New Zealand Banking Association
Te Rangapū Pēke

Submission

to the

The Reserve Bank of New Zealand - Te Pūtea Matua

on the

Crisis Management under the Deposit Takers Act 2023 Issues Paper

22 November 2024

NEW ZEALAND BANKING ASSOCIATION – TE RANGAPŪ PĒKE
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2. The following eighteen registered banks in New Zealand are members of NZBA:
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   - Kiwibank Limited
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   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Introduction

3. NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand - Te Pūtea Matua (**Reserve Bank**) on its issues paper "Crisis Management under the Deposit Takers Act 2023" (**Consultation**). NZBA commends the work that has gone into developing this document and the technical analysis supporting it.

Contact details

4. If you would like to discuss any aspect of this submission, please contact:

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- *Q1 Do you have any views on our proposed approach to implementing the crisis management framework under the DTA? Are there any factors we should, or should not, take into account when implementing the framework?*

NZBA supports general proposed approach to crisis management, but coordination, consistency and clarity are key

General support for approach

5. NZBA is generally supportive of the Reserve Bank's proposed approach to implementing a new crisis management framework.

6. We agree with the move to reflect international best practice and modernise approaches (particularly consistency with the FSB's Key Attributes (**Key Attributes**) and their compliant regimes such as Australia, the United Kingdom and Hong Kong)) – noting however our responses to question 3 in relation to contractual and statutory bail-in in the New Zealand context.

7. We also support further engagement on crisis management with members of the Council of Financial Regulators and (in relation to Group 1 deposit takers) Australian financial authorities.

Coordination, consistency and clarity are key

Implementation of Crisis Preparedness Standard

8. As noted in the Reserve Bank's concurrent Non-core Standards Consultation it is proposed that the OBR Pre-positioning Standard will be implemented in 2028, whilst the Crisis Preparedness Standard is proposed to be implemented in 2028 or 2029, and subject to a legislative backstop of July 2029.

9. We submit that the Reserve Bank should consider at an early stage how these Standards will interact, and provide guidance on this. In particular it would be helpful for industry to have an understanding of the extent to which the requirements included in the OBR Pre-positioning Standard will be moved into the Crisis Preparedness Standard, and whether, as a consequence, aspects of the OBR Pre-positioning Standard will be effectively superseded by the Crisis Preparedness Standard.

10. Given the significant work that deposit takers will need to undertake to comply with both standards we strongly encourage the Reserve Bank to avoid overlapping, conflicting or superseding requirements, particular given the gap between implementing these standards could be at most a year. This is especially so if it would otherwise result in deposit takers having to adopt a two stage approach, whereby deposit takers are required to significantly amend or build systems for an initial/temporary OBR Pre-positioning Standard to only then have to rebuild them for a Crisis Management Standard.

11. Considering these matters at an early stage should allow the Reserve Bank to avoid any potential delays in the implementation dates described above, while minimising unnecessary cost.

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Preparation of consolidated Crisis Management Standard

12. NZBA considers that the Reserve Bank should progress work on a consolidated Crisis Management Standard discussed under "Enhanced crisis preparedness" in the table below paragraph 12 of the Consultation (which should be scheduled for implementation after the mid-2028 target for the non-core standards).

13. We consider that the Crisis Management Standard should be developed as a single Standard that, as overarching principles:

    13.1. brings the current requirements together in order to reduce duplication and potential for inconsistency between the relevant Standards; and

    13.2. otherwise carries forward the substantive position with the OBR Pre-positioning Standard, Outsourcing Standard and Crisis Preparedness Standard (as well as the Operational Resilience Standard as discussed in paragraph 17). This should be used to streamline unnecessary costs involved in complying with three separate standards (OBR Pre-positioning Standard, Outsourcing Standard and Crisis Preparedness Standard), rather than creating new or substantially altered requirements.

