelines for Setting Charges in the Public Sector', the DTA principles, above, support evaluation with the options identified

Cost recovery analysis

Why are deposit takers charged a levy?

Section 235 and 239 of the Deposit Takers Act 2023 (DTA) requires deposit takers to pay a levy and specifies that it is desirable for those levies to meet all costs of the fund.

Specific design for cost recovery

Who pays?

Section 235 of the DTA requires deposit takers to pay a levy, this is where the legal incidence falls. However, as highlighted by some submitters during our public consultations, these costs could be passed onto depositors (or lenders). The economic incidence could fall on deposit takers, or consumers of financial products or a mix of both.

Estimating the degree to which the levy will be passed onto depositors or borrowers is very difficult. Interest rates provided to depositors and charged to borrowers is the primary lever deposit takers have to pass on costs. However, a multitude of inputs determine the interest rate deposit takers offer and charge - many unrelated to the DCS including other cost inputs. In addition, the DCS is likely to change the risk-profile of most deposit takers which should, notwithstanding whether the cost is passed on or not, place downward pressure on deposit rates and increase competition in the deposit taking market, by increasing the sensitivity depositors have to the interest rates they are offered (increase in price elasticity).

The degree to which levy costs are passed on, through interest rates, is a business decision for deposit takers to make.

Levy or fee?

The DTA defines the payment as a levy. The levies will be used, via the DCS fund, for the provision of financial services.

Partial or full cost recovery?

The DTA requires full cost recovery over time. In addition, outlined in section 385 of the DTA, there is a Crown backstop if the fund is insufficient to meet a payout.

What levy method options were considered?

Three methods for calculating how much each deposit taker is required to pay in levies were considered:

1. Composite risk-based approach
2. Credit rating risk-based approach
3. Flat rate model.

Hybrid models were also considered, but the focus of our analysis is on those three methods.

As the DTA requires the scheme to be fully funded by licensed deposit takers, not charging levies is not considered as an option.

1. Composite risk-based approach

Both the composite (option 1) and credit rating (option 2) approaches are risk-based, where the levy charged on deposit takers would reflect the risk they pose to the DCS fund (i.e. how likely a payout event is).

Risks under the composite risk-based approach would be based on a set of prudential risk indicators, including capital adequacy, liquidity, asset-quality and profitability. Once a risk score is calculated using the indicators, deposit takers are grouped into risk buckets and *progressively increasing levy rates are applied to each bucket.*

Levy rate difference between deposit takers

Using international guidance (IADI guidance[7] and EBA Guidelines[8]) to assist our decision making, we group deposit takers into four different risk buckets and use a four times difference in levy rates between the riskiest bucket and the least risky bucket.

We believe the number of buckets (four) and levy rate difference (four-times) provides effective incentives for the sound risk management of deposit takers i.e. the mitigation of moral hazard risk, while also having regard for the soundness impact of the levies. The four times rate difference is within international guidance ranges, for example, the EBA suggests the difference between the rates of the most risk deposit taker and the least risky deposit taker should be between two time and four times.

Some smaller deposit takers submitted that the four times was too punitive and resulted in deposit takers least likely to be able to afford the levies paying the highest levies. Other submitters suggested the rate differences should be far higher and reflect the market risk differential using credit ratings and deposit rate spreads as evidence of this. However, a higher rate difference is likely to be contrary to the principle of deposit taker soundness. We believe the proposed option of four times sufficiently reflects the differences in risk while weighing up the opposing impacts on moral hazard and deposit taker soundness (especially in the short run).

[7] Draft Business Plan: (iadi.org)
[8] Final report of the revised Guidelines on DGS contributions (europa.eu)

Prudential indicators of risk

In deciding on the risk indicators to use, we began with the international framework which relies on key prudential requirements (capital adequacy, liquidity, profitability, and asset quality) and customised it to reflect the New Zealand context. In particular, it was customised to reflect what prudential requirements are currently required and what data is received by deposit takers.

Following, two public consultation rounds and several workshops with deposit takers, the number of indicators and their corresponding weights were simplified for banks and NBDTs and is now more heavily weighted towards capital and liquidity metrics. This should improve the predictability of levies and better reflect the likelihood of a compensation event, by setting a longer-term focus.

Submitters highlighted concerns regarding the profitability indicator. Following further analysis, we agree with their suggestion that sufficient and steady profitability is more important than high levels of profitability. With this in mind, technical settings for the profitability indicator were adjusted to reflect submitters concerns.

On balance, we believe the proposed multipliers adequately mitigate the moral hazard risk of the DCS.

Banks and non-bank deposit takers (NBDTs) have different underlying formulas for calculating the specific indicators. This reflects their current different prudential requirements and data reporting. The model has been calibrated to ensure results are fair and expected, utilising the Reserve Bank's supervisory expertise.

Finally, we propose, that we review and recalibrate the adjustment factors prior to 2028 when new prudential requirements are introduced.

2. Credit rating risk-based levy

A risk-based method using credit ratings was also identified as a possible levy method.

Credit ratings are predominantly provided by three main rating agencies, Standard and Poor's (S&P), Moody's Investors Services (Moody's), and Fitch IBCA (Fitch). In New Zealand, some NBDTs receive ratings from Equifax. Some NBDTs are exempted from obtaining a credit rating due to their small size. To support fairness to other deposit takers, we proposed that those unrated deposit takers would be placed in the riskiest bucket.

Our concern with the credit rating is that it lacks transparency in terms of allowing deposit takers to understand how their levies are determined. Credit rating processes and judgements are determined by the individual rating agencies and include some qualitative assessment.

Submitters generally preferred the other levy options. Larger deposit takers generally preferred the composite indicators method, while smaller deposit takers the flat rate method. The credit rating method has practical problems, in that, some deposit takers are exempt from having a credit rating as well as the comparability of credit ratings across rating agencies.

A handful of submitters did highlight that the credit rating method had benefits. Credit ratings could be viewed as more accurate than the composite risk indicators, due to the expertise and experience of credit rating agencies.

The credit rating approach is not common internationally, with most countries who have recently reviewed their approach opting for a type of composite approach using international guidelines[9].

We have compared the results from the composite to the credit ratings approach as part of forming a view that the composite approach is giving predictable results.

3. Flat rate levy approach

A flat rate approach means deposit takers would pay levies based exclusively on a percentage of the total value of protected deposits they hold. The levy would be calculated by multiplying the contribution rate (which would be the same for all deposit takers) by the value of deposit taker's estimated protected deposits.

