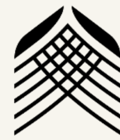

Depositor Compensation Scheme (DCS) Regulations.

Summary of Submissions

November 2024

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Background

In March 2024, the Reserve Bank of New Zealand - Te Pūtea Matua (we/the Reserve Bank) published a consultation document on the Depositor Compensation Scheme (DCS) regulations.[1] The regulations help to operationalise the DCS under the Deposit Takers Act 2023 (DTA). The consultation was open for submissions from 11 March to 10 May. The consultation sought feedback on the revised levy settings and initial policy proposals for further regulations.

The DCS will protect up to $100,000 per depositor per deposit taker in the event of a failure. This will support New Zealand's financial stability and contribute to the well-being of all New Zealanders, by facilitating a robust and trusted deposit-taking sector.

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 following policy proposals do not necessarily reflect the final regulation decisions, just our recommendations.

The consultation paper sought feedback on the following proposed policy:

- Design of the DCS levies to be paid by deposit takers
- Operational matters related to the payment of levies
- Scope and coverage of the DCS
- Relevant arrangements
- Exempt branches
- In-flight payments

The levy calculation methodology was previously consulted on from July to September 2023. The March 2024 consultation proposals (outlined in this paper) reflected adjustments made after feedback from the first consultation.

This document provides a summary of the feedback received. Some submissions requested clarity on additional aspects which were not mentioned in the consultation, these are acknowledged in this paper. We will also publish the full submissions alongside this summary.

Parallel to the Reserve Bank's consultation on DCS regulations, the Treasury also consulted on the Statement of Funding Approach (SoFA). The SoFA[2] has now been published; it sets the funding strategy for the DCS. Two key parameters of the SoFA relevant to the DCS regulations are the target fund size of 0.8% of protected deposits and the 20-year period to build the fund to the target size. Protected deposits are those deposits eligible for compensation. These settings determine the total amount of levies that will be collected by the DCS fund from deposit takers.

We expect regulations to be gazetted in December, with the DCS set to commence in mid-2025. The Single Depositor View (SDV) Standard is being consulted on separately[3], along with other prudential standards, for implementation in 2028.

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[1] DCS regulations consultation paper - master draft clean version (rbnz.govt.nz)
[2] Statement of Funding Approach – Funding Strategy for the Depositor Compensation Scheme - Consultation Paper - July 2023 - New Zealand Treasury
[3] Deposit Takers Core Standards Consultation Paper for publication (rbnz.govt.nz)

Consultation process

We published the consultation paper on Citizen Space, a recommended citizen engagement platform, via the Reserve Bank website. Participants had the option of using this platform or submitting PDF responses.

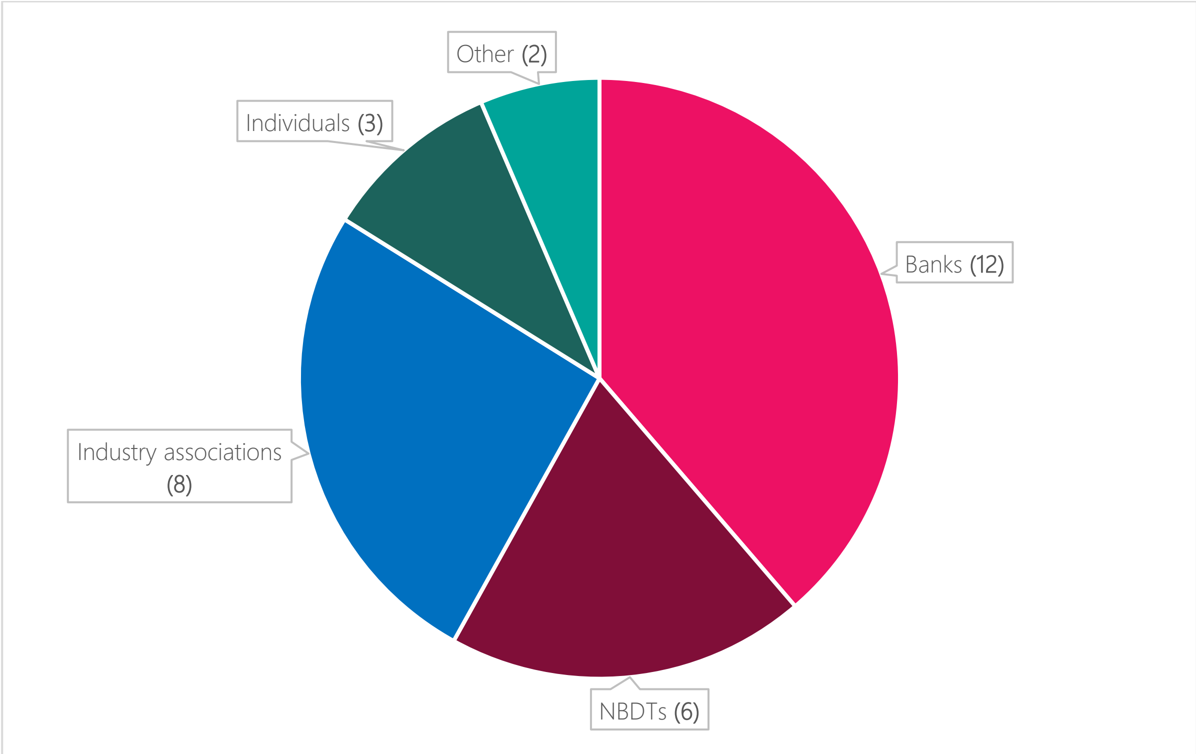
In total, we received 31 submissions on the consultation paper. These submissions came from a range of stakeholders, including registered banks, licensed non-bank deposit takers (NBDTs), industry associations (e.g. organisations that represent a number of stakeholders with a similar objective, or otherwise are involved in financial markets), and individuals.

We publicised the consultation through several channels and engaged with industry directly to encourage submissions. We held a number of workshops and bilateral meetings with deposit takers to discuss the proposals in the consultation paper.

We would like to thank everyone who took the time to make submissions. Feedback from stakeholders is a valuable and important part of the policy development process, and we appreciate the time and thought that industry has dedicated to this work.

Graph 1 below illustrates the make-up of submitters. There were several submissions made on behalf of a class of deposits takers, for example, one industry association represented over 90 stakeholders, including 8 NBDTs.

Graph 1: Make-up of submitters



Summarised consultation proposal, submission feedback, and our response

Chapter 1 - DCS levies

Submitters offered a significant amount of feedback on the levy proposals.

Initial Levy Base

Proposal in consultation paper

Prior to 2028, when accurate data based on depositors' total protected deposits at each deposit taker is collected, we proposed the size of protected deposits should be estimated for each deposit taker by applying an adjustment factor to survey data currently being collected. Separate adjustment factors would apply to banks (70% of deposits up to $100,000), building societies (40% of total deposits), credit unions (80% of total deposits) and finance companies (40% of total deposits).

If depositors begin deposit splitting (depositing up to $100,000 in separate deposit takers) it could result in an underestimation of the adjustment factor. We proposed to review and recalibrate adjustment factors prior to 2028, if there are significant depositor behaviour changes.

Submission feedback

Submitters supported the proposed approach to calculating the initial levy base, and generally supported the proposed adjustment factors for each deposit taking sub-sector. Some respondents from the NBDT sector suggested that a more accurate measure could be used by NBDTs where they had available data, for example, below and above $100,000 deposit segments.

A large bank raised concern about the adjustment factor for building societies and finance companies, noting they maintain similar average deposit balances to the big four banks. Thus, these deposit takers should have a more comparable adjustment factor.

Some submitters sought greater clarity on the review proposal. Firstly, how the Reserve Bank specifically intends to measure the depositor behaviour changes that would create cause for recalibration of the adjustment factors. Secondly, at what level of deviation from the estimated deposit base would the Reserve Bank consider a recalibration to be necessary before 2028.

