Reserve Bank of New Zealand
Te Pūtea Matua

Product hierarchy for the Depositor Compensation Scheme

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Background

1. The Deposit Takers Act 2023 (**DTA**) provides for the establishment and operation of the Depositor Compensation Scheme (**DCS**). Under the DCS, depositors of a failed deposit taker are eligible to be compensated up to $100,000 per depositor, per deposit taker. Deposit products which are eligible for compensation under the DCS are referred to as "protected deposits".
2. The DTA determines how compensation entitlements are paid. In particular, the DTA provides that the Reserve Bank of New Zealand (**RBNZ**) assumes all the rights and remedies that a depositor may have in relation to all or part of a protected deposit, where a compensation entitlement has been paid in respect of all or part of that protected deposit.
3. In some cases, depositors may have total protected deposits with a failed deposit taker which exceed $100,000 and are maintained across multiple deposit products. In this case, section 228 of the DTA (see Appendix 1) provides RBNZ with the discretion to apportion compensation across the protected deposits as it sees fit.
4. The purpose of this paper is to propose, for deposit taker feedback, how we might exercise our discretion to prioritise different types of deposits for DCS compensation under section 228 of the DTA.
5. The proposal is to introduce a deposit product hierarchy policy whereby protected deposits are grouped into tiers or ranked in order of priority to enable RBNZ to effectively allocate compensation across those protected deposits. It is proposed that the product hierarchy will apply in liquidation (and payout) as well as in resolution (for example if Open Bank Resolution (**OBR**) is applied).
6. The order in which compensation is apportioned across products also determines the order in which the RBNZ will subrogate an eligible depositor's rights and remedies relating to particular products in cases where a liquidation and payout is undertaken.
7. In OBR, it is expected that customers' accessible balances shall be available in the same accounts where they were located immediately before entering resolution. The deposit product hierarchy will guide the order in which various accounts held by a depositor are unfrozen.

Policy proposal

8. Section 228 of the DTA provides that RBNZ may apportion compensation across one or more protected deposits in the manner it sees fit. This paper sets out RBNZ's expectations of how each eligible depositor's compensation entitlement should be allocated across multiple accounts with a deposit taker, where an eligible depositor has total protected deposits that exceed $100,000.
9. If this policy is adopted, RBNZ intends to publish this policy in the form of guidance to assist deposit takers to comply with their regulatory obligations under the DTA.
10. RBNZ proposes that the apportionment take the form of a deposit product hierarchy. The hierarchy will consider liquidity and accessibility when determining the way in which compensation should be apportioned across protected deposits. It is proposed that the

deposit product hierarchy will apply in a payout (i.e. when a specified event notice is issued by RBNZ) as well as when a deposit taker is in resolution.

11. The deposit product hierarchy will:

    (a) make clear how RBNZ will consistently apportion DCS compensation to eligible depositors who hold balances over $100,000 across multiple accounts held with a deposit taker in a liquidation/payout or resolution (e.g. if OBR is applied);

    (b) clarify the order in which the RBNZ's right of subrogation applies to different protected deposits (the RBNZ's right of subrogation means that the RBNZ takes over the rights and remedies attaching to protected deposits for which compensation has been paid under the DCS);

    (c) support RBNZ's function under section 195 of the DTA to ensure that DCS compensation is provided as soon as practicable after RBNZ has issued a specified event notice, or the deposit taker enters resolution; and

    (d) support the RBNZ's consideration of a range of resolution strategies by clarifying the priority ranking of deposits in executing resolution tools such as, for example, use of transfer powers.

Deposit product hierarchy

Protected deposit product list

12. Section 193 of the DTA requires deposit takers to publish a list of protected deposits that are eligible for DCS compensation. To establish the deposit product hierarchy for a deposit taker, RBNZ needs to identify the scope of protected deposits across all deposit takers.

13. Section 192 of the DTA defines protected deposits as New Zealand dollar denominated "debt securities" that have terms which are governed by New Zealand law and meet the requirements of section 192(1)(c). They include current accounts, savings accounts and term deposits.

14. In the Deposit Takers Regulations 2025, a protected deposit (which includes both principal and interest) must be one or more of the following:

    (a) Current accounts and savings accounts
    - Call debt securities
    - Call credit union shares
    - Call building society shares
    - Credit union savings account products

    (b) Notice account products
    - Bank notice products
    - Products that are substantially equivalent to a bank notice product, except that they are not issued by a registered bank

    (c) Term deposit products
    - Fixed term deposit products

- Fixed term redeemable building society shares
- Credit union fixed term deposit products

(d) Rights in connection with revolving credit contracts (e.g. in connection with a positive balance in a revolving home loan or credit card contract).