During our consultations smaller deposit takers tended to prefer a flat rate model and emphasised the proportionality or competitive impacts of this approach.

The flat rate approach does not take into account the likelihood a deposit taker will fail, and therefore is unlikely to be an effective way to meet that statutory criterion. This approach would likely create excess moral hazard. Moral hazard is where a person is incentivised to take additional risk because they are protected from the full consequences of that risk.

At first glance, a flat rate model is consistent with the principle of deposit taker soundness, on the basis that a flat rate model results in lower levies for riskier deposit takers who are less sound than other deposit takers. However, cross-subsidising deposit takers with a higher risk of failure is likely to lead to more risk in the system by incentivising deposit takers to take on additional risk thereby compromising their long-term soundness.

Submitters argued that other regulatory requirements, reduce risk to the point that further incentives for risk taking are being overweighted. However, we are still of the view that self-discipline remains an important feature of a stable financial system.

In summary, there are some benefits from a flat-rate approach, in particular, the levy rate would be more predictable than one based on risk. In addition, it may reduce the impact from levies on deposit takers who are going through temporary difficulties. However, the option is unlikely to meet the statutory principle of taking into account the likelihood of a deposit taker failing. Furthermore, in the long run, the method may have a detrimental impact on the soundness of deposit takers.

Impact on deposit takers of the preferred composite indicators approach

Appendix 1 provides further detail on the proposed composite risk indicators formula.

Based on current data and our proposed approach, the four largest banks would be placed in the least risky band, band 1. The majority (6 of 9) of medium sized deposit takers fall into band 1 with a few falling into band 2 and 3. The smallest deposit takers are spread across all four bands, but the majority are in bands 3 and 4.

The recommended composite risk indicators method is deliberately simple and can result in risk scores that may not match other methods. For example, as shown in graph 1, some small credit unions and building societies are placed in band 1. This is because they have

[9] Guidelines on methods for calculating contributions to Deposit Guarantee Schemes (DGSs) | European Banking Authority (europa.eu)

very strong capital and liquidity, so the results are explicable, but other methods like credit ratings would more consistently assess larger entities as safer than smaller ones.

Although generally smaller deposit takers have a higher levy rate, the largest deposit takers pay the largest levy due to their size. This is because the levy rate is multiplied by the deposit taker's protected deposits. This means the method is naturally proportionate to the size of the deposit taker. As a result, specific setting changes to the levy rate are expected to have limited impact on competition and soundness.

Under the recommended method, the major four banks would pay the majority (76.2%) of the roughly $80-85 million per annum in levies. Under a flat rate they would pay around 83.4%. Table 3 is based on current risk scores and deposits. Deposit taker's risk scores and deposits may change prior to the commencement of the DCS but the major banks will continue to pay the overwhelming majority.

Deposit taker sector	Flat rate	Recommended method
	Estimated Levy ($)	
Big four banks (4 deposit takers)	$66.18m	$59.77m
Mid and small banks (11 deposit takers)	$12.29m	$16.41m
NBDT – Finance companies (7 deposit takers)	$0.16m	$0.39m
NBDT – CUBS (7 deposit takers)	$0.69m	$1.88m

The impact of the simplified DCS levy on the profitability of deposit takers, is likely to be unique to each deposit taker and will depend on several offsetting factors, including, the deposit taker's ability to:

- pass on the levy costs without losing deposits. Factors including banking services, community involvement, established relationship or the benefits of mutuality may determine a deposit takers ability to pass on costs;
- attract deposits through depositor's deposit-splitting;
- attract deposits by offering insured deposits at competitive deposit rates[10], which might still be lower than those they offer currently even after passing on the levy.

We expect the offsetting factors relating to deposit-splitting and ability to reduce deposit rates to positively impact small deposit takers who compete by offering higher deposit rates, for example, many finance companies. On the other hand, the impact on larger banks from

[10] There is currently divergence in the deposit rates offered by depositors. We expect this divergence to be reduced due to all deposit takers falling under the purview of the Deposit Takers Act, and the accompanying standards.

these effects may be minimal and the impact on their profitability is likely to be largely driven by their ability to pass on the levy costs. Their ability to pass on levy costs may also be reduced by the increased competition in the industry as a result of the rate compression by small deposit takers afforded by depositors being more sensitive to higher deposit rates.

Even assuming banks do not change the deposit rates offered and absorb the levy cost, the impact on banks' profitability from the levy is generally expected not to be significant. The levy cost as a percent of past net profit has a median of 0.70%, using net profit after tax for the 2024 financial year. The estimated levy amount would be more than 2% of the bank's 2024 financial year net profit after tax for four of the 15 banks.

For NBDTs, of those firms with positive net profit, the levy cost as a percent of past net profit has a median of 3.72%, using net profit before tax for the 2024 financial year. The estimated levy amount would be more than 3% of the NBDT's 2024 financial year net profit before tax for five of the 10 NBDTs who had positive 2024 profitability.

Modelling was undertaken comparing the expected savings deposit takers could receive from lower funding costs (reducing deposit rates) with the expected levy they would be required to pay. Deposit taker whose savings from lower funding costs exceeded their expected levy were considered net beneficiaries, alternatively deposit takers whose levies exceeded any savings from lower funding costs were considered net disadvantaged.

Our NBDT modelling suggests finance companies are likely to be net beneficiaries of the scheme, while credit unions and building societies are likely to not be materially impacted or net disadvantaged by the scheme.

The model assumes deposit takers will be required to offer a deposit rate premium as compared to the large banks (~30 basis points) in order to maintain their current deposit base. No change in the amount of deposits at each deposit taker is assumed. The 30-point basis point premium assumption may be inaccurate for some deposit takers. Some deposit takers may have to offer more or less than this amount due to a variety of reasons (e.g. reputation, services offered, branch location etc.). Some higher risk deposit takers currently offer in excess of 150 basis points for 1.5-3yr term deposits. The key point we are making is that this premium is likely to be pulled down by the DCS.

Detailed proposals

The tables below provide details of the risk indicators and weights that we propose to use to calculate each deposit takers risk score. The bank indicators rely upon the definitions outlined within the RBNZ's Dashboard that we publicly disclose, this consistency supports understanding and transparency. For NBDTs we currently do not disclose firm-specific prudential data received by NBDTs. However, we have relied upon the NBDT prudential survey, which can be found on our website, for definitions.