Our response

As outlined, submitters were broadly supportive of the approach proposed. Direct comparisons between the banks' adjustment factor and building societies, finance companies and credit unions cannot be made because the adjustment factors apply to different measures of deposits. Different measures of deposits are used as we wanted to utilise existing data where possible, instead of requesting more data from deposit takers just for the period 2025 to 2028. We propose no changes from those consulted on.

The power to review, prior to 2028, and what may trigger that review will not be set in regulation. However, we recognise that predictability is important to the sector and that a review will only be

undertaken if we see significant behavioural changes, (e.g. a significant decrease in average account size due to deposit splitting).

Levy Method

Proposal in consultation paper

We proposed that DCS levies be calculated based on a simplified composite risk-based approach.

We proposed the composite risk-based method would have three equally weighted indicators used to calculate the deposit takers' "risk score": liquidity, capital adequacy and business model/management (a profitability ratio).[4] Banks and NBDTs would have different indicator formulae reflecting the data we receive and their differing regulatory requirements (e.g. for capital).

Submission feedback

In general, submitters supported a composite risk-based method for calculating levies. Many respondents acknowledged that it does support the mitigation of moral hazard risk[5].

Some NBDTs and individuals preferred a flat-rate model, highlighting that it considers the impact of a deposit taker failure as opposed to the likelihood of failure as more significant (e.g. generally, smaller deposit takers may be more likely to fail but would have a lesser impact on the financial system compared to the failure of a large bank). The method's predictability, simplicity and equitable application to different business models were also raised as supporting a flat-rate approach. These submitters also argued that moral hazard is mitigated through stringent prudential regulation.

Alternatively, some respondents highlighted the independence and simplicity of using a credit rating approach.

Respondents agreed with a review of risk indicators and weights pre-2028, to align with the implementation of the new capital and liquidity standards.

While the composite risk-based method was generally supported, there were diverse views on the preferred risk indicators, and their respective weights or boundaries. This is outlined in further detail below. Generally, similar sized deposit takers had similar feedback.

Our response

Composite indicators method

The risk-based composite indicators method remains our preferred method for the calculation of levies. We recognise the credit rating and flat rate methods have their benefits. Both methods would likely result in less volatile levies. However, compared to the flat rate method, we find that the composite indicators method is preferred for mitigating moral hazard risk as it disincentivises deposit takers from increasing their risk. While it is more sensitive to changes in the riskiness of

[4] For simplicity and improved understanding, we refer to this indicator as the "profitability" indicator.
[5] A situation where deposit takers or depositors are incentivised to take on more risk than socially desirable because they do not bear the full costs of that risk (e.g. are partially insured by the DCS)

deposit takers, when compared with the credit rating method, and can be applied to each entity in the industry.

We believe the composite risk-based approach meets the levy making principles as it balances the need to account for the risk of deposit taker failure, with the deposit taker soundness and predictability of levies. Furthermore, we believe concerns around transparency and volatility can be mitigated through the method's settings. In particular, as part of the consultation, the formula we proposed to use when calculating each deposit taker's risk was disclosed and we sought feedback on each aspect. In addition, depositors through the RBNZ's Bank Financial Strength Dashboard can view the four metrics we propose to use and how banks compare: *Capital adequacy*, *Asset quality* (non-performing loans), *Profitability* and *Liquidity*.

Risk indicators

Submission feedback

Large banks generally supported the three factors. However, some highlighted that the factors should have a greater focus on long-term risk measures and preferred those factors closely aligned with prudential requirements, such as capital and liquidity. There was some suggestion of utilising credit ratings.

Small and medium sized deposit takers generally agreed with the proposed factors, with some minor suggestions regarding technical settings. However, many deposit takers of those sizes highlighted that the risk indicators failed to take into account competition and the diversity of business models within the deposit taking sector. Specifically, that some NBDTs are not-for-profit, community or purpose led.

Some submitters expressed concern that entities who can least afford the levy will proportionately pay the most. They suggest this may have detrimental impacts on maintaining a competitive and diverse financial sector, reducing financial access for various customers.

Profitability factor

Most respondents focused their submissions on the usage and weight of the profitability factor.

Many small and medium sized deposit takers highlighted that mutuals and not-for-profits/purpose led deposit takers are not focused on maximising profitability. Instead, they manage their profitability by giving back to the community, their members or for other purposes. These deposit takers highlighted that rebates, community grants, or favourable interest rates provided to members are reflected through higher expenses and lower profitability. Therefore, they suggested this should be considered when calculating risk scores. For example, rebates should be added back to the profitability factor when calculated. Or alternatively, deposit takers with these types of business models should have the profitability factor removed or given less weight in their risk calculation.

Some small and medium sized deposit takers also indicated that the profitability factor benefits large deposit takers, as economies of scale allow large deposit takers to generate higher profitability compared to smaller deposit takers. The profitability factor also decreases the predictability of levies for smaller deposit takers as the volatility of profit may frequently impact their risk band. Some suggested options to mitigate this concern would include decreasing the

boundary for small and medium sized deposit takers or lowering the weight of the profitability factor for all deposit takers.

Additionally, some deposit takers submitted the proposed weight for profitability was not international best practice. Some respondents suggested using a wider range of measures to reflect risk, in alignment with international practices. One deposit taker specifically noted that profitability has a weaker connection to bank failure than capital and liquidity, despite their equal weighting in the calculation.

Some overseas-owned deposit takers highlighted the risk indicators, specifically profitability, were less relevant to them, as they rely on international parents for access to capital and funding.

Submitters had varying opinions on the proposed removal of the asset quality (non-performing loans (NPL)) factor. Some respondents suggested capital adequacy already covers the risk identified by NPLs, while some smaller deposit takers preferred an NPL factor as a better measure of risk in comparison to profit. Some deposit takers indicated their preference for return on assets (ROA) instead of return on equity (ROE), but most understood the reasoning for the selection of the ROE.

Large banks in general supported the profitability factor, but highlighted some adjustments that could improve its correlation with risk and long-term focus. Some submitters suggested profit could be measured over a longer period to demonstrate asset quality and sound risk management.

<u>Our response</u>

Profitability factor

The intent of including a profitability ratio is as a proxy for the likelihood a deposit taker may fail, as low profitability may indicate that it faces financial problems that could lead to its failure. The measure is not designed to incentivise deposit takers to change their business model.

We therefore generally agree with submitters that the weight on profitability and the boundary settings should be re-calibrated correctly to reflect the purpose of the factor. We also recognise that sometimes a higher profitability may be more an indication of unsustainable growth rather than reflecting a healthy deposit taker.

In light of the reduced weight on profitability, our advice now includes the reintroduction of the asset quality indicator, measured as a non-performing loans (NPL) ratio. Both indicators are complementary in measuring the risk assumed by the deposit taker's business model. We propose the asset quality indicator would use the same ratio (NPL) and boundaries as consulted on during the September 2023 consultation, deposit takers were largely supportive of the overall technical settings for this indicator.

We continue to propose using a standardised net profit formula for calculating profitability for all deposit takers. We concluded that it would be too complex and open to potential arbitrage to analyse (or set guidance for) the types of donations, rebates, interest rate pricing that should be added back into net profit. Furthermore, questions remain around whether these distributions are part of the deposit takers core business (to attract deposits) or not (that is, they are discretionary).

On further analysis, we identified a data calculation error in the profitability factor for some deposit takers, which artificially reduced the impact we expected the factor would have for some deposit takers. Once this error was corrected, it became clear the profitability factor was having an oversized impact on the aggregate risk score for a handful of deposit takers. This correction is reflected in the new recommended risk bands.

Submission feedback

Capital factor

Some medium sized deposit takers raised concerns with the comparability of the capital factor. Their submissions suggested that the large banks who use the internal ratings-based (IRB) approach to calculate their risk-weighted assets were at a significant advantage, as large banks were able to maintain significantly lower capital for the same risk. The IRB approach permits banks to use internal risk models for measuring risk; this enables a more accurate risk measurement that typically requires a lower capital requirement, compared to the standardised approach. These deposit takers argued this is inequitable and detrimental to competition, and alternatively suggested adjustment to the capital factor settings or using standardised data for capital ratios in the risk calculation.

