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Factsheet:

A simple [factsheet](#) (PDF 110KB) on credit ratings has been developed to help investors understand credit ratings and how to use them.

Prudential regulation of NBDTs

What is an NBDT?

The Reserve Bank of New Zealand Act 1989 (the Act) refers to non-bank deposit takers (NBDTs) as “deposit takers”. In the Act, a “deposit taker” is defined as a person, other than a registered bank, that offers debt securities to the public, within the meaning of the Securities Act, and carries on the business of borrowing and lending money or providing financial services (or both).

The definition explicitly includes building societies and credit unions.

The definition will capture finance companies that raise funds from the public, as well as building societies, credit unions, and other such entities. The definition excludes issuers of collective investment schemes and finance companies and other entities that fund solely through non-public sources – e.g., those raising funds solely from related parties, or from corporate or wholesale sources. The Reserve Bank endeavours to provide general guidance on whether types of NBDTs meet the definition of deposit taker. This guidance is available from [policy positions](#).

In this website, we use either label (NBDT or deposit taker) when referring to these entities.

Who are trustees?

Under the Securities Act, a trustee is required for offers of debt securities to the public. This includes debentures issued by NBDTs. The purpose of this requirement is to provide some protection to depositors and investors, whereby an independent person (trustee) supervises the issuer’s compliance with the terms of the trust deed on behalf of depositors and investors, and has the capacity to intercede where those terms are breached.

The trustee must be either a trustee corporation or a person approved for the purpose by the Securities Commission.

What are trust deeds?

A trust deed is a private contractual agreement between a trustee and an issuer (e.g., NBDT) that forms the basis of the trustee's supervision and oversight. Trust deeds typically contain a number of covenants designed to ensure that the affairs of the issuer are managed prudently, and often include provisions relating to maximum exposure concentration, minimum capital, and liquidity requirements.

What is the objective of prudential regulation of NBDTs?

The Reserve Bank is tasked with promoting a sound and efficient financial system for New Zealand. In September 2006, the Reserve Bank released a discussion document on NBDTs, which noted that the then current regulatory arrangements for NBDTs were inadequate in several respects. The deficiencies highlighted included inconsistency in regulatory requirements and supervision across different NBDTs, the absence of minimum entry requirements for NBDTs, lack of governance requirements, and insufficient information to enable depositors to assess and compare the risks of depositing with NBDTs. Prudential regulation of this sector is aimed at raising standards and improving the sector's overall resilience to adverse market conditions in the future. Prudential regulation is not aimed at insulating individual deposit takers from failure.

Why should NBDTs be subject to prudential regulation?

The NBDT sector is an important component of the broader financial system because it provides funding to sectors of the economy that the mainstream banks often avoid, and provides alternative investment options for individuals and organisations.

NBDTs have special features that warrant a form of regulation that goes beyond that required for other debt issuers. These features include the following:

- Many NBDTs perform bank-like functions, including providing on-call or short-term deposit facilities and the provision of payments services. These functions suggest that NBDTs should be regulated in some respects in a manner similar to that applicable to banks, while still facilitating continued diversity, flexibility and competition in the NBDT sector.
- Unlike corporate bond and other debt issues, in which the funds raised are used to finance an issuer's own business, NBDTs lend to many clients. This makes it difficult for depositors to ascertain the true risk of an NBDT and provides a justification for additional prudential and disclosure-based regulation.
- NBDTs are potentially vulnerable to contagion risk, whereby the distress or failure of some NBDTs could trigger acute distress or failure in others. This suggests the need for enhancements to the standard regulation of debt issuers, such as in respect of public disclosure requirements, ratings and distress management arrangements.

Do NBDT requirements apply to all NBDTs?

If an NBDT meets the [definition of a deposit taker](#) then, unless exempted, all requirements would be expected to apply.

The Reserve Bank has the power to exempt entities or classes of entity from some or all of the NBDT requirements in circumstances where it would be unduly onerous or burdensome to apply the requirements. Exemptions may be granted on the basis of any terms and conditions that the Reserve Bank thinks fit. For further information, read about [exemptions from the NBDT regime](#).

The Reserve Bank may also recommend regulations to designate entities as NBDTs for the purposes of these regulations, where these entities are NBDTs in substance but are not captured by the definition. Similarly, the Reserve Bank can recommend regulations to designate entities as not being NBDTs for the purposes of the regulations, where these entities are captured by the definition but are not NBDTs in substance. The Reserve Bank has not made any regulations under this authority, to date.

It is unlawful for an NBDT to not comply with the requirements of the Act or regulations, unless exempted from those obligations by the Reserve Bank.

Will these prudential rules prevent future failures?

No. It is neither possible nor desirable to try to prevent institutional failure. The prudential rules are intended to improve overall standards and to make the risks and rewards of investing more transparent to investors. NBDTs will continue to be able to pursue a range of business strategies according to the risk appetite of their shareholders and investors. Ultimately, the risk of particular investments will still lie with investors.

How much time will be available for NBDTs in order to meet the requirements?

Transition periods may apply as each new element of the regime comes into effect. Additionally, exemptions granted can increase the transition period for certain entities, on application to the Reserve Bank.

Functions of the Reserve Bank and trustees

What are the functions of the Reserve Bank?

As the prudential regulator of NBDTs, the Reserve Bank is the authority that:

- prescribes minimum prudential regulatory requirements for NBDTs, in consultation with the Securities Commission;
- prescribes and monitors compliance with credit rating requirements;
- provides advice and recommendations to the Securities Commission on the performance of trustee corporations in the discharge of their NBDT supervisory functions; and

- will be responsible for monitoring compliance with governance requirements once they come into effect.

