



Reserve Bank of New Zealand



OBR made simple

New Zealand has a stable and healthy banking system. Bank failures are rare. However, as part of a kit of emergency tools, the Reserve Bank is introducing a process called Open Bank Resolution (OBR).



1 What is OBR?

OBR is a way of responding in the rare event of a bank failure. It provides access to depositors' funds that does not exist in a normal liquidation process, when depositors may not be able to access their accounts for extended periods. Under OBR, if a bank fails, it can be reopened the next day under statutory management. Customers have immediate access to most of their money. Under OBR, this money will be government guaranteed.

All banks incorporated in New Zealand, with more than \$1 billion in deposits, are required to prepare their IT systems for the scheme. Other registered banks may opt in. Most of the locally incorporated banks operating in New Zealand are required to prepare themselves for OBR.

2 Why is OBR important?

OBR is another tool in the emergency kit. It gives the Government options for dealing with a distressed bank. Without it, if no private sector solution can be found, then the only options are government bail-out – which can come with a hefty price tag for taxpayers – or liquidation.

With liquidation, depositors may not get access to their money until liquidators have settled the failed bank's accounts. This can take months or years. Even then, depositors will likely receive only a proportion of what they are owed.

What's more, the bank won't be operating. While a chain of shops can be shut down without causing many problems, that's not true for banks and the banking sector. A bank failure could disrupt the financial system as a whole, mainly because of the functions banks provide and their links to other entities in the financial system.

With OBR, the bank opens the next working day, customers can access most of their money in their day-to-day accounts, and financial transactions continue. Damage to the financial system is minimised.

3 What happens under OBR?

If a bank fails, it is placed under statutory management and closed. An assessment is made of the bank's liabilities. If losses cannot be covered by shareholders and the bank's available capital, then in addition a proportion of depositors' funds are set aside and frozen for the purpose. The bank re-opens next morning. Depositors can then access most of the money in their transaction and on-call savings accounts and conduct their normal business. How much of their funds depositors can access will be determined by an assessment of the bank's losses, and the amount, known as a *de minimis*, which is intended to enable depositors to conduct their daily transactions.

4 Do I get back funds frozen under OBR?

Possibly. Depositors still have a legal claim to their frozen funds as unsecured creditors, and if any money can be returned to depositors after the bank's financial situation has been worked through, it will be. It is important to note that bank losses will first be borne by the shareholders and subordinated debt holders. Only then would depositors incur a loss.

5 What about the rest of my money? Could more funds be frozen?

No. The OBR process is run only once on the failing bank. All funds that are not frozen will be subject to a government guarantee to ensure that participants in the financial system can engage with the re-opened bank, confident that transactions will be honoured.





6 Who decides to invoke OBR?

The Minister of Finance decides whether a failed bank enters into statutory management on the recommendation of the Reserve Bank. The Minister would also decide whether OBR was the appropriate option.

7 How likely is it that OBR will be used?

Bank failures are rare in New Zealand and we do not expect this to change. OBR is one of several options the Minister of Finance may use in the event of a bank failure. New Zealand's banking system is in good order and supervised by the Reserve Bank which has rules in place to ensure banks act prudently, and the Reserve Bank frequently reviews its rules to ensure they are adequate.

8 I thought banks were government guaranteed anyway?

There has never been a permanent guarantee on money in banks in New Zealand. After the Global Financial Crisis in 2008, the Government temporarily guaranteed money deposited in banks and other financial institutions, but that guarantee was withdrawn in 2011.

The Government also decided not to introduce deposit insurance. This was because it is difficult to price and blunts the incentives for both financial institutions and depositors to monitor and manage risks properly.

9 Will OBR help provide incentives for bank administrators to be more careful with their risks?

By reducing the potential for government support, OBR increases the incentives for bank management to properly conduct their business and for creditors (which includes depositors) to choose their bank carefully.

10 Will a failed bank carry on under old management?

No. Once the bank is placed under statutory management, it is unlawful for any of the bank's previous management to conduct the business of the registered bank except with the permission of the statutory manager.

11 Why not simply let a bank fail?

A liquidation remains an option. As mentioned, under normal liquidation, customers would lose access to all their money for a prolonged period.

12 Where is the safest place for my money?

Every financial decision carries risk. You may need to consult a registered financial adviser to match your investments to your willingness to take risk. To assist in assessing potential risks, the Reserve Bank publishes a *Financial Stability Report* twice a year, in May and November. Order your copy from the Reserve Bank Knowledge Centre, rbnz-info@rbnz.govt.nz or download from our website, www.rbnz.govt.nz.

The Reserve Bank has published a free book called *Upside, Downside, a Guide to Risk for Savers and Investors*, and a brochure called *Know Your Credit Ratings*, both are available from rbnz-info@rbnz.govt.nz.

For further information, go to <http://www.rbnz.govt.nz/faq/obrfaq.html>.



Glossary and further information

De minimis

A *de minimis* is a set amount of funds, determined in consultation with the Minister of Finance, that may be applied in an OBR. Depositors' funds up to the *de minimis* threshold would be exempt from being frozen.

Depositor

Someone who deposits money in a bank. Technically this means they have lent the money to the bank, and the bank is in debt to them for the amount deposited.

Liquidation

If a firm cannot meet its debts when due, it is insolvent and can be put into liquidation under the Companies Act 1993. Creditors have the right to apply for liquidation. The liquidation process involves the appointment of a liquidator, whose job it is to sell the assets of the firm to pay its debts. The business of the firm effectively ceases. Usually, there is a shortfall between the assets and the debts, meaning creditors are not paid in full.

Locally incorporated

Registered banks of a certain size (e.g., if they have retail deposits of a value of \$200 million or more) are required by the Reserve Bank to be incorporated as New Zealand companies. This is referred to as local incorporation and it means that the full suite of New Zealand company law applies to them. In contrast, companies incorporated overseas and doing business in New Zealand are known as "overseas companies". Overseas companies are primarily governed by overseas law and exempt from various aspects of New Zealand company law.

Registered bank

A registered bank is a financial institution that has applied for registration with the Reserve Bank and met the Reserve Bank's criteria for registration. The law restricts other organisations' ability to call themselves a "bank" if they have not been registered by the Reserve Bank.

Statutory management

If a bank becomes distressed, the Reserve Bank can assess the situation and may recommend to the Minister of Finance that the bank be placed under statutory management. The Minister of Finance is responsible for that decision. Statutory management means the existing management and board of the bank is replaced by an official appointed by the Government (the "statutory manager"). There is a moratorium on enforcement against the bank of its debts. The statutory manager has a number of powers to manage the bank, including the ability to transfer its assets to a new company. Statutory managers have broader objectives than a liquidator.

Further information

The Reserve Bank website contains information about how bank disclosure statements can be helpful. More information on Open Bank Resolution generally can be found on the website at <http://www.rbnz.govt.nz>