



TE TAI ŌHANGA
THE TREASURY

Statement of Funding Approach – Funding Strategy for the Depositor Compensation Scheme

Consultation Paper

July 2023

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How you can contribute

This public consultation provides New Zealanders with the opportunity to give their views on the funding strategy for the Depositor Compensation Scheme (DCS), that will be established by the *Deposit Takers Act 2023*.

An online form to assist you with providing written comments is available on the Treasury's website at <https://www.treasury.govt.nz/publications/consultation/statement-funding-approach-funding-strategy-depositor-compensation-scheme>. Or you can email to sofaconsultation@treasury.govt.nz. Alternatively, responses can be sent to:

Financial Markets
The Treasury
PO Box 3724
Wellington 6140

The deadline for submissions is **25 September 2023**.

We will share your submissions with the Reserve Bank of New Zealand, as it is currently publicly consulting on the related matter of the levy framework for the DCS.

You can also choose to make a submission to the Treasury directly on both this *Statement of Funding Approach* consultation paper and the Reserve Bank's *Levy Framework for the Depositor Compensation Scheme* consultation paper which we will then pass to the Reserve Bank. Please make this clear in your submission.

Current information about the *Deposit Takers Act 2023* is on the Reserve Bank of New Zealand's website at <https://www.rbnz.govt.nz/about-us/responsibility-and-accountability/our-legislation/proposed-deposit-takers-act>. Background information about the policy development process for the DCS and the Deposit Takers Bill can be found on the Treasury's website at <https://www.treasury.govt.nz/news-and-events/reviews-consultation/reviewing-reserve-bank-act/deposit-takers-bill>.

Questions about the consultation process can be sent by email to sofaconsultation@treasury.govt.nz. Following the completion of the consultation process, we intend to publish all submissions, as well as a report summarising the key messages and emerging themes. If you have any objection to your submission or parts of it being published, please state this in your submission. If you wish your submission to be anonymised, please indicate this in your submission.

Submissions and the Official Information Act 1982

Submissions received are subject to the Official Information Act 1982 (OIA). Please inform us with your submission if you have any objection to any information in the submission being released under the OIA. In particular, clearly state which part(s) you consider should be withheld, and the reason(s) for doing so.

The OIA sets out reasons for withholding information. Reasons could include that the information is commercially sensitive or that you wish us to withhold personal information, such as names or contact details. An automatic confidentiality disclaimer

from your IT system is not a reason to withhold information. Your objections will be considered when responding to requests under the OIA.

1. Executive summary

This consultation seeks your views on the funding strategy for the Depositor Compensation Scheme (DCS), which will be established by the *Deposit Takers Act 2023*.

The Act requires the Minister of Finance (the Minister) to publish a Statement of Funding Approach (SoFA) for the DCS at least every five years. The SoFA is the funding strategy for the DCS, and will set out its estimated costs, a target size for the DCS fund (if any), the timeframe to reach this target, how the fund will be invested, and a proposed approach to managing the Crown's financial position on the DCS.

This consultation paper should be read alongside the Reserve Bank's consultation paper on the levy framework for the DCS. The SoFA will set out the overall costs of the DCS that are to be recovered by a levy on deposit takers and the levy framework will set out how the DCS's costs are allocated amongst deposit takers. The Reserve Bank's consultation paper is seeking feedback on the approach to setting the levy for different deposit takers and the appropriate proxy for calculating the protected deposit base in the early years of the DCS.

This consultation paper seeks your feedback on the approach to setting the funding strategy for the DCS:

- Section 3 seeks your feedback on the objectives and decision-making principles used to guide the SoFA.
- Section 4 seeks your feedback on the conceptual approaches for funding the DCS, which are setting a target fund size and collecting *ex ante* levies, insurance-based pricing, or *ex post* levies.
- Section 5 seeks your feedback on our preferred approach of factoring in recoveries from a failed deposit taker when setting the funding strategy.
- Section 6 seeks your feedback on our preference for using a discretionary method for estimating the DCS's funding obligations.
- Section 7 seeks your feedback on the 'severe-but-plausible' failure scenarios we have used to estimate the costs to the DCS.
- Section 8 seeks your feedback on our preferred range for a target fund size, which is 0.5 to 1.1 per cent of protected deposits (or \$0.6 billion to \$1.4 billion based on the estimated current level of protected deposits).
- Section 9 seeks your feedback on a timeframe to reach the target fund size of between 10 and 20 years.
- Section 10 analyses the three options for a target fund size and timeframe and seeks feedback on your preferred option.
- Section 11 outlines the situations and considerations for when the SoFA would be revised, and whether we have missed any triggers for revising the SoFA.

- Section 12 outlines the next steps following this consultation. We will analyse submissions and prepare a full draft SoFA for a second consultation in early 2024. The DCS is expected to commence in late 2024. The Minister intends to publish a final SoFA and confirm the levy three months prior to commencement of the DCS.

2. The Treasury is seeking feedback on the funding strategy for the Depositor Compensation Scheme

1. In late 2017, the incoming Government announced an intention to review the *Reserve Bank of New Zealand Act 1989*, beginning with monetary policy arrangements. The second phase looked at the governance of the Reserve Bank of New Zealand, and matters related to prudential policy. A team of Treasury and Reserve Bank staff conducted policy work (including a three-stage consultation process) between 2018 and 2021. This led to two pieces of major reform.
2. First was the passage of the *Reserve Bank of New Zealand Act 2021*, that modernises the institutional arrangements of the Reserve Bank, provides a clearer financial policy mandate for the Reserve Bank focussed on promoting financial stability, and requires the Minister of Finance (the Minister) to issue a Financial Policy Remit to the Reserve Bank.
3. The second is the recent passage of the *Deposit Takers Act 2023* (The Act).¹ The Act deals with the framework for the regulation and supervision of banks, credit unions, building societies, and finance companies (referred to as “deposit takers”). The Act also introduces a formal scheme to protect depositors from loss, called the Depositor Compensation Scheme (DCS). The DCS will protect each eligible depositor up to \$100,000 per licensed deposit taker. The DCS fund may also be used to support a resolution of a failing deposit taker and/or compensate creditors or shareholders that are made worse off from a resolution action, relative to outcomes under a hypothetical liquidation.
4. The DCS’s costs will be funded by levies on all licensed deposit takers, that will be held in a DCS fund. If the DCS fund does not have enough money to meet its statutory obligations, the Act will require the Minister to provide public money to the fund on terms and conditions suitable to the Minister. The commitment to provide this ‘Crown backstop’ to the DCS will provide public assurance that compensation will be provided in a timely manner following the failure of a deposit taker. The Crown is expected to recover a significant portion of these funds from later in the process if a payout is triggered.² Any remaining money provided through the backstop would be recovered through the levies on the deposit-taking sector over the medium-to-long term.

¹ All references to the Deposit Takers Act in this paper are to the version published on the legislation.govt.nz website: [Deposit Takers Act 2023 No 35, Public Act Contents – New Zealand Legislation](#).

² For example, once the DCS compensates a depositor, the DCS can ‘stand in’ for the depositor during the liquidation process and receive any money owing to the depositor.

