# Increasing NZ's Household Savings Rate

# Contents

"It's not what you earn that matters, it's what you save that counts"

## Objective

1. Build a measureable, long term, low risk savings scheme in addition to Kiwi Saver to increase NZ's household savings rate

## Mission

2. A 5 step program:
   2.1. **Start** – Start small - Get people started, regardless of the amount being saved
   2.2. **Habit** – Keep them going long enough to form a habit
   2.3. **Hold it** – Encourage them to keep it instead of spending it
   2.4. **Next Gen** – Help them to start their kids saving (maybe the most important step)
   2.5. **Build it** – Work on increasing the amount being saved

## Overview

3. There are four foundation stones to this proposed consumer orientated banking facility that enable the above objective:
   3.1. **Super Saver**
   A bank account that facilitates the 5 mission steps

   3.2. **Home Equity Fund**
   A facility that enables home owners to utilise the equity in their home to generate income for their retirement. It is also used to support the funding of the Super Saver scheme if/when required and provides funding for the Government Superannuation Fund

   3.3. **Consumer Deposit Insurance**
   This is insurance on consumer deposits. It is not a Government Guarantee, and is self-funded by a premium on deposits and the newly created Consumer Premium (see below). It is for the sole benefit of New Zealand consumers

   3.4. **Consumer Premium**
   An interest levy on residential mortgages to fund the Consumer Deposit Insurance scheme, and contribute to the Government Superannuation Fund

4. This program is designed to enable people that have never saved before or are having difficulty saving to start and to continue saving with an increased likelihood of retaining their savings. It also offers an alternative for those people that are unable to or do not want to invest in the higher returning but more complex markets such as shares, managed funds and property

## Start – Getting people to start regular, automatic savings

### Barriers to savings

5. The many barriers to people beginning include:
   - 5.1. Fears & what-if's:
     - a) "I might not choose the bank / scheme with the best returns over the long term"
     - b) "How do I know what's safe, or still going to be safe in 20 years' time? It might go bust & I lose my money"
     - c) ".. something happens to me or the kids & I need to get the money"
     - d) ".. I want to help the kid's - education / to buy a house / with sick grand-children"
     - e) ".. it proves not to be the best option for me & I'm locked in"
     - f) ".. I can't keep up with the savings rate in the future"
     - g) ".. I may want the money to start a business"
     - h) ".. I might make a mistake"
   - 5.2. Can't & won't:
     - a) "I can't afford to save 10% of my income", or "4% after Kiwi Saver" (or whatever target someone tries to offer, yet without some sort of target, no-one knows what to aim for)
     - b) "I won't be told what I can & can't do with my own money"
     - c) "I don't know anything about investing / share market / banks …"
   - 5.3. Not worth it:
     - a) "I can't even spare $1 per week, & if I could, what good would that possibly do. It would be embarrassing to ask to set up an automatic payment for $1 a week"
     - b) "It would never earn enough interest in a bank account, especially after you pay tax on it"
     - c) "Not safe from inflation sitting in a bank account"
     - d) "You can't beat the property market." (you probably can't, & this scheme doesn't try to, although it may be a viable alternative for some & offer some relief around the fringes of the property market)
     - e) "Every time I get a little bit saved, something crops up & I have to dip into it & I can never make it back up"
     - f) "The Government is going to change the superannuation scheme before I retire and if I have savings I'm likely to miss out on some / all of the superannuation"
     - g) "It's just too hard"
   - 5.4. For really long term savings, you are asking young people to think about something a lifetime away when, for most of us, it was hard to think past the next weekend. And for a lot of us, that doesn't change much

### Removing the barriers

6. For many people to begin to save regularly, the barriers have to be removed. It needs to be safe & simple. The Super Saver would:
   - 6.1. Be voluntary
   - 6.2. Have unrestricted access to the funds, unlike Kiwi Saver
   - 6.3. Have no minimum deposit/contribution amount or frequency

6.4. Have a bank account that:

a) Has an interest rate 2% above the CPI rate and, eventually, have a minimum rate of 6% p.a. (once adequate funding is in place to support this during periods of low interest rates as we have currently)

b) Has full replacement insurance on deposits

c) Has deferred tax

d) Has no fees

## Starting gently

7. An analogy can be drawn with exercising. It is widely recommended that we do 40 minutes of moderate exercise a day at least 4 times per week

7.1. There are, not surprisingly, also lots of barriers (excuses) as to why people can't exercise. For example:

a) "No one has 40 minutes a day spare to exercise"

b) "If you have never exercised, or haven't exercised in a long time, 40 minutes will kill you"

7.2. If you do start too hard, or exercise for too long in the beginning, not only is it really going to hurt, but the chances of you continuing are pretty remote. It might even put you off trying again in the future. There is a good reason why there are so many unfulfilled Gym memberships

7.3. The trick for a lot of people is to start gently and not to worry about whether they are doing enough to get any health benefits from it. The thing for them is to just make a start and then keep it going to build a habit. It doesn't matter to them that they may not be doing enough to make it hurt, or to break out in a sweat or that they're not going to a gym. Then, after a while, they start to increase it a tiny bit – a small amount that is hardly noticeable. For example, if they start out at 2 minutes per day and each week they increase it by 1 minute, then, even with a few "consolidation" periods along the way, they are at 40 minutes per day well within the year. They can then start increasing the intensity, again by just a tiny bit each time. They might even join a Gym and actually use it

8. Savings start the same way. It must be regular, simple, and very gentle without any regard to whether it is enough. It doesn't matter if it is $1 per week or $1,000 per week. Just start!

# Super Saver

## The Framework

9. Institutions with a market share above 5% will be eligible to participate
10. Customers would open a Super Saver account at participating institutions (banks)

11. **Interest:**
    11.1. Super Saver accounts would receive a minimum Base rate of 5% p.a.

    11.2. For those funds that have been deposited for 5 years or more, a Bonus interest rate would also apply. Therefore, bonus is based on longevity rather than being based on amount. Thus, rewarding people that keep hold of their savings

    11.3. The Bonus interest rate would be a minimum of 1% p.a.

    11.4. The Base rate plus Bonus rate is called the Deposit rate

    11.5. Interest is calculated on a daily balance with interest compounding monthly but paid annually into the Super Saver account

12. **Deferred Tax for account holders aged under 65**
    12.1. Consumers pay tax on a cash basis rather than accrual basis i.e. tax is paid on available income. You don't count the income until the "cash is in your hand". Therefore, tax is calculated when interest is received into your account, and deducted as RWT

    12.2. Based on this principle, if the Super Saver account simply accrued the interest until the customer was 65 years old, still compounding monthly, and then paid it out into the account at 65 as one lump sum, then the customer would not have had any tax to pay until they reach 65 when they received the interest payment

    12.3. However, instead of accruing the interest until the customer is 65 years old, for simplicity reasons, the Super Saver account pays interest to the account annually. However, the principle of availability still applies in that interest is not available to the customer for consumption. Therefore, no RWT is paid and the interest is not included as Income in this tax period

    12.4. Another way of thinking of it is Income Capitalisation, the opposite of Expense Capitalisation. With Expense Capitalisation, an expense incurred in one period can be deferred across multiple periods i.e. across the lifetime of the product / service. With Income Capitalisation, the income from multiple periods would be accumulated together to be made available (paid out) in a later period

12.5. Once the customer turns 65 years of age, RWT is deducted on all subsequent interest payments, as these interest payments will now be available to the customer as they are paid

12.6. The amount of tax being deferred will be insignificant in the total tax take for the Government, however, they are very significant to the individual. Not only will the tax deferral give this scheme a greater chance of success (to get people started and keeping them going) it also provides stability to the funds when savers would otherwise be chasing rates or being enticed by other asset classes like property, when they are perhaps more suited to saving rather than investing

12.7. This scheme assimilates more closely to assets such as housing, shares, art, gold etc. (at least in the public's eye) where long term capital gains aren't taxed and the full capital gain is compounded. This scheme may be attractive for some people as an alternative to these other investments as well as some other non-interest bearing asset classes. As such, any transfer from those assets to the Super Saver scheme will have little impact on the tax take and may go a small way in helping to relieve artificial price pressures in those assets which occur from time to time

12.8. By compounding the gross interest amount, a lesser interest rate is required to achieve the long term savings rate. This is especially significant the longer the period of savings. If this tax amount was not available for compounding, a higher interest rate would be required to achieve the same results, which would impact on borrowers or, if a higher rate wasn't achievable, impact on the likely success of this scheme

12.9. Tax waiver: The ultimate prize. Upon reaching 65:

a) some or all of the deferred tax on this account will be waived based on the customer's regularity of contribution history (refer to point 48 on page 22)

b) As well as encouraging people to start, this is one of the key drivers helping customer's to keep hold of their savings (mission step 3), to start their kids savings (step 4) and a driver for increasing the amount being saved (step 5)

c) It demonstrates the Government's commitment to assisting and rewarding people who make long term savings, regardless of the amount

d) Deposits that do not have their RWT waived will have RWT deducted at the customer's tax rate when the interest is withdrawn by the customer. This still has the benefit of potentially having RWT on these interest transactions deducted at a much lower rate than would have been used at the time of accumulation

12.10. Interest will be included as Income for tax purposes in the same tax period that RWT, if any, is deducted

13. **Consumer Deposit Insurance (CDI)**

13.1. Deposits into the Super Saver account would be covered by the newly created Consumer Deposit Insurance scheme. Refer to the Consumer Deposit Insurance (CDI) section on page 40 for further details

14. **No fees**

14.1. No account fees, activity fees, inactivity fees etc.

15. **Success**

15.1. Success of this savings scheme is measured by the number of people regularly saving, not the amount being saved. That comes later (Step 5 – Build it). There is no point in trying to get people to save $10p.w., or $20p.w., or 1% of their income on top of Kiwi Saver, or 4% of their income on top of Kiwi Saver, or whatever target is chosen as the savings target, if people can't even save $1p.w.

