Regulatory Impact Statement: Deposit Takers Bill (Supplementary decisions)

Coversheet

Purpose of Document	
Decision sought:	Supplementary policy decisions for a new prudential framework for the regulation and supervision of deposit takers and the introduction of deposit insurance
Advising agencies:	Reserve Bank of New Zealand
Proposing Ministers:	Hon. Grant Robertson, Minister of Finance
Date finalised:	22 June 2022

Problem Definition

Some of the provisions included in the exposure draft Deposit Takers Bill (the Bill) need amendment to improve the quality of the supervision regime and to make the proposed Depositor Compensation Scheme more effective.

The proposals discussed here are intended to address decisions arising from feedback on the exposure draft of the Bill.

Executive Summary

This RIS provides advice to inform the supplementary Cabinet decisions that need to be made about certain sections of the Bill, in response to feedback received in response to the exposure draft.

The proposals cover the following aspects of the Deposit Takers Bill:

Parts 1-5:

1. Privilege settings

Part 6:

1. The *'large'* assessment criteria for non-financial corporates
2. The power to exempt deposit takers from the Deposit Compensation Scheme (DCS)
3. Liquidator's obligations under the DCS
4. Privacy issue related to payout

Part 7:

1. No creditor worse off (NCWO) appeal rights

Parts 1-5

Privilege settings

Cabinet agreed, in April 2021 that the on-site inspection powers provided in the DTA would not serve as a *'search and seizure power'* but rather for the purposes of *'business-as-usual'* supervisory monitoring. The Reserve Bank would not be permitted under the Bill to compel privileged or self-incriminatory information from individuals when gathering information.

The Reserve Bank's policy position is now that in order for the Reserve Bank to fulfil its supervisory functions under the Deposit Takers Act, the Bill needs to allow the Bank to compel information from deposit takers, subject to appropriate safeguards.

The Reserve Bank therefore recommends adjusting the privilege settings so that the privilege against self-incrimination will not be available to prevent the supply of information to the Reserve Bank, subject to safeguards. This amends the April 2021 Cabinet decision. The Treasury recommends maintaining the previous Cabinet decision that privilege against self-incrimination is available.

Part 6

The 'large' assessment criteria for non-financial corporates

Cabinet agreed in April 2021 that deposits held by *'large'* non-financial corporates should be excluded from the coverage of the DCS. The policy intent of that decision was to mitigate potential moral hazard problems and motivate large and sophisticated corporates to monitor the risk profile of large deposit takers.

In response to the exposure draft, several submitters challenged the practicality of assessing whether a corporation is *'large'*.

Both the Treasury and the Reserve Bank recommend that the criteria for assessing whether a corporate is 'large' be removed and therefore that all non-financial corporates would be classed as eligible depositors in the DCS.

The power to exempt deposit takers from the DCS

Cabinet agreed in April 2021 that "membership of the scheme will be compulsory for all licensed deposit takers".

Some finance companies and non-bank deposit takers (NBDTs) have challenged this decision and requested a *'restricted'* class of licence that would be excluded from the DCS. Feedback was also received from branches of international banks that operate in New Zealand suggesting that certain branches would prefer to be excluded from the coverage of the DCS and are willing to be subject (in exchange) to the restriction of not taking retail deposits.

Both the Treasury and the Reserve Bank recommend that the Bill provide for a regulation-making power to exempt certain classes of licensed deposit takers from the DCS. We propose a statutory test attached to this proposed regulation-making power for determining the type of firms that can be exempt.

Liquidator's obligations under the DCS

The exposure draft Bill does not require liquidators to provide all necessary information for a timely payout from the DCS. Implementation of a timely DCS payout will require the Reserve Bank having access to the records at a failed deposit taker.

Both the Treasury and the Reserve Bank recommend additional duties should be required for liquidators such that they are obligated to cooperate with the Reserve Bank in supplying access to necessary information to determine and calculate the eligible compensation amount and facilitate the payout process.

Privacy issue related to payout

To enable the payout process of the DCS, some relevant personal information of depositors will need to be shared by licensed deposit takers with the Reserve Bank through the *'single customer view'* (SCV) files. The information may include an individual's full name, date of birth, address, alternative bank accounts, etc. Similar personal information may need to be disclosed to the Reserve Bank by account holders of bare trust accounts and accounts held under relevant arrangement (referred to as *'special account holders'*). Those accounts will be treated by the *'look-through'* approach to identify the depositors who are eligible for compensation under the DCS.

According to Privacy Act 2020, an agency must obtain consent from an individual before disclosing any personal information of that individual with another agency. This may not be practical considering the goal of *'prompt payout'* under the DCS, if a deposit taker fails to obtain the consent before a payout event occurs. Both the Treasury and the Reserve Bank recommend:

- Licensed deposit takers, account holders of bare trust accounts and accounts held under relevant arrangement are provided with an exemption so they do not need to obtain customers consent before disclosing personal information to the Reserve Bank for the purposes of DCS payout.

- The Reserve Bank be provided with the power to disclose necessary information (including personal information) to any other person for the purpose of facilitating a DCS payout. This could include a payment agent or an acquiring bank who is taking the customer on.

Part 7

NCWO Appeal Rights

The choice of resolution, rather than liquidation, may create better outcomes for creditors and shareholders, but it may also be pursued in order to protect the public interest in ways that adversely affect the rights of some creditors. In April 2021 Cabinet agreed that an after-the-event compensation mechanism be established to compensate creditors if a resolution left them worse off than they would have been in an ordinary liquidation. Appeals were to be allowed based on points of law and points of fact but a second subsequent round of appeal to the Court of appeal would not be permitted. Further policy work has determined that allowing appeals based on points of fact may risk lengthy court proceedings eroding

confidence in the NCWO appeal process. Additionally, limiting to only one round of appeal restricts the accountability of the process.

Both the Treasury and the Reserve Bank recommend to limit appeal rights to points of law only. Additionally, we propose a second round of appeal be permitted from the High Court to the Court of Appeal (with permission of the Court of Appeal).

Revision of Previous Cabinet Decisions

Many of the decisions taken here are supplementary to those earlier decisions. They often relate to technical questions regarding practical implementation of previously agreed policy goals arising from stakeholder feedback and further policy analysis. However, there are cases in which the decisions taken here are revising a previous Cabinet decision in light of further policy work and feedback received from industry. These decisions include:

April 2021 Cabinet Decision	Revised Recommendation June 2022
Except for investigations, the Reserve Bank will not be permitted under the DTA to compel privileged, or self-incriminatory information from individuals	Reserve Bank preferred option: Remove the barriers of privilege and introduce an explicit statement for the Reserve Bank to be able to compel privileged or self-incriminatory information from individuals subject to limitations.
Deposit held by large non-financial corporates should be excluded from coverage of the DCS. (referred to as the *'large'* assessment criteria)	Removal of the *'large'* assessment criteria. Deposits held by all non-financial corporates will be covered up to the prescribed limit of $100,000.
Membership of the DCS would be compulsory for all licensed deposit takers.	The Bill provides for a regulation making power to potentially exempt a certain class or classes of licensed deposit takers from the DCS.

