New Zealand backflips on statutory bail-in

By Elisa Barwick

The New Zealand cabinet announced in April 2021 it would introduce a new statutory bail-in law to protect its banking system, as demanded by the International Monetary Fund. By October, fearing its legislative reform might fail to pass with the included bail-in feature, and perhaps trigger a broader popular backlash, the proposed change was rescinded. The bail-in mechanism, an invention of the Bank for International Settlements (BIS), which re-capitalises banks by stealing bonds and deposits, is part of the sweeping changes being introduced under an ongoing review of New Zealand's monetary policy framework. Launched in 2017, the review has already seen the *Reserve Bank of New Zealand Act 2021* become law, in August last year, replacing the *Reserve Bank of New Zealand Act 1989* as the foundational legislation for monetary policy.

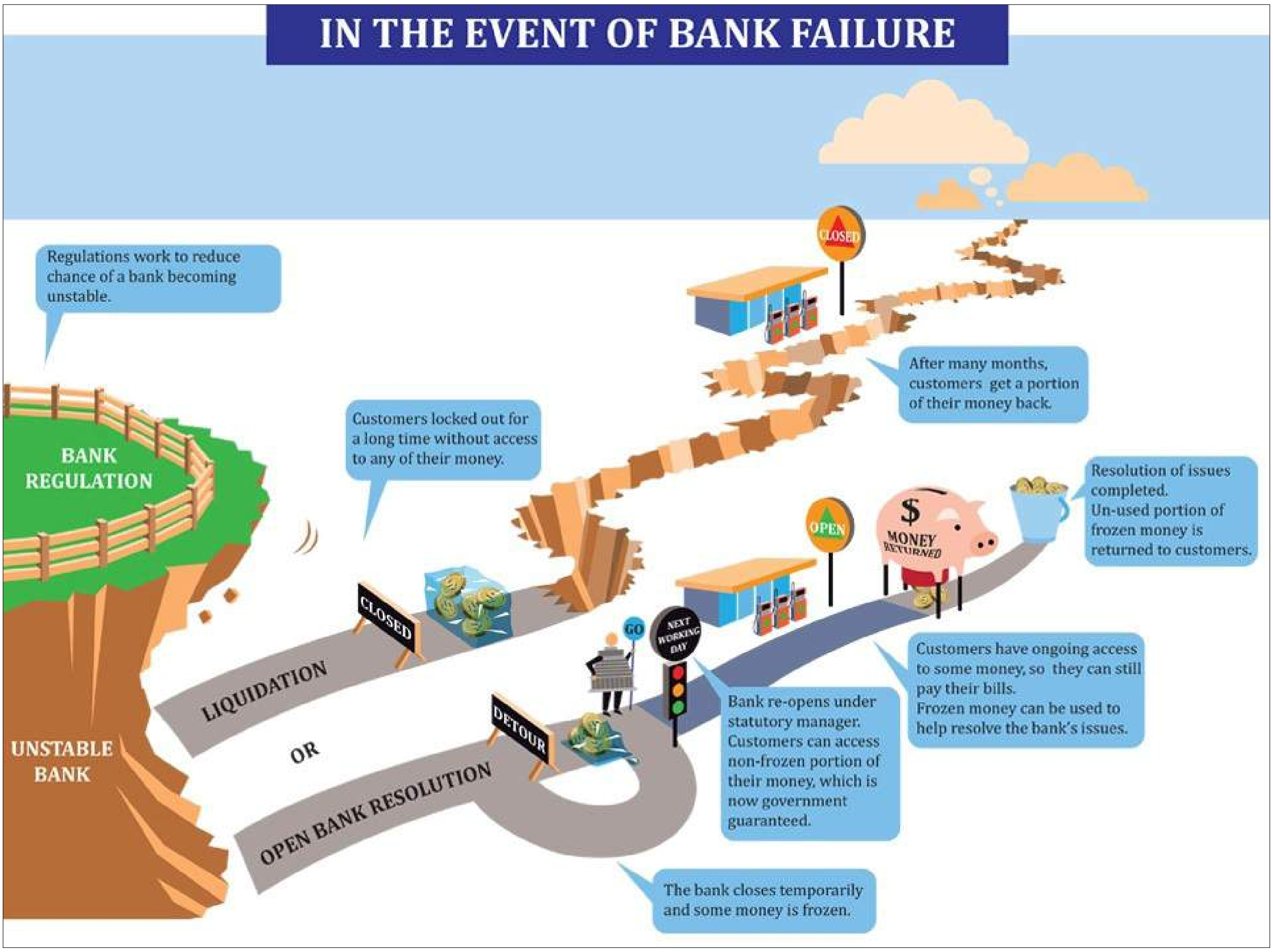
Phase one of the review included establishment of greater transparency and accountability of the monetary policy committee and its processes, and, significantly, "amending the objective of monetary policy to require us to consider maximum sustainable employment alongside price stability when making decisions on monetary policy", according to RBNZ. The 1989 Act, which delivered functional independence for RBNZ, had explicitly made *inflation* the top priority: "The primary function of the Bank is to formulate and implement monetary policy directed to the economic objective of achieving and maintaining stability in the general level of prices." This paralleled the push to deregulate and to block national credit and development in Australia described on p. 6; in fact New Zealand led the way in this agenda, as a Mont Pelerin Society model for the world.[1]

But challenging the "inflation" priority is where the useful aspects of the review end.