The NBDT sector generally supported the capital factor, however some suggested that the boundaries should be better aligned with regulatory minimums and banking sector settings. They subsequently proposed the boundary should be changed to 8-18%, from 9-20%.

An industry association requested clarification on the use of total capital as a metric for capital adequacy, as they believe risk-weighted capital would be a more appropriate measure. We note the use of the term '*total capital ratio*' for banks within the consultation document refers to the inclusion of both Tier 1 capital and Tier 2 instruments. The submitter is correct that for both banks and NBDTs risk-weighted capital ratios will be used.

Liquidity factor

Overall, medium sized and large deposit takers supported the weight and settings for the liquidity factor. Some deposit takers suggested a greater weight for the liquidity factor given it is a key regulatory measure, which reflects its importance in the role of financial stability.

Similar to the submissions received on the capital factor, the NBDTs supported the proposed liquidity factor and its weight. However, they unanimously suggested that the boundaries should be capped at a more attainable level. Submitters suggest the liquidity maximum should be set closer to 30%, instead of 50%, making it more consistent with prudent business management and regulatory requirements.

Our response

Capital and liquidity factors

With regard to the capital variable, we continue to recommend using risk weights calculated under the IRB approach or the standardised approach. The IRB approach aims to improve deposit takers' understanding and management of risk in their portfolios by encouraging granular modelling of risk. We do recognise for the purposes of risk scoring for the DCS, relativity is important, therefore,

using standardised measures does have its merits. On balance, we consider it is important to recognise the improved ability to manage risk that the IRB approach allows, therefore, at least until the 2028 review we recommend using risk weights calculated using the IRB approach (where applicable).

We agree with other proposed changes made by submitters, for example calibration of the liquidity factor for NBDTs, as outlined below.

Our suggested changes based on feedback are:

Profitability (return on equity, ROE) factor:

- Reduce weight from 33.3% to 15% for banks and NBDTs.
  - Reason: Lower importance to risk than capital and liquidity.
- Tighten boundaries to 1-10% for banks and NBDTs.
  - Reason: Focused on positive, sustainable profit.

Asset quality (NPL) factor:

- Introduce, with weighting of 15% for both banks and NBDTs.
  - Reason: Helps measure asset quality (like profitability) but tempers volatility and weight in the profitability factor.
- Boundaries: 0-3% for both Banks and NBDTs.
  - Reason: Same boundaries as first consultation are used.

Capital factor:

- Reduce NBDT capital boundaries to 8-18%
  - Reason: Align with banks and regulatory requirements.
- Increase weight to 35% for banks and 40% to NBDTs (extra 5% temporarily)
  - Reason: Recognises the importance of capital for deposit takers. The extra 5% for NBDTs is intended to be temporary to recognise the crude liquidity ratio, which will be reviewed in 2028 and will likely reduce to 35%, aligning with banks.

Liquidity:

- Increase weight to 35% for banks (Core Funding Ratio (CFR) 20%, Mismatch Ratio (MMR) 15%), reduce to 30% for NBDTs (simple coverage ratio 30%).
  - Reason: Focused on regulatory requirements and longer-term focus. NBDT's liquidity weight reflects the relative simplicity of the simple coverage ratio.
- Reduce boundaries for NBDTs to 10-30%.
  - Reason: Original maximum implied very large liquidity holdings. Proposal better aligns with Australia's prudential liquidity regulations for small deposit takers.

Band Size and Multiplier

Proposal in consultation paper

Deposit takers would be placed into four risk bands as determined by their risk score. The size of each risk band was calibrated to spread deposit takers more evenly in each band.

Band 2 would pay two times the levy rate than band 1, band 3 three times the rate of band 1, and band 4 four times.

Submission feedback

Submitters were generally supportive of the four risk bands and their sizes; however, some smaller deposit takers and industry groups opposed the proposed distribution of deposit takers among risk categories. They commented that the proposal appears to arbitrarily spread deposit takers among risk bands for an even distribution, which seems inconsistent with the policy intent.

Respondents had varying views on the levy risk multipliers for deposit takers across the four bands. Many submitters from the NBDT sector believed the multipliers should be less progressive (e.g. a deposit taker in Band 4 should pay a levy rate 250% greater than Band 1, instead of 400%). The NBDT sector considered the proposed levy differentials risked a disproportionate effect on the deposit takers who are least likely to be able to pay the levy, or those who wish to grow. A medium sized bank suggested more granular banding, or a calculation that could be applied to all risk scores without banding.

In comparison, some respondents suggested that the current 400% multiplier for Band 4 was not high enough to represent the relative riskiness of high-risk deposit takers as compared to the lowest risk deposit takers. Submitters referred to market pricing and credit ratings to illustrate that the multipliers were set too low.

Additionally, some submitters suggested a transition policy for deposit takers who move to a higher band from year to year. This would include a period of time following a band move that would allow the deposit taker to pay a levy based on the half-point between risk bands.

Our response

We agree with the feedback that band sizes based on an even distribution should not be the sole principle, as this is likely to result in arbitrary decisions and uncertainty as to whether sizes will be adjusted in the future. Instead, consistent with international guidelines, our advice seeks to treat deposit takers with different risk scores differently (consistent with the principle of the likelihood of deposit taker failure). We therefore investigated where large differences in risk scores arose when setting the band sizes.

We have advised, as proposed in consultation, that deposit takers are sorted into four bands with the riskiest band paying four times the levy rate of the least risky band. We acknowledge the competing arguments towards increasing or decreasing this four times multiplier, but believe it best balances the, at times competing principles of; taking into account the differences in risk of deposit takers and the effect the levies would have on the soundness of deposit takers.

A four times difference is within the range outlined by international guidance (two to four times multiple - *European Banking Authority guidelines*[6]). The guidelines do highlight the multiplier could be larger if the differences in business models and risk profiles of deposit takers would create moral hazard. We consider that the four times multiplier, combined with strong prudential

[6] Final report of the revised Guidelines on DGS contributions (europa.eu)

requirements, including capital adequacy, should be sufficient to limit moral hazard risk in the New Zealand context.

We considered, but did not recommend, half point transitions. We considered that as risk scores and levy rates are updated annually, the impact of higher levy rates may only apply for one year, therefore any benefits from having additional bands or half point transitions were outweighed by the expected complexity to administer.

Timing of Levy Calculations

Proposal in consultation paper

The risk scores and estimated covered deposits would be calculated at the end of the year using data provided through monthly prudential surveys throughout the year. Monthly averages would be used.

Submission feedback

There was strong support from submitters for the Reserve Bank to calculate risk scores based on the previous year's data and therefore finalise the levy rate prior to the start of the annual levy period. Or at minimum, give deposit takers some ability to incorporate the levy amount into their funding and lending decisions during the year. Deposit takers highlighted that this would help provide certainty and support them to manage their risks.

Submitters strongly supported the levy calculation using an average from 12 months to avoid the risk of an inaccurate result being drawn at a single point in time. Some deposit takers requested clarification of the data used to calculate annual averages for the levy base and levy rates. For example, what period's data would be used to calculate the first year's levy base and rate?

Some respondents advocated for a timeline which incorporates an extra six months between deposit takers being notified of their levy rate and the commencement of levies being charged. Submissions indicate this extra period would allow deposit takers time to price their upcoming deposit rates accordingly.

Respondents provided varying feedback on the timeline for review of risk indicators and weights. Submitters agreed with the first review of indicators and weights to be reviewed in 2028, though some deposit takers suggested they be reviewed at least once before this time, potentially after the first year. Furthermore, some suggested it should be reviewed every five years after the implementation of the SDV standard.

Our response

We agree, in general, with the submissions on timing, including the benefits of providing deposit takers with their risk scores and levy rates early. However, this needs to be balanced with ensuring the risk scores, to some degree, reflect the current risk of the deposit taker.