We also note the recommendation to permit appeals to the Court of Appeal is a change from the previous decision taken by the Minister of Finance under delegation of 'no rights of appeal against the High Court's decision'.[1] The change is an outcome of the exposure draft process and the feedback received.

Limitations and Constraints on Analysis

The primary constraint on the analysis for these proposals was that they need to fit into the framework already agreed to by Cabinet in April and October 2021. Both sets of decisions were informed by comprehensive regulatory impact statements.

[1] Joint report to the Minister of Finance: Technical Decisions Related to the Deposit Takers Bill November 2021)

Proposals were compared with international practice and standards across a range of jurisdictions. The evidence for proposed policy decisions is informed by our practical experience of prudential regulation in New Zealand.

Responsible Manager(s) (completed by relevant manager)
David Hargreaves Policy Projects, Prudential Policy Reserve Bank of New Zealand s9(2)(a) [redacted] 22 June 2022

Quality Assurance (completed by QA panel)	
Reviewing Agency:	Reserve Bank of New Zealand
Panel Assessment & Comment:	The regulatory impact statement has been reviewed by an independent assessor from within the Reserve Bank of New Zealand. The assessor considers that it meets the Quality Assurance criteria.

Contents

Section 1: The overall problem context

This regulatory impact statement (RIS) provides an analysis of the outstanding policy issues relating to the Deposit Takers Bill, which is the final legislation needed to implement the government's Review of the Reserve Bank of New Zealand Act 1989.

The analysis supplements a comprehensive RIS completed in April 2021 that assessed options for a new prudential framework for the regulation and supervision of deposit takers and the introduction of deposit insurance and a further RIS in October 2021 regarding decisions on the resolution framework.

The nature of the overall regulatory regime that will be contained in the Deposit Takers Bill was agreed in a series of Cabinet decisions in April 2021. A number of further decisions were then taken in October 2021, primarily relating to the regime for resolution and crisis management. Following the October 2021 Cabinet paper and the accompanying RIS, an exposure draft of the Bill was released in December 2021. The proposals reviewed in this regulatory impact statement result from feedback received on that draft.

This section provides a brief introduction to the overall review of the Reserve Bank Act and decisions that have already been made about the content of the Deposit Takers Bill.

The review of the Reserve Bank Act

The Reserve Bank sets monetary policy in New Zealand and is the prudential regulator for banks, non-bank deposit takers (credit unions, building societies and retail funded finance companies), financial market infrastructure providers and insurers. The Reserve Bank was established in 1934, primarily to issue currency, and was then significantly reformed under the Reserve Bank Act 1989, which provided it with operational independence, subject to a monetary policy targets agreement made with the government. The Reserve Bank was also responsible initially for the prudential regulation of registered banks, with decision-making autonomy vested in the Governor. Although important amendments to the Reserve Bank Act have been made since, the framework as a whole has not been reviewed for over 30 years.

During that time, international best practice in both monetary policy and prudential regulation has been transformed as global financial systems and economic theory have evolved. In terms of the Reserve Bank of New Zealand's role, some particularly important developments include:

- The growth and globalisation of the financial sector and consumers' changing expectations of it and engagements with it.
- The increased dominance of large Australian-owned banks in New Zealand.
- The Reserve Bank's increasing emphasis on local incorporation for banks and controls over outsourcing in the 2000s.
- The Reserve Bank becoming the prudential regulator for insurers, financial market infrastructures and countering financing of terrorism, supervisor for banks, NBDTs and life insurers.
- Changing patterns of prudential regulation internationally, accelerated by the lessons of the global financial crisis of 2008.
- the subsequent international and local evolution of central bank functions including the development of macro prudential policy, liquidity policy, more prescriptive capital requirements and new forms of resolution regime.

The objective of the Review (as set out in the terms of reference) is to modernise the Reserve Bank's legislation to support the development of a New Zealand economy that is productive, sustainable and inclusive. While the Reserve Bank Act (1989) has been amended several times since it was enacted in 1989, the core prudential provisions have been in place since the start. The Review aims to create a similarly enduring and trusted framework that promotes financial stability and supports the economy.

Phase 1 of the Review, completed in 2018, introduced a new overall economic objective for the Reserve Bank and created a Monetary Policy Committee to formulate monetary policy.

Phase 2 is a comprehensive review of the legislative framework and will result in two pieces of legislation.

The first, the Reserve Bank of New Zealand Act 2021, received royal assent on 16 August 2021. It modernises the institutional design and accountability requirements of the Reserve Bank, including by importing some of the transparency and accountability features of the Crown entity regime. The Reserve Bank Act 2021 introduces a new, and clearer, financial policy objective focussing on protecting and promoting the stability of New Zealand's financial system. The Act also requires the Minister of Finance to issue a Financial Policy Remit that the Board of the Reserve Bank must have regard to when fulfilling its prudential responsibilities.

The second piece of legislation will be the Deposit Takers Bill. This part of Phase 2 considers the prudential framework for regulating deposit takers under a single regulatory regime. This RIS reviews the remaining policy decisions required before completing the drafting of the Bill.

The Deposit Takers Bill

Cabinet agreed in April 2021 to introduce a new prudential framework for the regulation and supervision of deposit takers and to introduce deposit insurance [DEV-21-MIN-0076, DEV-21-MIN-0077, DEV-21-MIN-0078]. Supplementary decisions were taken in October 2021 regarding the resolution and crisis management regime [DEV-21-MIN-0079]. This new prudential framework responds to significant changes in the New Zealand and global financial systems and their regulation since the Reserve Bank of New Zealand (RBNZ) was established in its current form in 1989.

The exposure draft of the Deposit Takers Act (the Bill) was released on 6 December 2021 with submissions closing on 21 February 2022. The Reserve Bank provided an explanatory note to accompany the exposure draft and to help stakeholders navigate the Bill and draw attention to various issues that we are particularly interested in industry's views on – for example, implementation of the Depositor Compensation Scheme (DCS). During the consultation period, officials met with industry participants to help support their subsequent written submissions.

Given the nature of stakeholder feedback on the exposure draft, the timetable for expected introduction of the Bill into the House was revised from May to August 2022. The delay has allowed RBNZ to digest feedback from stakeholders more thoroughly and to engage in a number of follow-up workshops and discussions with industry participants. The intent of this further consultation was to improve the quality of the Bill before it enters the House and potentially save time during the subsequent Select Committee process.

Section 2: Detailed problem definitions and assessment of options for reform

Parts 1-5:

1. Privilege settings

DIAGNOSING THE POLICY PROBLEM

What is the problem?

Should the barriers of privilege in the Bill be removed?

In April 2021, Cabinet agreed to introduce a power for the Reserve Bank to conduct an on-site inspection. Cabinet agreed in April 2021 that under the new intensive supervisory approach the Reserve Bank would have the flexibility to conduct a *'no notice'* site inspection to proactively verify information provided by deposit takers.

Cabinet noted the use of these powers would be subject to appropriate limitations. Except for investigations, the Reserve Bank will not be permitted under the DTA to compel privileged, or self-incriminatory information from individuals. Under the current Bill, should the Reserve Bank raise issues with firms during routine supervision, persons may refuse to answer questions or provide information if it could incriminate them individually or place the entity into investigation. Certain information required by the Reserve Bank may also be held by directors or senior executives only, or contained within a group of people (i.e. a technical area of the firm such as market or liquidity risk) which exacerbates a more general information asymmetry that exists between the firm and the Reserve Bank.