15.2. Therefore, the emphases for this scheme is placed on regular savings using automatic payments/transfers

## The hook

16. While the above is advantageous to those who already save, or have savings, it is not likely to do much with regard to increasing the level of household savings. Likewise, while the above removes many, if not most, of the barriers to saving, it is unlikely to be enough on its own to get people to start saving

17. There still needs to be a hook, to get people to start and to also increase the level of saving. For most, saving for retirement seems an insurmountable task. Therefore:

17.1. There needs to be an alternative, another reason to save, that has a simpler, more seemingly achievable goal

17.2. Something that is a gentle, small, "something" to start with and then to keep them going. Something to start them on the road to long term savings without them even realising it

17.3. Something to get people to want to set up an automatic transfer. The amount being transferred is irrelevant, & may actually work best if kept as low as possible e.g. $1 or $2 per week to get things started

17.4. The "something" is a monthly prize draw. This enables people to have another reason to start to transfer money into a savings account other than the daunting task of saving for retirement

"I'm not saving - I'm just buying a ticket in the monthly raffle"

18. The prize draw in the Super Saver scheme is called the Bonus draw and is the key to this Super Saver scheme. It addresses all 5 mission steps

18.1. It is significant enough to really get saving momentum started in the public

18.2. It has eligibility criteria to get people to set up regular savings, emphasis on frequency rather than volume

18.3. It has achievable eligibility criteria based on longevity to encourage people to keep saving, again regardless of amount, to enable a habit to form

18.4. It has criteria and restrictions in place to help people to hang on to their savings

18.5. It provides information and demonstrations that encourage people to start saving for their children / grandchildren and to get their children to begin saving

18.6. Provides an opportunity to increase the savings amount by small increments as well as providing hooks for larger increments

19. The Bonus draw will be held monthly

20. To be eligible for a bonus draw, the customer must:

20.1. Have at least 1 active Super Saver automatic transfer in place

20.2. Have had no withdrawals during the month (if under 65 years old)

21. Every $1 transferred into the Super Saver account by Super Saver automatic transfers will equate to one entry in the draw. Deposits by other means will not be eligible for the draw e.g. cash transactions, online banking, other types of transfers - even other types of automatic payments (refer below for more details on the Super Saver automatic transfer). Part dollars are not eligible

22. The draw will be held at the beginning of the month following the draw month (once any reversals have occurred) i.e. for transfers made during the month of June, the June draw will be in the first few days of July

23. There will be multiple individual bonus draws each month, with the bigger bonuses having additional saving longevity eligibility criteria. This is to encourage people to keep saving and not to withdraw it. Draws of:

| Draw | Amount | Individual's eligibility criteria | Minimum total deposit amount for month for the institution |
|---|---|---|---|
| Super Bonus 1 | $10,000 | at least the previous 5yrs | $600k in draw month<br>Multiples of $600k |
| Super Bonus 2 | $5,000 | at least the previous 2yrs | $300k in draw month<br>Then every additional $600k |
| Major Bonus 3 | $1,000 | at least the previous 12 months | $200k in draw month<br>Multiples of $200k |
| Major Bonus 4 | $500 | at least the previous 12 months | $100k in draw month<br>Multiples of $100k |
| Bonus pool | Match savings ($1,000) | At least 1 previous month | $100k in draw month<br>Multiples of $100k |

24. The eligibility criteria for the individual draws is the requirement for the Super Saver account to have had continuous deposits by a Super Saver automatic transfer (of at least 1 per fortnight) for at least the previous stated duration. There is no minimum $ value of the transfer or minimum monthly value. The $10,000 can be drawn by an account holder that has only made fortnightly $1 transfers using a Super Saver automatic transfer for 60 months prior to the draw month and, therefore, only has 2 entries in the monthly draw

25. The Minimum total deposit amount for the month is the amount of transfers for the draw month into Super Saver accounts at an institution using the Super Saver automatic transfers. The multiples enable the number of these draws to increase as the amount of the savings per month grows. For example, if for the draw month $600,000 has been transferred to Super Saver accounts using Super Saver automatic transfers, then Super Bonus 1 of $10,000 will be drawn this month. When $1.2m in Super Saver automatic transfers is reached for the month, then there will be 2 draws for Super Bonus 1 for $10k each. By this stage, the total amount of the combined bonus draws for the month will be $54,000. Note that the Super Bonus 2 of $5,000 is added to the draws at $300k, $900, $1.5m etc.
26. This Bonus draw will occur each month by each individual participating institution (bank). As it is based on monthly savings rate, banks will have a different number of bonus draws to each other due to their market share and also their customer participation rate. For the customer, however, the chance of being drawn will be roughly the same regardless of which bank they use
27. The amount for the Bonus pool will match whatever the drawn account holder has transferred to their Super Saver account during the draw month using Super Saver automatic transfers. Draws will continue for this level until the Bonus pool is exceeded, so the number of winners will vary each month for this level
28. Lots of people are willing to buy $1 & $2 scratchies & raffle tickets. Super Saver is even better as everyone is a guaranteed winner, and the minimum prize is the ticket price $1. You get to go into the "raffle" & keep your money
29. Multiplication factor based on longevity

29.1. Each bonus will be able to be multiplied based on the number of years the account holder has been contributing to their Super Saver account using the Super Saver automatic transfer. The multipliers are:

| Amount | 12yrs | 24yrs | 36yrs | 48yrs | 60yrs |
|---|---|---|---|---|---|
| (Multiplier) | x 2 | x 4 | x 8 | x 16 | x 32 |
| 10,000 | 20,000 | 40,000 | 80,000 | 160,000 | 320,000 |
| 5,000 | 10,000 | 20,000 | 40,000 | 80,000 | 160,000 |
| 1,000 | 2,000 | 4,000 | 8,000 | 16,000 | 32,000 |
| 500 | 1,000 | 2,000 | 4,000 | 8,000 | 16,000 |

a) These represent how savings, at 6%p.a., will double every 12 years. This is intended to educate & motivate to:

- Start saving as soon as possible
- Keep saving regularly so as to be eligible for the multiplier if you are drawn in a bonus draw one day
- Get the kids saving or start saving for them (into accounts in their name). Displaying the 60yr multiplier demonstrates how powerful long term savings can be, and also that to obtain a 60yr multiplier, a child needs to have savings started for them at a very young age

29.2. When an account is drawn in a Bonus draw, if they have been saving for 12 years or more, the Bonus amount is double. If they have been saving for 24 years or more, the bonus is quadrupled etc.

29.3. To be eligible for the multiplier, the account must have 3 years continuous Super Saver savings in each and every 5 year period, from the oldest existing Super Saver automatic transfer (withdrawals remove oldest deposits first, so multiplier also acts as a deterrent to withdrawals – refer to **46 Withdrawals** on page 19 for more information on withdrawals)

30. Super & Major Bonuses must be kept for the earlier of 5 years or until 65 years of age before being withdrawn

30.1. This allows time for people to witness the increase in value by a 1/3. By this time, hopefully, they will realise that another 7 years & the bonus will have doubled. They will also realise that as it will be the oldest deposit(s) that will be withdrawn first if they make a withdrawal, it will likely effect their multiplier if they were to win another Bonus in the future as well as their tax exemption eligibility. It also gets them over the initial excitement of winning & the desire to spend it immediately

30.2. Bonuses may be transferred to any other Super Saver account, but must be kept for 5 years in the transferee account regardless of that account holder's age. The transferring of a Bonus is treated differently than a withdrawal. Unlike a withdrawal, the bonus transfer does not withdraw from the oldest transaction first, only the bonus transaction is effected. Therefore, transferring a bonus does not effect the saving age related history nor is it classed as a withdrawal, so does not effect eligibility to the monthly prize draw or tax redemption eligibility calculation. The deposit in the transferee account appears as a standard deposit other than being restricted from being withdrawn for 5 years. All other transfers from a Super Saver account are treated as per withdrawals