14. To be clear, NZBA does not advocate a delay in starting work on drafting the OBR Pre-positioning Standard (or other Standards that are to be consolidated into the Crisis Management Standard) in order to have these finalised in line with the current proposed timeline (i.e. by January 2027). Rather, we submit that the Reserve Bank should bring forward the start of the work on the proposed Crisis Management Standard so that it runs in tandem with the work on the other Standards.

Coordination with regard to OBR pre-positioning and outsourcing

15. As discussed in more detail in our submissions on the OBR Pre-positioning Standard and Outsourcing Standard, as part of NZBA's submission on the consultation on non-core standards (**Non-core Standards Consultation**), NZBA considers that it is not desirable to maintain separate OBR pre-positioning, Outsourcing and Crisis Preparedness Standards in the longer term. With this in mind, any changes to OBR pre-positioning made now should be done as part of a planned shift towards a single Crisis Management Standard.

16. The Reserve Bank's work on crisis management should inform developments in OBR pre-positioning and outsourcing, and any changes to existing resolution strategies (including the extent to which they impact on outsourcing) should, wherever possible, only be made where they will be consistent with the Reserve Bank's final crisis management framework, in order to avoid unnecessary and potentially highly costly rework.

Additional comments on scope and interaction of Standards

17. We also note that footnote 255 (at paragraph 888) of the Non-Core Standards Consultation Paper outlines that the Reserve Bank will need to consider how "systematically important activities" might intersect with "critical operations" in the context of the Crisis Preparedness Standard. We would welcome the Reserve Bank providing further information on this intersection in the crisis management and crisis preparedness context, particularly given the significant changes to the deposit taking sector scheduled to occur in 2027 - 2028.

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18. Additionally, we request that the Reserve Bank clarifies the scope of the Crisis Preparedness Standard. We understand that the Reserve Bank is still considering the extent to which branches of overseas banks will be included, although it is conscious of the limited role that branches generally have in the New Zealand financial system. However the Consultation includes examples of critical functions (Box 2: Systemically important activities, page 26) which include activities that could be offered by branches. We ask that the Reserve Bank provide this clarification as soon as practical to ensure the relevant entities are able to prepare accordingly.

- *Q2 Do you have any comments on our proposed approach to dealing with distressed deposit takers under the DTA? Are there any alternative approaches we should be considering?*

More clarity on the approach to dealing with distressed deposit takers will be required in advance of resolution

Clear Reserve Bank guidance on approach to resolution

19. Under the DTA, the Reserve Bank has a very wide discretion to recommend a deposit takers be placed in resolution and the Consultation proposes that the Reserve Bank would also have very wide discretion to apply a large number of relatively complex resolution tools, once a deposit taker enters resolution. The Consultation does not include any information explaining how that discretion might be applied, including which tools might be more or less relevant for each group of deposit takers or the grounds on which the Reserve Bank might choose one tool over another (nor does the Consultation suggest that this type of guidance will be produced).

20. NZBA is concerned that the Reserve Bank's proposed approach to resolution might have adverse impacts, including:

    20.1. for some deposit takers, the efficiency and complexity impacts of having to comply with multiple regimes. This includes:

    (a) compliance across multiple standards covering similar matters and potentially overlapping requirements (as discussed above); and

    (b) requirements for deposit takers that are part of international banking groups to maintain preparations for group-led resolution (driven by the rules of the home authority, which are generally closely aligned with the Key Attributes) alongside substantially different requirements under the DTA;

    20.2. creation of unnecessary uncertainty as to which tool might be used in resolution, among deposit takers, depositors, investors and other stakeholders. Simplicity and a high-level of certainty regarding New Zealand's crisis management framework is key to attract investment to New Zealand. As a related point, the Reserve Bank should not be requiring deposit takers to pre-position for a resolution tool that will not be used for that individual deposit taker in reality; and

    20.3. increasing the risk of conflict between new and updated crisis management related standards, given the complexity and high degree of optionality

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involved, already evidenced in the historical challenges in aligning existing resolution standards.

21. NZBA strongly recommends developing (and setting out in clear guidance) a standardised approach to crisis preparedness and resolvability, repackaging continuing resolution tools with new resolution tools into a single well-aligned and harmonious resolution framework.