As the DTA requires the scheme to be fully funded by licensed deposit takers, not charging levies is not considered as an option.

Risk indicators for NBDTs

Indicator (weighting)	Measure (sub-weighting within category)	Formula	Boundary
Capital adequacy (40%)	Regulatory capital ratio	$\frac{Net\ Regulatory\ Capital}{(Risk\ Weighted\ Assets + market\ risk)}$	8 – 18%
Asset quality (15%)	Non-performing loans ratio	$\frac{Loans\ 90\ days\ plus\ past\ due + impaired\ loans}{Total\ gross\ loan\ book}$	0 – 3%
Liquidity (30%)	Simple coverage ratio	$\frac{Liquid\ Assets}{Total\ Assets}$	10 – 35%
Business model and management (15%)	Return on equity	$\frac{Net\ income\ before\ tax}{Net\ regulatory\ capital}$	1 - 10%

Risk indicators for banks

Indicator (weighting)	Measure (sub-weighting within category)	Formula	Boundary
Capital adequacy (35%)	Total capital ratio	$\frac{Total\ Capital}{Total\ risk\ weighted\ assets}$	9 – 18%
Asset quality (15%)	Non-performing loans ratio	$\frac{Impaired\ loans + Loans\ 90\ days\ plus\ due}{total\ value\ of\ loans}$	0 – 3%
Liquidity (35%)	One month mismatch ratio (15%)	$\frac{1\ month\ mismatch\ amount}{Total\ funding}$	0 – 10%
	Core funding ratio (20%)	$\frac{One\ year\ core\ funding}{Loans\ and\ advances}$	75 – 100%

Business model and management (15%)	Return on equity	$\frac{Profit\ after\ tax}{Average\ equity}$	1 – 10%

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

	Option 1: Composite indicators	Option 2: Credit rating	Option 3: Flat rate
Desirable for the scheme to be fully funded by licensed deposit takers – **full cost recovery**	+	+	0
Comment: The levy collected under each option is set to fully cover the expected costs, as outlined in s 238 of the DTA and detailed in the Statement of Funding Approach.			
Reflect the likelihood of a compensation event – **Moral hazard**	++	+	0
Comment: The risk-based pricing options (Composite indicators and Credit Rating) help to mitigate moral hazard by maintaining incentives for deposit takers to self-manage their risk. The composite indicators option is better at reflecting risks that relate to a compensation event.			
Effect on the **soundness of deposit takers**	Long-run: **++** Short-run: **-**	Long-run: **++** Short-run: **-**	Long-run: **0** Short-run: **0**
Comment: ***Long-run*** Overall, the DCS is expected to improve the soundness of deposit takers by improving public confidence in the financial system and, more specifically, reduce the risk of runs on deposit takers. However, the flat rate option suffers from considerable moral hazard risk which is likely to negatively impact the soundness of deposit takers in the long run. The composite indicators approach is marginally better than the credit ratings approach as it can be better customised to reflect the soundness of deposit takers. ***Short-run*** In the short run the impact on deposit takers could be varied. The DCS may reduce the funding costs for deposit takers (e.g., finance companies) who rely on competitive pricing to attract deposits. For these deposit takers they may see an increase in deposits from depositor's "deposit splitting", which may benefit deposit taker's soundness in the short run. On the other hand, levies will be a cost to deposit takers that will need to be either passed-on			

to depositors or absorbed internally. Irrespective of whether the deposit taker absorbs the cost or passes it on (or the mix of both) the levy may negatively impact deposit taker soundness, at least, in the very short run.			
Predictable levies	**-**	**-**	**0**
Comment: The flat rate option scores highly on predictability and transparency. Of the risk-based options the credit rating option is less predictable given the uncertainty created by relying on international private agencies.			
Overall assessment	**++**	**+**	**0**
Comment: When evaluated against the statutory principles, the Composite Indicators method is the preferred option. The credit-rating method helps to mitigate moral hazard and supports soundness of deposit takers, but on balance falls short of the flexibility benefits of the composite indicators. Alternatively, the flat rate model results in relatively predictable levy rates but fails to mitigate moral hazard and may negatively impact financial stability of deposit takers.			

Key for options analysis:

++ much better than flat rate method

+ better than flat rate method

0 about the same as flat rate

- worse than flat rate method

- - much worse than flat rate method

2.2 Operational Aspects of Levies

DIAGNOSING THE POLICY PROBLEM

What is the problem?

The DTA allows for regulations to be made for a range of matters which empower smooth operationalisation of the DCS. Regulations are required for the administrative and operational aspects of levies.

Without the proposed operational levy regulations, the DCS is still expected to function. However, it would likely lead to inequitable outcomes or otherwise lead to uncertainty, which is inconsistent with the financial stability purpose of the DCS.

The four regulations the Reserve Bank is proposing, in respect of improving the functionality of the DCS, are:

- The charging of interest; to compensate the DCS fund for the time value of money and additional risk of non-payment associated with a delay in levies being paid.
- Relief provisions; to make the system fairer.
- Calculation frequency; to provide certainty for deposit takers, which improves the administration of the DCS.
- Time bar for reassessment; to increase certainty for both deposit takers and the DCS fund.

These regulations minimise compliance costs, increase predictability of levies, and ensure that the DCS is funded by licensed deposit takers.

What objectives are sought in relation to the policy problem?

The aim of the levy proposals is to ensure the smooth functioning of the DCS, including that the outcomes are equitable, transparent and consistent with the financial stability objective.

DECIDING UPON AN OPTION TO ADDRESS THE POLICY PROBLEM

What criteria will be used to compare options to the status quo?

The DTA contains powers to create regulations necessary for certain operational aspects of levies. The most significant of these is the power to charge interest on unpaid levies. Additional regulations underpin the payment and administration of levies.

In developing regulations, the DTA outlines a number of factors that must be taken into account by the Reserve Bank. The most relevant factors for this problem are:

- The desirability of **predictability.**
- To promote **public confidence** in the financial system or avoid risks to the **stability** of the financial system.
- To avoid unnecessary **compliance costs.**

The proposed regulations are intended to support this by ensuring that the DSC fund is compensated for late payment, with a margin for risk, and that **levies are able to be collected fairly, efficiently and with minimal compliance costs**. These regulations are also intended to provide options for managing exceptional circumstances.

What scope will options be considered within?