We therefore recommend that the risk score be calculated using the previous year's prudential data, prior to the start of the year the levy relates to. For example, for the 2025/26 year deposit taker's risk score will be calculated using averaged monthly data for the year ending 31 June 2025. This will allow us to notify deposit takers of their levy rate near the start of the year the levy relates to.

Practically, as bank survey data is usually published on the 40th working day following each quarter (via the Reserve Bank's *Bank Financial Strength Dashboard*) we would expect to be able to provide deposit takers, both banks and NBDTs, with their levy rate following publication.

We continue to recommend the estimated deposit base is calculated using the average monthly data for the year to which the levy relates, that is, the 2025/26 levy base would use average monthly deposit data for the 12 months ending 30 June 2026.

The levy invoice would then be sent after the year the levy relates to has ended, that is, the 2025/26 levy would be invoiced after 30 June 2026.

Transitional Arrangements

Proposal in consultation paper

Prior to the implementation of standards in mid-2028 we proposed two main transitional arrangements, that being, that SDV files would not be required until mid-2028, and relatedly, that the DCS protected deposits base would be estimated. No further levy specific arrangements were proposed.

Submission feedback

The NBDT sector noted that they would be paying supervisory fees to external supervisors as well as the DCS levy until 2028 when the DTA regime is in full force. Some submitters suggested NBDTs should be exempt from DCS levies, or the levy payable should be discounted by the amount NBDTs pay in supervisor fees during this time. They submitted this would not have a detrimental effect on the size of the fund but will be significant for the relief of NBDTs.

Similarly, respondents suggest a flat rate method or levy-free period could apply to allow the NBDT sector time to adjust their business models, add more capital (if necessary), and implement the DCS requirements. Mutuals and non-for-profit NBDTs are specifically identified as entities which would benefit from this exemption.

Our response

We believe that the levy cost and any supervisory or other regulatory costs are distinct, and therefore without a clear link between the two costs, there is no logical justification for lowering the levy. In addition, without a clear link, quantifying what costs should be deducted (and what should not) may be difficult to establish or otherwise ambiguous.

However, we do recognise that the DCS levy is a cost on deposit takers that may impact the soundness of deposit takers, and this has been factored into our advice on the levy multiplier. We have considered the competing principles of deposit taker soundness and the need for levies to reflect the risk of deposit takers failure. We recommend, on balance, that there is not a lower levy during the transition period.

Additional Levy Feedback

Further guidance was requested around GST treatment and deductibility of levy payments, as well as the levy treatment of relevant arrangements.

A bank queried what data would be used for calculating a deposit taker's risk score, especially where a deposit taker's banking group included overseas entities.

Our response

The tax treatment for individual deposit takers is outside the scope of the regulations, and the regulation making powers. However, with regard to the DCS fund (not individual entities), Inland Revenue has now completed work on the tax status of the DCS and provided a view that the DCS fund will be exempt from income tax under section CW38 of the Income Tax Act 2007 as a "public authority" and the DCS fund will make exempt supplies of financial services under section 14 of the GST Act 1985 for levies charged to deposit takers.[7]

Following the introduction of the single depositor view (SDV) standard in 2028, the calculation of the levy base will be based on SDV files. However, an adjustment will need to be made for the number of relevant arrangements that are flagged by the deposit taker. Prior to the introduction of the SDV standard, we plan on reviewing and updating, where necessary, the prudential levy indicators (to reflect the updated deposit taker requirements) and how the levy base is calculated. This review will include how levies will be calculated for relevant arrangements.

The prudential indicators for deposit takers will be calculated using bank balance sheet (BBS) survey data (relevant data and ratios are published on the Reserve Bank's Bank Financial Strength Dashboard) and NBDT survey data. We advised that data for New Zealand banking groups, e.g., entities that are New Zealand based, will be used for both the levy base calculation and the risk scoring, this data will be available as part of the bank balance sheet survey.

[7] See The Treasury's second stage consultation paper on the *Statement of Funding Approach – Funding Strategy for the Depositor Compensation Scheme, Second Stage Consultation Paper, May 2024.*

Chapter 2 - Operational aspects of levies

Frequency of Calculation and Payment

Proposal in consultation paper

Levies would be calculated annually in arrears, starting once the DCS commences. The first invoice would therefore be made in mid-2026 on the risk indicators of the 2025-26 financial year. Firms would be able to prepay (prior to an invoice being issued) if making more frequent payments was desired.

Submission feedback

Submitters were in support of the policy proposal. They welcomed the flexibility in general, but most indicated that for simplicity they would make annual payments. Some submitters indicated that flexibility could assist with budgeting. It was also noted that allowing payments at a higher frequency than quarterly may not be useful due to the administrative effort and costs of managing these.

Our response

Given the proposal to set levy rates at the start of the year (see ***Timing of levy calculations*** above), there is no clear predictability advantage to deposit takers from making more frequent payments. However, we recognise that some flexibility around prepayments may be useful for deposit takers for other reasons. Accordingly, we do not recommend the regulations contain detailed provisions specifying options for more frequent payments, however the Reserve Bank would not disallow deposit takers from prepaying.

Time Bar for Reassessment

Proposal in consultation paper

A four-year time bar to limit the reassessment of paid levies would be implemented. If information arises which impacts the calculation of a levy that has been paid, the deposit taker would be able to receive a refund (or be liable for the shortfall). This would be limited to within four years of the original levy payment.

Submission feedback

Respondents agreed with the four-year time bar. They supported the comparison to the four-year time bar that applies to tax matters and felt it would appropriately reflect the likelihood of error in levy calculations.

One submitter suggested a materiality threshold as opposed to a time bar. They suggested this would eliminate the risk of errors being reported in an untimely manner, in addition to balancing the costs of performing the reassessment and redistributing payments.

Our response

We recommend a four-year time bar for the reassessment of paid levies. We appreciate the suggestion of a materiality threshold, but prefer the simplicity of a time bar and feel it properly reflects the likelihood of a levy calculation error.

Interest, Relief and Instalment Arrangements, and other Operational matters

Proposal in consultation paper

Interest on unpaid levies would be set at the Official Cash Rate (OCR) + 4% and would start to accrue the day after payment was due. Interest would be calculated daily, charged monthly, and the interest would compound.

We proposed that a variety of forms of relief would be available in exceptional circumstances. The Reserve Bank would be able to provide relief, if it would be inequitable for a deposit taker to pay a levy. We proposed the types of circumstances where relief could be available and the different forms of relief that would be offered.

We provided no position on whether interest would be charged on unpaid levies discovered via reassessment.

Submission feedback

Respondents were generally supportive of the other levy operational issues. Some proposed minor amendments such as further case for relief, or requested clarification of processes.

Respondents agreed that the circumstances for relief should be exceptional, and that the relief should be temporary. Two industry groups suggested that if a deposit taker is in liquidation or an NBDT is undergoing a restructure that relief should be provided. A medium sized bank suggested relief should be considered if a levy were to detrimentally impact a deposit taker's business operations or ability to compete.

A large bank requested further clarification on the circumstances under the "administrative or technological issues" category. Additionally, there was a query as to whether the Reserve Bank will share details of the circumstances and extent that relief has been provided with the rest of the industry.

Some respondents requested clarification for the charging of interest on reassessed amounts. A few submitters suggested that interest should only apply from when reassessment occurs. One industry association submitted that interest should not apply to reassessed amounts. Another bank suggested that if an underpayment is caused by a deposit taker's error, the reassessed levy payment should bear interest.

Our response

Given the support that circumstances for relief should be exceptional, we continue to recommend the deliberately broad proposal of circumstances and forms of relief that would be available. We recommend against overly prescriptive rules, as these may inadvertently exclude the option for relief in appropriate circumstances.

We acknowledge the preference for relief to be available under conditions that involve liquidation, restructuring, or inability to compete. However, we intend relief to be available for unforeseeable

circumstances, and do not consider it desirable to limit discretion to assess the appropriateness of relief in individual cases by issuing a prescriptive list. As part of the regulation drafting process, we can assess whether it is preferable to define a broad list of circumstances or whether relief powers should be more generally applicable.