5. The Act requires the Minister to publish a Statement of Funding Approach (SoFA) at least every five years. Before publishing the SoFA, the Minister will need to consult the Reserve Bank and the public and have regard to their views. The Reserve Bank will operate, administer, and invest the DCS fund according to the requirements set by the SoFA. The SoFA will need to contain information about:
 - the likelihood of a payout event occurring (including the likelihood of using the DCS fund to contribute to a resolution measure)
 - the estimated costs of the DCS (including underlying assumptions and evidence for the estimates)
 - the target level/band for the fund (if any) and estimated timeframe to reach the target (including the underlying reasoning)
 - requirements for the investment of the fund, and
 - the proposed approach to managing the Crown's financial position in connection with the DCS, including arrangements to be prepared to provide public money to meet any deficiency in the fund.
6. The Minister must have regard to the SoFA and advice given by the Reserve Bank when making a recommendation on levy regulations to the Governor-General.
7. This consultation on the SoFA should be read alongside the Reserve Bank's consultation paper on the levy framework for the DCS. The SoFA will set out the overall costs of the DCS that are to be recovered by a levy on deposit takers and the levy framework will set out how the DCS's costs are allocated amongst deposit takers. The Reserve Bank's consultation paper is seeking feedback on the approach to setting the levy for different deposit takers and the appropriate proxy for calculating the protected deposit base in the early years of the DCS.
8. We intend to undertake public consultation on the SoFA in two stages. This first consultation focusses on the approach to building the DCS fund, the estimated costs of the fund, determining a target size of the DCS fund (if any), and a timeframe for reaching any target. A second consultation is planned for early 2024, for which we consult on a full draft of the SoFA and seek feedback on more operational aspects of the funding strategy. This will include information on the ongoing operational costs of the DCS (e.g. the DCS's administrative functions such as fund management).

3. The Deposit Takers Act sets out the objectives and principles that guide the funding strategy in the Statement of Funding Approach

9. Table 1 below contains the objectives for the DCS and the decision-making principles that will guide the development of the funding strategy in the SoFA. These are based on the levy principles in the Act (see sections, 190, 238, and 239), cost recovery guidelines, and consideration of the implications for the Crown’s balance sheet given its commitment to ‘backstop’ the DCS.

Table 1: Objectives and decision-making principles to guide the Statement of Funding Approach

Objective or principle	Explanation
The DCS has the objective of contributing towards protecting and promoting the stability of New Zealand’s financial system by protecting depositors and allowing the DCS fund to be used to support a resolution measure (public confidence).	The funding arrangements (the fund and the Crown backstop) must enable the DCS to rapidly pay out eligible depositors following failure of a deposit taker, thereby limiting incentives for depositors to run.
The DCS should be fully funded by industry over time (accountability).	The costs of the DCS should be borne by deposit takers who benefit from the DCS.
The funding strategy should aim for levies to be predictable over time (predictability).	The intended future path of levies should be well-signalled to levy-payers, along with the factors that could cause the Minister to adapt the strategy.
The DCS’s funding strategy should have regard to the impact of failures on the Crown’s balance sheet and the wider deposit-taking sector (resilience).	The funding strategy should have regard to the impact of the DCS on the volatility of the Crown balance sheet and avoid creating a need to charge large pro-cyclical levies on deposit takers after a failure.
The DCS’s funding strategy should consider the likelihood of failure, and be tailored to the nature of New Zealand’s financial system and existing and forthcoming prudential regulation (system alignment).	The DCS is part of New Zealand’s financial ‘safety net’ and intends to protect depositors following failure of a deposit taker; consideration should be given to other aspects of the ‘safety net’ that aim to reduce the likelihood of failure, such as capital requirements and prudential supervision.
The DCS’s funding strategy adopts an equitable approach to funding over the long-term (equity).	The funding strategy should aim to spread the costs of the DCS over as large a cohort as possible to avoid the costs falling disproportionately on one group at any given time.
The DCS’s funding strategy adopts an efficient approach to funding over the long-term (efficiency).	The funding strategy should ensure that levies reflect the true costs to the DCS and avoid over-charging deposit takers for the benefits they receive.

Question:

- Are there other principles that you think we should consider?

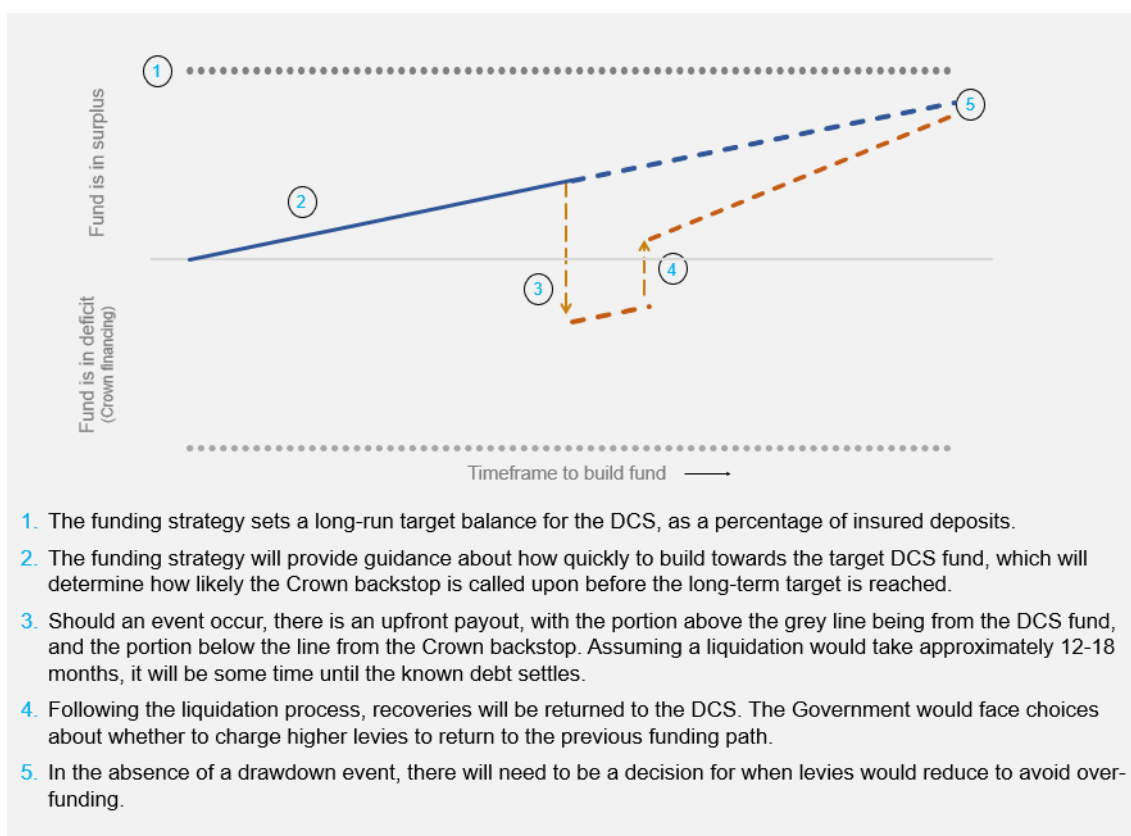
4. Conceptual approaches to the funding strategy

10. There are a number of conceptual approaches for funding the DCS, which would be consistent with the principle that the DCS is fully funded by deposit takers over time.

Target fund approach

11. As illustrated by Figure 1 below, specifying a long-term target for the fund could be a useful way to communicate the future path of levies. There are a number of design choices to be made as part of the target fund approach, including the timeframe to build towards any target, the approach to levies once the long-term target is reached, and how the use of the DCS to provide compensation to depositors would affect the future path of levies. These design choices are discussed in the following sections.