31. Super Bonus draws first, followed by Major Bonus draws and then Bonus draws

31.1. Those account holders that meet the Bonus level criteria, if any, are entered for the draw

31.2. Draws are made while eligible account holders exist and Bonuses for that level remain

31.3. Account holders that are drawn are not included in any of the remaining draws at any level i.e. an account holder can only receive one Bonus regardless of the number of entries (amount of transfers) they had during the month

32. Draw results are emailed to all Super Saver account holders each month

32.1. This is an opportunity to provide information, promotion & motivation

32.2. Super & Major Bonus winners are used as examples for promotion & motivation. No names, just age in years (used to show how many years to retirement), location (town/city) based on physical address (so people are able to relate better), the amount of the bonus, the multiplier if used, and how much the bonus will be worth when they reach 65. It is important that this is done as low key as possible i.e. no attempt to sell anything to the customer or to try to get them to increase their savings amount. This is purely motivational & team building

32.3. The number of Bonus pool customers is reported

32.4. The Bonus draws are imperative to keep motivation up so as to keep people saving. The downside of regular long term savings is that it takes a very long time to see the benefits, especially when starting out small. Emailing savers monthly helps to keep momentum, and by having results to email out each month is a good reason for this contact and the results demonstrate the immense power of Time & Compound Interest

32.5. Pledges are used as a tool to encourage customers to increase their savings rate

a) Bonus draws are added as the monthly savings rate increase. Using the online banking facility, the customer can pledge an amount to increase their Super Saver automatic transfer by. Once the total of the combined monthly savings rate plus pledged amounts reach the threshold amount required to invoke the next level of bonus draw, the pledges are automatically applied to the Super Saver auto transfers. Thus the savings rate is increased and the next layer of bonus draw is invoked

b) The email each month detailing the Bonus draw results can also include a chart showing the current monthly savings rate (total of monthly Super Saver automatic transfers) and the total amount pledged against the threshold for the next bonus level. The customer can then decide if they want to make a pledge

32.6. Information can also include details like the age of the youngest customer to join during the month, with the corresponding charts to show how much the Super Saver account will grow by age 65 at different savings rate e.g. $1p.w, $2p.w. $5p.w., possibly what the recommended target amount is (if a target amount can be agreed upon) & what the savings rate will need to be to reach the same amount at 65 if starting is delayed until 20, or 30 or 40. Again, informational, to enable people to make choices

## Super Saver automatic transfer (SSat)

33. The Super Saver automatic transfer must:

33.1. Be as easy as possible to set up e.g.

a) Check boxes for $1, $2, $5, $10, $20 and Other (which can be specified by the customer)

- The $1 option reinforces that saving $1 is completely acceptable and encouraged. No more than $20 as a check box so as not to intimidate
- This is also key to encouraging young people and new entrants to the work force to start a regular savings habit – even if $1 per week

b) Check boxes for weekly or fortnightly
No other frequencies, as it needs to be regular to reinforce the habit. It also ensures, by default, a minimum average savings rate of $2.16 per month instead of $1 per month

c) The SSat will automatically adjust for CPI annually. At a minimum, the savings amount needs to be increased in line with inflation when saving long term. This will be superseded when the customer embraces step 5 – Build it, and increases the savings of their own accord. Inflation = death to savings if the interest rate or savings amount doesn’t keep up with inflation

d) Check boxes for CPI rounding up to the nearest 20cents (default), 50cents, $1, and $5

While on the surface this appears to be a nice house keeping function to keep the savings amount to nice round numbers, it subtly increases the regular savings amount for those starting out at the lower end of the savings rate

e) Have a start date input field but no end date or duration field
Demonstrates that this is intended as a long term savings plan

f) Ideally it would be able to be set-up & modified through on-line banking without having to go into a branch. However, to reduce the amount or cancel the automatic transfer, the customer must request in writing (not electronic) or go into a branch (another deterrent to stopping)

g) Be able to nominate multiple Super Saver accounts on the single automatic transfer. This is to enable people to easily split savings between partners, or to save the same amount for each child / grandchild etc.

33.2. Have no fees attached

34. When advising the customer via email of the new Super Saver automatic transfer amount once the annual automatic CPI adjustment is applied, it can be an opportunity to:

34.1. Encourage the customer to increase their savings rate beyond the CPI adjustment

a) This should wait a few years for the habit to sink in before doing this & should be a very soft approach so as not to scare the customer off e.g. no words about increasing the savings amount, just a chart demonstrating the savings progress to date and the savings projection until retirement at the existing rate against the projection of an increase of $1 per week. By this stage the customer won't need a hard sell, just the benefits easily defined

34.2. Use charts i.e. pie charts, to display how much has been saved, how much interest has accumulated and how much RWT has been deferred. Also shows this as a projection using existing savings rate as well as a projection using a slightly increased savings rate. These will also show how much RWT is projected to be waived at 65

a) This is not only to demonstrate how powerful savings are and to encourage an increase in the savings rate, but also to make it clear that RWT is payable if deposits are withdrawn and what impact saving at the target rates and not withdrawing funds will have on the RWT waiver at age 65

35. It is a simple scheme and is easy to demonstrate the benefits, especially to a young person, which is important to enable them to start the saving habit early

36. This scheme must be measurable so that other barriers can be identified and quantified. As is sometimes suggested, kiwis may already be saving above international standards, with our home ownership rates, high number of households with 1 or 2 rental properties, households with a Bach / Crib, and the high percentage of small businesses making up New Zealand's commercial sector. However,

"If you can measure it, you can better manage it"

## Funding the Bonus draw

37. The Reserve Bank will also have an account (RBNZ Super Saver account) at each participating institution (Bank)

38. Bonus payments are funded by the minimum 1% Bonus interest rate that is withheld during the first 5 years of the deposit in the Super Saver account e.g.

    a) $400,000 transferred to Super Saver accounts at the institution using Super Saver automatic transfers during the month

    b) Total bonus draws:

| | |
|---|---|
| ➢ 1 x $5,000 Super bonus 2 | $ 5k |
| ➢ 2 x $1,000 Major bonus 3 | $ 2k |
| ➢ 4 x $500 Major bonus 4 | $ 2k |
| ➢ 4 x $1,000 Bonus pool | $ 4k |
| | $13k |
| c) $400,000 @ 1% x 5 years | $20k |

    d) The next level of bonus draw will not occur until monthly savings reach $500k for the month. At this new level, an extra $1k is added to the Bonus pool, as well as 1 more Major bonus 4 draw of $500. Therefore, up to $99k may be transferred for the month without triggering the additional bonus draws, earning up to almost $5k more in interest over the next 5 years

    e) In addition to this is the 1%p.a. Bonus interest for the next 5 years on all other deposits to Super Saver accounts not made by Super Saver transfers. This may be substantial

    f) Also in addition to these, is any margin between the Deposit rate and Funding rate as well as all interest earned at the Funding rate on funds held in the RBNZ Super Saver account (refer to point 44 Funding Rate on page 16)