22. To reduce complexity and uncertainty, we recommend there be a hierarchy of resolution options, and/or a clear indication of whether the Reserve Bank's preferred resolution tool for each deposit taker is bail-in, transfer/ sale or insolvency (based on size / systemic importance) (i.e. similar to the model in the United Kingdom).

23. To the extent permitted under the DTA, we request that the Reserve Bank more closely align its crisis management framework to the Key Attributes, which provide for a crisis management framework that has:

    23.1. simple and clear crisis management objectives for both rule setting and regulatory decision making;

    23.2. clear delineation between business as usual, recovery and exit and resolution stages;

    23.3. appropriate and transparent triggers to move between stages, with the trigger for resolution being non-viability of the deposit taker;

    23.4. appropriate and ongoing engagement, detailed forward planning and testing between home and host resolution authorities; and

    23.5. detailed regulatory guidance that ensures stakeholders have a clear understanding of the basis on which home and country regulators would exercise their discretions.

Clear delineation between recovery and exit, and resolution

24. The Key Attributes provide for clear delineation between crisis management stages (being business as usual, recovery and exit and resolution). This delineation is important when determining the point at which the deposit taker enters in or out of resolution and who bears responsibility for decision making and managing the affairs of the deposit taker both before and after.

25. While the diagram in paragraph 51, Table C separately identifies all resolution tools, the Reserve Bank states elsewhere that "recovery and resolution processes are likely to overlap in practice" (para. 235).

26. It would be helpful for the Reserve Bank to confirm that it intends to treat recovery and exit and resolution as operationally separate.

Clarity on triggers for moving between stages

27. The DTA grants the Reserve Bank significant powers over a deposit taker once it enters resolution. Triggers for resolution under section 280(1)(a) of the DTA extend beyond non-viability to include circumstances where the deposit taker has:

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27.1. contravened, may have contravened, or is likely to contravene a requirement under an applicable standard, or a condition of its licence, to maintain a minimum amount (or ratio) of capital;

27.2. contravened a direction given under subpart 3;

27.3. persistently or seriously contravened any other 'prudential obligation' (extended to include AML/CFT requirements),

provided that the Reserve Bank "is satisfied that there is no reasonable prospect of the matters that apply under paragraph (a) being adequately dealt with to [its] satisfaction in a timely and orderly way other than through resolution."

28. This means that, in a number of respects, the Reserve Bank has a far greater discretion under the DTA to trigger resolution than would be found in regimes aligned to the Key Attributes (where non-viability is a pre-condition for resolution, and in some cases must be evidenced by a third-party non-viability assessment).

29. Given the Reserve Bank's wide discretionary powers, it seems essential that the Reserve Bank provides guidance regarding how it intends to exercise its discretion, particularly in circumstances where a deposit taker remains viable.

30. On a similar note, it should be made expressly clear that a direction order is not intended to automatically trigger BS11 bank separation. If such a trigger was intended, further would be needed around the resolution hierarchy having regard to BS11 bank separation and Group led resolution, and how that might work in practice under the DTA.

31. Finally, we would like to better understand the grounds on which the Reserve Bank might recommend the end of resolution under section 282.

32. Without clear guidance, we are concerned that the Reserve Bank's broad resolution powers, combined with low threshold triggers for resolution, will create significant uncertainty and a lack of market transparency for when resolution might be triggered.

Advance engagement between home and host resolution authorities

33. NZBA strongly supports the Reserve Bank's inclusion of Group led resolution as an appropriate resolution tool for foreign owned deposit takers. We also support the ongoing engagement between APRA and the Reserve Bank on crisis management (where appropriate and proportionate depending on the type and nature of deposit taker), particularly through the Crisis Management Group.

34. The Consultation refers to the 2010 Memorandum of Cooperation on Trans-Tasman Bank Distress Management between APRA and the Reserve Bank. In light of more recent changes to the FSB's crisis management framework and Australia's crisis management framework and now the Reserve Bank's own proposed changes, we are keen to understand whether APRA and the Reserve Bank have plans to revisit this Memorandum, to ensure it remains fit for purpose.