We do not consider that any changes to the proposed method for calculating interest need to be made considering the general support from submitters. We would like to clarify, that reassessment would likely require issuing an invoice reflecting the reassessment, and that interest would only be payable if this invoice was unpaid.

Chapter 3 - DCS scope

This chapter covered eligibility of revolving loans and credit cards in positive balance, and some technical points around trusts and classes of deposits.

Protected Deposits

Proposal in consultation paper

We proposed that the definition of protected deposits includes standard banking products, such as current accounts, savings accounts and term deposits, as well as equivalent products offered by non-bank deposit takers.

We also proposed that covered deposits include credit balances of specific lending products (credit cards, revolving credit facilities, revolving home loans) as these can be equivalent to current accounts in substance.

Finally, we proposed a rule that only the most senior class of deposits would be eligible for coverage.

Coverage of "standard banking products" and not "readily tradeable"

Submission feedback

Respondents were generally in agreement with the proposals in the consultation paper. Some submissions asked for clarification on the treatment of certain accounts, and technical adjustments regarding specific products.

Some submitters requested clarity regarding terms used to define protected deposits, such as “readily tradeable” versus “transferable” products. Furthermore, it was noted that regulations should be precise to prevent inadvertently excluding products. A few deposit takers made submissions concerning specific products they offer to ensure they are considered in the drafting of regulations. These included subordinated products, and products which have the economic substance of a protected deposit.

Two deposit takers disclosed they have higher classes of deposits above their main tranches and submitted their main tranche should be covered.

Two submitters referred to the proposal that tradeable debt securities are not covered by the DCS, confirming that the proposal would require some NBDTs to remove tradability clauses from their trust deeds for the product to be eligible under the DCS. One NBDT requested an exemption from the non-transferability clause until the DTA comes fully into effect in 2028, when trust deeds between NBDTs and their supervisors will become redundant.

Our response

Consistent with our prior proposal, and given the overall support from submitters, we recommend that “standard banking deposit products”, such as retail deposits, cheque accounts, current accounts, savings accounts and term deposits should be protected deposits. In addition, products of similar economic substance offered by NBDTs, such as redeemable shares in credit unions or building societies should also be covered.

We also recommend that debt securities that are readily tradeable should be excluded. However, following submitters suggestions, we have sought to provide additional detail as to what this means in practice. Securities that are tradeable on a licensed or established market, such as bonds or notes are not included. In addition, securities whose terms and conditions allow the investor to readily sell the product and a process for transferring ownership is described should be excluded.

We recommend providing certainty to depositors on whether products are covered or not, and therefore have not recommended transitional clauses.

Lending products with credit balances and subordinated products

Submission feedback

A large bank noted a potential boundary issue with a specific borrowing product, which can fall into credit, they offer. They suggested these should be covered due to their similarity with other eligible products.

Banks agreed with the proposal of including credit balances on specific borrowing products. A couple of NBDTs disagreed with this proposal due to the procedural difficulty some entities would face with locating these accounts. A submitter noted that including credit cards as protected deposits is not necessarily a low-cost option for deposit takers to administer, especially when considering SDV requirements, as indicated in the consultation.

Our response

We recommend that credit balances of revolving loan products and credit cards should be covered. We have not recommended that the test include any reference to whether the original intent was for the lending product to have a credit balance.

It was helpful to hear we may have underestimated the compliance costs of including lending products. However, given the similar economic substance and the perception depositors that use these products have, we believe inclusion is still desirable. In addition, we note that including lending products within the customer's single depositor view (SDV) file is not required until 2028.

We have recommended that only the most senior class of deposits in liquidation should be covered. However, as some building societies have historical deposit products with different priority, we have recommended that an exception for building societies be provided. This exception should apply only to existing structures and be monitored by the Reserve Bank.

Entitlement Conditions

Proposal in consultation paper

We proposed two broad entitlement conditions:

- that depositors cannot be paid twice for the same deposit where funds are recovered by a liquidator; and
- that deposits held on trust created by or under a trust deed or enactment would be covered.

Submission feedback

Submitters were generally in agreement with the proposals, however raised some technical points regarding the treatment of specific trusts and suggested explicit requirements to be placed on relevant documentation.

Respondents requested a list of covered trusts, and further detail for the treatment of statutory trusts, deceased estates, and suspension accounts. A bank also noted that they rely on customers to advise them of any changes in documentation.

Another bank noted an issue regarding the treatment of construction company retentions. They suggested that retention accounts may be pooled under a single account, so covering it as a 'trust' could be inequitable due to the different set up possibilities. Treating them as relevant arrangements was preferred instead.

Our response

We do not recommend any major changes to the proposals in the consultation are required, aside from minor drafting changes for the clarification of eligibility.

We recommend that regulations should be made that ensure depositors cannot receive payment twice (for example, once through the liquidation process, and once under the DCS) for the same deposit.

For clarity, we have recommended that 'trusts' can broadly be treated in three distinct categories:

1. as a relevant arrangement;
2. as a separate legal relationship; and
3. treated as being held personally by the trustee/s.

Chapter 4 below outlines those trust relationships that are (or we have recommended should be) treated as relevant arrangements, they include:

- Money held in a trust under a custodial service, which includes peer-to-peer lending products, cash management accounts offered by brokers as an alternate way to access bank accounts, and digital products that offer clients access to savings accounts and term deposits.
- Deposits held by lawyers, accountants, real estate agents, and retirement villages on behalf of clients.
- Deposits held on behalf of investors under a cash-only PIE fund issued by the deposit takers (or its subsidiary), commonly referred to as a '*captive cash PIE fund*'.

With regard to category 2, we recommend a trust be treated as separate legal relationship if it meets certain conditions. We recommend that a condition for trust relationships (including family trusts, deceased estates and statutory trusts) to be covered by the DCS as a separate legal relationship, and therefore eligible for separate entitlement, is that the trust must be established by trust deed, legislation or other verifiable written document (e.g., a will).

This means, constructive trusts would not be treated as a separate person and therefore fall into the final category where the trust is treated as being held personally by the trustee/s.

Construction retentions are discussed below, see Relevant Arrangements below.

Chapter 4 - Relevant arrangements

Proposal in consultation paper

We proposed an outline for the treatment of 'relevant arrangements' and proposed that specific client account arrangements and bank-sponsored PIE funds are specified as relevant arrangements through regulations. Besides the "Client Money accounts" (RCMPS) covered by the DTA, we proposed regulations to extend look through coverage to Conveyancers, Lawyers, Accountants, Real Estate Agents and Retirement Village deposits. This means that deposit takers will need to be able to identify and flag these accounts, and that in a payout event, eligibility will be calculated with reference to the client's eligibility rather than the account holder.

Submission feedback and proposed policy advice

There was broad agreement with the proposed scope of coverage for relevant arrangements, but respondents offered some detailed feedback on technical situations and requested clarification on certain points. These are discussed below.

Record keeping requirements

Submission feedback

Respondents requested clarification on any requirements for deposit takers to flag relevant arrangements before the implementation of the SDV standard. An industry association indicated deposit takers will do what they can for customer identification before the SDV files come into force. Since this 'best endeavours' approach has been implied by the Reserve Bank, they requested confirmation that there are no legal obligations for flagging relevant arrangements before 2028.

Some respondents suggested it is not low cost to identify relevant arrangements, as deposit takers' IT and operational systems may require significant work. Products which are governed by underlying legislation or held as specific product types will be easily identifiable, but some arrangements are not readily identifiable under the current data form. It was suggested that for these accounts, customers should be responsible for identifying the relevant arrangement with their deposit takers. Furthermore, they noted the necessity for the Reserve Bank to offer clear communication to the public for consistency across the industry.

A large bank suggested the final regulations specify detailed record keeping requirements for deposit takers to follow. In the event of a payout, this would reduce compensation errors resulting from flawed record keeping.