(e) Redeemable shares issued by non-bank deposit takers such as credit unions and building societies which are similar in purpose to normal banking products.[1]

Assessment considerations

15. The proposed deposit product hierarchy is designed to group protected deposits into tiers or rank them based on two assessment criteria: liquidity and accessibility.

16. Liquidity refers to the feature of certain protected deposits of being funded at all times. This enables customers to have immediate access to their funds (sometimes on a daily basis). Inability to have access to liquid funds could potentially harm the depositor if they are unable to meet financial obligations or make purchases. Accessibility refers to whether there are restrictions or limits to the number of transfers or withdrawals that can be executed on the deposit account. Note that the concepts of liquidity and accessibility often overlap.

Group A (Transactional accounts):

17. Prompt restoration of access to transactional accounts following a failure event is essential to preserving public confidence and maintaining financial stability. Material delay in accessing funds would be disruptive not just to the individual depositor but for the wider community and economy.[2]

18. Accordingly, it is proposed that deposits that are transactional in nature be prioritised over other types of deposits. These deposits have no maturity period, are liquid and either payable at par on demand or after providing a notice period to withdraw the funds. We propose two tiers of deposits in Group A: Tier 1 and Tier 2.

Tier 1

19. Tier 1 deposits are liquid and readily accessible given their transactional nature. The depositor is able to make unlimited transfers or payments from the deposit account to another party (including another account of the depositor at the same deposit taker or another institution).

20. The frequency with which depositors or account holders can use these accounts is a key feature of Tier 1 deposits. Depositors often require daily access to their funds to pay bills and everyday expenses.

[1] The DTA allows for these to be included as protected deposits given their similar economic substance to other protected deposits.

[2] During the GFC, the US FDIC introduced the Temporary Account Guarantee Program (TAGP) which provided unlimited insurance to non interest-bearing transaction accounts and other low interest-bearing account to calm depositors and forestall bank runs. This shows that transactional accounts are essential to the economy (by maintaining market liquidity), support public confidence in the financial system and promote financial stability. United States: Transaction Account Guarantee Program (yale.edu)

21. The transfer or payment/withdrawal of funds from Tier 1 deposits can be done through various means such as via internet banking, phone or mobile banking, ATM and branch withdrawals, by using a debit card and other electronic means of transferring funds.

22. To summarise, the common characteristics of Tier 1 deposits are:

- they are liquid; i.e. payable at par on demand (no pre-specified maturity period);
- there are no restrictions on the number of transfers/withdrawals within a given period;
- they do not require prior notice to transfer or withdraw funds;
- they may or may not be interest-bearing;
- fees may or may not be charged for maintaining the account; and
- they are accessible by electronic order/instructions to pay third parties or transfer funds.

23. Examples of Tier 1 deposits include:

- on-call/demand and current accounts;
- on-call savings accounts that do not require prior notice for withdrawal;
- redeemable shares (if they function as transactional account in substance); and
- revolving home loans, revolving credit facilities and credit cards with credit (positive) balances that operate like transactional accounts.

Tier 2

24. Tier 2 deposits have transactional features such as being accessible, but there are restrictions on withdrawals. They have the following features:

- they are accessible but there may be a requirement for prior notice before withdrawal or there are restrictions on the number of withdrawals (e.g. per month);
- they have no specified maturity period;
- fees or penalties may or may not apply;
- they are interest-bearing (note that the interest rate could be variable).

Group B (Non-transactional accounts)

Tier 3

25. Tier 3 deposits are designed to set aside money for future use or to hold money that is not expected to be used on a regular basis. They have pre-determined maturity date and earn fixed interest rates. An example is a term deposit.

26. Term deposits are not liquid, i.e. not callable on demand by the depositor but can be terminated before maturity, often incurring a penalty. While there is no minimum maturity period to qualify as Tier 3 deposit, terms available in the market range from seven days to five years. Most term deposits also require a minimum balance to be maintained.

Example of deposit product hierarchy operation

27. Set out below is an example of how the deposit product hierarchy operates, and a summary of the proposed deposit product hierarchy approach.

