

# Non-Bank Deposit Taking Institutions update

In August 2006, the Ministry of Economic Development released a discussion document on the non-bank deposit taking institution (NBDT) sector, seeking to address perceived inadequacies in the current regulatory arrangements. In June 2007, Cabinet released its proposal following a review of the discussion document. For the most part, the original discussion document forms the basis for Cabinet's proposal with some minor changes. The key points of Cabinet's proposal are:

- NBDTs will be *licensed* by a prudential regulator and must comply with minimum prudential, governance and "fit and proper" requirements
- NBDTs will be *supervised* by trustees under an enhanced supervision regime
- NBDTs will be required to *obtain* and publicly disclose a *credit rating*
- NBDTs will be subject to *enhanced* public disclosure obligations, and
- the Reserve Bank of New Zealand will be the prudential regulator and the Securities Commission will regulate market conduct.

## Supervision and licensing

Cabinet recommended that the existing system of NBDT supervision by trustees should remain (the earlier discussion document mooted the idea that the Reserve Bank should supervise certain NBDTs, while other NBDTs were supervised by trustees – the so-called "two tier" approach).

Submissions from the NBDT sector on the discussion document largely disliked the concept of a two-tier system of supervision. Cabinet agreed, observing that any such system could create an artificial gap in trustworthiness between "tier one" and "tier two" NBDTs because people might consider a Reserve Bank monitored NBDT to be safer than a trustee monitored one.

Accordingly, trustees will continue to be the primary supervisor responsible for responding to breaches of trust deeds and taking action where the solvency of a NBDT may be in question. Enhanced supervision powers of trustees will be set out in the second round of reforms in the review of financial products and providers which will occur later this year.

All NBDTs will be required to be licensed by a prudential regulator – the Reserve Bank – who will be required to ensure that minimum prudential, governance and "fit and proper" requirements are set and enforced. The prudential supervision will not be designed to prevent NBDT failures but the Reserve Bank will have the power to step in if the failure of a NBDT affected the financial system.

The proposed reforms will depend on the definition of "NBDTs" and "deposits" respectively. Legislation will be required for this and to determine the minimum requirements to be imposed on NBDTs.

The minimum requirements will be assessed both at the time of licensing and on an ongoing basis. These requirements are intended to

promote consistency of supervision and sound governance and risk management in the NBDT sector.

## Fit and proper management minimum requirement

"Fit and proper" requirements for:

- shareholders with significant influence or control, and
  - directors and senior management,
- will be imposed on NBDTs. These will be designed to ensure that appropriately capable and experienced people are in charge of NBDTs.

The discussion document had contemplated that trustees would supervise the "fit and proper" requirements. However, Cabinet considered the role better left to a governmental agency and the Reserve Bank's appointment to the role should result in consistency between the approach applied to the registered bank sector and the NBDT sector.

NBDTs will also be required to demonstrate that they can competently manage their affairs on a regular basis. This will be determined by the trustee responsible for a NBDT.

Cabinet indicated that these "fit and proper" requirements would be similar to those set out in the discussion document for "tier two" NBDTs. However, the discussion document was not overly detailed in this respect, and it is likely that the specific details of these requirements will not be elaborated on until regulations are drafted.

To tell us what you think of this newsletter, or to have colleagues added or yourself deleted from the mailing list, contact [moreinfo@minterellison.co.nz](mailto:moreinfo@minterellison.co.nz)

# Further information

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## Capital adequacy minimum requirement

A minimum level of capital will be required for each NBDT. The level will be determined by regulations and Cabinet will make its recommendation in late July. NBDTs will also be required to include in their trust deed a minimum capital ratio measured on a basis determined by the Reserve Bank and set out in regulations.

## Governance minimum requirement

There will be a requirement to either limit or disclose exposures to related parties.

Minimum governance requirements will be introduced, including minimum board size and composition (most likely including a requirement for a minimum number of independent directors and an independent chairman). These requirements will also be set out by Cabinet in its recommendations in July.

## Credit ratings

NBDTs will now be required to obtain and publicly disclose a credit rating. Cabinet is yet to determine how this will work but there are likely to be significant compliance costs – in the order of \$25,000 to \$35,000 or more annually.

The imposition of a requirement to obtain a credit rating is designed to increase transparency in the NBDT sector and allow investors an easy way to compare the relative riskiness of NBDTs.

Cabinet noted that the requirement to obtain and disclose a credit rating is consistent with the approach being taken with NBDTs in a number of other countries and reflects the current requirement on registered banks.

## Enhanced disclosure obligations

Enhanced public disclosure requirements will also be implemented and administered by the Securities Commission. Cabinet has indicated that this could involve risk-focused six-monthly disclosure contained in a user-friendly format. The Securities Commission will continue to be responsible for monitoring and regulating market conduct and ensuring compliance by NBDTs with the securities legislation. The Securities Commission will also likely be responsible for exempting certain NBDTs from legislative requirements where appropriate.

## Comment

It appears that the aim of the NBDT reforms is to align NBDTs with registered banks, given the close association of the business carried on by those institutions. This may make registration as a bank a more attractive proposition for some NBDTs as the disclosure, capital adequacy and credit rating obligations on NBDTs will likely be similar to those imposed on registered banks because of the choice of the Reserve Bank as the prudential supervisor.

Cabinet also noted that many of the obligations may force smaller NBDTs to amalgamate or leave the industry (which, in Cabinet's view, may not necessarily be a bad thing). Accordingly, the opportunity for larger NBDTs to acquire some of their smaller competitors is a real possibility depending on the compliance costs involved in implementing Cabinet's recommendations.

Cabinet is yet to confirm some details of its proposal and although its recommendations will not necessarily reflect the final form of any legislation in the NBDT sector, in view of the collapse of several finance companies recently, it is likely that the requirements imposed on NBDTs will be stringent – particularly if Parliament wants to increase confidence in the NBDT sector.