Our response

The records for a deposit under a relevant arrangement should be kept by the account holder in the manner specified by existing record-keeping requirements under its governing legislation (for example, section 112 of the Lawyers and Conveyancers Act 2006) or documentation (for example, the PIE trust deed). We expect most relevant arrangements to be governed by underlying legislation and easily identifiable for deposit takers. The relevant arrangements that are not flagged will still be eligible for compensation in the event of a deposit taker failure pre-2028, however there may be a delay in payment if the account is identified post-failure.

Scope of relevant arrangements

Submission feedback

A submitter NBDT noted regulations should not be prescriptive in defining relevant arrangements. Instead, they should include any situation where a custodian holds funds with a deposit taker, on behalf of a client. The submitter suggests a broader definition will support financial innovation by allowing more products to fall under the scope. This relates to the fact that some money held on trust (e.g. by a fintech) may not currently meet the proposed criteria to be a relevant arrangement.

Further clarification was requested for arrangements which are similar to the proposed relevant arrangements but are not governed by underlying legislation or a trust. Some examples include body corporates, suspense accounts, and tenancy bonds held by government agencies. A large bank advocated for the inclusion of budget advisory services and care provider entities that support individuals with intellectual disabilities. They submit that excluding arrangements such as these would be detrimental for vulnerable members of the financial system.

An NBDT industry body noted that NBDTs hold funds in banks as they do not currently have access to ESAS accounts. Therefore, they suggested that the accounts held by that bank should receive look-through to the respective customers of their entity.

Our response

We acknowledge the general point that some 'pooled' accounts will not meet the criteria to be treated as relevant arrangements, for example body corporate accounts. We aimed to add a relatively limited set of additional arrangements that have well defined record keeping obligations and was not overly open-ended. With new business models and fintechs, we could recommend adding them in the future once their business and regulatory models are more settled.

We do not recommend that accounts held by NBDTs within banks should receive look-through treatment. At this early stage of the scheme, we recommend limiting the number of relevant arrangements primarily to examples where the underlying depositor remains in control of where their deposit is held (for example, discretionary managed funds) or otherwise treats the deposit as if it was with the licensed deposit taker (for example, in-house PIE regimes). Limiting the number of relevant arrangements supports a timely compensation payout process.

PIE funds

Submission feedback

Submitters agreed that PIE funds invested wholly in bank deposits should be considered relevant arrangements. However, it was suggested the arrangements should not be limited to bank-sponsored PIE funds. Some respondents supported the inclusion of any PIE fund sponsored by a licensed deposit taker and invested in their products.

Multiple submitters suggest PIEs should be handled the same way as ordinary deposits, being paid directly to customers. They also submitted these should be paid out more quickly than other relevant arrangements, as the information will be readily available for immediate payment.

Our response

We have carefully considered the submission about paying PIEs sooner than other relevant arrangements. As a broader issue, we agree that relevant arrangements should be paid when data is available for a particular arrangement, rather than waiting till data on all relevant arrangements is submitted (which would cause undue delays). Assuming PIEs are included in SDV (as planned) this is likely to lead to them being paid out more rapidly. The levy base (once SDV is available after 2028) can then also include deposit taker PIEs in a customer's SDV file, allowing their entitlement to be known pre-failure.[8]

We have also considered the feedback on the inclusion of NBDT-sponsored PIE funds. We agree that all deposit-taker sponsored PIEs should be included as relevant arrangements, conditional on PIE fund products being solely invested in protected deposits issued by that deposit taker.

Specific relevant arrangements (retirement villages, construction company retentions, accountants and lawyers)

Submission feedback

A large bank noted potential issues with the proposal of including retirement village deposits as relevant arrangements. They submitted that retirement village operators hold deposits with an independent third party, thus receiving look-through treatment. Therefore, the inclusion of retirement villages as a category may create overlap with other relevant arrangement accounts.

Additionally, a medium sized bank and an industry association requested clarification for the treatment of construction company retentions as trusts. Since retention accounts may hold funds for multiple people on multiple contracts, treating them as trusts may result in different outcomes as opposed to treating the accounts as relevant arrangements. The respondents requested clarity on the treatment of different construction account set ups.

An industry association indicated a potential boundary issue regarding the definition of "accountants". They endorse the proposal that trust accounts are subject to the record-keeping requirements in NZICA's client monies standard.

Further guidance on the definition of custodial arrangements in comparison to the Financial Markets Conduct Act (2013) (FMCA) was requested.

A legal industry group expressed support for relevant arrangements to include lawyers' trust accounts and for payouts to be transferred to the account holder, since lawyers often hold funds that are subject to conditions.

Our response

We recommend the five categories of relevant arrangements proposed in consultation should be specifically treated as relevant arrangements, deposits held:

- by lawyers and conveyancers on behalf of their clients,
- by accountants on behalf of their clients,
- by real estate agents on behalf of their clients,
- under a retirement village deposit arrangements on behalf of residents, and

[8] Banks are already guided to "look-through" captive Cash PIEs and report these based on the original source of funding, for the purposes of reporting under the Bank Balance sheet survey. Therefore by extension, as the pre-SDV estimated DCS base uses this data the estimated levy base should, to some degree reflect the relevant arrangement treatment of captive PIE funds.

- in a deposit-taker sponsored cash PIE (PIE funds issued by a deposit taker who invests only in protected deposits of that deposit taker).

We have sought to clearly define “accountants” to ensure only those subject to professional standards are covered.

We have not recommended that construction contracts should be included as relevant arrangements, as these are covered by trust provisions. The Construction Contracts Act 2002 creates separate trust arrangements for retention money held by multiple parties. To protect the money that is owed to subcontractors, it is required to be kept in separate trust accounts for the different beneficiaries. The general trust requirements would therefore apply to these types of arrangements, which allows each subcontractor up to $100,000 of compensation.

Additional 'look-through' feedback

Multiple layers of relevant arrangements

Some respondents had queries regarding the levels of “look-through” for relevant arrangements. For example, a custodial arrangement provider may hold funds in a bank-sponsored PIE, or an express trust may have funds in a solicitor’s trust account. Respondents requested clarification on how a situation like this would be treated, and suggested the DCS compensation should be looked through to the underlying beneficiary. One industry association suggested specifically that wholesale Managed Investment Scheme (MIS) funds held for investors should be relevant arrangements.

Our response

We do not foresee any limits on having multiple relevant arrangements, especially with regard to a relevant arrangement holding a PIE fund. We do note that similar to the expectation that payouts of relevant arrangements are likely to be paid after direct holdings, we would expect payout of multiple layers of relevant arrangements to take longer than simpler arrangements.

Managed investment schemes (MIS)

Three submissions referred to the coverage of Managed Investment Schemes (MIS). In particular, an industry association suggested all MIS should be covered on a per depositor basis (look-through or relevant arrangement basis). The organisation suggested that only looking through bank sponsored PIE funds disproportionately benefits banks. Another organisation suggested that any bank deposits held in a MIS fund that also holds tradable securities should be covered under the DCS.

Our response

We do recognise the argument for allowing look through treatment for all cash management accounts, or at least those that only contain protected deposits. However, we recommend at this stage with regard to MIS that only money held in trust under a custodial service (covered under s 431W Financial Markets Conduct Act) should have look through treatment, this includes peer-to-peer lending products, “cash management accounts” offered by brokers as an alternative way to access bank accounts, digital products to savings account and term deposits, and discretionary investment management services (DIMS).

These products are already given look through treatment under the Act, s 191(2)(b), and we do not advise, at this stage that further MIS be included via regulations. However, we do want to monitor the development of MIS products and may look to adjust the regulations if it becomes clear that other MIS products have a similar economic substance to standard banking products.

International experience

An individual suggested that the Reserve Bank use international experiences, such as those of the OECD to determine scope.

Our response

New Zealand is currently an outlier in not having a depositor compensation scheme, and we have maintained awareness of settings used by other jurisdictions and guidance from international organisations. For example, our advice has considered international norms and guidelines from the International Association of Deposit Insurers (IADI).