The DTA sets out what regulations are allowed.

What options are being considered?

Interest on levies

The first option is that interest on unpaid levies is set at OCR plus 4%. Alternative options for the charging of interest are to not charge interest, charge interest at a fixed rate, or to charge interest benchmarked to an alternative rate.

Of these options, not charging interest is unlikely to meet the requirements of the DTA as the time value cost of unpaid levies would not be met by deposit takers, charging interest at a fixed rate is likely to require more frequent updating over time, and would be less reactive to changes in interest rates. Benchmarking to an alternative rate would have similar costs and benefits to the preferred option but may be perceived as more independent from the Reserve Bank. However, we think that this is not significant as the process for setting the OCR is robust and alternative benchmark rates are likely to be significantly influenced by the OCR anyway. In practical terms the use of alternative benchmarks may be clunkier in practice.

	Not Charging Interest	Option 1: Interest charged at OCR + 4%	Option 2: Interest charged at a fixed rate	Option 3: Interest charged at an alternative benchmark rate
Supports predictability	+	-	+	- -
Promotes public confidence and stability	-	+	+	+
Avoids high compliance costs (on deposit takers and the Reserve Bank)	- -	-	-	-
Levies are able to be collected fairly and effectively	- -	++	-	+
Overall assessment	-	++	+	+
Option 1 is the preferred option – it results in a fair and effective levy collection, while using a well-known benchmark.				

Relief and Instalment Arrangements

The options for relief and instalment arrangements include providing relief in exceptional circumstances, or not having any regulations for relief. Subsequently, if relief is to be

available in exceptional circumstances, then determining these specific circumstances and the appropriate form of relief.

	Option 1: No regulations for relief	Option 2: Relief available
Supports predictability	**0**	**0**
Promotes public confidence and stability	**0**	**+ (if used in limited circumstances)**
Avoids high compliance costs (on deposit takers and the Reserve Bank)	**0**	**-**
Levies are able to be collected fairly and effectively	**-**	**++**
Overall assessment	**-**	**+ (Preferred option)**

Frequency of calculation and payment

Making regulations for the calculation frequency of levies increases certainty for deposit takers, which improves the administration of the DCS. The assessment period for the levy payment, and the flexibility in payment frequency, were both considered as a way to increase certainty for deposit takers. Flexibility in payment frequency can minimise individual compliance costs, but also increase complexity of the regulations and compliance.

We consulted on a proposal to have the levies calculated annually in arrears, with the possibility for more frequent payment. Feedback from submitters indicated that it would be advantageous for certainty and pricing if levies were calculated based on the risk indicators for the prior financial year. We accept that this is a sensible modification. This change modifies the options from what we consulted on.

We have identified three options. Firstly, that no regulations on the assessment period or the payment frequency of levies would be made. Instead, the Reserve Bank would have discretion of determining when these occur. Secondly, that levies would be assessed quarterly, with the option for payments to be made throughout the year. Thirdly, levies would be based on the prior year's risk indicators to specify upcoming levy rates to deposit takers, with levies charged at the end of the year. If more frequent payments are desired by deposit takers, they can voluntarily make payments throughout the year. Our preferred option is the third option.

	Option 1: no regulations	Option 2: quarterly assessment and payments throughout the year	Option 3: annual assessment and payment
Supports predictability	- -	+	++
Promotes public confidence and stability	0	0	0
Avoids high compliance costs (on deposit takers and the Reserve Bank)	0	-	+
Levies are able to be collected fairly and effectively	0	+	+
Overall assessment	-	+	+ + (Preferred option)

Time bar for reassessment

A time bar to limit reassessment creates certainty when a certain amount of time passes after levies are paid. It could increase the likelihood that errors in levies are not corrected. As a result, it is desirable to set the time bar at a level that is proportionate with the likelihood of errors occurring. Our proposal of four years is based on that which applies in respect of tax (on the basis that the calculation of levies is likely to be approximately as complex).

The proposed regulations on time bar should improve the administration of the DCS, however, having no time bar regulation is a possible option.

Overall, the costs and benefits are likely to be shared between the DSC fund and deposit takers, assuming that it is equally likely for errors to result in overpayments and underpayments. However, the time bar increases certainty for both deposit takers and the DCS fund, so is desirable.

	Option 1: no regulations	Option 2: proposed regulations
Supports predictability	0	0
Promotes public confidence and stability	0	+
Avoids high compliance costs (on deposit takers and the Reserve Bank)	0	-

Levies are able to be collected fairly and effectively	**-**	**++**
Overall assessment	**-**	**+** **(Preferred option)**

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

Interest on levies

The Reserve Bank's preferred option is interest on unpaid levies is set at the OCR +4%. This would ensure that the DCS fund is compensated for additional risk borne in the event that deposit takers do not pay their levies on time and reflects the time value impacts of delayed payment of levies. Our preferred option ensures that the interest rate will maintain relativity to other interest rates, and so be proportionate over time. Given other interest rates are influenced by the OCR, it is unlikely that using an alternative rate would lead to significantly different interest rates over time. The margin of 4% approximates the additional risk of non-payment borne by the DCS fund and balances the likelihood of a compensation event for a deposit taker with the potential impact on the soundness of the deposit taker.

Although we expect that deposit takers will generally meet their requirements to pay levies, therefore, charging interest should be rare, we believe regulations are required to provide incentives against deposit takers paying levies late and therefore adding risks to the DCS fund.

We note that our proposed rate is lower than equivalent overseas rates, in some cases significantly so. The proposed rate will also be lower than other Government underpayment rates such as the Use of Money Interest rate[11].

Relief and instalment arrangements

The Reserve Bank prefers that a variety of forms of relief would be available for exceptional circumstances to be resolved. This makes the system fairer by reducing the likelihood of unforeseeable circumstances leading to additional interest being imposed. The major risk with relief provisions is that they risk worsening long term compliance by reducing the costs associated with non-payment. Our preferred option is to recognise that the circumstances in which relief would be provided are limited, and to allow for instalment arrangements as a graduated option which can maintain some incentives for payment.

We expect that it would be rare for this relief to be applied but consider it useful to have powers available to resolve issues if they arrive. We propose that the Reserve Bank would be able to provide relief in exceptional circumstances, if it would be inequitable for a deposit taker to pay a levy. The types of circumstances in which we expect that relief could be available include:

- Small outstanding amounts that are uneconomic to collect;
- Significant changes in circumstances;
- Facilitating an orderly wind down of a deposit taker business;

[11] Set at the floating first mortgage new customer housing rate plus 250 basis points.