35. It would also be helpful to understand whether APRA and the Reserve Bank plan to develop institution specific cross border cooperation agreements for each key foreign owned bank (along the lines recommended under Annex 2 of the Key Attributes).

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36. We recognise that the Statement of Approach to Resolution will include information on the Reserve Bank's approach to cooperation with Australian financial authorities. However, that document will not be made available to deposit takers until mid-2029 (a full year after the DTA is expected to come into force).

Additional work required for use of bridge institution tool

37. In principle we support the potential usage of a bridge institution (as has been used in a number of international examples). However, we consider that significant additional work will be required by the Reserve Bank, as well as dedicated resourcing, in order to effectively use a bridge institution tool (consistent with the Consultation's comments at paragraphs 123 and 124). In particular, we agree that further analysis would be required on how this may be adequately capitalised, noting that any framework should not be imposed on industry at a time of likely market stress.

- *Q3 Do you agree with our assessment of the costs and benefits of a potential statutory bail-in power? Are there additional costs or benefits we should consider? Do you have any view on the need for statutory bail-in powers given the structural and contractual bail-in options are already available with the powers under the DTA?*

Any new bail-in regime needs to be carefully considered, and it is not clear that such a regime is required given New Zealand's capital requirements

New bail-in regime unnecessary in the New Zealand context

38. It is not clear that introduction of statutory bail-in (by amendment to the DTA) has any strong drivers.

39. The decisions made by the Reserve Bank during the Capital Review (resulting in banks needing to fully meet the new capital requirements in 2028) will result in New Zealand banks being extremely well capitalised by international standards.

40. Structural bail-in options are already available under the DTA (without creation of a specific Standard), and the Reserve Bank's other powers will provide for a workable resolution regime without the need to develop an additional statutory bail-in regime.

41. Further, as discussed below, we consider that any decision to expand bail-in would inevitably need to include Additional Tier 1 (**AT1**) and Tier 2 instruments. However:

    41.1. Introducing a statutory bail-in regime at this point in the overall prudential supervision review will add additional complexity to both the DTA and the features of capital instruments. This would be in contrast to one of the objectives of the Capital Review, to reduce this complexity.

    41.2. Making AT1 and Tier 2 subject to bail-in would also introduce unnecessary complexity for investor relations and the treatment of legacy (existing) AT1 and Tier 2 (as acknowledged in footnote 64 at paragraph 200 of the Consultation). The confusion this would create in the market and with investors is likely to result in unnecessary increased compliance costs (inconsistent with the principles that the Reserve Bank must take into account, as described in paragraph 48 of the Consultation). It is vital that any statutory changes do not create uncertainty for international investors

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looking to invest in New Zealand deposit takers, otherwise funding costs for the market generally will be increased and potential supply may reduce.

Bail-in cannot be adequately considered without revisiting decisions from the Capital Review

42. NZBA understands that the Reserve Bank does not intend to revisit decisions from the 2017-19 Capital Review (which determined to remove contractual bail-in mechanics from regulatory capital instruments) as part of this Consultation.

43. If the Reserve Bank does consider it necessary to introduce new bail-in requirements, we consider that the structure of regulatory capital instruments (and the Capital Review generally) must be revisited.

44. Introducing statutory bail-in and not applying it to regulatory capital instruments (as per the outcomes of the Capital Review) would effectively require a new form of 'bail-in-able' senior instrument (as discussed in paragraph 162 of the Consultation). If the Reserve Bank were to let this happen, we consider that it would have a number of undesirable consequences.

45. Such an approach would not respect the "capital stack", as it would leave existing AT1/Tier 2 instruments outstanding while using new 'bail-in-able' senior instruments to absorb losses. Notwithstanding the 'no creditor worse off' safeguard, we consider that New Zealand would be an unjustified outlier in this respect, and, accordingly, such a decision could adversely affect deposit takers' ability to issue such instruments in the financial markets.