Official Assignee and Bishops

Additionally, a respondent suggested we explicitly consider the unique status of the Official Assignee[9] and Bishops who are a Corporation Sole[10] in New Zealand. They suggest that the Official Assignee and Bishops who are a Corporations Sole should be eligible for repayments from the DCS.

Our response

We do not recommend that the Official Assignee nor Bishops should receive look-through treatment, for example, by treating them as relevant arrangements. This is primarily from a practical standpoint. Both the Official Assignee and Bishop are legal persons in their own right, and therefore look-through treatment (e.g. looking through to natural persons) is unlikely to be possible. For completeness, the Official Assignee nor the Bishop is a licensed deposit taker (e.g. a registered non-bank deposit taker) and therefore are ineligible from issuing protected deposits.

[9] Insolvency Act 2006 No 55 (as at 01 April 2023), Public Act 3 Interpretation – New Zealand Legislation
[10] Roman Catholic Bishops Empowering Act 1997 No 4 (as at 30 January 2021), Private Act 5 Bishops to be corporations sole – New Zealand Legislation

Chapter 5 - Exempting deposit takers from the DCS

Proposals in consultation paper

Due to the recent change in regulatory settings, branches of foreign banks operating in New Zealand (i.e. without having a locally incorporated subsidiary) are required to only interact with wholesale customers (e.g. corporates and institutions) after 2028. Most branch banks already meet this, while others are transitioning to do so.

We proposed exempting wholesale-only branches from the DCS from the start of the DCS. As branches with existing retail customers divest them, they would then also be exempted from DCS membership.

Submission feedback

Submitters agreed with the proposal to exempt 'wholesale-only' branches of overseas banks, based on the cost-benefit analysis of excluding them from the DCS.

Some respondents sought clarity regarding the cases for exemption. A large bank specifically inquired about the treatment of overseas branches that provide non-deposit services to retail persons. They have the view that these branches should also be exempted to avoid additional compliance costs between the start of the DCS and the implementation of the Branch Policy. An industry association also indicated it will be difficult to divest all retail customers before the start of the DCS, and the divestment test should instead focus on deposits and credit facilities, offered to retail depositors, as opposed to other retail business that would not be covered by the DCS.

Additionally, they submitted the exemption should allow branches to hold a *de minimis* level of retail deposits after the start of the DCS. They also made some technical points about the definition of 'wholesale investors' under the Branch Policy Review, as opposed to the definition under the Financial Markets Conduct Act (FMCA).

A large bank requested confirmation of deposit coverage in the case of a foreign branch holding DCS-eligible retail deposits before their required divestment in 2028. They asked whether all the branches' deposits would be eligible for protection, or exclusively the retail deposits. To clarify, once the DCS commences and until the deposit taker is exempted, all eligible depositors are eligible for the $100,000 protection and being a wholesale client does not make a depositor ineligible.

A deposit taker did not support the proposed exemptions, suggesting such exemptions add unnecessary complications to manage, and instead preferred a simple scheme.

An industry association and a medium sized bank raised a technical point on the proposed 'Wholesale Test' in the context of the DCS. Respondents suggest that the Wholesale Test needs to reflect branch business models. Particularly, they note that some wholesale entities create bespoke New Zealand subsidiaries for their New Zealand operations. These are considered too small to meet the "large" criteria required by the Wholesale Test. However, they would otherwise meet the requirements if their large international corporate parent were taken into account. Further clarification is requested on these points.

Our response

We acknowledge submitters' concerns around the exact boundary for exemption, and the need to mitigate deposit takers unintentionally being included in the scheme where their exemption would still meet the policy intent of the recommendation. However, consistent with considering the implications to public confidence and depositor protection, if a deposit taker is holding itself out as a deposit taker servicing retail depositors (i.e. those who will benefit most from the DCS) then inclusion into the scheme is appropriate.

As part of our 2022 Branch Policy Review, we have worked with branches on their divestment strategy of their retail customers and are now satisfied the deposit takers have strategies in place or otherwise will not have material amounts of retail deposits once the DCS starts in mid-2025.

In light of submitters' concerns, we recommend that overseas licensed deposit takers, commonly referred to as branches, should all be excluded from issuing protected deposits and therefore not required to pay the DCS levy or comply with similar DCS costs.

The definition of wholesale and other technical decisions are also relevant to the implementation of the branch standard, and we wish to remain consistent with this standard to the extent possible. We continue to discuss the matter with those working on the branch review.

Chapter 6 - In-flight payments

Proposals in consultation paper

We proposed that DCS entitlements would largely follow similar rules to Open Bank Resolution[11] (OBR), another tool the Reserve Bank can use for responding to a bank failure.

Our proposal was that for payments made via Settlement Before Interchange (SBI) or the High Value Clearing System (HVCS), the transaction would be taken into account in calculating DCS entitlements where the interbank element of the payment had been settled through ESAS. Most notably, this means settled payments between banks would impact entitlements even if the account balance was not yet debited or credited at the point of failure (crediting often happens with a delay).

However, for card payments (e.g. payments made through the Visa or Mastercard networks), we proposed that transactions would only be taken into account in calculating DCS entitlements if they had been fully settled and finalised before 'quantification time'.

Submission feedback

Limited feedback was received on this proposal. Respondents were generally in agreement with the proposed treatment of in-flight payments but noted some logistical concerns.

Firstly, some submitters requested technical details on the treatment of in-flight payments and further clarification on the interaction between the DCS and OBR in the event of a deposit taker failure.

[11] Open Bank Resolution - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)

Respondents supported the Reserve Bank's intention to align the treatment of in-flight payments under the DCS with their respective treatment under the OBR. A medium sized bank noted the OBR considers 'standing direct debits and automatic payment instructions' as 'on-us' payments and suggest the DCS applies the same treatment to support alignment.

Two banks and the NZBA expressed concern with the proposal for card payments, stating that waiting for a transaction to be settled could potentially result in unfair outcomes. One bank suggests that card payments should instead be reflected in account balances at the quantification time where the card transaction has been authorised and approved at the point of sale. They suggest this would mitigate the risk of customers being credited by the DCS despite receiving the goods/services.

Some submitters noted the logistical complexity of timing settlements for in-flight payments. A large bank disclosed the specific time their 'on-us' payments are settled, indicating the cut-off for payments being processed should be similar to that time (a "*cut-off time*"). They also note the intervals at which interbank settlement in ESAS occurs. Subsequently, the respondent suggested the quantification time should be late in the day to reduce the overall number of in-flight payments.

Our response

There are some legal issues to consider before regulations are able to be issued for in-flight payments and therefore at this stage do not recommend any regulations relating to in-flight payments. We consider that this is acceptable at least in the short term, as in the absence of regulations, legal DCS entitlements will default to being determined by balances at the point of failure.

For completeness, we do in general agree with submitters, although do have some reservations that delaying the declaration of failure to the point in the day when payments are considered complete may not be possible or desirable.

In the longer term, we are of the view that alignment with OBR is preferred and will consider this is a future policy issue.

Other queries

Submission Feedback

Multiple respondents noted the current timeline does not incorporate time for an exposure draft to be published before the finalisation of regulations. Respondents expressed concern that this could lead to unintentional consequences if feedback is not received in the intended manner and there is not the opportunity for submitters to review an exposure draft.

Some submitters suggested DCS data should be transparent and available to the public. Specifically, they suggest that the risk bands should be published so depositors know where their deposit taker places.

Some respondents suggested that all entities regulated under the DTA and covered by the DCS should be able to call themselves 'banks'. This would help the public clearly identify the deposit takers that have coverage and as they are all subject to the same regulator. It would also be the most equitable outcome.

Similarly, some deposit takers requested more detail regarding the terms of use for the DCS visual identity. They signalled their preference for a clear and accurate set of conditions in which the DCS symbol would be used, so customers can confidently identify covered deposits. This will also help maintain consistency across the Reserve Bank's and deposit takers' communication with the public. A large bank noted their obligations under the Conduct of Financial Institutions (CoFI) legislation to disclose clear information on products and services to customers.