- Refunding overpayments;
- Unforeseen and exceptional circumstances such as natural disasters.

Relief in the form of discounts, waivers, refunds and instalment arrangements would be available in exceptional circumstances. This would allow for some relief to be provided where unforeseeable circumstances interfere with the ability of deposit takers to make levy payments.

Frequency of calculation and payments

We propose that levies are calculated on an annual basis, based on the prior year's risk indicators, starting once the DCS commences. The first invoice would therefore be made in mid-2026 on the risk indicators of the 2024-25 financial year. As a result, it will be possible to charge levies annually at the end of the year, so there is little advantage in allowing deposit takers to make more frequent payments. We thus propose levies are invoiced annually in arrears. We also note that firms would be able to prepay (prior to an invoice being issued) if making more frequent payments was desired.

Time bar for reassessment

If information comes to light that would impact the calculation of a levy that has been paid, we propose that the deposit taker would be able to submit this information and receive a refund on the next levy paid. We propose that this would be limited to within four years of the original levy payment, to increase the certainty in levies paid. This strikes a balance between accuracy of assessment and certainty of levies paid.

What are the marginal benefits and costs of the preferred option?

Interest on levies

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Deposit Takers	If levies are not paid on time, interest would be charged.	Low	Medium – the charging of interest is certain, however, it is difficult to predict the behaviour of deposit takers.
Depositors	Interest charges could be indirectly passed onto depositors.	Very low	Low – it is uncertain the extent to which deposit takers would pass on any costs associated with levies. The quantum is likely to be minimal.
Additional benefits of the preferred option compared to taking no action			
DCS fund	Interest charged compensates the scheme for any non-payment and helps ensure that levies are paid.	Medium	Medium

Depositors	A well-functioning DCS ensures that depositors are protected from the impacts of a deposit taker failure.	Low	Low – deposit taker failures are unlikely.

Relief and instalment arrangements

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
DCS fund	Options to provide relief risks worsening compliance.	Low	Medium – it is difficult to predict the behavioural response of deposit takers.
Additional benefits of the preferred option compared to taking no action			
Deposit takers	Provides clarity that exceptional circumstances can be resolved fairly.	Low	Medium

Frequency of calculation and payment

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
DCS fund	Flexibility slightly increases the complexity of administering the levies.	Low	High
Additional benefits of the preferred option compared to taking no action			
Deposit takers	Provides certainty of the frequency of calculation and minimises compliance costs for deposit takers.	Low	Medium

Time bar for reassessment

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Deposit takers	Risks historic overpayments not being refunded.	Low	Low
Additional benefits of the preferred option compared to taking no action			
Deposit takers and the DCS fund	Additional certainty of historic levy payments.	Low	Medium

2.3 Scope and Coverage of DCS

DIAGNOSING THE POLICY PROBLEM

What is the problem?

Protected deposits are those covered by the DCS. Protected deposits, as defined in the DTA, are New Zealand dollar denominated "debt securities"[12], and include current accounts, savings accounts and term deposits. This is the status quo.

However, to ensure that the coverage of the DCS is clear and unambiguous, protected deposits, as defined in the DTA, are New Zealand dollar denominated "debt securities", and include current accounts, savings accounts and term deposits. The Act also allows other products offered by deposit takers to be included or excluded as protected deposits through the use of regulation. In particular, the eligibility of certain credit products, and the treatment of debentures and subordinated products is unclear. In addition to these products, other regulations are required to narrow entitlement in particular circumstances where funds are recovered from the liquidator or deposits are held on trust.

What objectives are sought in relation to the policy problem?

The product scope regulations (described in section 192 of the DTA) are intended to be based on considerations described in section 457 of the DTA.

Broadly, that debt securities:

- are commonly referred to in the financial markets as **current account, savings account, or term deposit products**, and
- are **not readily tradable.**

In addition, the regulation-making test places emphasis on the **economic substance** of the securities to which the regulations relate. For example, non-bank deposit takers (NBDTs) such as Credit Unions and Building Societies have products which are similar in purpose to

[12] 'Debt security' has the same meaning as in section 8 of the Financial Markets Conduct Act 2013.

normal banking products (redeemable shares). The Reserve Bank is responsible for identifying and including these debt securities in regulations, otherwise they may go unprotected from the DCS despite their similar economic substance to eligible products.

DECIDING UPON AN OPTION TO ADDRESS THE POLICY PROBLEM

What criteria will be used to compare options to the status quo?

As outlined above, the DTA sets out certain factors that must be considered: the economic substance should be an emphasis and that debt securities are those that are commonly referred to as current accounts, savings account, or term deposit products, and they are not readily tradeable. In addition, consistent with the desirability of a clear and unambiguous DCS coverage, the options have also been assessed against:

- Whether the arrangements are easy to define and understand for depositors, and
- The practicality of implementation from industry's perspective.

What scope will options be considered within?

The DTA, through the considerations outlined above, provides the scope for what protected deposits are covered by the DCS.

What options are being considered?

Protected deposits

The options considered are whether or not the regulations should include credit balances on specific borrowing products.

	Option 1: regulation making credit balances on specific borrowing products protected deposits	**Option 2: no regulations making credit balances on specific borrowing products protected deposits**
Similar economic substance to 'debt securities'	+	-
Commonly referred to as current account	0	0
Non-tradeable products	0	0
Clear and unambiguous - Easy to define and understand, practical to implement	+	0
Overall assessment	**++** **(Preferred option)**	-

Entitlement conditions

In addition to specific products above, other regulations to narrow entitlement in particular circumstances could be beneficial in creating a clear and unambiguous DCS, including:

- That a depositor cannot be paid twice for the same deposit; and
- That entitlement to compensation for deposits held on trust is limited to express trusts.

	Option 1: regulation making specified entitlement conditions	Option 2: no regulations
Integrity of the DCS	++	- -
Clear and unambiguous – Easy to define and understand, practical to implement	++	-
Overall assessment	++ (Preferred option)	-

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

Protected deposits

Consistent with the DTA's statutory considerations (similar economic substance, commonly referred to as a current account and non-tradable ability) and the objective of having a clear and unambiguous DCS, the Reserve Bank's preferred adjustment to the DTA's 'debt security' definition of protected deposits is:

- Include standard banking products and equivalent products offered by NBDTs.
- Exclude tradeable products (e.g., tradeable debentures).
- Include credit balances of specific lending products where these are equivalent to current accounts in substance.
- Include the senior tranche of deposit-like products and generally excludes any products subordinated to that tranche, with an exception to that rule for building societies.