> *Deposit product hierarchy*
>
> Depositor A has $75,000 in a current account and $50,000 in a term deposit with Bank B for a total sum of $125,000.
>
> Bank B fails and depositor A is entitled to receive $100,000. Using the deposit product hierarchy, depositor A is compensated as follows:
>
> - $75,000 from the current account (full compensation) and
> - $25,000 of the term deposit (partial compensation).
>
> This means that the current account is given priority over the term deposit.

Summary of the proposed deposit product hierarchy approach

Group/Tier	Features	Deposit Product
Group A	**Transactional products**	
Tier 1	Liquid, i.e. payable at par on demand (no pre-specified maturity period or restriction imposed prior to withdrawal) Accessible, i.e. there is no limit on the number of transfers or withdrawals May or may not be interest-bearing May be accessed by electronic order or instructions or similar instruments to pay 3rd parties or transfer funds	Current accounts (call debt security, call credit union share, call building society share); on-call savings accounts or similar (rights in connection with revolving credit contract e.g. a revolving home loan or credit card contract) or similar
Tier 2	Requirement for prior notice before withdrawal or there are restrictions on the number of withdrawals per period No specified maturity period Interest-bearing subject to maintaining a minimum balance Fees or penalties may or may not apply	Notice saver accounts or similar
Group B	**Non-transactional accounts**	
Tier 3	With pre-determined maturity date Earn fixed interest rate Not liquid, i.e. not callable on demand by the depositor but may be terminated before maturity, often incurring a penalty May require a minimum balance to be maintained	Term deposits (fixed term deposit, fixed term redeemable building society share, credit union fixed term deposit product) or similar

Other considerations

Accrued interest

28. Under section 192 of the DTA, protected deposits are comprised of the principal and any accrued interest as at a particular point in time. The RBNZ's apportionment power under section 228 includes the power to apportion the compensation between principal and interest. Accrued interest is interest that has been earned by the depositor but not yet paid out.

29. In accordance with section 218 of the DTA, RBNZ may determine the amount of accrued interest by making an *estimate that is reasonable in the circumstances* if RBNZ considers that:

    (a) there is uncertainty as to the entire amount of interest that has accrued; or
    (b) the time required to ascertain the entire amount of interest that has accrued would be so long as to unduly delay the payment of compensation; or
    (c) the costs and expenses that would be incurred in the calculation made to ascertain the entire amount of interest that has accrued would outweigh the benefit of making the calculation.

30. Deposit takers have different IT configurations or manners of calculating accrued interest, for example, in some cases, interest earned in one period is re-invested to earn further interest or updated monthly or upon maturity of the deposit.

31. For a deposit taker in OBR, prioritising the principal portion in respect of calculating entitlement to compensation could reduce the complexity in unfreezing protected balances (i.e. notional DCS entitlements)[3] to enable next day access to funds.

32. We propose to prioritise the principal part of the deposit before accrued interest as this may involve less intervention or steps in the DCS calculation process (whether in liquidation or resolution), thus minimising execution risk. As such, accrued interest from all types of accounts would have a lower priority in the deposit hierarchy than Tier 3 deposit products.

Relevant arrangements

33. Relevant arrangements are arrangements where a protected deposit is held under a regulated client money or property service, or under a trust, scheme or other similar arrangement. For the purposes of the DTA, the provider of a relevant arrangement is not entitled to compensation (see section 208 of the DTA). Rather, compensation entitlement is calculated at the level of the underlying client.

34. However, deposit takers are not required to hold the 'look-through' information on these accounts. Due to the nature of relevant arrangements, it is expected that calculation of the compensation entitlement for the underlying client (the ultimate DCS beneficiary) would be slower. This is because the deposit taker does not normally have the data to identify the underlying client and will have to request further information from the service provider of the relevant arrangement.

[3] In resolution, we would generally not trigger a DCS payout (by issuing a specified event notice). As such, no entitlement to receive DCS compensation technically exists.

35. Meanwhile, section 202 of the DTA sets out the general entitlement rule as to who is entitled to compensation from the DCS fund. Calculation of an eligible depositor's entitlement includes any deposit held for or on behalf of the eligible depositor under a relevant arrangement.

36. Because of the slower process in determining the ultimate beneficiary (eligible depositor) in relevant arrangements, we propose that eligible deposits held in the name of relevant arrangement providers have a low priority in the proposed deposit hierarchy.

37. Bank captive PIEs is an exception as the deposit taker has the necessary data to determine the ultimate depositor. In this regard, the protected deposits where bank captive PIEs are invested in shall follow the proposed deposit hierarchy.