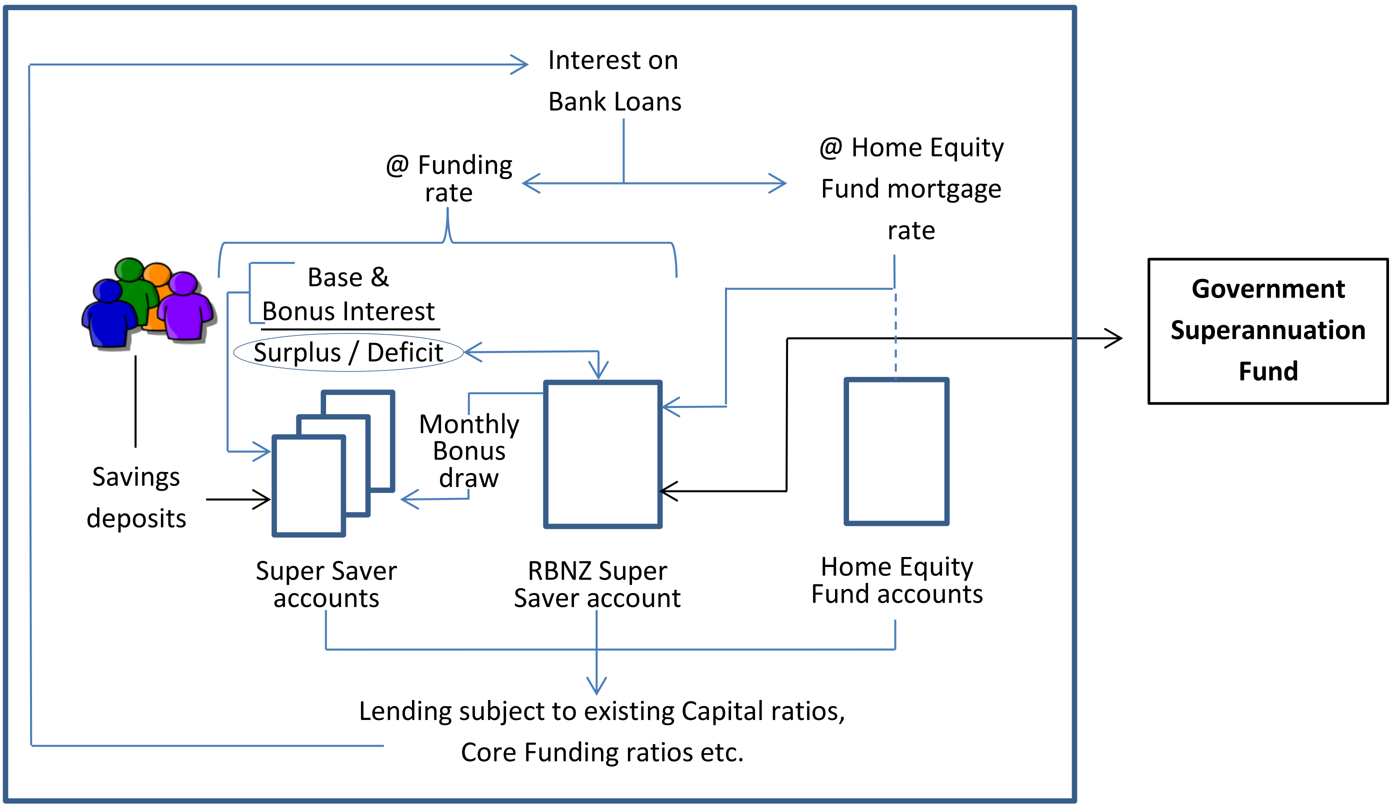
39. Funding for the bonus draws will be drawn from the RBNZ Super Saver account and be replenished over the subsequent 5 years

40. The $5k surplus allows for some withdrawals as well as providing additional funding for any age related multiplier applied to a drawn customer. It will be a minimum of 12 years after launch of the Super Saver scheme before any customer becomes eligible for a multiplier if drawn

41. The institution will also contribute funds to the monthly Bonus draw

42. Additional funding for the RBNZ Super Saver account will come from the interest rate charged by the RBNZ on the Home Equity Fund mortgages (Refer to Home Equity Fund – Generating income from your home on page 28 for how this scheme works)

## Workings in more detail




43. **Deposits**

43.1. There is a restriction on the amount that may be deposited to a Super Saver account

a) $1,000.00 per month using Super Saver automatic transfers

b) $1,000.00 per month from other customer deposits e.g. cash deposits, transfers from other accounts, online payments to this account

c) The exception may be the transferring of funds from Kiwi Saver for customers over 65yrs old

43.2. This is to ensure that:

a) This scheme is used for new savings, rather than an alternative holding structure for existing savings / investment funds

b) The growth of these funds is manageable, and does not put a strain on existing funding channels for the bank as well as the ability to meet the minimum Deposit rate

43.3. These limits will have no impact on the vast majority of customers

43.4. For those customers that do want to use this scheme as their primary savings vehicle, and they have funds which exceed these limits, then a facility will exist to enable the customer to link-in Term Deposits to their Super Saver account, as follows:

a) Excess funds are deposited into a Term Deposit at the institution holding the customer's Super Saver account and are flagged as being linked-in to the Super Saver account (excess funds from 43.1 above will also be transferred to a one year linked-in Term Deposit for the customer automatically & the customer notified by email and/or online banking)

b) The Term Deposit will attract the same interest as that offered for other Term Deposits of the same amount and term at the institution

c) Interest on the Term Deposit, when paid, will have RWT deducted and be transferred automatically to the customer's Super Saver account. These interest transactions will:
   - appear as linked-in deposit transactions rather than Super Saver interest transactions in the Super Saver account
   - have no additional restrictions placed on these linked-in transactions
   - not be included in the monthly account deposit limit (43.1 above) calculation

d) The customer, any time after five years, may, if they choose, transfer some or all of this Term Deposit to their Super Saver account
   - These transferred funds are also treated as linked-in transactions as per 43.4(c) above
   - Will have their aging information adjusted to reflect that they have been in the Super Saver scheme from their linked-in date i.e. 5 or more years previously

44. **Funding rate**

44.1. The Funding rate will be determined by the RBNZ

a) For example, the RBNZ my link the funding rate to the bank lending rate (the OCR rate + 0.25%). As this is the rate that banks borrow from the RBNZ and aligns to the 5 year Government Bond rate, which is a major component in the setting of mortgage rates by banks, this scheme will not impact on this function

b) If OCR was used, no further involvement would be required by the RBNZ

44.2. Increases to the funding rate would have a notice period of 12 months. Reductions in the funding rate would take effect immediately. Therefore, a rate reduction may immediately reduce the funding rate or may reverse some or all of one or more rate increases within their notice period and not yet applied

44.3. Where the Funding rate is above the Deposit rate, the interest charged to the institution for these funds will be higher than what the account holders will actually receive. This difference (surplus) will accumulate in the RBNZ account at that institution. Likewise, interest calculated at the Bonus rate on those funds that have been deposited for less than 5 years will also accumulate in the RBNZ account

44.4. Interest is calculated on a daily basis and paid monthly into the RBNZ account

45. **Interest**

45.1. The base rate will only change if the Inflation rate exceeds 4% p.a. This is to keep a 1% p.a. buffer between the Inflation rate and Base rate and, therefore, a 2% p.a. buffer between the Inflation rate and Deposit rate (Base rate + Bonus rate), as the Bonus rate has a minimum of 1%. p.a.

45.2. A Base rate move will be effective from the 1st of the month following the CPI announcement for the previous quarter

45.3. As lending costs rise, as they inevitably will, the margin between the Funding rate and the Deposit rate will grow i.e. the Funding rate will increase by more than the Deposit rate. This is especially true once mortgage rates rise above 8% p.a. The need to increase the bonus rate will be dampened by the tax exemption benefits. This benefit materially increases as the deposit rate increases. The accumulation of funds into the RBNZ account will escalate, strengthening the account before the next down turn. If returns on other investments begin to significantly outpace the Deposit rate, increasing pressure on customers to withdraw funds from their Super Saver account, then the Reserve Bank can increase the Bonus Rate

45.4. As interest rates on loans fall, the Funding rate will fall and the RBNZ may also reduce the Bonus rate until the Bonus rate is at its minimum of 1% p.a.

45.5. If loan interest rates continue to drop, the Funding rate will reduce to below the Deposit rate. When this happens, interest earnt on the RBNZ account will be used to top up the shortfall in interest on Super Saver accounts. These funds that are paid out from the RBNZ account are then replenished by the Home Equity Fund mortgages and from the margin between the Deposit rate and Funding rate when the rates increase again

45.6. The RBNZ account is used as a holding account to smooth out the interest demands on the Super Saver accounts. Deposit rate on the Super Saver accounts will not reach the heights of soaring rates on other accounts, as the peaks will be smoothed out to allow a floor to be placed under the Deposit rate at 6% p.a.

45.7. Minimum 1% Bonus interest for funds that have been deposited for 5 years or more

a) Funds deposited for less than 5 years receive interest at the 5% p.a. Base rate. The additional 1% p.a. (or more) is paid into the RBNZ account. This is not visible to the account holder

45.8. While it is not recommended, other bonus rates could be applied in addition to the minimum 1% p.a. bonus interest paid on funds deposited for 5 or more years. For example, other longevity bonus rates at other intervals e.g. 10yrs, 15yrs, 25yrs and 35yrs. However, this is not likely to be practical to implement & not warranted, as the Bonus draw has a multiplier based on longevity

45.9. Interest is rounded up to nearest $ when paid. This has more visual impact to the customer and as it is paid annually, also appears like a more substantial amount than seeing 12 individual smaller amounts

45.10. For account holders 65 years and over, interest is paid monthly (without being rounded up and with RWT deducted)

45.11. The Reserve Bank would determine when the Bonus rate would be increased or decreased and this would be included in the OCR announcement

45.12. While it is contrary to have deposit rates set by the RBNZ, it is necessary to keep consistency of these accounts across institutions, as customers are deterred by financial disadvantage if they transfer between participants