The exception for building societies is because we have found in some cases building societies already have multiple classes of deposit products and we consider any additional risk this creates for the DCS can be managed through the Reserve Bank's prudential supervision.

Without these regulations, it would likely be unclear to depositors and deposit takers what fringe products are covered or not, for example, redeemable shares issued by NBDTs may appear to not be covered without clarity provided. A consequence of this is NBDTs may unnecessarily restructure their products or organisation to clarify that their products are covered.

Entitlement conditions

In addition to product characteristics above, we recommend other regulations to narrow entitlement in particular circumstances. We suggest that entitlement is limited to ensure that depositors cannot be compensated twice for the same deposit by reducing entitlement by an equivalent amount when funds are recovered by a liquidator.

Additionally, compensation for trusts is only available for trusts created under a trust deed or enactment, to ensure that compensation can be paid with certainty. Documents would need to be provided to the Reserve Bank to verify the existence of an eligible trust in a payout event. This would maintain the integrity of the payout process and ensure that the DCS was not open to claims based on verbal or other verifiable agreements.

What are the marginal benefits and costs of the preferred option?

Protected deposits

Including credit balances on specific borrowing products as protected deposits for DCS coverage appears to have significant net benefits, in terms of public confidence and financial stability relative to excluding these products. It is important to include products which are similar to normal deposits in substance and form, as an exclusion of these would be a risk to perception of the DCS. They can also cause bank runs, like normal deposits. Thus, including these products will minimise potential volatility to the banking system, as customers (especially those who frequently have credit balances) will not need to change their behaviour.

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Deposit takers	Will need to accurately identify and flag credit balances on specific borrowing products.	Low	High – existing requirements already exist for some deposit takers to identify such accounts.
Additional benefits of the preferred option compared to taking no action			
Holders of credit balances on specific borrowing products	Promotes public confidence as customers will not need to change their behaviour.	Medium	High

Entitlement conditions

For the entitlement condition proposals, the major benefit is increased certainty in a payout event and the avoidance of inconsistent treatment, which should support public confidence.

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Depositors	Some depositors may receive less than they would if conditions did not apply	Low	High
Additional benefits of the preferred option compared to taking no action			
Reserve bank	Ability to act with certainty in a payout event	Medium	High

2.4 Relevant Arrangements

DIAGNOSING THE POLICY PROBLEM

What is the problem?

DTA section 191(2) deems certain account arrangements to be ‘relevant arrangements’ for DCS compensation entitlement purposes. Relevant arrangements receive ‘look-through’ treatment, where the underlying beneficial owner of the funds, not the named account holder, will be entitled to DCS compensation.

Look-through treatment maintains public confidence in the continued use of these types of arrangements and ensures equitable treatment between these types of deposits and those held directly. If relevant arrangements were not covered by the DCS there may be an incentive to avoid the use of these types of arrangements, even when it makes commercial sense.

While section 191(2)(a) explicitly includes one type of relevant arrangement (a deposit held under regulated client money or property service as defined in the FMCA), it also includes other trusts, schemes, or arrangements prescribed by regulation (under section 191(2)(b)). These regulations are therefore required.

What objectives are sought in relation to the policy problem?

The Reserve Bank seeks to:

- Clarify the concept of a regulated client money or property service; and
- include additional arrangements (other trusts, schemes or arrangements) for ‘look-through’ treatment.

DECIDING UPON AN OPTION TO ADDRESS THE POLICY PROBLEM

What criteria will be used to evaluate the options?

The Reserve Bank have considered the following assessment principles when proposing account arrangements for inclusion in the relevant arrangement definition via regulation:

- The impact on financial stability and public confidence of inclusion,
- Whether the arrangements are easy to define and understand, and
- The practicality of implementation from industry's perspective.

What scope will options be considered within?

Relevant arrangements are provided for under the DTA.

DTA section 191(2) deems certain account arrangements to be 'relevant arrangements' for DCS compensation entitlement purposes. Section 191(2)(a) explicitly includes one type of relevant arrangement (a deposit held under regulated client money or property service as defined in the FMCA), and allows the inclusion of other trusts, schemes, or arrangements via regulations (under section 191(2)(b)).

What options are being considered?

The first option includes prescribing the relevant arrangements listed under section 191(2)(b) of the DTA, that is, other trusts, schemes or arrangements.

If regulations were not issued, certain arrangements would not be covered as relevant arrangements, which may result in an incentive to avoid the use of these types of arrangements, even when it makes commercial sense.

Accordingly, we consider issuing regulations to broaden the scope of the relevant arrangement definition. This option proposes the regulations include deposit taker-sponsored PIE funds as well as the following client accounts to be specified as relevant arrangements:

- Conveyancers
- Lawyers
- Accountants
- Real estate agents
- Retirement village deposits

These accounts are all cases where the holding of client money is largely incidental to the primary business of the entity and subject to professional regulation which ensures that the funds are held independently for the benefit of the client. Additionally, record keeping requirements are already imposed on these holdings in the legislation which governs them, which makes paying entitlements viable in a payout event and minimises additional compliance costs. We suggest the record keeping requirements for these arrangements would refer to these requirements in the governing legislation (e.g. section 112 of the Lawyers and Conveyancers Act 2006) or documentation (i.e. PIE trust deed or retirement village statutory supervisor's deed of supervision).

It is recommended that holdings in bank-sponsored PIE funds are included as relevant arrangements, as these appear equivalent to bank deposits to depositors, like the positive credit balances previously mentioned. Bank-sponsored PIE funds are funds issued by a related entity of a bank and only invest in that bank's New Zealand dollar deposits. These funds offer investors the tax advantages of the portfolio investment entity (PIE) regime, paying tax at the prescribed investor rate (PIR) of the investors, rather than at the issuer's tax

rate. The rationale for prescribing bank-sponsored PIE funds as relevant arrangements rests on their economic substance of being wholly invested in deposits which would otherwise be eligible for DCS compensation.

The alternative option is to not issue such regulations. This option would restrict relevant arrangement coverage to the section 191(2)(a) arrangements (deposits held under regulated client money or property service).