Figure 1: Illustrative path for the DCS fund under a target fund approach, with or without the failure of a deposit taker



12. A target fund approach provides the most flexible framework for charging levies before a payout event ('*ex ante* levies'). The approach would support the Government to signal its long-term intentions for funding the DCS to provide transparency to deposit takers and depositors. Moreover, the target fund approach enables the Minister to use the funding strategy to mitigate the amount of short and medium-term liquidity risk that is transferred to the Crown through the provision of the Crown backstop.

13. In calibrating the target fund approach, the Minister would need to make a risk appetite decision that strikes a balance between the efficiency and equity principles (which would imply levies that are spread over a long period) and the resilience principle (which would imply that levies are front loaded during the early years of the DCS). A target fund approach that aimed to build the fund over an extended period, regardless of any failure events, would align more closely with the traditional insurance-based model described below.
14. The target fund approach is consistent with international practice. According to a survey by the International Association of Deposit Insurers (IADI), most countries adopt a target fund approach, with 69 per cent of respondents that charge *ex ante* levies setting a target for the fund, and the remainder having a plan to set a target.³ Annex 1 outlines international practice on the various design choices required to implement the target fund approach.

Insurance based pricing

15. An alternative approach to funding a depositor compensation scheme is to use a pricing model similar to traditional insurance. Annual levies would be based on the expected costs of the DCS, consisting mainly of total payments out of the fund following a payout event, less recoveries in the medium-term. The levies would be charged indefinitely based on the underlying long-term risk, without specifying a target for the fund. This would provide a high degree of stability and predictability in levies over time, as levies would continue regardless of the size of the fund, and only increase after a payout event to the extent that it provides new risk information that alters the modelled expected losses.
16. The lack of information and data in New Zealand on the likelihood of failures makes it challenging to estimate the expected losses of the DCS and to adopt this approach. In addition, there are a number of differences between the DCS and an insurance business, including the lack of direct contracts between depositors and the DCS and the absence of a profitable business model for insuring depositors against loss.

Ex post funding

17. '*Ex post*' levies funding would rely entirely on recovering the costs of failure events from deposit takers in the years after a failure occurs. This approach would have the benefit that the costs of the failure would be known with certainty, whereas other approaches require the DCS to approximate these costs based on limited data.
18. An *ex post* approach would be inequitable because failed deposit takers would not contribute to the costs of their own resolution or liquidation, which may in turn result in excessive risk-taking ahead of a failure. The use of *ex post* levies would also initially put the cost of payout events on the Crown, and subsequent levies to recover this cost may have procyclical impacts on the economy.

³ See International Association of Deposit Insurers (IADI), 2018, "Deposit Insurance Fund Target Ratio: Research Paper", accessed at https://www.iadi.org/en/assets/File/IADI_Research_Paper_Deposit_Insurance_Fund_Target_Ratio_July2018.pdf, "Deposit Insurance Fund Target Ratio: Research Paper", p4.

19. The Government's preference is to charge levies for the DCS ahead of failures occurring. Regardless of whether the target fund or insurance approach is preferred, the calibration of the funding strategy would be revisited in successive SoFA documents, taking into account new information on risks to the DCS. However, a target fund approach would be more sensitive to the economic and financial context, and would be more consistent with levies being increased to recover the costs of failures.

Question:

- Do you agree with adopting a target fund approach to communicate the future path of levies? Why or why not?

5. The role of post-failure recoveries in the funding strategy

20. An important factor in estimating the costs of the DCS is the likely recoveries that would be made following a liquidation, that arise from the ability of the DCS to 'stand in' for the claims of protected depositors after a payout. The existence of recoveries means there is a large upfront funding obligation of the DCS in a liquidation, but a high degree of certainty that a significant proportion of that funding will be repaid through subsequent recoveries.
21. We propose that the likelihood of recoveries from the failed deposit taker should be taken into account in the funding strategy to provide confidence that the deposit-taking sector would pay, over time, levies that align with the long-run costs of operating the DCS. This means a lower target fund that would only need to meet the estimated shortfall in the fund following recoveries from the failed deposit taker. This would place greater reliance on the Crown backstop for a payout event.
22. A target fund size that does not factor in recoveries could potentially be at odds with the Treasury and Auditor-General's guidelines that levies should reflect the costs of providing the goods or services. Such an approach would also be inconsistent with the efficiency principle, as the levies charged over time would exceed the long-term costs to the DCS associated with deposit taker failures. As discussed below, the target fund size will also interact with the timeframe for reaching the target to determine how costs are allocated to deposit takers over time.
23. The DCS would still be able to meet its objectives to promptly pay out depositors in a manner that contributes to financial stability under a funding model that factored in recoveries. However, until recoveries are returned to the DCS fund, the Crown would need to backstop the DCS.

Question:

- Do you agree that the target fund size should take into account likely recoveries from failed deposit takers? Why, or why not?

Box 1: The Government will ‘backstop’ the Depositor Compensation Scheme

The Act commits the Government to lend money to the DCS if the DCS fund balance is insufficient to meet its payment obligations. The Minister may determine any terms and conditions for providing the funds to the DCS (e.g. setting an interest rate for a loan). The DCS will repay the Government with the money recovered from a failed deposit taker and through levies if the DCS fund is in deficit as a result of the payout event. Levies will re-build the DCS fund once the loan from the Government has been repaid, but the Government’s obligation for providing the backstop for any future event remains at all times.

The Government maintains a ‘liquidity buffer’ of cash and liquid, high-quality financial assets to enable it to immediately respond to unexpected events, such as economic crises. The Government currently holds \$15 billion as a buffer. The liquidity buffer is kept under review to ensure the Government can efficiently and effectively finance its obligations in different economic conditions. The Government’s obligations in connection with the DCS will be part of future reviews to ensure the buffer is sufficient.

6. Methodology for assessing the funding obligation of the DCS in severe but plausible failure scenarios

24. The Act will require the SoFA to contain “information on the likelihood of the [Reserve Bank] issuing 1 or more specified event notices during the period of the statement” (i.e. the likelihood of a deposit taker failing over the five-year period), or the likelihood of the Reserve Bank authorising an amount to be paid out of the fund to support resolution measures for a deposit taker; and estimates of the costs associated with such events.
25. Internationally, there are three broad approaches to estimating the costs of deposit insurance schemes, and determining an appropriate target for the deposit insurance fund based on these costs:
 - Statistical method – relying on statistical modelling to estimate the DCS’s loss distribution, which can be used to determine the adequate fund level.
 - Discretionary method – relying on judgements based on, for example, the features of the jurisdiction’s financial system and international best practice. Historical data may or may not be used.
 - Combination method – a combination of the above methods.⁴
26. According to a survey of depositor compensation schemes conducted by IADI, 39 per cent (17) used the discretionary method, 23 per cent (10) used the combination method, and 14 per cent (6) used the statistical method, while 25 per cent (11) did not specify the method.⁵
27. We have used the discretionary method for estimating the likelihood and costs. This choice reflects that there is limited data and information available in New Zealand to estimate the costs to the DCS. There have been very few failures in recent years of deposit takers that would provide data to estimate the likelihood of failures, and the costs to the DCS in the event of failures. The most recent are the failure of finance companies during the Global Financial Crisis.
28. Our modelling draws on the methodology in the Reserve Bank’s accompanying consultation paper to estimate the value of protected deposits affected in the failure scenarios. To estimate the size of losses for an individual deposit taker in the event of failure, we reviewed data from the United States, where individual deposit taker failures occur more frequently, and loss information is published. We also looked at data from recent failures in the European Union. For the non-bank sector, we drew on the experience under the Crown Retail Deposit Guarantee Scheme, where nine finance companies failed, causing the Crown to pay out about \$2 billion to depositors. Recoveries from the failed finance companies are estimated at about \$0.9 billion.