45.13. A Deposit rate of 6%p.a. is used as:

a) It is about the average 6 month term deposit rate over the past 25 years, so will enable a reasonably balanced funding profile i.e. the amount deposited into the RBNZ account during times when the Funding rate is higher than the Deposit rate will be reasonably close to the funds withdrawn when the Funding rate is less than the Deposit rate

b) It is also reasonably close to the average 10 year Government Bond rate for the decade prior to the GFC, so enables long term savers to access rates not otherwise available to them on small deposits outside of managed funds

c) The Deposit rate is not intended particularly to provide a higher than average rate of return on cash, but rather to flatten the rate curve to enable a consistent growth trajectory and a known rate of return in retirement, regardless of where other interest rates are on the interest rate curve. This is especially important to retirees that are relying on interest receipts to live

d) While not quite the “double every 10 years” some financial advisers recommend, doubling every 12 years still makes a significant impact to savings

e) Provides simplicity of calculation e.g. 0.5% per month. This may be more important to people than initially assumed when decisions are being made about whether to spend or save and when working out roughly what different sums will provide at retirement. For example, it’s reasonably easy to work out how much interest would be earnt per month for a particular dollar amount (work out 1% of an amount by just jumping the decimal point to the left 2 places and then half this amount to get 0.5% per month e.g. for an amount of $1,000.00, 1% = $10.00 so 0.5% = $5 per month)

6% p.a. = 0.5% per month

So, for $1,000.00, 1% =

| $1,000.00 | $1 0 0.0 00 | $10. 0 0 00 |
|---|---|---|

Therefore, 0.5% = $10 / 2 = $5 per month

f) Has there been a structural decline in interest rates, making the lower rates since the GFC permanent, or just here for a long time (and how long is long)? Is 6% too high? 6% is an adequate margin above the RBNZ target rate of 1% to 3%, which is not likely to change, without being excessive. This scheme provides retirees with a low risk, well-yielding and stable income option, that coupled with an aging population, may provide stability to the economy going forward. Savings providing a long and stable income will become more important in the future as not only will there be more retirees, but they will be living longer and will be required to fund more and more social services themselves e.g. medical and age-related care

45.14. The Funding rate will usually differ to the Deposit rate (the rate used to calculate the interest actually credited to the individual's Super Saver account). The institution will pay interest at the Funding rate on the total combined balance of the RBNZ account and the Super Saver accounts. Therefore, the Deposit rate has no effect on the institution in terms of cost of funds

45.15. Interest payments are treated as new deposits for calculating its interest & if withdrawn

46. **Withdrawals**

46.1. Limit withdrawal frequency to a maximum of 4 per year

46.2. A 32 day notice period required for withdrawals

46.3. Oldest deposits are withdrawn first. Therefore, individual credit transactions need to be retained against the account for the life of the account (or until they are withdrawn), as these will be regularly referred to as many aspects of this account operation are based on the age of deposits

46.4. For customers aged less than 65yrs old:

a) The interest earnt on withdrawn funds is treated differently, depending upon the length of time that these funds have been deposited

b) As discussed above, individual transaction details are kept. A withdrawal may cover one or more deposits, as well as a combination of deposits and interest receipts

c) When a transaction is selected as part of a withdrawal, one of the following actions will occur depending upon the transaction type and how long the transaction has existed:

| | | | |
|---|---|---|---|
| Some transactions will have a time restriction placed upon them, e.g. may not be withdrawn for 5 years. If the selected transaction is restricted, and its minimum deposit duration has not lapsed, then this deposit is skipped and not available for withdrawal | | | |
| If the selected transaction is a deposit, that has been deposited for: | | | |
| Duration of deposit | Interest rate | RWT | Notes |
| < 12 months | 0% p.a. | No | Accrued interest is not paid out on these deposits (so no RWT is payable either). The accrued interest is retained in the RBNZ account held at that institution. |

| | | | |
|---|---|---|---|
| 12months to < 3yrs | OCR rate | Yes | Interest is recalculated using the lesser of either the OCR rate or base rate less 2%. For interest that has already been paid into the account, the difference from the recalculation is reversed from the customer's Super Saver account and paid into the RBNZ account held at that institution. The OCR rate is used to approximate the on call rate while providing consistency across institutions, however, withdrawn amounts will always receive at least 2% less than the Base rate. RWT is paid on interest paid out on this deposit |
| 3 years to < 5 years | Not recalculated | Yes | Interest is not recalculated, so both the interest paid and that accrued using the Base rate is retained. However, RWT is paid on this interest (as it would have been if this deposit had been in an on-call account or on a Term Deposit) |
| 5 years or more | Not recalculated | No | |
| If the selected transaction is an interest payment: | | | |
| If RWT has already been deducted from this transaction | | No further deduction | |
| If RWT has not been deducted | | Deduct RWT at the customer's tax rate | |

d) This split is not intended to be punitive, but to reflect likely income levels had the customer not deposited these funds into a Super Saver account. While ensuring that the customer is not just using the Super Saver account to obtain its benefits without any intention to save long term, it is also stepped to provide greater rewards for the customer the longer that they have managed to keep these savings in their Super Saver account. For example, if they ensure that funds are kept in this account for 3 years, then they get to keep the interest calculated at the base rate, which is an interest rate that is likely to be well above on-call rates (especially for account balances less than $10k). It provides some short term achievable goals with financial rewards

e) The split is also intended to encourage people to not withdraw their funds, as they can see real benefits to leaving the funds in place. This aligns to mission statement 3: Hold it

f) RWT is deducted from interest paid out on those deposit transactions that have been deposited for less than 5 years, as they would have been had these deposits been left in an on-call account or put on Term Deposit

46.5. RWT is not deducted from the interest received on funds that have been deposited for 5 years or more, as 5 years is a big achievement for a lot of people and demonstrates a real commitment to long term savings. The Bright-line test is only 2 years on residential property as a basis of longevity. This is a way for the Government to be seen to be actively encouraging household savings (However, if the paid out interest transaction is also being included in the withdrawn amount, or is subsequently withdrawn as part of a later withdrawal, then it does have RWT deducted as this interest income has become available to the customer)

46.6. The exception to the under 65 treatment of withdrawals may be for 1st home buyers for political reasons, although better alternatives exist

46.7. For Customers aged 65 and over, there is no recalculation of interest as the RWT has already been deducted from their interest payments

46.8. Only accessible via branch or online

46.9. Depositors aged 65 and over would also be permitted to set up an automatic transfer to another account at the same institution in their name, including joint accounts, and:

a) Have a maximum frequency of fortnightly

b) Have only one active automatic transfer at a time

c) The 32 day notice period would apply to commence a new automatic transfer or to increase the transfer amount

d) The transfer amount may include principal as well as interest received, as principal may be required to supplement retirement income

e) If paying to a joint account, provision should be made to ensure that payments continue to the other joint account holder on the death of the Super saver account holder, as the other joint account holder may be dependent upon this income

46.10. Withdrawals are taken in age order, with the oldest deposits being withdrawn first, impacting on the age related bonuses

46.11. Only permitted to amend a withdrawal request to extend the notice period or reduce the amount of the withdrawal – any other changes would require another notice to be issued and the notice period would recommence

47. **Open Bank Resolution (OBR)**

47.1. OBR to be modified to ensure that people over the age of 65 that have an automatic payment setup from their Super Saver account continue to receive it while the bank is under the OBR. All other withdrawals from the Super Saver accounts will be prohibited while under the OBR

47.2. Super Saver accounts have their own source of funds to be used to fulfil the Government Guarantee implemented under the OBR, so limited impact to the Government (taxpayer)

47.3. No further deposits to Super Saver accounts except from existing Super Saver automatic transfers and linked-in Term Deposits

47.4. Ensure that Super Saver automatic transfers continue to operate under OBR, regardless of whether the Super Saver account is held at this institution or not, and:

a) Source these transfers from the frozen portion of the customer's account, if any, providing that the Super Saver account is held at the same institution. This is because the funds are not leaving the institution and are moving from being potentially at risk to protected funds for the customer. It keeps the savings going without impacting on the available funds under OBR

b) New Super Saver automatic transfers are not permitted from accounts under OBR, nor are existing transfers permitted to be increased

47.5. If an institution goes into receivership, the Reserve Bank will facilitate the transfer of Super Saver accounts to other institutions, maintaining the age of these deposits so that customers do not lose their age related bonuses. Refer to the section Consumer Deposit Insurance (CDI) on page 40 for further details

48. **Tax waiver upon reaching 65 years of age**

48.1. It is generally accepted that tax concessions have a big impact on how savings are made, rather than on how much savings are made

48.2. Upon the customer reaching 65 years of age, if the customer has made deposits using the Super Saver automatic transfers, then some or all of the Super Saver interest payments in the customer's Super Saver account paid prior to turning 65 will be waived as exempt from RWT

48.3. It is based on the number of qualifying months and the amount being saved. A qualifying month is where at least 2 Super Saver fortnightly transfers or 4 weekly transfers have been made to the account during the month and no withdrawals have been made

48.4. The amount is based on 2 target savings rates applying for that month. These saving targets are set by the Retirement Savings Commission and will be periodically adjusted up, based on the number of people saving and the number achieving the existing targets (step 5 – Build it)

48.5. It would function as follows:

a) RWT waiver % = 0%

b) For each month from when the Super Saver account was opened until the customer turned 65 years old:

- If the month has at least 2 fortnightly Super Saver transfers or 4 weekly transfers (or combination of these) and no withdrawals, then:
  - If the savings for the month from all Super Saver automatic transfers made to this account during this month is greater than or equal to the 1st target rate, then
    - Add 0.15% to the RWT waiver %
  - If the savings for the month from all Super Saver automatic transfers made to this account during this month is greater than or equal to the 2nd target rate, then
    - Add a further 0.1% to the RWT waiver %

c) Where the total RWT waiver percentage is 90% or greater, round to 100%

d) The total of all interest payments to this account that have not already had RWT deducted is multiplied by the RWT waiver %. Each of these interest payments is then flagged as exempt from RWT starting with the oldest interest transaction, until either the totalled waived amount is reached or no more interest transactions exist

48.6. Any accrued interest on the Super Saver account would be paid out 1 business day prior to the account holder's 65th birthday (as RWT will be deducted from all further interest payments from age 65 onwards)

48.7. Note: withdrawals remove transactions in date order, therefore, a withdrawal later in the savings history may remove many months' worth of Super Saver automatic transfers, thus significantly impacting the value of this RWT waiver. This is another incentive for the customer to try and hold on to their savings

48.8. Therefore, someone turning age 65 that has contributed every fortnight at the applying top target rate for that month using Super Saver automatic transfers for 30 years without making a withdrawal, will have 100% of the paid out interest to their Super Saver account waived from RWT deductions (30 x 12 x 0.25% = 90% → 100%). 360 months is used to allow those people that delayed starting or have had to break into their savings occasionally or have not been able to meet the target each and every month to still obtain the full benefit, and for others it is still a significant benefit to attract late starters and to encourage those that have struggled to save or to hold on to their savings

48.9. This will also be an incentive to parents to open a Super Saver account for their children, as a fortnightly savings rate at the minimum target rate without withdrawals for 60yrs will also qualify for the 100% RWT waiver

48.10. The interest payment is waived in order of date as this is the order in which these transactions will be withdrawn. Therefore, during retirement, interest payments exempt from RWT will be withdrawn first, and once exhausted, remaining interest payments that are not exempt from RWT (if any) have RWT paid as they are withdrawn. This is to enable these interest payments to be subject to a lower tax rate and also prevents the tax rate from being skewed by having the RWT calculated on the total interest payments upon turning 65 i.e. would push the income received higher at that point of time and potentially push the account holder into a much higher tax bracket

48.11. This Super Saver account is treated more like a capital account than an interest bearing account. If the customer had put savings into art, or land banked etc., no tax would have been collected on the capital gain nor would any economic benefit have been received by the public. The Super Saver account, not only benefits the customer, but also increases the size of NZ's capital market for economic growth and provides other benefits to the economy both before and after the account holder turns 65. They are the very reason why the Government is so strongly promoting savings in the first place. These advantages outweigh the cost of not receiving RWT on these funds

48.12. For people opening Super Saver accounts in the first 5 years of this scheme, a multiplier will apply upon turning 65 years old, so that people are encouraged to join regardless of how close they are to retirement i.e. nobody over the age of 35 would otherwise be able to achieve the 100% tax waiver as there isn't 360 months before they reach age 65. The multiplier would be:

a) 480 / #months between today's date and when the Super Saver scheme started * RWT waiver %

b) This multiplier would only exist for the first 40 years of the Super Saver scheme and only applied to those customers who joined the scheme in its first 5 years

48.13. An 'Early Retirement' option from age 60

a) RWT waiver is calculated and all other restrictions and conditions using age 65 as the criteria would use age 60 instead

b) This option can be invoked by any account holder at any time after turning 60 years old

c) The account holder must agree to a voluntary delay to the commencement of their Government Superannuation of 3 years i.e. the Government pension would now start for the account holder at age 68 instead of age 65

49. **No fees**

49.1. One free Automatic Transfer to this account will be allowed from any other transaction type account held at this institution i.e. no establishment fee, transaction fee or amendment fee

49.2. Institutions have discretion to wave fees for additional automatic payments

50. **Super Saver automatic transfer (SSat) reversal**

50.1. A reversal of a SSat transaction:

a) will not incur bank fees of any kind

b) The reversal amount will be $1 less than the transferred amount, unless the transferred from account would still be in o/d. This is to enable the continuous deposit history to remain intact for the customer. This also shows the customer the importance that the bank places on savings

c) The SSat will retry every night until either successful, or the next regular automatic transfer for this SSat falls due. The:

- Customer will bear no cost to this, regardless of how many attempts are made and regardless of whether the transfer is finally successful or not

- Retry will be for the amount less $1 if this was already deposited to the Super Saver account from the original reversed transfer

  This will need to be specified on the Super Saver Automatic Transfer authority

d) If neither the $1 from the original reversed transfer was able to be retained nor the transfer subsequently successful, then it is highly recommended that the bank transfer a substitute $1 into the customer's Super Saver account from the bank's own funds. This:

- Is at the discretion of the bank, and may be any amount the bank sees fit
- $1 should appear to be a SSat transaction, so as to not break the continuity of savings requirement
- This $1 will be flagged to prevent it from being withdrawn until the customer is 65yrs old
- If the customer is drawn in a bonus draw, the bank waives all rights to the bonus
- Even though it may only be $1, and is likely to cost more than this amount in bank resources to perform this act, it shows an enormous commitment by the bank towards enabling saving by everyone. It shows enormous community spirit
- It is not expected that the bank would continue to do this for a customer that is not making every effort to try to save and to get their accounts in order. Some customers will take longer and require more encouragement than most

  "The test of our progress is not whether we add more to the abundance of those who have much; it is whether we provide enough for those who have too little." — Franklin D. Roosevelt

e) If after multiple consecutive reversals the bank may, at its discretion, cancel the Super Saver automatic transfer if it is satisfied that it is probable that the customer will not be able to fund this transfer further

51. **Eligibility**

51.1. Available only to NZ citizens / permanent residents

51.2. If a depositor loses citizenship/residency, then the account converts to an on-call account and the early withdrawal conditions are applied

51.3. Account to be held by Individuals only, no other types of accounts, not even joint accounts

51.4. IRD number must be supplied

51.5. While it may be desirable to restrict to only those NZ citizens residing in NZ, the effort required probably outweighs the benefit. It may even prove to be an advantage if NZ citizens residing overseas were attracted to invest in this scheme

52. **Macro-prudential policies**
   52.1. There is no impact on Macro-prudential policies, minimum core funding ratios, capital ratios, reserve / liquidity requirements or their calculations
   52.2. The Reserve Bank's Government mandate is for stability, not improving the household savings rate. This is not changed. The variables within the Super Saver scheme that may be changed by the Reserve Bank will only be done so with a view of improving the stability of the finance sector. The impact to the household savings rate is not a consideration, other than its effect on stability

## Matching the mission steps:

53. **Start** =
   53.1. Bank account (Consumer Deposit Insurance cover, minimum interest rate, access to funds, tax exemption) removes barriers to starting
   53.2. Monthly Bonus Draw (the hook) gets people started by giving them a reason other than the thought of long term savings
54. **Habit** =
   54.1. The Bonus draw requirement of having a Super Saver automatic transfer at least fortnightly
   54.2. Having to contribute during the month of the draw to be eligible
   54.3. Having to have had regular monthly savings in multiple previous months to be eligible for this month's Major and Super Bonus draws
55. **Hold (on to) it** =
   55.1. Withdrawals – discouraging people from removing it:
      a) The 32 day notice period
      b) The loss of all or most of the interest when withdrawing within 3 years
      c) Oldest deposits withdrawn first, impacting on the multiplier effect if drawn in a Monthly Bonus draw and also impacting on the RWT waiver calculation at age 65
      d) Not eligible for the Bonus draws if a withdrawal occurs in that month
      e) RWT deducted on interest payments withdrawn and on the interest previously paid on the withdrawn deposit
   55.2. Super & Major Bonus draws – encourages people to keep it
      a) Requiring to have savings for multiple previous months
      b) The multiplier effect, as mentioned above
   55.3. Monthly email notifications of the draw results provides an opportunity to educate the account holder on the benefits of time & compounding interest using the Bonus draw examples
56. **Next Gen** =
   56.1. The multiplier effect, encouraging parents, caregivers, Grandparents etc. to start regular savings for their children / grandchildren etc., with the impact of the 60 year multiplier being of greatest impact and only being available to those that had someone start saving for them at a very early age

56.2. Demonstrating to parents etc. the importance of starting savings as early as possible so that they encourage their children to start saving, or to keep saving if the child is taking it over

56.3. The ease of setting up & maintaining multiple monthly transfers of the same frequency & amount to multiple Super Saver accounts on the one Super Saver Automatic Transfer form

56.4. The ability to transfer Bonuses across Super Saver accounts to share it amongst the children / grand children

56.5. Ability for an adult to set up a Super Saver account for a child and control when that child will be able to access those savings