46. Further, as a practical matter, the creation of such a 'bail-in-able' senior instrument would be redundant or inappropriate and would create unnecessary issuance costs:

    46.1. In relation to Group 1 deposit takers, international standard 'total loss absorbing capital' (**TLAC**) requirements could be met just by making New Zealand AT1 and Tier 2 instruments bail-in-able given existing ratio requirements (set by the Reserve Bank to provide that the likelihood of a deposit taker resolution is approximately 1-in-200 years), rather than creating a whole new tier of instrument that reintroduces the complexity that the Capital Review sought to remove. This could efficiently be achieved by re-introducing contractual bail-in on such AT1 and Tier 2 instruments.

    46.2. In relation to Group 2 deposit takers, we note that internationally TLAC is typically reserved for very large banks. The TLAC standard was developed by the FSB to apply to globally systemically important banks (G-SIBs) – banks many times the size of New Zealand's participants. Adopting a proportionate approach, consistent with the original development of TLAC, there is no clear need or driver to impose such bail-in on Group 2 deposit takers.

47. Moreover, given the introduction of the DCS to protect depositors, effectively only uninsured senior liabilities would remain available for statutory or contractual bail-in.

If bail-in is further considered, extensive engagement should be undertaken and the Capital Review decisions must be revisited

48. If the Reserve Bank does intend to continue exploring statutory or contractual bail-in options, then a wider, robust, cost/benefit analysis would be needed. This is especially

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so given the current high capital requirements mean that the increased benefit would be marginal, and there would be real costs involved.

49. Furthermore, given the concerns and comments discussed in this submission, and consistent with the suggestion at paragraph 202 of the Consultation and the fact that the current Consultation is preliminary by design, extensive and constructive engagement would be required with industry at a detailed level to work through the proposals and discuss all relevant issues. For instance (and without limitation):

    49.1. Clarification would be required as to whether the Reserve Bank intends to use bail-in in resolution only or whether it also might be applied in advance of resolution (the latter approach being used in Australia, and consistent with a contractual bail-in approach as discussed above);

    49.2. For overseas owned deposit takers, if Group-led resolution is the first tool used (including loss absorbing at Group level), clarity would be required as to whether bail-in of instruments from the New Zealand subsidiary would be used only if a Group-led resolution failed;

    49.3. Consideration would need to be given to features that might make bail-in instruments attractive to investors (both in New Zealand and overseas);

    49.4. Consideration should be given as to the degree to which costs of issuing bail-in might be mitigated by having regard to credit agencies' considerations; and

    49.5. Would OBR functionality (beyond customer account access) still be required if a robust bail-in framework was put in place? As a deposit taker can be placed in resolution while still solvent (e.g. at the point a (possibly high) minimum capital ratio is, or may potentially be, breached) then a tool freezing, and presumably in the future bailing-in, senior preferred creditors seems unwarranted.

- *Q4 Do you have any view on the potential new crisis preparedness requirements (i.e., recovery and exit planning, and resolvability)? If these requirements were imposed, do you have any initial comments on how they should be designed?*

Requirements to Prepare for Potential Distress and a Crisis Preparedness Standard

The Reserve Bank needs to be clear in communicating its expectations for recovery and exit planning by deposit takers

50. The proposed requirements for deposit takers to undertake recovery and exit planning during normal operations are extensive and will require significant resource. They include a requirement on deposit takers to consider an extremely wide range of potential (hypothetical) scenarios and continuously assess them in the context of a wide ranging set of potential recovery or resolution tools.

51. To support compliance and a consistent standard across industry, we ask that the Reserve Bank provide a set of crisis management scenario(s) for deposit takers to complete. It would avoid the risk of multiple crisis tests needing to be run across multiple scenarios, which could result in testing fatigue. Additionally, this would allow

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the Reserve Bank to have a consistent standard and view across industry, enabling the Reserve Bank to have a better informed holistic view of crisis preparedness across the industry.