	Option 1: cover a specified list of arrangements (preferred option)	**Option 2: no further relevant arrangements**
Financial stability and public confidence	**+**	**-**
Easy to define and understand	**+**	**0**
Practicality of implementation	**+**	**0**
Overall assessment	**++** **(Preferred option)**	**-**

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

The Reserve Bank recommends specifying the previously identified client accounts as relevant arrangements to promote public confidence.

In a payout event, it is suggested that payment would be made to an account held by the account holder with equivalent terms. This would avoid any unintended consequences if there were conditions attached to the funds held which mean that funds should not be made available to the underlying account holder.

There is an exception for the treatment of deposit taker PIES. Payments will be made directly to depositors, as a payment to the account holder of a bank-sponsored PIE would be challenging in the case of a deposit taker failure. Since per customer entitlement will be known pre-failure, deposit taker PIEs can be treated as normal deposits included in SDV and will likely be paid out before other relevant arrangements.

Ensuring relevant arrangements receive look-through treatment maintains public confidence in the continued use of these types of arrangements and ensures equitable treatment between these types of deposits and those held directly. If relevant arrangements were not covered by the DCS there may be an incentive to avoid the use of these types of arrangements, even when it makes commercial sense.

What are the marginal benefits and costs of the preferred option?

Our analysis indicates that prescribing relevant arrangements under regulations has significant net benefits in promoting public confidence in the continued use of client money or property scenarios (relative to not making these regulations).

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Deposit takers	Will need to accurately identify and flag relevant arrangement accounts	Low	High – existing client money requirements give deposit takers the ability to identify many affected accounts
Additional benefits of the preferred option compared to taking no action			
Holders of protected deposits under relevant arrangements	Gain access to ‘look-through’ treatment. Promotes public confidence in the continued use of client money scenarios	Medium	High – will give clients of lawyers, accountants etc. continues confidence is using their services, as the clients continue to be eligible for the $100,000 maximum entitlement

2.5 Exempt Branches

DIAGNOSING THE POLICY PROBLEM

What is the problem?

New Zealand’s regulatory settings allow certain foreign banks to operate branches in New Zealand without having a locally incorporated subsidiary. The Reserve Bank has recently announced the Branch Policy Review[13] which requires branches of foreign banks operating in New Zealand (i.e. without having a locally incorporated subsidiary) to only interact with wholesale customers from 2028. Most branch banks already meet this, while others are transitioning to do so.

If a deposit taker is covered by the DCS, in general the wholesale deposit accounts it offers will be eligible for payout, but the scale of the payout is likely to be low relative to average account balances. This means the benefits of the scheme appear relatively low, while the operational costs of being a member of the scheme (paying levies and producing a single depositor view file) would be significant.

DECIDING UPON AN OPTION TO ADDRESS THE POLICY PROBLEM

[13] The Branch Policy Review also describes which banks operate in New Zealand as branches, and the list of registered banks maintained on the Reserve Bank’s website also shows this. It is important to note that many banks are “dual-registered” in New Zealand, meaning they operate a branch and a local subsidiary. In these cases, retail deposit accounts are within the local subsidiary and will be eligible for DCS coverage under the proposal we describe here.

What criteria will be used to compare options to the status quo?

Two principles that are particularly relevant include the reduction of compliance costs and the maintenance of competition.

What scope will options be considered within?

The DTA allows regulations to be made that exclude debt securities issued by certain deposit takers (or classes of deposit takers) from DCS coverage. These regulations (described in s 192(2)(c) of the DTA) are intended to be based on a test described in section 459. Broadly, the test is either that:

- The deposit taker generally does not issue protected deposits to retail investors, or
- There are alternative protections for relevant investors that are satisfactory in the circumstances (such as a foreign deposit compensation scheme that can reliably be expected to protect New Zealand depositors).

The branch policy review has proposed the definition of wholesale investor in the Financial Market Conduct Act 2013[14] (Clause 3(2), Schedule 1). This is described in more detail in the second consultation paper on the Branch Policy Review.

What options are being considered?

The first option includes exempting wholesale-only branches from membership in the DCS.

If this regulation was not issued, wholesale-only branches would be covered under the DCS. These branches would have high costs yet low benefits from being a member of the scheme. This may deter foreign bank branches from becoming or remaining licensed members of the New Zealand market, decreasing the variety of wholesale services and impacting competition.

How do the options compare to the status quo/counterfactual?

	Option 1: regulation making wholesale-only branches non-members	**Option 2: no regulations making firms non-members of DCS**
Reduce compliance costs	**++**	**0**
Competition (in wholesale markets)	**0**	**- -**
Protection of eligible deposits (DCS objective)	**-**	**0**
Overall assessment	**++** **(Preferred option)**	**-**

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

[14] Financial Markets Conduct Act 2013 No 69 (as at 16 March 2024), Public Act – New Zealand Legislation

The Reserve Bank recommends exempting debt securities issued by wholesale-only branches of foreign banks from the protected deposit definition. This would effectively remove branches from coverage under the DCS, meaning that no protection would be available, and no levies would be payable.

Feedback indicated branches agree an exemption would be appropriate. Our preferred option is to remove the existing wholesale-only branches from the DCS from the start date of the DCS using the regulation power above.

Branches that currently have retail customers are working through how they will divest those customers prior to the 2028 deadline set by the branch policy review. We have not identified home country DCS schemes to which these firms belong that appear to match the protections that would be offered by the New Zealand DCS sufficiently to be 'satisfactory alternative protections'.

Therefore, we recommend these firms remain as members of the scheme at its inception if, at that point, they have not essentially divested their retail deposit books. However, divestment should occur prior to 2028 and, at this time, they should qualify for an exemption. Because SDV requirements are only likely to arise from 2028, this still removes a key administrative burden from those firms.

What are the marginal benefits and costs of the preferred option?

Branches will have few eligible customers, and they will tend to be only protected in respect of a small proportion of their balances. For the same reason, the financial stability benefits of those accounts having DCS protection will be very small (a large wholesale deposit is still likely to run in the event of deposit taker distress whether or not the first $100,000 is insured).

As in the table below, the exemption of wholesale-only branches appears to have significant net benefits. Two principles that are particularly relevant are the reduction of compliance costs and the maintenance of competition. In particular, removing regulatory obligations for foreign bank branches that wish to be licensed in New Zealand increases the possibility that more of those firms will enter the market and offer a wider range of wholesale services.