57. **Build it** =

57.1. This will occur naturally for a lot of people the longer they save. They realise that they can manage an extra dollar or two a week, or more

57.2. Rounding up on the Super Saver Automatic Transfer

57.3. Regular communication by way of the Monthly Bonus draw results to demonstrate the impact of saving

57.4. Communications when the Super Saver Automatic Transfer is automatically CPI adjusted

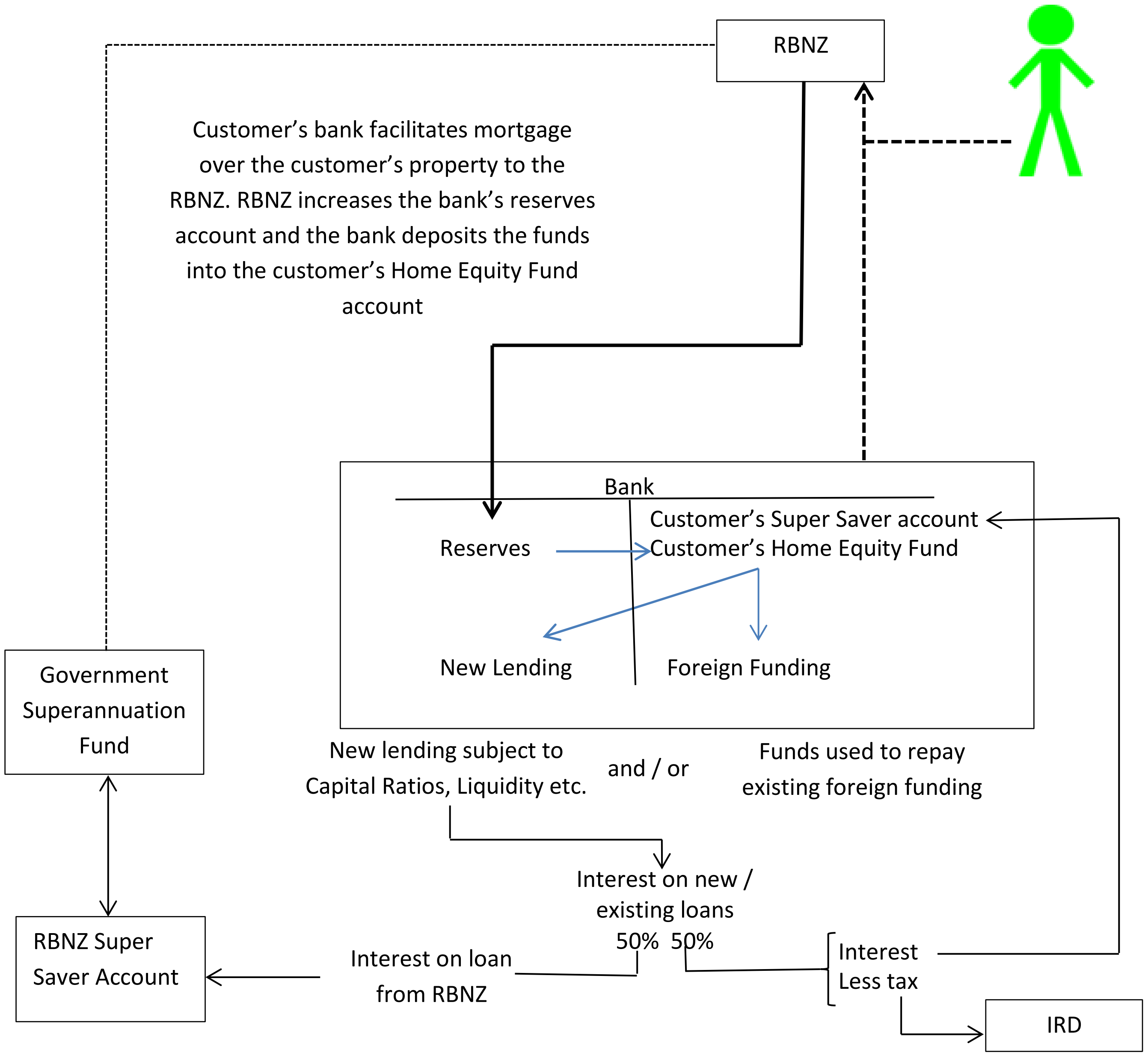
57.5. Buying a couple more entries in the Monthly draw

## Home Equity Fund – Generating income from your home

58. As the name suggests, this scheme uses the equity in an owner-occupier residential property to generate an income. For retirees, this income is available for consumption. For non-retirees, this income is a contribution to their Super Saver account. As well as an income to the homeowner, this fund will also generate income to either support the Super Saver (individual's superannuation) scheme or contribute directly to the Government Superannuation Fund

58.1. The customer's bank will organise a mortgage over the customer's property. The mortgage is held by the RBNZ, not the customer's bank

58.2. The RBNZ will lend money to the customer which will be deposited into a separate bank account called a Home Equity Fund. These funds are not accessible by the customer



58.3. Interest earnt on the Home Equity Fund account is paid into the customer's Super Saver account. Interest rates are set independently by the banks participating in this scheme

58.4. An equal amount of interest is paid to the RBNZ Super Saver account held at that bank. In effect, this is the mortgage interest payable on the customer's RBNZ mortgage loan for these funds

59. The Super Saver scheme is designed to be self-funding. The moving Super Saver Funding Rate should average out just above the average Deposit Rate (which will also fund the bonus draws). However, if the Super Saver scheme commences with a Deposit Rate higher than the Funding Rate, or during periods of extremely low interest rates where the Funding Rate is less than the Deposit Rate for an extended period, an additional funding source is required. This Home Equity Fund scheme provides this additional funding source

60. This Home Equity Fund scheme provides a source of:

60.1. Income for retirees

60.2. Super Saver funding

60.3. Government Superannuation Fund contribution

61. Funds in a customer's Home Equity Fund account are not Government guaranteed, only OBR applies (to limit moral hazard)

62. These funds are not covered by the Consumer Deposit Insurance (CDI) unless the CDI scheme has been rolled out beyond just the Super Saver accounts. Refer to the Consumer Deposit Insurance (CDI) on page 40 below

63. Mortgages are not securitised. The Mortgage is not held by the institution (bank), but by the RBNZ. However, the institution will perform the charge & discharge functions on behalf of the RBNZ. Therefore, no involvement is required by RBNZ in administering this scheme

64. Interest on the RBNZ mortgage is collected by the institution (bank) and paid into the RBNZ Super Saver account held at that institution. The Government Superannuation Fund Authority (GSFA) will manage the funds in that account. During periods where the Super Saver Deposit Rate is greater than the Super Saver Funding Rate, the GSFA will use funds in the RBNZ Super Saver account to fund the shortfall. Surplus funds in the RBNZ Super Saver account will be transferred by the GSFA into the GSF

65. The funds received from the RBNZ by the institution (mortgage funds on customer's property) are paid into a separate account (not the customer's Super Saver account), called a Home Equity Fund account, so that:

65.1. it is clear that these funds are not included under the Super Saver scheme and different rules apply

65.2. The interest rate can move independently of the Super Saver Deposit and Funding rates

65.3. It is easier to manage by the institution

65.4. Funds are unable to be withdrawn from this account by the customer except to repay the RBNZ mortgage, either in part or in full (interest is automatically paid to the customer's Super Saver account held at this institution). The RBNZ will have a caveat over these funds

66. Mortgage against residential property
   66.1. Mortgage 1.5 x rateable value (allows Home Equity Fund loan to be increased as equity builds without the need to alter mortgage documentation)
   66.2. Maximum loan amount 70% of property's rateable value. If existing mortgages exist, total of all mortgages are not to exceed 70% (whether existing mortgages are Home Equity Fund mortgages or not)
   66.3. There will be a mortgage agreement between RBNZ and the first charge mortgage holder if one exists to limit lending to 70%
   66.4. The RBNZ will decline any additional mortgage request i.e. a second or third charge mortgage request by an institution
   66.5. The following further restrictions apply on implementation of this scheme:
      a) Maximum loan amount per residential property e.g. $200k to limit the initial update of these loans so as to avoid stress on the financial system
      b) Customer must be named on the title of the residential property
      c) Property must be occupied by the customer as their main residence, therefore, only 1 residential property as collateral per customer / institution
67. The RBNZ will maintain the following parameters based on market conditions and the RBNZ's stability mandate:
   67.1. Maximum total lending percentage e.g. 70%
   67.2. Maximum loan amount per residential property e.g. $200k
   67.3. Minimum mortgage/deposit rate to be applied to Home Equity Fund account by an institution e.g. 1%p.a.
68. Customer must be eligible for and have a Super Saver account
69. The interest from the Home Equity Fund account will have RWT deducted and be paid into the customer's Super Saver account
70. Initially, customers must be 65yrs of age or over. Again, this is to limit update to avoid stress on the financial system
71. Once established, the program will be extended to home owners under 65yrs old. For under 65 year olds:
   71.1. The account holder will not be permitted to withdraw these Home Equity Fund interest payments from their Super Saver account until they are 65yrs or over (so as not to increase consumption). This is to enable households to use the equity in their home to generate savings for their retirement. The mortgage also prevents them from using equity in their home to obtain loans for consumption or to fund the purchase of other assets i.e. rental properties
   71.2. This interest income would not be eligible to be included in any Debt to Income calculation, as this income would not be available for debt servicing