⁴ See IADI, 2018, “Deposit Insurance Fund Target Ratio: Research Paper”, pp 15-16.

⁵ See IADI, 2018, “Deposit Insurance Fund Target Ratio: Research Paper”, p. 17.

29. Given this lack of data on the likelihood of failures, we have chosen not to apply more formal modelling tools to estimate the size of the expected losses of the DCS. Although it would be possible to commission independent credit modelling by a third party, it is unclear that such modelling would provide better information on the likelihood and cost of failures. However, we welcome feedback on whether such modelling – which could be undertaken ahead of the second consultation – would have merit.

Questions:

- Do you agree with using the discretionary method? If not, why not? What method would you recommend and why?
- Do you think we should commission independent modelling to estimate the DCS's expected losses?

7. Using 'severe-but-plausible' failure scenarios to estimate costs to the DCS

30. Given the lack of data, our approach uses the discretionary method to estimate the likely costs to the DCS from 'severe-but-plausible' scenarios of deposit taker failures. This approach provides scope to factor in features of New Zealand's financial system (such as regulatory requirements) into the calibration of the failure scenarios. We propose to use the scenarios outlined in Table 2 as the basis for determining the target fund size.

Table 2: 'Severe-but-plausible' failure scenarios

Failure scenario	
Resolving a large deposit taker to maintain financial system stability or continuity of critical services	In this scenario, the DCS fund can contribute to a resolution, subject to a maximum contribution equal to the net cost of a hypothetical liquidation. We have assumed that a large deposit taker would be resolved and not liquidated to avoid significant damage to the financial system, consistent with the additional purposes of Part 7 of the Act ⁶
Liquidating one medium-sized bank	In this scenario, the DCS compensates depositors up to the \$100,000 limit. We have conservatively assumed that a medium-sized bank could be liquidated or placed into receivership for the purpose of estimating the potential cost to the DCS. However, the resolution authority (the Reserve Bank) may decide that resolution may be in the interest of both the deposit taker and depositors, in which case the cost to the DCS will not exceed the net cost of a hypothetical liquidation.
Widespread liquidations in the non-bank deposit-taker sector	In this scenario, the DCS compensates depositors up to the \$100,000 limit.

31. In developing these scenarios, and assessing their implications for the appropriate target fund size, we have considered a number of factors:
- Although there is a large amount of uncertainty, large- and medium-sized banks tend to be lower risk than non-bank deposit-takers. In its *Financial Stability Report* for May 2023, the Reserve Bank commented that the NBDT sector has less resilience than the banking sector.⁷ This is also consistent with the Reserve Bank's option for tailoring levies to the riskiness of deposit takers.
 - There are changes underway that are likely to strengthen the resilience of deposit takers relative to history, including the implementation of new revised capital and liquidity requirements, and the more intensive supervisory model being implemented alongside the Act. This is an important driver of why we have not considered scenarios with more widespread failures of banks in the table above.

⁶ Part 7 of the Deposit Takers Act has the additional purposes of avoiding significant damage to the financial system by maintaining the continuity of systemically important activities and by mitigating, or otherwise managing, any loss of confidence in the financial system.

⁷ Reserve Bank of New Zealand, Financial Stability Report, May 2023, p. 39, accessed at <https://www.rbnz.govt.nz/hub/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2023/may-2023/fsr-may-23.pdf>

32. We do not propose to include ‘systemic scenarios’ where multiple large banks fail. The likelihood of systemic failure scenarios is more remote than idiosyncratic ones, and there could be very large costs involved in meeting the costs of systemic scenarios through the DCS. As a result, we assess that seeking to fund systemic failure scenarios through the pre-failure levies for the DCS is not consistent with the efficiency principle, particularly given the relatively high concentration of the New Zealand financial system. In an IADI survey of 41 deposit insurance agencies, only six out of 44 (14 per cent) have set a fund target that considers systemic failure.⁸
33. The table below shows the assumed loss given default in the failure scenario (i.e. the percentage that is not recoverable from liquidation), based on evidence from the United States and European Union, as well as from New Zealand in the case of finance companies. These assumptions are for the purposes of understanding the required target fund size and should not be misinterpreted as the Treasury or the Reserve Bank’s assessment of the relative riskiness of individual deposit takers within each category.

Table 3: Assumed losses given default for different classes of deposit takers

Type of deposit taker	Assumed loss given default (per cent of total assets)
Large banks	5 – 15 per cent
Small-to-medium size banks	10 – 25 per cent
Non-bank deposit takers	25 – 50 per cent

Questions:

- Do you agree with our ‘severe-but-plausible’ failure scenarios? Are there other scenarios we should consider or modelling assumptions that are more appropriate?
- Do you agree with the assumed losses given default for the different classes of deposit taker? If not, why not? What would be an alternative approach?

⁸ See IADI, 2018, “Deposit Insurance Fund Target Ratio: Research Paper”, pp. 42-43.

8. Options for a target fund size

34. The Treasury has modelled the exposure of the DCS in the scenarios described above. We have modelled both the money required for an upfront payout and the money required to meet a shortfall in the DCS fund following recoveries from a failed deposit taker. Our assumptions are explained further below. In these scenarios, the medium-term costs to the DCS of a liquidation, or in the event that the DCS contributes to a resolution or no creditor/shareholder worse off payment, are estimated to reach up to \$3.3 billion in the event of the resolution of one of the largest five banks. The required upfront payment in the event that a payout of depositors is triggered could reach up to \$3.4 billion following the failure of a medium-sized bank.

Table 4: Funding requirements for the DCS in severe but plausible failure scenarios

Failure scenario	Funding required for upfront payout to depositors (\$ billion)	Losses after recoveries are made or following use of resolution tools (\$ billion)
Resolution of one of the largest five banks	Not estimated, given the low expected likelihood that liquidation would be used over resolution	0-3.3 The upper end is the estimated maximum contribution the DCS would make to a resolution of a deposit taker
Liquidation of one medium-sized bank	1.3-3.4	0-0.3
Widespread liquidations in the non-bank deposit taker sector	0.8-0.9	0.1-0.4

35. We are seeking feedback on the appropriateness of a target fund size in the range of **0.5 to 1.1 per cent of protected deposits**, which is estimated to be equivalent to a fund size ranging between **\$0.6 billion and \$1.4 billion** based on the estimated current level of protected deposits:
36. The lower end of this range is consistent with the approach of setting a target fund size that factors in recoveries from a failed deposit taker but would involve greater reliance on the Crown backstop. The lower end of the 0.5 to 1.1 per cent range would likely cover a material proportion of the costs of contributing to a resolution of a large bank (estimated to range between 0 and \$3.3 bn dollars). It would also enable the DCS to compensate depositors if multiple non-bank deposit takers failed (even widespread failures in the sector are estimated to cost between \$0.8 and \$0.9 bn).
37. The upper end of this range would be more likely to cover the estimated cost of contributing to the resolution of a large bank and enable the DCS to fund most of the upfront cost of paying out the depositors of a medium-sized bank (estimated to be between \$1.3 and \$3.4 bn dollars). The upper end of the range is more consistent with the approach of setting a target fund size that does not rely on the Crown backstop (although this would also depend on the timeframes for reaching the target fund size). However, if costs of contributing to a resolution of a large bank tend toward the upper end of the range in the table above, the Crown backstop will be needed to meet the shortfall in the DCS fund.

