

29 April 2013

Ian Woolford
Reserve Bank of New Zealand
P O Box 2498
WELLINGTON 6140

By email: ian.woolford@rbnz.govt.nz

**SUBMISSION on
Open Bank Resolution Pre-positioning Requirements Policy**

Thank you for the opportunity to make a submission. This submission is from Consumer NZ, New Zealand's leading consumer organisation. It has an acknowledged and respected reputation for independence and fairness as a provider of impartial, and comprehensive consumer information and advice.

Contact: Sue Chetwin
Consumer NZ
Private Bag 6996
Wellington 6141
Phone: 04 384 7963
Email: suzanne@consumer.org.nz

1. General comments on the Open Bank Resolution policy

1.1 Given the limited opportunities to date for consumer input into the Open Bank Resolution (OBR) policy, we have taken this opportunity to comment on the efficacy of the policy itself rather than the proposed implementation process outlined in the consultation paper.

1.2 In the absence of a deposit guarantee scheme to protect small depositors, Consumer NZ does not support the OBR policy. As proposed, we believe the policy will undermine consumer confidence in the banking system and will not achieve the stated objective.

1.3 The policy fails to recognise that the position of ordinary consumers is separate and distinct from that of the bank's owners and managers, who are ultimately responsible for the company's success or failure. The interests of consumers are also distinct from those of a bank's bondholders, who are either institutional investors or sophisticated private investors with much greater ability to assess the risks they are taking on. As small depositors, ordinary consumers are the group least well placed to assess and mitigate the risks of bank failure.

1.4 We are also concerned that the policy has been developed without adequate consultation. Given the significant financial implications for consumers, we would have expected to see targeted consultation with consumers and consumer organisations. As far as we are aware, this has not happened.

2. The case for consumer protection

2.1 The OBR policy has been advanced on the basis that it will reduce "moral hazard" by strengthening the incentives on depositors to scrutinise their bank's affairs.¹ The assumption underlying the policy, namely that consumers have the capacity to and actively use bank disclosure statements and other documents, is naive.

2.2 Many consumers understand banks to be among the safest institutions in the financial system. While the global financial crisis has highlighted that the investment decisions made by banks can entail significant risks, as small depositors, consumers are unlikely to be aware of these decisions or the risks associated with them.

2.3 Consumers therefore look to regulators to ensure the banking system is sound and that risks are managed. In our view, the OBR policy does not ensure risks are allocated appropriately. It places an unfair burden of risk on individual consumers, who are least well placed to assess and mitigate this risk.

2.4 Since the global financial crisis, regulators in other countries have recognised the need to safeguard small depositors through deposit guarantee schemes. In Australia, for example, the Financial Claims Scheme provides permanent protection up to a maximum of AU\$250,000 per person per institution.

2.5 Deposit guarantees schemes are also widely recognised by consumer organisations such as Consumers International (of which Consumer NZ is a member) as essential to maintaining consumer confidence and supporting financial stability in the event of bank failure.

2.6 Our view is that a deposit guarantee scheme is required in New Zealand. No comprehensive case has been advanced against its use and it is difficult to see a legitimate argument why consumers here should be afforded less protection than their counterparts in Australia, Europe, the US and elsewhere.

3. The risks to financial stability

3.1 The OBR policy has also been advanced on the basis that it "helps depositors" because it will allow the bank to re-open the next working day and will give customers partial access to their (unfrozen) accounts.² It is further argued that this will promote stability in the banking system. In the absence of a deposit guarantee to protect small depositors, we believe the policy could have the opposite effect.

3.2 One possibility is that customers may respond to a partial freeze of their funds by withdrawing all money that is available to them, effectively creating a "run" on

¹ Reserve Bank of New Zealand . November 2012. "Regulatory Impact Assessment of pre-positioning for Open Bank Resolution." Retrieved 17 April 2013 from <http://www.rbnz.govt.nz/finstab/banking/5014272.pdf>

² Reserve Bank of New Zealand. March 2013. "Consultation Paper: Open Bank Resolution (OBR) Pre-positioning Requirements Policy." Retrieved 17 April 2013 from <http://www.rbnz.govt.nz/finstab/banking/5175857.pdf>

the bank. Another possibility is that a rumour a bank is in difficulty could see depositors withdraw their funds to avoid a future "haircut". Both situations could have flow-on effects throughout the financial system including the possibility the "contagion" may spread to other banks. This would bring about the systemic instability the OBR is purportedly designed to avoid.

3.3 For a significant number of consumers who rely on access to their funds for the purchase of basic necessities (e.g., food, housing and utilities), a partial freeze will also have major implications. The OBR policy does not consider the impacts on these consumers and the potential flow-on effects for the welfare system.

3.4 While the policy suggests that a *de minimis* amount may be exempted from the partial freeze, this amount has not been identified. The consultation document indicates the *de minimis*, if set at all, will be at a very low level. The figure quoted in the document is \$500.

3.5 If set appropriately, the *de minimis* could be employed as an effective deposit guarantee. Our preference would be for an explicit *de minimis* to be set at a level at least comparable to that of Australia's deposit guarantee scheme. Any partial freeze would only apply to balances above this amount.

4. Adequacy of consultation

4.1 Until recent media publicity, there has been little attention given to the OBR policy. We understand the Reserve Bank has been consulting with banks for some time on the policy. However, there appears to have been little targeted consultation with consumers, one of the main groups who stand to be affected by its implementation.

4.2 Information contained in the Reserve Bank's Regulatory Impact Statement on the OBR details a range of consultation processes used to engage industry. However, we cannot identify any specific consultation processes that have sought to engage consumer organisations. This is disappointing given the obvious consumer interests at stake.

5. Recommendations

5.1 The case for the OBR policy in the absence of a deposit guarantee scheme has not been well made. We recommend the Reserve Bank not proceed with its introduction in July 2013 as proposed and consults more widely on the policy options available to achieve the desired outcome.

5.2 If the Bank elects to proceed with the policy without further consultation, we recommend a specific *de minimis* should be included in the OBR policy and that this should be set at a level at least commensurate with Australia's deposit guarantee scheme.

Yours sincerely



Sue Chetwin
Chief Executive