The Bill also provides for *'deemed liability'* – directors may be individually liable and convicted if a deposit taker or associated person is convicted of making a false or misleading representation or declaration to the Reserve Bank where they know, or ought reasonably to have known, that the statement was false or misleading. However, the application of the privilege against self-incrimination, implies that a director may not be compelled to give evidence which would arguably incriminate them. In these circumstances it may be difficult for the Reserve Bank to obtain evidence against the entity if the only person who has the requisite information is the director.

This section addresses whether the barriers of privilege should be removed from the Bill and whether an explicit statement for the Reserve Bank to be able to compel privileged, or self-incriminatory information from individuals should be included.

What objectives are sought in relation to the policy problem?

The aim of these proposals is to ensure that the Reserve Bank is empowered with appropriate tools to overcome information asymmetry to fulfil our role as the prudential regulator. Protection should also be provided to persons who answer questions and supply information.

DECIDING UPON AN OPTION TO ADDRESS THE POLICY PROBLEM

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

We will compare options based on the following criteria:

- **Ability to obtain information:** the regime should provide the Reserve Bank with an empowering and flexible set of tools to allow it to proactively monitor deposit takers to address risks arising from the financial system that may threaten financial stability.

- **Encourage compliance:** the Reserve Bank's supervisory approach should encourage ongoing compliance with prudential requirements.

- **Public confidence:** the Reserve Bank's supervisory approach should support public confidence in the prudential regulation of deposit takers.

- **Provides adequate legal rights to employees**: providing adequate legal rights to employees protects the information source to foster continued information exchange between the deposit taker and the Reserve Bank.

What scope will options be considered within?

Options are considered against the background of previous decisions and Reserve Bank regulatory practices in addition to privilege settings in comparable legislation (e.g. Commerce Act 1989 and Fair Trading Act 1986, and in the Reserve Bank Act 1989).

What options are being considered?

Option One: (Treasury Preferred Option) – previous Cabinet proposals (status quo)

On-site inspection powers would not function as a *'search and seizure power'*. The Treasury recommends that the Bill maintain barriers of privilege. Cabinet agreed in April 2021 that under the new intensive supervisory approach the Reserve Bank would have the flexibility to conduct a *'no notice'* site inspection to proactively verify information provided by deposit takers. Barriers of privilege (e.g., restrictions on compelling privileged or self-incriminatory information) are an important limitation on these inspection powers.

Option Two: (Reserve Bank preferred option) – Remove barriers of privilege

Remove the barriers of privilege and introduce an explicit statement for the Reserve Bank to be able to compel privileged or self-incriminatory information from individuals. However, the self-incriminating statement may not be used as evidence against that person in prosecution except when the person provides evidence inconsistent to admission, refuses or fails to answer a question, or answers any question or supplies information in a way that is false or misleading in a material manner.

Removal of the barriers of privilege instigates a potential human rights issue and we acknowledge that sufficient safeguards will need to be put in place. We see this power as essential for the Reserve Bank to effectively fulfil its supervisory functions. There are

precedents in other legislation including the Commerce Act 1989 and Fair Trading Act 1986, and in the Reserve Bank Act 1989. In the 1989 Act:

- A person is not excused from answering any question, supplying any information, producing any document, or providing any explanation, on the basis of self-incrimination.
- And the self-incriminating statement may only be used in a prosecution for any offence should they provide evidence inconsistent with that statement, refuse or fail to answer a question, or answer any question or supply information in a way that is false or misleading in a material manner.

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

	Option One – Cabinet's previously agreed approach (status quo)	Option Two – Remove barriers of privilege
Ability to obtain information	0 May be difficult for the Reserve Bank to obtain evidence against an entity if the only person who has the requisite information is the director	++ Reserve Bank can fulfil its supervisory functions without restriction
Encourage compliance	0 Information asymmetry exacerbated as the Reserve Bank is not able to compel information potentially reducing deposit takers incentives to maintain compliance.	+ Information asymmetry reduced as the deposit taker is compelled to answer or supply information. Depending on the quality of the answer and information, information asymmetry may still exist.
Public confidence	0 Both options support public confidence in the Reserve Bank's supervisory approach while removing the barriers of privilege may have marginal benefits.	++ Both options support public confidence in the Reserve Bank's supervisory approach while removing the barriers of privilege may have marginal benefits.
Provides adequate legal rights to employees	0 Other than an investigation, the information source is not required to answer or supply information.	+ Information provided will not be used as evidence against the information source provided it is accurate.[2]
Overall assessment	0	++

[2] Information may be used as evidence when the person provides evidence inconsistent to admission, refuses or fails to answer a question, or answers any question or supplies information in a way that is false or misleading in a material manner.

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

The Reserve Bank's view on privilege settings

The Reserve Bank prefers Option Two. That the privilege against self-incrimination not be available to prevent the supply of information to the Reserve Bank. This is to allow prudential supervision to be conducted effectively through the unfettered supply of information. However, to retain protection for individuals, we propose that self-incriminating information may not be used as evidence against that person in prosecution except when the person provides evidence inconsistent to admission, refuses or fails to answer a question, or answers any question or supplies information in a way that is false or misleading in a material manner.

The Treasury's view on privilege settings

The Treasury prefers to retain Cabinet's previous decision that the Reserve Bank will not be permitted to compel privileged or self-incriminatory information from individuals. The Treasury notes that barriers to privilege are an important safeguard on *'no notice'* inspection powers, and removing these limitations may raise Bill of Rights Act (BORA) issues.

What are the marginal benefits and costs of the preferred option (relative to previous Cabinet decisions)?

Affected groups *(identify)*	**Comment**	**Impact**	**Evidence Certainty**
Additional costs of the preferred option compared to taking no action			
Deposit Takers	Increased demand to monitor, document, and report on areas of non-compliance.	Medium	High
Creditors		None	
The Reserve Bank	Should the Reserve Bank identify prudential concern with a deposit taker through admission or the supply of information, the Reserve Bank may conduct an investigation. The escalation to an investigation has the potential to strain the Reserve Bank's relationship with regulated entities.	Medium	Medium In the Reserve Bank's view, as long as the rationale for the investigation is clearly communicated, the risks to relationship with regulated entities can be mitigated.
Others (government and the public)		None	

Non-monetised costs		Medium	High
Additional benefits of the preferred option compared to taking no action			
Deposit Takers		None	
Creditors		None	
The Reserve Bank	Reserve Bank is able to fulfil its supervisory functions without restriction	High	High
Others (government and the public)		None	
Non-monetised benefits		High	High

Part 6:

1. The *'Large'* assessment criteria for non-financial corporates

DIAGNOSING THE POLICY PROBLEM

What is the problem?

Should the 'large' assessment criteria for non-financial corporates be removed from the Bill?

Cabinet agreed in April 2021 that deposits held by *'large'* non-financial corporates should be excluded from the coverage of the DCS [DEV-21-MIN-0078]. The policy intent of that decision was to mitigate potential moral hazard problems and motivate large and sophisticated corporates to monitor the risk profile of deposit takers (i.e. their ability to exert *'market discipline'*). However, in response to the exposure draft, several submitters challenged the practicality of assessing whether a corporation is *'large'*.