38. The proposed consultation range is broadly consistent with the typical target fund sizes adopted in OECD economies, although there is a wide range of practice. For example, some countries have significantly larger fund sizes (the United States), while others rely entirely on *ex post* funding (e.g. Australia).
39. We note that most comparable jurisdictions have 'depositor preference', which means that depositors rank ahead of other secured creditors in a liquidation. This results in higher recoveries for the depositor compensation scheme, meaning a lower target fund size as the risk of shortfalls is lower.
40. New Zealand will not have depositor preference, and this has been reflected in the proposed range for the target fund size. The Government decided not to introduce depositor preference given the impacts it would likely have on creditors and deposit takers. Although there would be benefits of a depositor preference, these would ultimately come at the cost of making other creditors worse off. A depositor preference may result in smaller deposit takers facing greater challenges attracting and retaining unprotected deposits or wholesale funding, potentially undermining competition, and diversity in the financial system. During consultation for the Review of the Reserve Bank of New Zealand Act, deposit takers also submitted that a depositor preference could increase funding costs, create complexities in resolution frameworks, and potentially significantly alter the funding profiles of some deposit-taking entities.⁹

Question:

- What is your preferred target fund size? Why?

⁹ See Regulatory Impact Statement: A New Prudential Framework for the regulation and supervision of deposit takers and the introduction of deposit insurance
<https://www.treasury.govt.nz/system/files/2021-04/rbnz-dtb-RIA-4444132.pdf>

9. Timeframe to reach target fund size

41. The timeframe for building up the DCS fund will affect the timing of costs on deposit takers, which deposit taker bears these costs, and the extent that the Crown backstop will be called on. The size of the levies would reduce once the long-term target fund size is reached. At this point, levies would reflect the DCS's ongoing operating costs, growth in eligible deposits, or any new information that suggested the DCS's costs were higher than expected.
42. A shorter timeframe to reach the target fund size (i.e. building up the DCS fund faster) would result in a lower risk that an existing deposit taker would not have contributed to the costs of its own failure. This cost would have to be met by other deposit takers (with beneficial impacts on equity). The Crown backstop would also be less likely to be called on if there is a failure in the early years of the DCS (resilience principle). On the other hand, a longer timeframe would mean that the costs of the DCS are spread over a 'larger' cohort of deposit takers that benefit from deposit protection (i.e. a more equitable outcome).
43. The timeframe to reach the target fund size may also affect the effectiveness of using a risk-based levy to reduce moral hazard risks. A moral hazard risk can arise when depositors seek higher returns from riskier deposit takers that are members of a deposit insurance scheme. The inflow of money may lead these deposit takers to make riskier investments than would otherwise be the case. Risk-based levies, where riskier deposit takers pay a higher levy rate, can push against this risk by reducing returns offered by such deposit takers. A short timeframe for building the fund may limit the DCS's ability to reduce this moral hazard risk once the target fund size is reached, but moral hazard problems will also be mitigated through prudential regulation and supervision activities.
44. We are proposing a timeframe for building the DCS fund of **between 10 and 20 years** to balance the competing considerations described above. Compared to an even longer timeframe for building the fund, the proposed approach would mitigate the amount of short- and medium-term liquidity risk borne by the Crown while the DCS fund is built and provide greater confidence that any failed deposit takers contribute to the costs of their own failure. The following section contains analysis of the impacts of the combination of target fund sizes and timeframes on deposit takers and depositors.
45. Building the target over a 10-to-20-year period is consistent with international practice. While most jurisdictions do not report a specific timeline for reaching their targets, for those that do, 10 years is the general trend. See Annex 1 for further detail on international comparisons.

Questions:

- Do you prefer a 10-, 15-, or 20-year timeframe to build up the DCS fund? Why?
- Do you prefer an alternative timeframe? Why?

10. Options analysis

46. Table 5 below provides an analysis of three possible target fund size and timeframe calibrations that are consistent with earlier sections:
- **Option A** – an approach that prioritises lower upfront costs with a target fund size of 0.5 per cent fund over 20 years.
 - **Option B** – a middle ground option with a target fund size of 0.8 per cent over 15 years.
 - **Option C** – an approach that mitigates reliance on the Crown backstop with a target fund size of 1.1 per cent over 10 years.
47. These options are assessed against the objectives and decision-making principles set out in Table 1 and compared against a status quo benchmark of *ex post* funding (reflecting that the Government has decided to introduce the DCS but the funding arrangements are yet to be determined). Some of the objectives and decision-making principles are excluded from the analysis on the basis that:
- The DCS can be fully funded even without levies being charged ahead of a failure, as long as the full cost is recovered from surviving deposit takers.
 - Any of the strategies can be well-signalled and predictable through transparent guidance in successive SoFA documents.
 - Clear communication of the availability of liquidity through the Crown backstop should support public confidence in the DCS, even if the fund is small.
48. The three proposed options are all found to outperform the benchmark of *ex post* funding, given that this approach would require the Crown to bear all the short- and medium- term liquidity risk associated with the DCS and would not take into account the non-zero likelihood of deposit taker failure(s). The preferred strategy within the consultation range depends on the weights placed on competing decision-making principles. In particular, option A performs more strongly on the efficiency and equity principles, while option C would better mitigate the impact of failures on the Crown balance sheet.

Question:

- Which of the three options do you prefer and why?