Phase 2 of the review replaces the 1989 Act with two new pieces of legislation: the *Reserve Bank of New Zealand Act 2021*, which sets the model for revised objectives, functions and governance, and puts a clearer, overarching focus on the bank's mandate to protect financial stability; and the *Deposit Takers Act*, which establishes a regulatory regime specifically for deposit-taking financial institutions and will include a deposit insurance scheme, guaranteeing NZ$100,000 per account. The *Deposit Takers Act* is still in the consultation phase until 21 February.[2] The new Act was to include statutory bail-in powers. Such a regime would allow liabilities to be written down or converted into worthless shares, without relying on contractual provisions laid out in the terms and conditions of particular bank liabilities (bonds or deposits).

New Zealand already has an explicit bail-in regime, called Open Bank Resolution (OBR), but it is a ministerial

1. "Nazi 'reforms' rip New Zealand—Australia next", *New Citizen*, Jan./Feb./Mar. 1997.
2. You can email a submission to dta@rbnz.govt.nz; more details are available at the RBNZ webpage on the Reserve Bank Act Review.



The RBNZ's illustration of Open Bank Resolution leaves no doubt that NZ bank deposits can be bailed in. However, the NZ government has dropped plans to enshrine bail-in in clear legislation, concerned about the backlash from the public. Photo: RBNZ direction power made at the recommendation of the RBNZ, rather than being based on legislation. It is effectively the same as a statutory power: under OBR the RBNZ can recommend bail in, and after receiving government approval, the collapsing bank is placed under statutory management and funds placed under moratorium. Envisioned as part of the *Deposit Takers Bill*, the statutory power was supposed to streamline the process. The Regulatory Impact Statement for the bill states that "The resolution [bail-in] authority needs to be independent so that it can make decisions rapidly and without any perception of inappropriate political influence."

In October, however, cabinet decided to "rescind the decisions that would have provided the Reserve Bank with a statutory bail-in power". Cabinet papers revealed the government preferred to stick to the "simple" contractual model of bail in, at least for the moment: "Full statutory bail-in powers are complex (and proper analysis and consultation could delay the passage of the DTA)", wrote the Finance Minister. "I consider they would be best looked at again after resolution strategies are advanced under the new resolution framework, if further evidence suggests that contractual bail-in and other relevant resolution powers prove inadequate."

Insurance motive

New Zealand does not have a deposit insurance safeguard but was advised by the IMF in 2017 to adopt a scheme to mitigate against bank runs by depositors panicked about having their savings bailed in. A June 2019 report, "Safeguarding the future of our financial system", part of the Reserve Bank Act review, makes clear that the deposit insurance scheme was offered to smooth the way for a broader, statutory bail in power. The report explains that "*Without explicit exclusions, deposits would be 'bail-in-able' liabilities alongside other unsecured liabilities* like non-covered bonds. [Emphasis added.] A deposit insurance scheme would therefore become an important element to protect depositors from what might otherwise be seen as an unfair imposition of losses on those who are least able to monitor and manage the risk of bank failure." (Note the implications for Australia's bail-in legislation, the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018*, which contains a loophole a mile wide, by listing the liabilities that may be bailed-in and adding, "any other instrument", which legal experts confirm could include deposits. The Citizens Party is fighting to close the loophole by adding language to explicitly exclude *all* deposits, as the RBNZ report suggests is necessary.)

In another disingenuous method observed by Australians, the same document states: "For New Zealand, one option for introducing statutory bail-in would be to provide for the general power in primary legislation, with eligible liabilities and exemptions set out in regulation, while options for the foreign enforcement of the power are developed further." Exemptions contained in a regulation can be changed without a parliamentary vote, leaving depositors at the mercy of individual ministers.

While no longer containing the statutory bail-in clause, the *Deposit Takers Bill* still takes up various aspects of the "mechanics of 'bail-in' powers" to write down or convert creditors' claims in a liquidity crisis; deposit insurance and its funding; use of deposit insurance to contribute to resolution costs; and compensation for creditors under the No Creditor Worse Off principle (compared to liquidation of the bank) as adopted across European jurisdictions.