The DCS needs to strike a balance between covering a significant base of depositors to maintain confidence in financial institutions during a stress event whilst minimising the potential moral hazard problem and administrative burden on industry. In light of feedback received in response to the exposure draft and further policy work undertaken, this section asks whether the *'large'* assessment should be removed from the Bill.

Submitters also argued that moral hazard issues can still be managed without the *'large'* assessment, since large corporates generally have balances significantly higher than $100k, therefore still have strong incentives to monitor the risk-taking of their deposit takers.

Internationally, it is common to exclude government agencies, financial institutions and related parties of scheme members from the deposit insurance coverage. However, it is rather rare (no jurisdiction in our literature review—Canada, US, UK, Singapore, HK, and Australia) to assess size when deciding investors' eligibility.

It is noted that in April 2021 that Cabinet also agreed deposits held by government agencies, financial corporates and related persons will be excluded from the DCS. This policy is to remain unchanged.

What objectives are sought in relation to the policy problem?

The policy intent of the decision to include a *'large'* assessment was to mitigate potential moral hazard problems and motivate large and sophisticated corporates to monitor the risk profile of deposit takers (i.e. their ability to exert *'market discipline'*). We seek to uphold that objective whilst implementing policy that is practical for deposit takers and the Reserve Bank. Additionally, the overall objective of the DCS is to protect depositors from loss and thereby contribute to financial stability.

DECIDING UPON AN OPTION TO ADDRESS THE POLICY PROBLEM

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

We will compare options based on the following criteria:

- **Mitigate moral hazard risks and encourage market discipline:** Encourage *'large'* corporates to monitor the risk taking behaviour of the deposit takers they bank with.
- **Practicable for licenced deposit takers:** Additional administrative burdens on licenced deposit takers should be reasonable and practical.
- **Enhance confidence in the DCS:** thereby contribute to financial stability.
- **Minimise the likelihood of calling on public funds:** in the unlikely event of a payout before the target size of the DCS fund is reached.

What scope will options be considered within?

Options are considered against the backdrop of previous decisions made regarding the coverage of the DCS, international best practices and feedback received in response to the exposure draft.

Option One – Cabinet's previously agreed approach (status quo): Maintain the *'large'* assessment

Retain the 'large' assessment as outlined above.

Option Two – (preferred option): Remove the *'large'* assessment

Remove the *'large'* assessment criteria for determining the eligibility of non-financial corporates under the DCS. This will simplify the eligibility criteria for the scheme and reduce the compliance burden on deposit takers, without necessarily any commensurate reduction in the market discipline exerted by large corporates. Under this option the first $100,000 of large corporates deposits held at a deposit taker will remain covered by the DCS.

In response to the exposure draft, several submitters challenged the practicality of assessing whether a corporation is *'large'*. The main reasons include:

I. The assessment is not one-off, but rather on-going. Deposit takers will need to undertake this assessment at least annually, to provide confirmation on the (non)eligibility of corporate depositors.

II. It is rare to collect relevant data (e.g. total assets or turnover of a corporate) for a corporate customer that only has a deposit taking relationship with the deposit taker.

III. The exclusion may reduce small and medium size enterprises' confidence in the DCS, particularly if they are near the boundary for inclusion/exclusion in the scheme.

Large corporates would typically have balances significantly higher than $100,000 and therefore maintain a strong incentive to monitor the risk-taking of their deposit taker. Therefore, industry also observed that the moral hazard issue supporting the exclusion might be overstated.

In the international context it is common to exclude government agencies, financial institutions and related parties from deposit insurance coverage. However, it is less common to exclude non-financial corporates from protection based on a size criteria.

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

	Option One – Cabinet's previously agreed approach (status quo)	**Option Two – Remove *'large'* assessment**
Mitigate moral hazard risks and encourage market discipline	0 Slight increase in motivation for large corporates to do their due diligence.	- Potentially lowers incentive for market participants to do their due diligence
Practicable for licenced deposit takers	0 Significant ongoing administrative burden on industry	++ Removes ongoing administrative burden
Enhance confidence in the DCS	0 May reduce SMEs confidence in the DCS, especially as they approach the boundary for *'large'*	+ Clarity for SMEs that their first $100,000 in deposits will be covered irrespective of their size
Minimise the likelihood of calling on public funds	0 With a relatively smaller target fund size, less likely to call on the government backstop in a pay-out scenario before the target fund size is achieved	- Increases the likelihood of relying on public funds to provide a backstop, since the target fund size will be larger when having deposits by large corporates covered under the DCS[3]

[3] Note that if the public backstop is called upon, it can later be recovered via ex post DCS levies.

Overall assessment	0 Benefits are uncertain and the administrative burden is not practical for industry, plus potentially dampening SME depositors' confidence in the Scheme	+ Increase in potential costs are limited, while the improvements in practicality and public confidence are significant

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

Both the Reserve Bank and Treasury prefer Option Two. The previous decision to include a *'large'* assessment would create an unworkable administrative burden for industry and would potentially reduce confidence in the DCS. Additionally, the moral hazard argument for maintaining the large assessment is likely not as strong as previously considered.

What are the marginal benefits and costs of the preferred option (relative to previous Cabinet decisions)?

Affected groups *(identify)*	**Comment**	**Impact**	**Evidence Certainty**
Additional costs of the preferred option compared to previous Cabinet decisions			
Deposit Takers	Potentially higher administrative burden in the event of a DCS payout	Low	Medium
Creditors		None	
The Reserve Bank	Potentially higher administrative burden (more eligible depositors) in the event of a DCS payout	Low	Medium
Others (government and the public)	Increases the risk of government backstop being called upon before a larger target size of the DCS fund is reached.	Low	Medium
Non-monetised costs		High	Medium
Additional benefits of the preferred option compared to taking no action			
Deposit Takers	Removes the administrative burden of a dynamic *'large'* assessment	High	High

Creditors	SME confidence in the DCS is improved	Medium	Medium
The Reserve Bank	Mitigate the uncertainty of deciding whether a corporate is large when a payout event happens, therefore improve the overall efficiency of a payout	Low	Low
Others (government and the public)	Improved confidence in the DCS potentially reduces the risk of a bank requiring public funds in resolution	Low	Low
Non-monetised benefits		Medium	Medium

2. Exemption power

DIAGNOSING THE POLICY PROBLEM

What is the problem?

Should the Bill include a regulation making power that could be applied to exempt certain types of deposit takers?

Cabinet agreed in April 2021 that "membership of the DCS scheme will be compulsory for all licensed deposit takers" [DEV-21-MIN-0078].

Feedback in response to the exposure draft suggested that for some firms the additional administrative cost of DCS membership including meeting *'single customer view'* (SCV) requirements and potentially more stringent prudential requirements would outweigh the potential benefits for those deposit takers and for the financial system. For example, many branches of international banks that operate in New Zealand concentrate on products and services for wholesale investors. Some have suggested they would prefer to be excluded from the coverage of the DCS and are willing to be subject (in exchange) to the restriction of not taking retail deposits. There are also some finance companies that do take retail investments from members of the public, but currently focus on doing so using debentures which will not be insured products under the DCS.