Table 5: Options analysis

	Status quo benchmark: DCS with <i>ex post</i> levies	Consultation option A: 0.5 per cent fund over 20 years	Consultation option B: 0.8 per cent fund over 15 years	Consultation option C: 1.1 per cent fund over 10 years
<p>Resilience:</p> <p>The DCS’s funding strategy should have regard to the impact of failures on the Crown’s balance sheet and the wider deposit taking sector</p>	<p>0</p> <p><i>Ex post</i> funding would require the Crown to bear all the short and medium-term liquidity risk associated with the DCS, and the DCS would repay the Crown from a combination of levies on deposit takers and recoveries from the failed deposit taker(s)</p>	<p>+</p> <p>Reduces the impact of failures on the Crown balance sheet in the short- and medium-term compared to the status quo</p>	<p>++</p> <p>After the first 15 years, would prevent the Crown bearing medium-term costs in severe but plausible failure scenarios, including the failure of one of the five largest banks</p>	<p>+++</p> <p>Would provide a buffer against the net cost of the failure of one of the largest five banks after the first 10 years of the DCS</p>
<p>System alignment:</p> <p>The DCS’s funding strategy should consider the likelihood of failure, and be tailored to the nature of New Zealand’s financial system and existing and forthcoming prudential regulation</p>	<p>0</p> <p>Levies would not be charged ahead of a failure based on the likelihood of a specified event</p>	<p>+</p> <p>Levies would fund a significant portion of the estimated cost of severe but plausible failure events, which incorporate a qualitative assessment of likelihood of failure</p>	<p>+</p> <p>Levies would broadly match the estimated cost of severe but plausible failure events, which incorporate a qualitative assessment of likelihood of failure</p>	<p>+</p> <p>Levies would provide a small buffer over and above the estimated cost of severe but plausible failure events, which incorporate a qualitative assessment of likelihood of failure</p>
<p>Equity:</p> <p>The DCS’s funding strategy adopts an equitable approach to funding over the long-term</p>	<p>0</p> <p>The cost of the DCS would be concentrated on remaining deposit takers (and their customers) following a failure</p>	<p>+++</p> <p>The costs would be spread over a larger cohort of beneficiaries of the DCS relative to the status quo and alternative consultation options</p>	<p>++</p> <p>The costs would be spread over a larger cohort of beneficiaries of the DCS than the status quo, but more frontloaded than under option A</p>	<p>+</p> <p>The costs of the DCS would be concentrated in the first 10 years, although the lower costs to surviving deposit takers following a failure offsets the negative impact on equity relative to the status quo</p>
<p>Efficiency:</p> <p>The DCS’s funding strategy adopts an efficient approach to funding over the long-term</p>	<p>0</p> <p>The levy amount would be calibrated <i>ex post</i> based on the known cost of failure events, but the absence of pricing of risks to the DCS prior to failures could result in allocative inefficiencies (due to moral hazard)</p>	<p>+</p> <p>Provides greater scope for calibrating the scale of levies over time based on actual failure events than other consultation options, while introducing pricing of risks to the DCS in normal times</p>	<p>-</p> <p>Although the levies are set based on the estimated cost of severe but plausible failure scenarios, they would probably exceed the expected cost of failures during the 15-year build-up period</p>	<p>--</p> <p>There is a greater risk that levies exceed the expected cost of failure events over time, taking into account likely recoveries made during the course of a liquidation</p>

Key:

0 same as status quo

+ better than status quo

- worse than status quo

Potential impact on deposit takers and depositors

49. Tables 6 and 7 show how the choice of timeframes to build the fund would interact with the target fund size to determine the impact on deposit takers, taking into account investment returns on the fund, deposit growth, and tax payments. Under the preferred calibrations as discussed in previous sections and indicated by the shaded cells, the levies during the build-up phase would reduce deposit taker profits by an annual average between 0.6 - 2.4 per cent (if the full cost is borne by deposit takers), or deposit rates by between 4 - 15 basis points (if the full cost is borne by *protected* depositors).
50. Ultimately, it is a commercial decision for each deposit taker to determine how to absorb the cost. The cost could be met through the deposit taker's profits or transferred to depositors through lower deposit interest rates, higher fees, or higher loan interest rates.

Table 6: Estimated impact on deposit takers of DCS levy

Levies as a percentage of covered deposits (<i>basis points</i>)					
	Target fund size (per cent of covered deposits)				
Timeframe (years)	0.25	0.5	0.8	1.1	2
10	4	7	11	15	28
15	3	5	8	11	20
20	2	4	7	9	17

Notes: The estimated costs take into account investment returns on the fund of 2 per cent, deposit growth of 6.2 per cent and the payment of tax. Blue shaded region indicates the consultation range.

Table 7: Estimated impact on deposit taker profits

Levies as a percentage of deposit taker profits (<i>per cent</i>)					
	Target fund size (per cent of covered deposits)				
Timeframe (years)	0.25	0.5	0.8	1.1	2
10	0.5	1.0	1.6	2.4	3.9
15	0.4	0.7	1.3	1.6	2.9
20	0.3	0.6	0.9	1.3	2.4

Notes: The estimated costs take into account investment returns on the fund of 2 per cent, deposit growth of 6.2 per cent and the payment of tax. Blue shaded region indicates the consultation range.

Potential impacts on the government’s balance sheet and surviving deposit takers

51. Tables 8 and 9 below illustrate how alternative combinations of target fund sizes and timeframes would affect the potential scale of the impacts on the Crown and the deposit-taking sector if one of the largest five banks were to fail 10 years after the implementation of the DCS. Although the funding requirement through the Crown backstop would fall well within the Crown’s liquidity buffer, the consultation strategies could result in the Crown carrying additional debt of between 0.47-0.76 per cent of nominal GDP over the medium-term. Alternatively, the Crown could seek accelerated repayment through *ex post* levies, which could potentially reduce banking sector profits by between 20 and 33 per cent over the subsequent five-year period.

Table 8: Estimated impact of the funding strategy on the government’s balance sheet

Resolution cost to the Crown in excess of DCS fund (per cent of nominal GDP)					
	Target fund size (per cent covered deposits)				
Timeframe (years)	0.25	0.5	0.8	1.1	2
10	0.76	0.67	0.57	0.47	0.15
15	0.79	0.73	0.66	0.59	0.38
20	0.81	0.76	0.71	0.66	0.50

Notes: For illustrative purposes, the table shows the impact of the upper end of the large bank failure scenario from Table 4. Blue shaded region indicates the consultation range.

Table 9: Estimated impact of the funding strategy on deposit takers

Resolution cost in excess of DCS fund (per cent of surviving deposit taker profits)					
	Target fund size				
Timeframe	0.25	0.5	0.8	1.1	2
10	34	30	25	20	7
15	35	32	29	26	17
20	36	33	31	29	22

Notes: In the period after the assumed failure, the profits of surviving deposit takers are assumed to be 20 percent lower than during the build-up period and are cumulative over a five-year horizon. For illustrative purposes, the table shows the impact of the upper end of the large bank failure scenario from Table 4. Blue shaded region indicates the consultation range.

11.Changes to the Statement of Funding Approach

52. The Act will require the Minister to publish the SoFA at least every five years. These regular updates will provide an opportunity to reassess the funding strategy in light of the current conditions of the economy and financial markets and any new data on the risks and costs of failures. A regular five-year update would also allow the funding strategy to incorporate new information about the risks to the DCS and take into account the economic and financial context (for example, whether levies are likely to have procyclical impacts). In addition, this approach would allow the levies to be adjusted if the target is reached sooner than expected (for example, reduce the rate of levies until an event occurs).
53. Given that there is limited evidence available to calibrate *ex ante* levies, the funding strategy would likely be reassessed following the failure of a deposit taker. In doing so, the Government would need to decide on a post-failure funding strategy that adheres to the principles in the Act and considers the shortfall in the DCS fund and the likely timeframe for any recoveries.
54. Increased levies following a failure would be consistent with returning the DCS to its long-term target over time (or under the previously anticipated timeframe) as depicted in Figure 1 and limiting the extent to which the Crown provides funds to the DCS for an extended period. However, the decision would also need to take into account the risk that additional levies could have procyclical impacts on the financial system, and the benefits of spreading the costs of the DCS over a large cohort of deposit takers that benefit.

Question:

- Do you agree with how we have described the process for updating the SoFA? Have we missed any key triggers for a review?

12. What happens next?

55. We will consider all feedback and prepare the draft SoFA for a second round of consultation in early 2024. The second consultation is expected to focus on how the operating costs of the DCS will be reflected in levies, how the fund should be invested, and the proposed operational arrangements for providing funding through the Crown backstop.
56. The DCS is expected to commence in late 2024. The Minister intends to publish a final SoFA and confirm the levy three months prior to commencement of the DCS.

Question:

- Do you have any other comments on matters covered in this discussion document?