Joint accounts

38. In the case of a depositor holding joint accounts, we would be interested in views on whether individual accounts should take priority over joint accounts if both types are held. (if so, this individual account preference would likely apply within each tier of the proposed product hierarchy).

39. For example, this would mean that a term deposit (tier 3) held in the name of an individual would be prioritised over a term deposit held jointly in the name of that individual and another individual. But that individual term deposit would not be prioritised over a joint on-call savings account (tier 1) in the proposed product hierarchy.

Alternative options to adopting a deposit hierarchy policy

40. One alternative is to apportion compensation on a pro rata apportionment across all protected deposit balances. Below is an example of the pro rata approach:

Pro rata apportionment

Depositor A has $75,000 in a current account and $50,000 in a term deposit with Bank B for a total sum of $125,000.

Bank B fails and depositor A is entitled to receive $100,000 in compensation. Using the pro rata option, depositor A is compensated as follows:

- $60,000 of the current account (partial compensation representing 60% based on the share of the $75,000 in the current account to total deposits)
- $40,000 of the term deposit (partial compensation based on the share of the $50,000 in term deposit to total deposits).

41. A pro rata apportionment may be better suited to deposit insurance schemes that are of a 'paybox' nature; one with a narrow mandate limited to reimbursing depositors when an insured entity fails. There would be no pressing need to prioritise deposits in this case. Nonetheless, depositors must be paid as soon as practicable under Section 195 of the DTA.

42. By contrast, a wider mandate (such as with our DCS) includes the ability for the scheme to use its funds to support other resolution measures (aside from liquidation) such as bridge banking or purchase & assumption.[4]

43. Another policy option is to not prescribe any apportionment or hierarchy treatment for DCS deposit products. Instead, under this option we would rely on reactive ad hoc arrangements. For example, RBNZ could issue an apportionment rule as it sees fit when a specified event notice is issued. The same discretion may apply to the statutory or resolution manager when a deposit taker enters resolution.

44. However, ad hoc arrangements are unlikely to give consistent outcomes to depositors, and unlikely to support the timely calculation of DCS entitlement. This could have the potential to undermine public confidence and cause adverse impact on the credibility of the DCS.

45. We consider the following assessment principles as being the most relevant when designing an apportionment framework:

- the impact on public confidence and financial stability;
- whether the arrangements are easy to define and understand for depositors; and
- the practicality of implementation from industry's perspective.

46. Below is a summary assessment of the options.

Criteria	Option 1: Deposit product hierarchy *(preferred option)*	Option 2: Pro rata apportionment	Option 3: Ad hoc or no apportionment rule
Public confidence and financial stability	+ +	+ -	-
Arrangement easy to define and understand for depositors	+ +	+	-
Practicality of implementation from industry's perspective	+	+ -	+
Overall assessment	+ +	+ -	-

[4] Refer to the DCS contribution to resolution in section 230 of the DTA.

Engagement questions

Q1	Do you agree with the proposal to establish a protected deposit product hierarchy for apportioning compensation under the DCS?
Q2	Do you have any comments on the proposal to have two broad groups in the deposit hierarchy, namely transactional and non-transactional deposit products, based on characteristics such as liquidity and accessibility?
Q3	Do you agree with prioritising principal in the protected deposits before accrued interest when apportioning compensation under the DCS?
Q4	Do you agree to the proposed treatment of accrued interest and deposits held under relevant arrangements when apportioning compensation under the DCS?
Q5	Do you agree with individual accounts being prioritised over joint accounts within each tier of the proposed product hierarchy?

We also welcome any other feedback you may have in relation to this policy proposal.

Appendix 1

Section 228 of the Deposit Takers Act 2023

228 Bank may apportion compensation to determine respective rights and remedies

(1) This section applies if—

(a) the Bank pays compensation to, or on account of, an eligible depositor (A) in respect of 2 or more protected deposits issued by a licensed deposit taker (B); and

(b) the amount that is paid is less than the total amount referred to in section 203(1)(a).

(2) The Bank may apportion the compensation to 1 or more of the protected deposits in the manner that the Bank thinks fit.

(3) The Bank's power includes the power to apportion the compensation between principal and interest.

(4) The Bank's apportionment is binding on each relevant person, B, the Bank, and any third parties for the purposes of determining rights, obligations, and remedies in respect of the protected deposits.