Some submitters on the exposure draft of the Bill requested that the Reserve Bank reconsider the idea of a *'restricted'* class of licence by providing licensed deposit takers an ability to effectively opt out of the DCS scheme, whereby this class:

- Would not need to contribute to the DCS levy, and
- Would be subject to less stringent prudential requirements compared to other classes of licensed deposit takers given a lower level of moral hazard.

This section explores whether the Bill should include a regulation making power that could be applied to exempt certain types of licensed deposit takers from the DCS.

What objectives are sought in relation to the policy problem?

The purpose of the DCS is to promote financial stability through protecting eligible depositors up to the prescribed limit of $100,000 per customer in the case of a payout event. While deposit takers will need to be subject to robust prudential oversight in order to reduce risks to the DCS fund, we also want to provide a flexible solution to DCS coverage so that we do not unduly limit viable business models for the financial sector.

DECIDING UPON AN OPTION TO ADDRESS THE POLICY PROBLEM

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

We will compare options based on the following criteria:

- **Promote financial stability:** Protect a wide base of depositors up to the prescribed limit in the event a deposit taker enters liquidation.
- **Clarity for general public:** Mitigate ambiguity for the general public by providing a clear distinction between covered and uncovered deposit takers.
- **Proportionality:** Deposit takers should face prudential requirements proportional to the relative levels of risk they pose to financial stability.
- **Promote a diverse financial sector:** Supports a diverse financial sector incorporating a variety of business models.
- **Future-proofing:** Allows for flexibility to adapt to new business models and a changing regulatory environment.

What scope will options be considered within?

Options are considered against the backdrop of decisions made by Cabinet in April 2021 [MIN-0077, DEV-21-MIN-0078] regarding the coverage of the DCS, international best practices and feedback received in response to the exposure draft.

What are the options being considered?

Option one - Cabinet's previously agreed approach (status quo): No exemption power

This is the status quo option under the Bill, where all licensed deposit takers will be compulsory members of the DCS in New Zealand. Under this option, the prudential and DCS regulatory perimeters are aligned. All licensed deposit takers, whether choosing to issue or not issue protected deposits, would be required to meet *'single customer view'* (SCV) standards.

This option implies the Reserve Bank might need to uplift the prudential requirements on some classes of deposit takers to ensure that the risks to financial stability and the DCS scheme are closely monitored and properly managed, together with the risk-levy approach.

Option Two (preferred option) – Include exemption power

This option proposes that the Governor-General may, by Order in Council, on the advice of the Minister given in accordance with a recommendation of the Reserve Bank, make regulations to exempt a specific class or classes of firms from the DCS.

A statutory test would be attached to this regulation-making power to ensure that the Reserve Bank may only make a recommendation to the Minister of Finance to exempt certain types of licensed deposit takers from the DCS, if it has had regard to matters along the following lines:

- The nature of deposit taking businesses carried on by the class of deposit taker;
- The type of customers of the class of deposit taker;
- The standards applicable to the class of deposit taker;
- The scope and level of protection provided by foreign deposit compensation schemes (where the class of deposit taker is a branch of a foreign bank or other deposit taking entity); and

The Reserve Bank must also consult with the persons (or representatives of the persons) that it considers will be substantially affected by the regulations.

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

	Option One – Cabinet's previously agreed approach (status quo): No exemption power	Option Two: With exemption power
Promote financial stability	0 Higher prudential requirements and more intensive supervision may reduce risks to investors, and therefore may improve confidence in the financial system	0 Exemption power is only applied to firms that meet the regulation-making test in a way that Reserve Bank is satisfied that the overall impact of excluding those firms from the DCS will have no significant impact on the overall confidence of the financial stability in New Zealand.
Clarity for general public	0	0 Potential reduction in clarity as there could be some particular class of deposit takers that are not covered under the DCS. This ambiguity is expected to be mitigated by the Reserve Bank maintaining a list of licensed deposit takers that are allowed to offer protected deposits on its public facing website.
Proportionality	0 Firms that provide products with different natures or provide services to a special group of customers would have to face similar prudential	+ Options for some firms to face prudential requirements that are proportionate to their status of imposing/not imposing risk to the DCS

	requirements as other licensed deposit takers	
Promote diversification	0 Increased compliance burden for existing firms and higher regulatory barrier for potential new entrants	+ Avoid increasing non-necessary compliance cost for existing firms and have potentially lower regulatory barrier new entrants
Future-proofing	0	+ Exemption power can be applied to new entrants, should the type of customers and nature of products offered by the new entrants meet the regulation making test
Overall assessment	0	+

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

We recommend Option Two because it would best promote a diverse financial system and will allow for flexibility in the way the Reserve Bank regulates licensed deposit takers. Any additional uncertainty Option Two may create regarding the DCS coverage can be mitigated by maintaining an exhaustive list of covered firms on the Reserve Bank website.

What are the marginal benefits and costs of the preferred option (relative to previous Cabinet decisions)?

Affected groups *(identify)*	**Comment**	**Impact**	**Evidence Certainty**
Additional costs of the preferred option compared to taking no action			
Deposit Takers		None	
Creditors	Some risk of uncertainty regarding the DCS coverage. We believe that this risk can be mitigated by a clear publication on the Reserve Bank website listing covered licensed deposit takers under the DCS.	Medium	Medium
The Reserve Bank	Resources will be needed for evaluating whether exemption power will be applied and developing	Medium	Medium

	relevant regulations to enable that power.		
Others (government and the public)		None	
Non-monetised costs		Medium	Medium
Additional benefits of the preferred option compared to taking no action			
Deposit Takers	Flexibility for a class or classes of firms to be excluded from DCS coverage and requirements.	High	High
Creditors	May benefit from a more diverse financial system if firms that would otherwise have closed continue operations in New Zealand.	Medium	Medium
The Reserve Bank	Provides for regulatory flexibility to future proof Reserve Bank policy in the event a new class of financial entity develops. The preferred option will also reduce resources needed for having uplifted prudential requirements and corresponding supervisory resources.	High	High
Others (government and the public)		None	
Non-monetised benefits		High	High

3. Liquidator's obligations under the DCS

DIAGNOSING THE POLICY PROBLEM

What is the problem?

Should the Bill specify additional duties for liquidators in cooperating with the Reserve Bank and supplying access to necessary information for calculation of DCS levies?

Implementation of a timely DCS payout will require the Reserve Bank having access to the records at a failed deposit taker. Under the Deposit Takers Bill, payout will be triggered by a *'specified event'* which includes when a licensed deposit taker is put into liquidation either by

the Reserve Bank, or by another person and agreed by the Reserve Bank. The general duties of liquidators are described in the Companies Act 1993. This section explores whether additional duties from liquidators should be required such that they are obligated to cooperate with the Reserve Bank in supplying access to necessary information to determine and calculate the eligible compensation amount and facilitate the payout process.

What objectives are sought in relation to the policy problem?

The DCS needs to be capable of making a timely and accurate compensation should a payout event occur. This is an essential element in achieving the overarching DCS objective of protecting eligible depositors and supporting public confidence in the financial system.