Annex 1: International comparisons

Jurisdiction	Target fund size and signalled timeframe for reaching the target (if available)	Depositor preference	Deposits covered	Current annual premium	Establishment date
Australia	None – uses <i>ex post</i> funding	Depositor preference	\$AU250,000 per account holder per authorised institution	None – <i>ex post</i> funding	2008
Canada	Initial long-range target of 1 per cent of insured deposits within 10 to 15 years. Current near-term target of 0.85 per cent of insured deposits within 4 to 5 years	No depositor preference	\$CA100,000 per member institution for each eligible category	Not publicly available	1967
European Union	0.8 per cent of covered deposits over 10 years	Depositor preference	€100,000 aggregated amount for each depositor	Information not currently available	1994 (uniformity legislated in 2009)
Hong Kong SAR	0.25 per cent of covered deposits	Depositor preference	\$HK500,000 per depositor per scheme member	At least \$HK50,000 0.0175-0.490 per cent of deposits depending on supervisory rating	1995
Japan	0.7 per cent of insured deposits in the next 10 years (from 2022 to 2031)	No depositor preference	¥10m per depositor per financial institution	Specific Deposits: 0.021 per cent General Deposits etc: 0.014 per cent Effective rate: 0.015 per cent	1996
South Korea	As a percentage of insurable deposits, separate fund targets for – Banks: 0.825 per cent to 1.100 per cent Savings banks: 1.650 per cent to 1.925 per cent	No depositor preference	KRW50m per depositor per financial institution	Banks 0.08 per cent, Life/non-life insurance & Financial investment 0.15 per cent, Savings Bank 0.4 per cent	1996

Jurisdiction	Target fund size and signalled timeframe for reaching the target (if available)	Depositor preference	Deposits covered	Current annual premium	Establishment date
Singapore	0.3 per cent of aggregate insured deposit base of all scheme members over 10-11 years	Depositor preference	\$S75,000 aggregated amount for each depositor	Risk-based with a minimum annual premium of \$S2,500	2005
Switzerland	None – uses <i>ex post</i> funding	Depositor preference	CHF100,000 per client and bank	None – <i>ex-post</i> funding	2005
Taiwan	2 per cent of covered deposits	Depositor preference	\$NT3m per depositor per insured institution	Risk based: Banks 0.05-0.15 per cent Credit cooperatives: 0.04-0.14 per cent Other: 0.02-0.06 per cent	1985
United States	Federal Deposit Insurance Corporation (FDIC) has a long-run target of 2 per cent of insured deposits. In September 2020, the FDIC adopted a Restoration Plan to restore the reserve ratio to at least 1.35 per cent (statutory minimum) within eight years (30 September 2028)	Depositor preference	\$US250,000 per depositor per insured bank	Annual assessment rates averaged approximately 4.0 cents and 3.6 cents per \$100 of the assessment base in 2022 and 2021, respectively	1933

Source: International Association of Deposit Insurers.

Notes: Depositor preference refers to whether depositors rank ahead of other unsecured creditors in the event of a failure. By increasing recoveries, the existence of depositor preferences lowers the risk of medium-term losses to the deposit insurer.

Analysis

Target funds

The table shows that 8 out of 10 analysed jurisdictions use *ex ante* funding for their depositor compensation schemes. The exceptions are Australia and Switzerland which use *ex post* funding. Target fund size ranges from 0.25 per cent (Hong Kong SAR) to 2 per cent (USA) with a median of 1 per cent and mean of 1.14 per cent. It is notable that South Korea has set separate targets based on the risk level of banking products, with a higher target fund size for savings banks. While most jurisdictions do not report a specific timeline for reaching their targets, in those that do (e.g. Canada, the EU, Japan, Singapore), 10 years is the general trend.

According to research by the International Association of Deposit Insurers (IADI)¹⁰:

- The most common factors considered in setting the fund target are financial system structure and characteristics (e.g. number of member institutions, financial condition of member institutions, risk exposure of the deposit insurance agency, types of deposits and depositors covered, degree of concentration and loss experience of the deposit insurance agency), legal framework, and macroeconomic conditions.
- Deposit insurance agencies use different approaches in setting their fund target. Only 14 per cent use a statistical approach, with the remainder using discretion or a combination of statistical and discretion, or not specifying. Some countries specify their target fund in legislation.
- Most deposit insurance agencies conduct periodic reviews of the target.
- 66 per cent of respondents have a policy response in case of a fund surplus (i.e. where the fund exceeds target), such as reduction of premium rates or suspension of premium collection.
- 84 per cent of respondents have a policy response in the case of a fund deficit, such as an increase in premiums, a special premium, an advance on future premiums or a government capital injection.
- Only six deposit insurance agencies (14 per cent) have considered funding for failure during a systemic crisis in setting their fund target.

Deposits

The table displays a tendency towards depositor preference with seven out of ten jurisdictions ranking depositors over other unsecured creditors in the event of a failure. There is also variation in the approach to protecting deposits. Most jurisdictions protect deposits on a “per account holder, per institution” approach. Whereas the EU and Singapore are outliers covering an aggregated amount per depositor.

Annual premiums

In jurisdictions that publicly report annual premiums, all take a risk-based pricing approach with some basing this on individual risk assessments e.g. the US, Taiwan, Singapore and, Hong Kong SAR. South Korea bases the annual premium on the type of institution and Japan on the type of deposit.

¹⁰ See IADI, 2018, “Deposit Insurance Fund Target Ratio: Research Paper”.

Capital Requirements

Banking Jurisdiction	Minimum Capital Requirements	Basel III member (Y/N)
Australia	<p>The minimum Common Equity Tier 1 (CET1) capital ratio for authorised deposit-taking institutions (ADIs) is set as the 4.5 per cent internationally agreed minimum, plus a capital buffer that provides an additional cushion. These buffers make up an additional 2-4 per cent of CET1 capital.</p> <p>Capital explained APRA</p>	Y
Canada	<p>The following applies to Canada's six largest banks, known as Domestic Systemically Important Banks (D-SIBs)</p> <ul style="list-style-type: none"> • 0 per cent to 4.5 per cent - Minimum Common Equity Tier 1 Capital Requirement • 4.5 per cent to 7 per cent - Capital Conservation Buffer • 7 per cent to 8 per cent - Surcharge • 8 per cent to 11 per cent Domestic Stability Buffer (DSB) – 3 per cent effective February 1, 2023 <p>Canada reviews the DSB twice a year in June and December</p> <p>Domestic Stability Buffer (osfi-bsif.gc.ca)</p>	Y
European Union	<p>The aggregate capital requirements in 2023 are estimated at 15 per cent of risk-weighted assets (RWA), up from 14.7 per cent in 2022. The EU reviews its capital requirements yearly.</p> <p>Aggregated results of SREP 2022 (europa.eu)</p>	Y
Hong Kong SAR	<p>Banks incorporated in Hong Kong are required to maintain a CET1 capital ratio of at least 4.5 per cent, a Tier 1 capital ratio of at least 6 per cent and a total capital ratio of at least 8 per cent.</p> <p>Banking Regulation in Hong Kong: Overview Practical Law (thomsonreuters.com)</p>	Y
Japan	<p>In compliance with Basel III, International Operation Banks organised in Japan (that is, banks having branches or banking subsidiaries outside Japan) must maintain a capital ratio of at least 8 per cent. Domestic Operation Banks, although exempt from the Basel III capital adequacy standards, must maintain a capital ratio of at least 4 per cent.</p> <p>Banking Regulation in Japan: Overview Practical Law (thomsonreuters.com)</p>	Y
South Korea	<p>The Banking Act states a minimum capital requirement of KRW100 billion for a national commercial bank, or KRW25 billion for a provincial bank.</p> <ul style="list-style-type: none"> • The capital adequacy framework is in line with the Basel III capital requirements, which are a: <ul style="list-style-type: none"> • Common Equity Tier 1 (CET1) of 4.5 per cent (equities such as cash and stock). • Tier 1 of 6 per cent (instruments that are not common equity). • Total capital of 8 per cent of the risk-weighted assets at all times. <p>Banking Regulation in South Korea: Overview Practical Law (thomsonreuters.com)</p>	Y