52. Given this task the Reserve Bank should be clear in communicating its expectations for recovery and exit planning by deposit takers during normal operations, and should be seeking to actively engage with industry at the earliest convenience to gauge deposit taker capability to carry out this planning.

It is important to ensure consistency with international approaches to recovery and exit planning

53. We note the Reserve Bank's objective is to ensure that recovery and exit planning across banking groups is consistent, including the expectation that deposit takers who belong to overseas deposit-taking groups develop their local recovery and exit plan in a consistent and coordinated manner with their overseas deposit taking group.

54. In order to best enable this, we submit that (where appropriate and proportionate) the Reserve Bank should seek to align any resolvability assessments and recovery and exit planning requirements with international requirements (particularly having regard to APRA requirements in relation to the Group 1 deposit takers). This would better enable deposit takers, which are members of overseas deposit-taking groups, to ensure their group and local recovery and exit plans are consistent, therefore enabling consistent resolution approaches in a group-wide recovery scenario.

55. The Consultation states that the recovery and exit planning requirements "would mostly be principles based" (paragraph 223), which would reflect the approach taken under Key Attributes (and adopted by other FSB compliant regimes).

56. However, the essential elements described in paragraph 220 appear very specific (as opposed to principles-based). We are concerned that these are likely to result in tick box planning, as opposed to a holistic, less siloed approach to planning. Ideally, these would be reframed at a principles level.

57. We also seek clarification as to whether branches of overseas banks will need to comply with the recovery and exit planning requirements, as we currently understand that these requirements may apply to all deposit takers. We note in this regard that in Australia, APRA's equivalent standard (CPS 190: Recovery and Exit Planning) specifically excludes branches (unless otherwise determined by APRA). This is consistent with the approach taken in other international jurisdictions (for example, the UK, US and the EU) where branches are not required to provide stand-alone recovery plans.

58. We submit that requiring branches to have recovery and exit plans is unlikely to be meaningful, given that branches do not have stand-alone New Zealand capital requirements and their liquidity is often managed centrally at a parent level.

Deposit takers need more clarity on timing

59. As discussed in our response to question 1, we submit that the Reserve Bank should closely consider, at an early stage, on how the OBR Pre-positioning standard (to be implemented in 2028) is proposed to interact with the Crisis Preparedness Standard (to be implemented no more than a year later in practice). Such early consideration will be vital to ensure there are no delays in implementation, while avoiding unnecessary compliance cost.

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Resolvability

60. NZBA considers that execution risks will be significantly increased if resolution pre-positioning is spread across multiple standards.

61. The timing for the Reserve Bank's preparation of orderly resolution plans required by section 260 of the DTA are referred to in the Consultation, but the timeline remains uncertain. NZBA strongly recommends that the Reserve Bank commences this work early. The complexities and challenges of maintaining multiple standards, while seeking a high level of optionality, may only become truly clear once the Reserve Bank moves through that planning phase.

62. Further to our comments above, we believe that taking a holistic approach to identifying and prepositioning for capabilities and activities to support a range of resolution strategies is the better approach. This could be developed within a single Crisis Management Standard.

63. It will also be important to ensure that recovery and exit and resolvability planning requirements do not create a lot of unnecessary duplication of effort and information, which would have efficiency and cost implications.

Other Comments

- *Q5 Are there any other issues that we should consider when operationalising the crisis management framework under the DTA?*

64. The Consultation discusses developing the 'Sale of Business' tool (paragraph 110 onwards). If the Reserve Bank intends for deposit takers to pre-position this in their recovery and exit planning, then ultimately this would require industry-level solutions regarding customer transition and "on-boarding" matters such as AML and privacy.

65. Additionally, we would like to see the Reserve Bank consider setting up a centralised forum for deposit takers to allow fast and direct communication during a crisis event. The intention is that this would not interfere with the ability of the failing/failed entity and resolution authority to work through the crisis issues themselves. But a central communications forum would allow the rest of the industry to collaborate and respond in a more efficient and faster manner in relation to consequential issues affecting them during a crisis, qualities which are beneficial to effective crisis management.

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