DECIDING UPON AN OPTION TO ADDRESS THE POLICY PROBLEM

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

We will compare options based on the following criteria:

- **Facilitate the calculation of DCS entitlement and payout:** Reserve Bank has timely access to all information required to implement DCS payout.
- **Impose reasonable regulatory burden on liquidators**
- **Enhance confidence in the DCS:** thereby contribute to financial stability.

What scope will options be considered within?

The options being considered are either relying on existing liquidator's duties generally described in the Companies Act 1993, or being more specific about the liquidator's duties under the DCS.

What options are being considered?

Option One (Status quo)

Currently the DTA does not specify the duties of liquidators under the DCS.

Option Two (preferred option) – DTA to include relevant clauses about the duties for liquidators under the DCS.

The DTA is to include relevant clauses that specify the duties for liquidators under the DCS (in addition to those in the Companies Act 1993). This will include:

- Providing the Reserve Bank with access to records of the failed deposit taker, and records of the liquidator, to facilitate the calculation of entitlement and payout; and
- Providing the Reserve Bank with assistance to facilitate the calculation of entitlement and payout.

To ensure the effective cooperation from liquidators, we also propose that the Reserve Bank would be provided with the power to apply to Court for the enforcement of liquidator duties similar to section 286 of the Companies Act 1993.

We acknowledge the additional burden these obligations will place on liquidators but emphasise the necessity of the information provided to the successful timely implementation of the DCS. Although *'single customer view'* files will not be immediately required when the DCS is in place by 2024, liquidators will be required to facilitate the Reserve Bank to have access to any information that would be useful if a payout event were to occur starting from when the DCS is operationalised.

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

	Option One – status quo	Option Two – DTA to include relevant clauses about the duties for liquidators under the DCS
Facilitate the calculation of DCS entitlement and payout	0	++ Reserve Bank is provided a legal avenue to ensure access to relevant information.
Imposes reasonable regulatory burden on liquidators	0	- Liquidators will face an additional burden to provide additional information to the Reserve Bank. We believe that this risk can be mitigated as long as deposit takers and liquidators are made aware of this information and are prepared to provide it in advance of a liquidation.
Enhance confidence in the DCS	0	+ Will provide for an effective mechanism to ensure cooperation by the liquidator, thereby enhancing confidence in the DCS and financial stability
Overall assessment	0	++

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

The Reserve Bank and Treasury both prefer Option Two, that the DTA include relevant clauses about the duties for liquidators under the DCS. As noted above, the proposed approach would support the ability of the Reserve Bank to implement DCS payout in a timely manner thereby improving confidence in the scheme and enhancing its ability to support financial stability.

What are the marginal benefits and costs of the preferred option (relative to previous Cabinet decisions)?

Affected groups *(identify)*	**Comment**	**Impact**	**Evidence Certainty**
Additional costs of the preferred option compared to taking no action			
Deposit Takers		None	
Creditors		None	
The Reserve Bank		None	
Liquidator	Liquidators will need to need the requirement to corporate with the Reserve bank to provide information to facilitate timely payout.	Low	High
Others (government and the public)		None	
Non-monetised costs		Low	
Additional benefits of the preferred option compared to taking no action			
Deposit Takers		None	
Creditors	Improves creditor confidence that DCS payment will be made in a timely manner in the event their deposit taker enters liquidation	High	High
The Reserve Bank	Gives the Reserve Bank a legal avenue to ensure access to information relevant to calculation of DCS payments	High	High
Others (government and the public)		None	
Non-monetised benefits		High	High

4. Privacy issue related to payout

DIAGNOSING THE POLICY PROBLEM

What is the problem?

How will the Bill address the issue of privacy relating to DCS payout?

To enable the payout process of the DCS, some relevant personal information of depositors will need to be shared by deposit takers with the Reserve Bank through the *'single customer view'* (SCV) files. The information may include an individual's full name, date of birth, address, alternative bank accounts, etc.

Similar personal information may need to be disclosed to the Reserve Bank by account holders whose accounts will be treated by the *'look-through'* approach. This will apply to account holders of bare trust accounts and those holding accounts under relevant arrangement (*'special account holders'* as follows). For example, a lawyer may hold funds on a client's behalf under *'relevant arrangement'* (as defined in the DTA and relevant regulations). Rather than a DCS payout compensating the lawyer, the Reserve Bank will *'look through'* to the client who is the eligible depositor and compensate them directly. The Reserve Bank will require the lawyer to disclose necessary personal information with the Reserve Bank in order to determine the eligible depositor and their entitlements.

The Reserve Bank may also need to share private information with another deposit taker, in the following scenarios:

- Having a deposit taker act as the paying agent on behalf of the Reserve Bank.
- Establishing a new account on behalf of eligible depositors with a viable deposit taker.

This section explores whether there should be clauses in the DTA to exempt licensed deposit takers and '*special account holders'* from obtaining depositors' consent before disclosing necessary personal information with the Reserve Bank for the DCS payout purposes. This section also explores whether there should be similar clauses in the DTA to enable the Reserve Bank to disclose necessary personal information with other licensed deposit takers for the payout purposes.

Other jurisdictions have included different levels of detail in legislation to enable the disclosure of personal information for the purposes of payout. For example, the Australian Banking Regulation 2016 specifies the personal information that APRA or a liquidator may disclose to authorised deposit takers regarding establishing a new account on behalf of eligible depositors. That information includes the name, address, date of birth and tax file number of account holders, etc.

What objectives are sought in relation to the policy problem?

The objective is to ensure prompt DCS payout by having necessary mechanism to facilitate the process. This works towards the overarching objective of supporting public confidence in the DCS and thereby supporting financial stability.

DECIDING UPON AN OPTION TO ADDRESS THE POLICY PROBLEM

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

We will compare options based on the following criteria:

- **Facilitate timely and accurate DCS payout.**
- **Practicability of implementation.**

What scope will options be considered within?

The scope is considered within the broader practices in the New Zealand legal system and principles set out in the Privacy Act.

What options are being considered?

Option One – Reserve Bank requires licensed deposit takers to amend their terms and conditions with depositors to allow for the sharing of personal information in a DCS payout.

The Reserve Bank would require all licensed deposit takers to amend their terms and conditions pertaining to each covered deposit under the DCS such that depositors are made aware of and agree to the potential for their personal information to be shared for the purposes of facilitating a DCS payout. Similarly, *special account holders* such as account holders of bare trust accounts and accounts held under relevant arrangements (e.g. a lawyer's client account) will also be required to amend their terms and conditions to obtain consent form their customers before disclosing any personal information of their beneficiaries/customers with the Reserve Bank for the purposes of DCS payout. This option would provide a solution within the framework of the Privacy Act.

Submissions on the exposure draft asked the Reserve Bank to consider and be satisfied that new standards would not unduly or unnecessarily burden deposit takers.

The Reserve Bank considers this option to be impractical given the extensive number and variety of products retail banks offer. In addition, this option implies that the Reserve Bank would have to monitor compliance with this standard. In the event of a payout, the Reserve Bank would have trouble dealing with any exceptions where this permission had not been obtained. Considering the diversity of account holders of bare trust accounts and accounts held under relevant arrangement, it would be a major challenge for the Reserve Bank to monitor whether the consents from depositors are obtained by lawyers, accountants, real estate agencies and other relevant account holders before a payout event happens. Should such consent not be obtained, it will form a barrier to achieving prompt payout under the DCS.