Banking Jurisdiction	Minimum Capital Requirements	Basel III member (Y/N)
Singapore	<p>Singapore-incorporated banks which are designated as D-SIBs must meet at both solo and group levels, at a minimum:</p> <ul style="list-style-type: none"> • Common equity Tier 1 capital adequacy ratio of 6.5 per cent. • Tier 1 capital adequacy ratio of 8 per cent. • Total capital adequacy ratio of 10 per cent. <p>Singapore-incorporated banks that are not designated as D-SIBs must maintain the minimum ratios in accordance with Basel III. Singapore-incorporated banks must also hold a capital conservation buffer at and above the capital adequacy ratios set out above. This is met with common equity Tier 1 capital. This is currently 2.5 per cent.</p> <p>Banking Regulation in Singapore: Overview Practical Law (thomsonreuters.com)</p>	Y
Switzerland	<p>Non-systemic banks must have a capital of at least 10.5 per cent (that is, a minimum regulatory capital of 8 per cent plus a buffer of at least 2.5 per cent) of the risk-weighted positions; larger banks must have a total capital of at least 12.86 per cent.</p> <p>Banking Regulation in Switzerland: Overview Practical Law (thomsonreuters.com)</p>	Y
Taiwan	<p>According to Taiwan law:</p> <ul style="list-style-type: none"> • The common equity tier 1 ratio shall not be less than 7 per cent • The Tier 1 capital ratio shall not be less than 8.5 per cent • The total capital adequacy ratio shall not be less than 10.5 per cent <p>Regulations Governing the Capital Adequacy and Capital Category of Banks - Article Content - Laws & Regulations Database of The Republic of China (Taiwan) (moj.gov.tw)</p>	N
United States	<ul style="list-style-type: none"> • A minimum CET1 capital ratio requirement of 4.5 percent, which is the same for each bank • The stress capital buffer (SCB) requirement, which is determined from the supervisory stress test results and is at least 2.5 percent; and • If applicable, a capital surcharge for global systemically important banks (G-SIBs), which is at least 1.0 percent. <p>Federal Reserve Board - Annual Large Bank Capital Requirements</p>	Y
New Zealand	<p>New requirements being phased in from 2021-2028:</p> <p>By the end of 2028 all banks must meet the following minimum requirements:</p> <ul style="list-style-type: none"> • a CET1 capital ratio of 4.5 per cent • a Tier 1 capital ratio of 7 per cent • a total capital ratio of 9 per cent. <p>In addition, D-SIBS will have to maintain a prudential capital buffer (PCB) of at least 9 per cent completely made up of CET1 capital, resulting in a total capital ratio of 18 per cent. Non-D-SIBs will be required to have a PCB of at least 7 per cent completely made up of CET1 capital, resulting in a total capital ratio of 16 per cent.</p> <p>Capital requirements for banks in New Zealand - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)</p>	N

Annex 2: Glossary

Term	Definition
Crown backstop	If the Depositor Compensation Scheme (DCS) does not have enough money to meet its statutory obligations, the Act will require the Minister to provide public money to the fund on terms and conditions suitable to the Minister. The commitment to provide this is known as ‘Crown backstop’ to the DCS. It will provide public assurance that compensation will be provided in a timely manner following the failure of a deposit taker.
Deposit takers	Firms that are in the business of borrowing and lending; includes banks, credit unions, building societies, and finance companies. Deposit takers must be licensed by the Reserve Bank of New Zealand.
Deposit Takers Act (the Act)	This Act will replace the existing prudential regulatory regime contained in the Banking (Prudential Supervision) Act 1989 and the Non-bank Deposit Takers Act 2013. The integration of these previously separate regimes will create a single, consistent framework for the regulation and supervision of financial institutions that essentially engage in the same activity – the business of taking ‘deposits’ from the public, and lending to individuals, households, and businesses.
Depositor Compensation Scheme (DCS)	A scheme, established by the Act to protect deposits up to \$100,000 per eligible depositor, per licensed deposit taker, in the event of the deposit taker failing.
Ex post funding	Refers to systems in which funds to cover deposit insurance obligations are only collected from surviving banks after a bank failure (IADI 2014).
Insurance-based pricing	Similar to traditional insurance, annual levies would be based on the expected costs of the DCS, consisting mainly of total payments out of the fund following a payout event, less recoveries in the medium-term.
International Association of Deposit Insurers (IADI)	A non-profit organisation based in Switzerland, which has the goal of enhancing the effectiveness of deposit insurance systems by promoting guidance and international cooperation. IADI’s membership consists of 94 deposit insurers. See: https://www.iadi.org/en/
Liquidation	If a company cannot pay its debts, it may be put into liquidation, meaning all its unsecured assets are sold to pay creditors.
Moral hazard	With deposit insurance schemes, a moral hazard risk can arise when depositors seek higher returns from riskier deposit takers that are members of a deposit insurance scheme. The inflow of money may lead these deposit takers to make riskier investments than would otherwise be the case. Levies charged according to a deposit taker’s risk and prudential supervision can reduce moral hazard risk.

Term	Definition
No creditor or shareholder worse off (NCWO)	The Deposit Takers Act establishes a mechanism to compensate creditors or shareholders if a resolution of a deposit taker has left them worse off when compared to the expected outcomes of an ordinary liquidation.
Non-bank deposit taker (NBDT)	A non-bank deposit taker can be a credit union, building society, or finance company. NBDTs are regulated by the <i>Non-bank Deposit Takers Act 2013</i> but will be regulated under the <i>Deposit Takers Act 2023</i> in the single regulatory perimeter for deposit takers.
Prudential regulation	Regulation that aims to reduce the risk from deposit takers; regulation can be firm-specific (“micro”) or system-wide (“macro”).
Resolution	Resolution is the restructuring of a deposit taker by a resolution authority using resolution tools to safeguard public interests, including the continuity of the deposit taker’s critical functions, financial stability, and minimal costs to taxpayers. Resolution can involve another deposit taker purchasing the assets and assuming the liabilities of the failing deposit taker or transferring the assets and liabilities to a bridge bank until a buyer is found.
Risk-based levy	A levy that is charged to a deposit taker or group of deposit takers according to the risk they pose to the DCS. See the Reserve Bank’s consultation document, <i>Levy framework for the Depositor Compensation Scheme</i> for further information.
Statement of Funding Approach	The funding strategy for the DCS, and will set out its estimated costs, a target size for the DCS fund (if any), the timeframe to reach this target, how the fund will be invested, and a proposed approach to managing the Crown’s financial position in connection with the DCS.
Target fund size	An approach to funding depositor compensation in which a fund is built up to meet a target, usually expressed as a percentage of protected deposits.