

# Inquiry into the Financial Sector Legislation Amendment Bill 2017

## Response to Written Questions on Notice to the Senate Economics Legislation Committee

January 2018

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In response to the written questions provided on 25 January 2018, the Reserve Bank of Australia (the Bank) has prepared the following answers in relation to the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 (the Legislation). The Bank has consulted with the Australian Treasury and the Australian Prudential Regulation Authority (APRA) in the preparation of its responses and has referred to responses by those agencies where the views expressed are consistent with the Bank's views.

**1a) Can you please provide a response to issues raised in the following submissions:**

- i. Dr Wilson Sy (submission 1)**
- ii. Banking and Finance Consumers Support Association (submission 6)**
- iii. Citizen's Electoral Council (submission 11 and supplementary submission 11.1)**

Please refer to the responses to the Questions on Notice provided by Treasury (Question 1) for a response consistent with the Bank's views on this matter.

**2) Do you have any specific response to concerns raised by some submissions that APRA might, in extreme situations, have to make decisions that might promote financial stability at the cost of losses to deposit holders?**

The Bank considers it very unlikely that financial stability would be promoted by imposing losses on deposit-holders. On the contrary, depositor protection is an important element of the Australian financial system, which promotes financial stability. Even small losses to deposit holders would increase the likelihood of disruption, including potential depositor runs on other financial institutions; that is, it could lead to contagion and potential financial instability.

Further, the Legislation in the Bank's view does not imply that losses could be imposed on deposit-holders. Please refer to the responses to the Questions on Notice provided by Treasury (Questions 1, 2 and 5) for responses consistent with the Bank's view on this matter.

**2a) Can the RBA please explain clearly how the Australian approach differs from the Reserve Bank of New Zealand's "Open Bank Resolution" policy with regards to deposit holders?**

In Australia, the Financial Claims Scheme (FCS) protects depositors of authorised deposit-taking institutions (ADIs) and policyholders of general insurance companies from potential loss arising from

the failure of these institutions. Under the FCS, the Australian Government guarantees the prompt repayment of deposits at a failed Australian ADI of up to \$250 000 per depositor.

Deposits in excess of the FCS cap in Australian ADIs benefit from the legislated 'depositor preference'. Under the *Banking Act 1959*, depositors are granted a priority claim on the assets of a failed ADI ahead of other unsecured creditors (once the Government has been reimbursed for any payouts and expenses arising from the FCS).

In contrast, the Bank's understanding is that New Zealand does not have a similar mechanism to protect depositor funds. Under the Reserve Bank of New Zealand's (RBNZ) 'Open Bank Resolution' regime, the losses of a failed bank are borne first by its shareholders and then by its subordinated debtholders. Any remaining losses are then allocated proportionally across all of the bank's unsecured creditors, including its depositors. The initial response under a resolution would be that an equal share of each unsecured creditor's funds would be frozen, based on the RBNZ's conservative assessment of the bank's potential losses. Hence, even small depositors could have some portion of their funds frozen. The unfrozen portion of funds would be accessible by depositors immediately after the bank reopens on the next day; these funds would be supported by a government guarantee. Ultimately, depositors may lose some or all of their frozen deposits, subject to the final assessment of the losses incurred by the bank.

Hence, depositors in New Zealand could lose some or even all of their deposits at a failed bank in the same proportion as the other unsecured creditors of that bank. Depositors in Australia, on the other hand, are protected by depositor preference arrangements, which have been considerably strengthened with the introduction of the FCS in 2008.

**3) Can you confirm for the Committee that in the RBA's view, this Legislation does not give APRA additional power to force an ADI into a capital restructure to the detriment of retail depositors?**

In the Bank's view, the proposed Legislation does not give APRA any additional powers that could be used to the detriment of retail depositors. Please refer to the responses to the Questions on Notice provided by APRA for a discussion of the effect of the Bill on APRA's powers in relation to capital requirements and by Treasury (Question 2) for a discussion of the capacity of deposits to be treated as an instrument that could be converted or written off. Both are consistent with the Bank's views on this issue.

**4) Can you please confirm for the Committee how this Legislation assists APRA and the RBA in regulating the compliance of ADIs and insurers with the Basel III Accords?**

The Bank does not directly regulate ADIs and insurers, although it is involved in regulatory framework discussions within the Council of Financial Regulators. For replies consistent with the Bank's views on how this Legislation assists APRA in regulating the compliance of ADIs and insurers with the Basel III Accords, please refer to the responses to the Questions on Notice provided by Treasury (Question 4).

We would like to reiterate our view that this Legislation is an important step in providing APRA with the necessary powers to manage resolution of financial institutions in an orderly way that reduces the likelihood of more widespread financial instability.

Reserve Bank of Australia  
30 January 2018