Option Two (preferred option) – DTA to include an exemption from the requirement to obtain depositors' consent before disclosing necessary private information for the DCS payout purposes

Under this option, licensed deposit takers would be provided with an exemption from the requirement to obtain depositors' consent before disclosing necessary private information to the Reserve Bank for the purposes of DCS payout. A similar exemption will be provided to '*special account holders'*, because the Reserve Bank will apply the *'look-through'* approach to

those accounts and collect information from those account holders to enable the Reserve Bank to identify eligible depositors and the amount of entitlement for compensation.

Under this option, the Reserve Bank would be provided with the power to disclose necessary information (including personal information) to any other person if the Reserve Bank believes that the disclosure of the information is necessary to:

(a) Ascertain whether a person is an eligible depositor who is entitled to compensation under the DCS.

(b) Calculate the person's entitlement to compensation under the DCS.

(c) Pay the compensation to, or on account of, the person.

This approach would not stop banks from notifying customers that their information would be shared in a payout event, and the Reserve Bank could also make this clear in communications about the DCS.

The Privacy Commissioner (OPC) has been consulted and supports the policy intent of compensating depositors under the DCS. While information privacy principle 11 (IPP) of the Privacy Act does provide a solution to the privacy problems officials have identified (amending terms and conditions), OPC agree this solution would be administratively burdensome for the Reserve Bank and deposit takers, such that the legitimate policy intent of compensating depositors would be frustrated. In these circumstance, a limited override of IPP 11 is justifiable. Officials including OPC will continue to discuss to ensure that the override is limited to IPP 11, and that on the operational side, all involved parties understand their other responsibilities under the Privacy Act.

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

	Option One – No exemption provided for disclosing private information for the purposes of DCS payout.	**Option Two – DTA to include an exemption power for sharing necessary private information for the DCS payout purposes**
Facilitates timely and accurate DCS payout	- In the event of a payout, the Reserve Bank may have trouble dealing with any exceptions where deposit takers had failed to obtain consent from depositors (by changing their terms and conditions). The same problem may happen for the Reserve Bank to collect information from *special account holders* about the beneficiaries/clients of an account. Also implies that the Reserve Bank would need to extend	++ The exemption will enable a much faster and smooth payout process, because licensed deposit takers and *special account holders* will have the confidence that they can disclose necessary personal information with the Reserve Bank should a payout event occur. The Reserve Bank will also be relieved from attaining consent from depositors before disclosing necessary personal information to another deposit taker in a payout event and therefore can accelerate the process of payout.

	the payout process significantly to obtain consent from depositors before having another agency playing the role of making payment on behalf of the Reserve Bank.	
Practicability of implementation	-- Would require not only licensed deposit takers, but also all special account holders to amend the terms and conditions for each individual product which would impose a significant administrative burden. Would also require Reserve Bank to monitor the compliance of amending the terms and conditions and dealing with any non-compliance and the potential trouble in a payout due to the non-compliance.	++ Would not require changing the terms and conditions mentioned in Option 1. Provide certainty to creditors (customers of deposit takers) that their entitlement and compensation would not be impacted due to deposit takers' failure to amend relevant terms and conditions to enable the disclosure of necessary information.
Overall assessment	--	++

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

We propose Option Two, that the Reserve Bank have an explicit power to disclose personal information for the purposes of facilitating prompt and accurate DCS payout. This purpose arguably goes beyond the scope of information privacy principle 11 set out in section 22 of the Privacy Act 2020. Risks to privacy will be mitigated by the Reserve Bank following the Privacy Principles to make sure that only necessary personal information is collected and shared, for the purposes of facilitating DCS payout, and the personal information is handled in a safe manner.

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

Affected groups *(identify)*	**Comment**	**Impact**	**Evidence Certainty**
Additional costs of the preferred option compared to taking no action			
Deposit Takers		None	None
Creditors		None	None
The Reserve Bank	The Reserve Bank need to communicate clearly with the public about the exemption	Low	High

	power in a relevant educational campaign.		
Others (government and the public)		None	
Non-monetised costs		Low	High
Additional benefits of the preferred option compared to taking no action			
Deposit Takers	Decrease in compliance costs as deposit takers don't have to amend large sets of terms and conditions.	Medium	High
Creditors	Allowing information to be shared will provide for timely and accurate payment of DCS funds to creditors. Also, relieve creditors of deposit takers from reviewing any revised terms and conditions associated with disclosing private information for the DCS purposes.	High	High
The Reserve Bank	Relieve the Reserve Bank from monitoring whether the terms and conditions of each covered product under the DCS have already been changed correctly. Also, relieve the Reserve Bank from checking the terms and conditions between special account holders (bare trust trustees and lawyers, real estate agents, etc.) and their beneficiaries/clients to enable the disclosure of personal information with the Reserve Bank. Also potentially avoid the issue of dealing with any exceptions where this permission had not been obtained.	High	Medium
Others (government and the public)		None	
Non-monetised benefits		High	High

Part 7:

1. NCWO appeal rights

DIAGNOSING THE POLICY PROBLEM

What is the problem?

Should NCWO appeal rights be limited to points of law but allow for second round appeals?

The choice of resolution, rather than liquidation, may create better outcomes for creditors and shareholders, but it may also be pursued in order to protect the public interest in ways that adversely affect the rights of some creditors. In April 2021, Cabinet agreed that an after-the-event compensation mechanism be established to compensate creditors if a resolution left them worse off that they would have been in an ordinary liquidation [DEV-21-MIN-0079]. Whether a creditor or shareholder is worse off will be determined by a valuer appointed by the Minister of Finance. The valuer will compare the resolution outcome to the expected outcome of an ordinary liquidation (if commenced immediately before the deposit-taker entered into resolution). While the resolution authority's statutory purposes oblige it to try to preserve the creditor hierarchy, financial stability interests or considerations may over-ride the hierarchy in some circumstances. In such cases, it is appropriate to provide a compensation mechanism for affected prescribed persons (creditors or shareholders) in recognition that property rights have been adversely affected.

In October 2021 Cabinet agreed to a set of proposals detailing specific features of the NCWO mechanism, including that appeal rights on points of law and points of fact be available to prescribed persons in respect of determinations made by the independent valuer, subject to appropriate limitation periods [DEV-21-MIN-0204].

A potential risk is that broad NCWO appeal rights could result in significant costs, delays and uncertainty for both prescribed persons and the Reserve Bank, due to protracted court proceedings. This section therefore considers amending the October 2021 Cabinet decision by limiting appeal rights to assessing whether the NCWO valuer applied the law correctly, and allowing for the possibility of a second round of appeals to be accepted at the discretion of the Court of Appeal.

What objectives are sought in relation to the policy problem?

In carrying out a resolution in accordance with its financial stability purposes, Cabinet has already agreed that the Reserve Bank should seek to minimise the cost of dealing with a licensed deposit taker. This includes having regard to preserving the value of the entity in resolution, maintaining the creditor hierarchy, and protecting public money. Introducing the requirement to make NCWO payments where necessary helps to re-enforce these requirements, since NCWO payments may well require recourse to public funds. For all these reasons, the Reserve Bank will have incentives to develop resolution strategies that preserve franchise value (which is likely to be lost in a liquidation).