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Wholesale customers	Lose access to protection on first $100,000	Low	High – that it will not be material for most wholesale customers is highly plausible but quantitative data is limited
Additional benefits of the preferred option compared to taking no action			

Wholesale-only branches	Diminished compliance costs of operating in NZ; and ability to compete more effectively in wholesale markets	Medium	High – clear, and consistent with feedback from affected parties

Section 3: How will the new arrangements be implemented?

The regulations the Reserve Bank proposes in this RIS are required to bring the DCS into force. However, the development of systems and processes by the Reserve Bank and deposit takers is required before the operationalisation of the DCS. The timeline we suggest has taken into account the time required for these changes to be made. The Reserve Bank is responsible for the development of systems and processes in order to collect relevant data on an ongoing basis from deposit takers and developing payout processes. Functionality of the DCS will be available from mid-2025 and will gradually improve until 2028 when a more permanent solution will be deployed.

Additionally, the Reserve Bank will be responsible for communicating details of the DCS to the public, to ensure consistent information is shared with each deposit taker and their customers.

Deposit takers will need time to make operational, compliance and systems changes to support the DCS requirements before its commencement in 2025. Deposit takers have indicated that they will need time to:

- Communicate with depositors which of their products will be covered by the DCS, and the extent to which they are covered.
- Adjust product terms to fit more clearly within the scope of the DCS, so that depositors have certainty in which products are protected.
- Divest retail depositors (in the case of branches).
- Create and implement systems in order to identify and treat relevant arrangements.
- Make any other outstanding changes required by the DCS regulations …

Industry has indicated that this will require at least 6 months from the publication of regulations but would prefer a longer timeframe. We propose maintaining the suggested timeline, in order to protect New Zealanders' deposits as soon as possible. Our view is that protection is desirable, aligning with our decision to prioritise the DCS ahead of the rest of the legislation coming into effect.

The Reserve Bank has a project team focused on the implementation of the DCS. The team expects the technical details for the functionality of the DCS to be available from mid-2025. These specific aspects will be communicated with the sector as soon as possible. This should allow industry enough time to make the changes required for to support the DCS requirements.

The deposit taking sector contains a relatively small number of entities that the Reserve Bank will continue engaging with throughout the DCS implementation process. Continuous

communication with industry ensures deposit takers are aware of the requirements set out by the DCS regulations, while allowing the Reserve Bank to consider feedback from the sector.

In the event of a deposit taker failure pre-2028, prior to the introduction of the SDV, the Reserve Bank will collect any relevant data from the failed entity. Using this data, along with other sources of information provided by the failed entity, DCS entitlements will be calculated for eligible depositors. Once entitlements have been calculated, steps will be taken for payments to be made to eligible depositors.

How will the new arrangements be monitored, evaluated, and reviewed?

In alignment with the new standards set by the DTA, the Reserve Bank is responsible for the supervision of the deposit taking sector and will monitor the impact of the regulations on the industry.

As previously explained, until the DCS standards come into force in 2028, we will use a proxy based on current survey data for the protected deposits base. Deposit takers will be required to produce an SDV file when the other standards are set and required to be complied with in 2028. This will enable a more accurate assessment of levies and enable a significantly quicker and more accurate payout in the event of a deposit taker failure.

Deposit takers will be monitored as the DCS comes into effect to ensure a smooth transition to the new regime. The review frequency for estimating the protected deposit base was also consulted on as part of the previous consultation. Following (or in anticipation of) the introduction of the scheme, depositors may begin deposit splitting (depositing up to $100,000 in a separate deposit taker) resulting in a greater proportion of all deposits being protected deposits. This could result in an underestimation of the adjustment factor.

The Reserve Bank will review the levy calculation methodology on an ongoing basis to ensure it adequately reflects the overall risk of the sector as it adjusts. Furthermore, if there are significant depositor behaviour changes, we would review and recalibrate the adjustment factors prior to 2028. On an ongoing basis after 2028, estimation should no longer be required as the SDV standard should provide accurate data on the DCS levy base.

The Treasury will review the SoFA every five years after it has come into force. This review will provide an opportunity to reevaluate the size and growth of the fund and will make adjustments if deemed necessary.

Appendix 1 **Detailed levy method proposal**

The tables below provide details of the risk indicators and weights that we propose to use to calculate each deposit takers risk score. The bank indicators rely upon the definitions outlined within the RBNZ's Dashboard that we publicly disclose, this consistency supports understanding and transparency. We currently do not disclose prudential data received from NBDTs. However, we have relied upon the NBDT prudential survey, which can be found on our website, for definitions.

Risk indicators for NBDTs

Indicator (weighting)	Measure (sub-weighting within category)	Formula	Boundary
Capital adequacy (40%)	Regulatory capital ratio	$\frac{Net\ Regulatory\ Capital}{(Risk\ Weighted\ Assets + market\ risk)}$	8 – 18%
Asset quality (15%)	Non-performing loans ratio	$\frac{Loans\ 90\ days\ plus\ past\ due + impaired\ loans}{Total\ gross\ loan\ book}$[15]	0 – 3%
Liquidity (30%)	Simple coverage ratio	$\frac{Liquid\ Assets}{Total\ Assets}$[16]	10 – 35%
Business model and management (15%)	Return on equity	$\frac{Net\ income\ before\ tax}{Net\ regulatory\ capital}$	1 - 10%

[15] 'Total gross loan book excludes off balance sheet items.
[16] Liquid assets include bank deposits and securities, Government securities, claims on public sector entities, other assets with an approved credit rating 1,2 or 3, cash.

Risk indicators for banks

Indicator (weighting)	Measure (sub-weighting within category)	Formula	Boundary
Capital adequacy (35%)	Total capital ratio	$\frac{Total\ Capital}{Total\ risk\ weighted\ assets}$	9 – 18%
Asset quality (15%)	Non-performing loans ratio	$\frac{Impaired\ loans + Loans\ 90\ days\ plus\ due}{total\ value\ of\ loans}$	0 – 3%
Liquidity (35%)	One month mismatch ratio (15%)	$\frac{1\ month\ mismatch\ amount}{Total\ funding}$	0 – 10%
	Core funding ratio (20%)	$\frac{One\ year\ core\ funding}{Loans\ and\ advances}$	75 – 100%
Business model and management (15%)	Return on equity	$\frac{Profit\ after\ tax}{Average\ equity}$	1 – 10%