In 2007, Cabinet approved a number of additional powers for the Reserve Bank, to go into a subsequent Bill. The intention was that once a Bill containing the remaining elements of the prudential regime is passed, the Reserve Bank will be the authority that:

- applies the fit and proper requirements to NBDTs' owners (with control or significant influence), directors and senior managers;
- is responsible for monitoring compliance with governance requirements;
- has the power to intervene in distress or failure situations where the NBDT's circumstances may pose a threat to the soundness of the financial system; and
- has the power to license and (subject to appropriate checks and balances) delicense NBDTs.

All of the functions listed above are provided for in Part 5D of the Reserve Bank of New Zealand Act or will be provided for in a Bill that is expected to be introduced to Parliament in late 2010. The Bill is expected to include provisions relating to licensing, distress and failure management, changes of ownership, and imposing fit and proper requirements.

What are the functions of trustees generally?

The trustees continue to be the front-line supervisors for NBDTs. Their functions include:

- establishing a trust deed for particular offers of securities, in agreement with the NBDT;
- prescribing the financial, reporting and other covenants in the trust deed;
- ensuring that provisions in the trust deed comply with regulatory requirements, where applicable;
- enforcing trust deed covenants and supervising and monitoring NBDTs; and
- taking remedial actions in response to breaches of trust deed requirements or financial distress in an NBDT, including advising the Reserve Bank and Registrar of Companies of any material breaches of trust deed covenants or emerging financial difficulties.

Is there duplication of the functions of the Reserve Bank and trustees?

There is no duplication of function between trustees and the Reserve Bank. The Reserve Bank's responsibilities are largely limited to setting and enforcing minimum standards relating to capital, liquidity and related party exposures across the NBDT sector, and administering the credit rating regime and governance requirements. A new Bill expected to be introduced into Parliament in late 2010 will make the Reserve Bank responsible for licensing and delicensing of NBDTs, fit and proper vetting of directors, senior managers etc., and change of ownership requirements. Provision will also be made for Reserve Bank involvement in distress and failure management, where necessary, to maintain the soundness of the financial system.

The Reserve Bank is not the primary supervisor of NBDTs. It will not be involved in monitoring compliance with trust deed covenants. Nor do we expect that the Reserve Bank will be involved in the handling of NBDT distress or failure other than in the rare situation when an NBDT's circumstances may pose a risk to the soundness of the financial system. Rather, the trustees are expected to have these functions – the trustees will be the primary supervisors of NBDTs. The Reserve Bank's supervisory responsibilities will generally relate only to licensing and delicensing, fit and proper vetting, change of ownership requirements, credit rating requirements and governance.

Obligations on deposit takers and trustees

What are the existing obligations of NBDTs under Part 5D of the Reserve Bank of New Zealand Act and the Securities Act?

NBDTs are subject to the Securities Act, which requires them to have a trust deed (and therefore be supervised by a trustee corporation), a prospectus, and an investment statement. In addition, they are required to meet the [prudential obligations](#) under Part 5D of the Reserve Bank of New Zealand Act. Once prudential regulations relating to capital and related party exposures are promulgated, NBDTs and trustees must ensure that NBDT trust deeds include provisions required by those regulations. It will be a criminal offence for an NBDT to fail to comply with the regulatory requirements.

What are the obligations of trustees under Part 5D of the Reserve Bank of New Zealand Act?

Under the Act, trustees have the following obligations to the Reserve Bank:

- Trustees may be required by the Reserve Bank to attest as to the NBDT's compliance with requirements.
- Trustees are required to report material non-compliance or likely non-compliance on the part of the NBDT to the Reserve Bank.
- Trustees are required to disclose information to the Reserve Bank, if requested to do so or if they become aware of information that leads them to form an opinion that the NBDT is unable to pay its debts as they fall due, or the value of the NBDT's assets is less than the value of its liabilities, or the NBDT has breached, or is likely to breach, the terms of its trust deed, or the terms of any offer of debt securities to which the trust deed relates.

Prudential requirements for NBDTs

Do the risk management programme guidelines impose requirements?

No, the requirements in relation to risk management programmes are set out in sections 157M to 157O of the [Reserve Bank of New Zealand Act](#). The [risk management programme guidelines](#) (PDF 129KB) are intended to provide guidance on the key components of any risk management programme, and are cast in a

manner intended to accommodate the diversity of operations in the NBDT sector. NBDTs have, since 1 September 2009, been required to have, and comply with, a risk management programme.

What should happen when an NBDT gives its risk management programme to its trustee?

When a trustee receives a risk management programme from an NBDT, the trustee must satisfy itself that the programme meets the requirements set out in the legislation (section 157M(2)). However, if the trustee is not then satisfied, the trustee can ask the NBDT to amend the programme and resubmit it.

Will NBDTs need to have their risk management programme audited?

Section 157O gives the trustee the power to require an NBDT to have its programme audited at the NBDT's expense. However, the Reserve Bank expects that this power would be exercised only on rare occasions, and generally only in relation to the particular aspects of the programme that the trustee is not satisfied with (after giving the NBDT the opportunity to amend and resubmit its programme).

Powers of other regulators

What is the role of the Securities Commission?

As in the case of other aspects of trustee-based supervision (e.g., for debt issuers), the Securities Commission has responsibility for authorising and supervising trustee corporations. The Commission also has responsibility for enforcing NBDT disclosure and advertising requirements under the Securities Act 1978.

Is there an overlap or duplication in functions between the Reserve Bank and Securities Commission?

The functions of the Reserve Bank and Securities Commission are distinct and do not involve duplication of responsibility. The Reserve Bank's role relates to prudential regulation setting, while the Securities Commission's role relates to market conduct and disclosure. In order to ensure effective coordination between the Securities Commission and Reserve Bank, there are information-sharing and coordination arrangements in place.