The NCWO framework needs to provide prescribed persons with a credible and fair process for determining any payment due, respecting their property rights in an insolvency process. While appeal rights can ensure decisions are in accordance with the law, and incentivise good

decision-making, they need to strike a balance between protecting the interests of affected parties against enabling the Reserve Bank to pursue its statutory mandate efficiently and effectively.

DECIDING UPON AN OPTION TO ADDRESS THE POLICY PROBLEM

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

We will compare options based on the following criteria:

- **Credibility and fairness**: Prescribed persons should be presented with a credible and fair process for determining their treatment in a way that respects their property rights in an insolvency process.

- **Accountability/Transparency:** Decision-making by the resolution authority with accountability for their actions.

What scope will options be considered within?

Options are considered against the backdrop of decisions made in the April and October 2021 Cabinet papers and with regard to international best practices.

What options are being considered?

Option One (Status quo) – Previous Cabinet proposals

Decisions were taken in October 2021 such that only a single right of appeal could be taken regarding both points of law and points of fact and a time limit on appeals was applied (3 months from the NCWO calculation).

Broad rights of appeal could increase the risk of protracted court proceedings given the subjectivity and uncertainty associated with highly technical NCWO valuations. These risks could be mitigated by the design of the NCWO calculation by ensuring that the information, valuation principles, and assumptions that the independent valuer must take into account are sufficiently clear.

Option Two (preferred option) – Appeal rights be limited to points of law but allow for second round appeals

We propose to limit appeal rights to points of law only and that a second round of appeal be permitted from the High Court to the Court of Appeal (with permission of the Court of Appeal).

Limiting appeal rights to points of law only, mitigates the risk that the High Court will simply be asked to substitute the opinion of one expert over another, which the High Court may not be well placed to assess due to the technical nature of NCWO matters.

The second subsequent appeal will serve as an important safeguard. The Court of Appeal provides distinct advantages:

- The Court of Appeal sits as three judges with decisions being reached by the majority.
- Decisions of the Court of Appeal develop the case law through precedent and increase certainty, reducing long run costs.
- It is common for second round appeals to focus on a particular matter, with more careful argument.

Internationally, there is a variety of approaches to NCWO appeal rights. Limiting appeal rights to points of law would not appear to place New Zealand as an outlier in the broader international context. For example, in Canada, appeal only triggers an independent valuation rather than a court hearing, and in Australia there is no formal NCWO mechanism at all.

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

	Option One – previous Cabinet proposals (status quo)	**Option Two – Appeal rights be limited to points of law but allow for second round appeals**
Credibility and fairness	0 Allowing appeals to be based on a broad definition including questions of law and questions of fact risks extended court proceedings and high costs thereby reducing the credibility of the NCWO appeal mechanism.	+ Limiting appeals to points of law reduces the risk of extended court proceedings thereby improving the credibility and fairness of the NCWO mechanism.
Accountability/Transparency	0	+ Allowing for a second round of appeals improves the accountability of NCWO.
Overall assessment	0	+

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

The Reserve Bank and Treasury both recommend Option Two. The benefits of restricting appeal rights to points of law but allowing for a second round of appeals will improve the durability of the NCWO appeal process over the long run.

Permitting appeals to the Court of Appeal is a change from the previous decision taken by the Minister of Finance, under delegation, 'no rights of appeal against the High Court's decision'.[4] The change is an outcome of the exposure draft process and the feedback received.

[4] Joint report to the Minister of Finance: Technical Decisions Related to the Deposit Takers Bill (November 2021)

What are the marginal benefits and costs of the preferred option (relative to previous Cabinet decisions)?

Affected groups *(identify)*	**Comment**	**Impact**	**Evidence Certainty**
Additional costs of the preferred option compared to taking no action			
Deposit Takers		None	
Prescribed persons (Creditors and shareholders of an entity in resolution)	Creditors and shareholders are limited to only appeal rights on the grounds of points of law.	Low	High
The Reserve Bank		None	
Others (government and the public)	Potential for increased workload on the Court of Appeal.	Low	High
Non-monetised costs		Low	High
Additional benefits of the preferred option compared to taking no action			
Deposit Takers		None	
Prescribed persons (Creditors and shareholders of an entity in resolution)	Creditors are less likely to face lengthy and costly court proceedings. Creditors also benefit from the potential of a second level of appeal.	Medium	High
The Reserve Bank	The Reserve Bank also benefits from being less likely to face lengthy and costly court proceedings.	Medium	High
Others (government and the public)		None	
Non-monetised benefits		Medium	High

Section 3: How will the arrangements be implemented?

How will the new arrangements be implemented?

The changes proposed here are part of those that will be given effect by the Deposit Takers Bill scheduled for introduction in early August 2022. This Bill will create a new Deposit Takers Act. Subject to Parliamentary Process, we expect the Bill to be enacted mid in 2023.

This process will be led by the Reserve Bank and the legislation, once enacted, will be administered by the Reserve Bank. The Treasury will also monitor the performance of the Reserve Bank on behalf of the Minister of Finance.

Implementation of the DTA as a whole will be a multi-year process, potentially taking until 2026-27. There will be substantial work to develop new prudential requirements for deposit takers. Licensing of deposit takers under the new standards will also be an extensive process.

The implementation of the Deposit Compensation Scheme is planned for 2023, with insurance coverage planned to come into effect in 2024. Some operational elements of the scheme will require further development and public consultation including, for example, the size of deposit taker levies and regulations requiring depositors to update their data systems so as to group together all accounts belonging to the same depositor (a *'single customer view'*).

The comprehensive regulatory impact statement produced in April 2021 notes a range of risks involved in implementation, particularly: resourcing for the Reserve Bank; the potential moral hazard that may arise from implementing the Deposit Compensation Scheme before some elements of the new prudential framework; and the risk of unintended consequences in the Trans-Tasman context, particularly in relation to resolution and crisis management regimes. The Reserve Bank will be given a new statutory resolution function of coordination with other authorities and significant coordination with Australian counterparts is anticipated in resolution planning and operation of any actual resolution.

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

The Reserve Bank Board is accountable for the Reserve Bank's governance and all of its functions including financial policy. The Board will therefore ensure information flows and assurance processes are in place that allow it to monitor the effectiveness of the new arrangements.

As part of its role in administering the new Deposit Takers Act, the Reserve Bank will review the new prudential regime for deposit takers and the deposit insurance scheme five years after it has come into force. This review will provide an opportunity to evaluate the effectiveness of the new prudential regulatory regime and deposit insurance scheme, and to ensure no unexpected issues have arisen. It will also allow the Reserve Bank to examine the interactions with the new Reserve Bank Act.

As monitor of the Reserve Bank, established through the Reserve Bank of New Zealand Act 2021 and appointed by the Minister of Finance, the Treasury will be establishing robust ongoing monitoring arrangements. This includes establishing flows for information from the Reserve Bank that provide assurance and insight on the performance of the entity in its functions and working with the Reserve Bank to identify and assess relevant performance metrics.