Two submitters argued that the DCS is largely unnecessary for financial stability in New Zealand. They suggested that New Zealand has some of the highest prudential regulation requirements and therefore does not require a compensation scheme with the respective impacts of levies on deposit rates. Alternatively, they indicate that the intended outcomes of the DCS could be better achieved through more stringent prudential supervision.

A large bank and an industry group highlighted the importance of having a clear payout priority for DCS, that is, what accounts would be compensated first. This is partly due to overseas reporting obligations; this requires the bank to disclose specific liquidity and protected deposits proportions of the offshore group. They also requested detail of the interaction between the DCS and OBR for customers' benefit of understanding the payout process in the event of a deposit taker failure.

An individual requested further clarity of how the collected DCS levies will be held, to ensure the fund is appropriately ring-fenced. Additionally, they expressed concern that the costs of the levies will be passed on to depositors instead of the economic incidence remaining on deposit takers.

Our response

Exposure draft / further consultation

An exposure draft, or similar, is not part of the current process. Our advice to date has benefited significantly from the time and effort industry and submitters have provided to the two rounds of public consultation and workshops, so far. However, an exposure draft would require either the delay of the publishing of regulations, thereby, reducing time available for the sector to prepare for the DCS commencement or otherwise delay the commencement of the DCS scheme. In addition, exposure drafts are generally reserved for lengthy and complex legislation. For example, the DTA, was subject to an exposure draft process.

In addition, we are cognisant of the consultation burden placed on stakeholders, especially in light of other regulatory changes led by us and other Council of Financial Regulator agencies in the third quarter of this year.[12]

Most of the other comments were largely outside the scope of the consultation document, nevertheless, we have passed them on to colleagues in those areas, where appropriate. Nevertheless, for completeness, we note:

- Currently, we do not plan on releasing deposit taker risk scores or risk bands. The Reserve Bank Dashboard already provides information on key metrics for banks.

[12] regulatory-initiatives-calendar-q2-2024.pdf (cofr.govt.nz)

- The DTA allows the Reserve Bank to authorise the use of restricted words, like "bank", similar to its power under the Banking (Prudential Supervision) Act 1989. A decision on the use of this power under the DTA is likely to be made in 2025.
- Development of the DCS visual identity and brand communications is now well underway, and we expect to be in a position to provide additional information on the identity by the end of the year.
- We agree with submitters that prudential requirements and supervision are important components to ensure the financial stability of New Zealand. However, the DCS will contribute to this by promoting trust and public confidence in our financial system. It is consistent with the IMF FSAP recommendations for the New Zealand financial sector in 2017.
- The DTA does not require regulations on payout priority, however, we recognise the importance of providing depositors and deposit takers certainty, as well as enabling deposit takers to meet their overseas reporting requirements. We will endeavour to publicly outline our expectations on how payout is likely to be administered and expect this to be completed and released prior to the commencement of the DCS.
- The DCS fund will be held by the Reserve Bank on behalf of the Crown, as outlined by the Statement of Funding Approach[13] (SoFA). This account is solely used for collected levies and can only be accessed for a payout and for certain other operational costs of the DCS, as intended by the DTA.
- We acknowledge the concern that the cost of levies will be reflected in deposit takers' rates, however the extent to which an individual deposit taker passes the costs and benefits of the scheme on to their customers is a commercial decision. We do not expect the impact on depositors to be significant and believe the benefits of the DCS outweigh the costs.

Next Steps

We will continue to work with the deposit taking sector to operationalise the DCS regulations by mid-2025.

Our proposed policy advice will be considered by the Minister of Finance and Cabinet, and with their approval, the regulations will be made gazetted by mid-December 2024. It is intended the DCS will officially commence 1 July 2025, to give industry the time required to implement any necessary changes defined by the regulations.

[13] Statement of Funding Approach – Funding Strategy for the Depositor Compensation Scheme - Consultation Paper - July 2023 - New Zealand Treasury

Appendix 1 – Consultation questions

We sought feedback on the following questions:

Chapter 1 – DCS levies

Initial levy base

Q1

Do you agree with our preferred approach and have any final comments?

Levy approach

Q1

Do you agree with the revised composite approach with respect to the quantitative risk indicators, boundaries, and weights for each input?

Q2

Do you agree with our preferred DCS levy approach?

Q3

Do you agree with our assessment of alternative options we have disregarded?

Q4

Do you agree that the composite risk factors and weights should be reviewed in 2028 to better reflect updated standards?

Q5

Do you have any other comments about the proposed DCS levy approach?

Chapter 2 – Operational aspects of levies

Interest

Q1

Do you support our proposed default rate of the OCR+4%?

Relief and instalment arrangements

Q1

Do you agree with our proposed approach? Are there any other circumstances in which you consider it would be appropriate to consider relief for deposit takers?

Frequency of calculation and payments

Q1

Do you agree that regulations would be desirable to provide certainty in payment frequency?

Q2

Do you agree that it is useful to have options for deposit takers to make more frequent levy payments, or are you comfortable with making a single annual payment? Alternatively, would you prefer another payment frequency (other than annually) if regulations did not allow for flexibility?

Time bar for reassessment

Q1

Do you think that a time bar would be necessary, or is it sufficiently unlikely that recalculations would be required?

Q2

If a time bar is necessary, is four years an appropriate length of time?

Chapter 3 – DCS scope

Q1

Do you have any comment on the proposal that the protected deposit regulations include normal banking products such as current accounts, savings accounts and term deposits, as well as similar products offered by non-bank deposit takers?

Q2

Do you agree with the proposal that the protected deposit regulations also include credit balances on specific borrowing products (revolving home loans, revolving credit facilities, and credit cards)?

Q3

Do you foresee any boundary issues arising from the protected deposit proposals? For example, are you aware of any financial products which appear to not clearly fall in or out?

Q4

Do you agree with our entitlement condition that funds paid from the liquidator that would have been part of your DCS entitlement are subtracted from your compensation amount?

Q5

Do you agree with our proposals to only cover express trusts and those created by enactment, subject to the relevant documentation being provided?

Chapter 4 – Relevant arrangements

Q1

Do you agree with our proposal that protected deposits held under the following client account arrangements be prescribed as relevant arrangements: conveyancers, lawyers, accountants, real estate agents, and retirement village deposits?

Q2

Do you agree with our proposal that holdings in bank-sponsored PIE funds be prescribed as relevant arrangements?

Q3

Do you foresee any boundary issues arising from the proposals? For example, are you aware of any financial products which may not clearly fall in or out of the intended scope of the proposals?

Q4

Do you have any comments on the proposals with regard to possible implementation challenges, timeframes to implement and likely scale of accounts covered?

Q5

Do you agree with our proposal to make payments into 'like' accounts for relevant arrangements?

Q6

For relevant arrangement record-keeping requirements, are you aware of any instances where records are not required (or not available) and how else eligible depositors' shares could be identified/notified?

Chapter 5 – Exempting deposit takers from DCS membership

Q1

Do you agree with our analysis that the protection offered by the DCS is unlikely to be particularly significant for wholesale depositors?

Q2

Will it be possible to manage a situation where some deposit takers are not DCS members, noting that they will not be allowed to take deposits from retail depositors if they are not members (unless an equivalent foreign scheme provides adequate protection).

Q3

Do you agree with our overall assessment of the costs and benefits of exempting foreign branches from DCS membership?

Chapter 6 – In-flight payments

Q1

Do you agree with our conclusion that on-us payments will automatically be included in protected deposit balances for the purpose of calculating DCS entitlements? If not, how would you recommend these payments be treated?

Q2

Do you agree with our proposal that in-flight payments requiring interbank settlement in ESAS only be included in protected deposit balances for the purpose of calculating DCS entitlements where the interbank settlement has been completed? If not, how would you recommend that these payments be treated?

Q3

Do you agree with our proposal that in-flight card payments only be included in protected deposit balances for the purpose of calculating DCS entitlements where the payment has been settled, and the protected deposit has been debited or credited to take into account the transaction. If not, how would you recommend that these payments be treated?