71.3. Potentially, this could replace the foreign funding by our banks with long term domestic funds, with minimal ,if any, detectable impact on GDP and while investing in the individual's retirement as well as the Government Superannuation Fund

72. The Home Equity Fund account will be in an individual's name (just like Super Saver)

73. IRD number must be supplied

74. A residential property is permitted to have multiple Home Equity loans against it providing conditions in 66 above are met. For example, both partners have a Home Equity loan against their joint property, either of the same or different loan amounts, paid into their individual Home Equity Fund account, with interest paid into their individual Super Saver account

75. Only 1 Home Equity Fund account per customer per institution, although multiple amounts of different fixed terms and amounts may exist

76. Tax is deducted at the customer's (account holder's) tax rate

77. No fees – this includes no fees on the Home Equity Fund account, the setting up of the loan, the registering of the mortgage or for the discharge of the mortgage

78. The deposit rate (the rate applying to the Home Equity Fund account) will:

78.1. be determined by the individual bank as per standard banking practices, as they do currently for any other type of interest rate based on their individual funding requirements

78.2. have a minimum fixed interest rate period of 1yr (to match liquidity rules)

78.3. will have a minimum interest rate set by the RBNZ

79. The deposit rate may be very low initially so as not to place financial institutions under strain should there be a large update of this facility

80. As the financing rate (Mortgage rate) will match the deposit rate, no involvement is required by the RBNZ to administer this facility

81. Loan duration 30 years

82. The institution may treat funds in the Home Equity Fund accounts as per other types of deposits e.g. Super Saver accounts and Term Deposits, in regards to bank lending i.e. the same Capital & Equity ratios & other macro-prudential criteria apply

83. As institutions are not permitted to charge fees on the Home Equity Fund accounts or their associated loans & mortgage requirements, it will be very easy and at no cost to the customer to change institutions for a better deposit rate at the end of their fixed term period. This will encourage competition between the institutions resulting in a more efficient market and better returns for the customer. As fees and costs will be built into the deposit rate they will be spread across all loans making it cheaper for the smaller loans

84. Mortgage loan to RBNZ is repaid:

84.1. on sale of mortgaged property

84.2. when the mortgaged property ceases to become primary residence

84.3. when the customer's name is removed from the title

84.4. upon death of the customer

84.5. at the request of the customer at the end of their fixed interest period. Loans will either not be permitted to be repaid early or will require a substantial notice period

85. If the institution enters into receivership:

85.1. the funds in the Home Equity Fund accounts are classed as senior debt

85.2. Due to the very long term & stable nature of these deposits, they could prove crucial in navigating through a bank or financial system crash

86. It has been argued that having equity in people's homes is not an efficient use of resources for the economy

87. It is not freeing up equity in one's home for consumption but enabling the generation of an income stream from it

88. It is more efficient, more controllable and safer for everyone than if retirees decided to take out a mortgage on their home and lend the money to others at a higher interest rate to generate an income. It may also be more beneficial to the economy than, as is becoming more prevalent, using the equity in their home as a deposit on a rental property in the hope of some rental income and some tax free capital gain

89. New lending (or repaying of more expensive funding such as offshore funding) by the institution will pay for the interest paid out on Home Equity Fund accounts (plus margin)

90. If desirable, the RBNZ could implement and maintain a funding ratio to control the amount of funds that the RBNZ will make available to the institution for Home Equity Fund deposits. It could be a percentage of the combined funds held in the RBNZ Consumer Premium account and the customer Super Saver accounts. This funding ratio would be used to control the volume of Home Equity Fund funds as part of their stabilisation management of the economy. It would also incent institutions to promote savings into the Super Saver accounts

91. Example of an unencumbered owner-occupied residential property

| | |
|---|---|
| $350k | Value of property (Rateable value) |
| $245k | Max lending 70% |
| | For this example, assume that the RBNZ have instigated a $200k Home Equity Fund loan limit per owner-occupied residential property |
| $200k | Available to lend from RBNZ for deposit into the customer's Home Equity Fund account |
| (pre tax) | |
| $58 p.w. | At today's low interest rates, customer's rate likely to be 1.5% p.a. ($3,000 p.a.) |
| $58 p.w. | Equal contribution to Superannuation (1.5% p.a.) – either left in the RBNZ Super Saver account to support the Super Saver scheme or transferred to the Government Superannuation Fund |
| $525k | RBNZ 1st charge mortgage – 1.5 x Rateable Value |

92. Example with an existing 1st Charge Mortgage loan

| | |
|---|---|
| $350k | Value of property (Rateable value) |
| $245k | Max lending 70% |
| $ 80k | For this example, an assumed existing mortgage loan |
| $165k | Available to lend from RBNZ for deposit into the customer's Home Equity Fund account |
| (pre tax) | |
| $48 p.w. | At today's low interest rates, customer's rate likely to be 1.5% p.a. ($2,475 p.a.) |
| $48 p.w. | Equal contribution to Superannuation (1.5% p.a.) – either left in the RBNZ Super Saver account to support the Super Saver scheme or transferred to the Government Superannuation Fund |
| $xk | 1st charge mortgage with institution with $80k loan |
| $525k | 2nd charge mortgage to RBNZ – 1.5 x Rateable value |

93. This meets the emphases on domestic funding rather than foreign funding, as encouraged by the RBNZ
94. If the rateable value of the home reduces, this will restrict further new borrowing but will not require the Home Equity Fund to be reduced in order to maintain the 70% maximum loan limit. This may become a major benefit in stabilising the economy during times of stress
95. While there are concerns about the impact of a significant decline in property values, these are mitigated by this scheme by:
    95.1. Only being offered on owner-occupied properties. Declining house prices effect investment properties greater than owner-occupied properties in relation to economic stability
    95.2. Only being available for properties that already have a lower debt to value ratio, so are less likely to be effected by a value reduction from a debt security perspective as well as availing to greater options for debt servicing relief in times of the owners debt servicing stress e.g. if declining house prices coincided with being made unemployed
    95.3. Providing a stable domestic funding platform should the wider economy also experience a crisis which would drive foreign investment away and undermine the stability of the financial system
    95.4. Providing an incentive for homeowners to reduce mortgage debt rather than to borrow for consumption
    95.5. Providing an alternative to borrowing against the equity in their home to purchase other assets such as rental properties
96. As more overseas funding is replaced by Super Saver funds, funds in the RBNZ Consumer Premium account and the Home Equity Fund, the RBNZ may gain more influence over mortgage rates. As well as increasing mortgage rates to curb inflation, they may also want to limit the fall in mortgage rates to not only avoid asset bubbles, but also to protect consumers. Are we heading for another crisis if / when mortgage rates return to more historical levels of 8%p.a.? Are those people that have taken loans at 4.5% - 5% going to cope?

97. If funds are used to replace existing funding i.e. foreign funding, & no new loans are made that couldn't have been made prior to this Home Equity Fund deposit, then there is no change to the money supply and, therefore, no inflationary pressure. The only difference is that the interest is paid into Super Saver accounts & retained within the economy instead of disappearing overseas

98. If new lending is made as a result of this new Home Equity Fund mortgage, that couldn't have been made previously, then theoretically it will add to the money supply and inflationary pressures, but in practice it will be muted as:

   98.1. The amount of money added to the Money Supply will be limited by the bank's ability to lend based on the capital ratio of the RBNZ macro-prudential policy

   98.2. Inflation is a product of Velocity of money as well as the change in Money supply. Velocity, as evident by the very low interest rates and low inflation, is currently very low (PY = MV)

   98.3. The Home Equity Fund is not available for consumption as it is paid into a bank account and cannot be withdrawn. Any new loan will then be a smaller amount than this deposit due to reserve requirements, so velocity starts off slower than a money supply increase would otherwise

   98.4. As velocity of money fluctuates, the link between money supply and inflation is weak. That is why Interest rates, rather than money supply is used as a means to control short-term inflation

   98.5. By placing a mortgage on their property and declining requests of additional subordinate mortgages and by restricting total lending to 70% of the property's rateable value, restricts the customer from extracting more equity out of their property by way of loans for consumption

99. Returns to the Government are being produced by way of taxes, Government Superannuation Fund contributions, reducing some other Government funding requirements (i.e. Rates rebate) and supporting the economy

100. By the RBNZ utilising home-ownership equity, they are able to positively influence the economy by:

   100.1. providing an incentive not to borrow for consumption

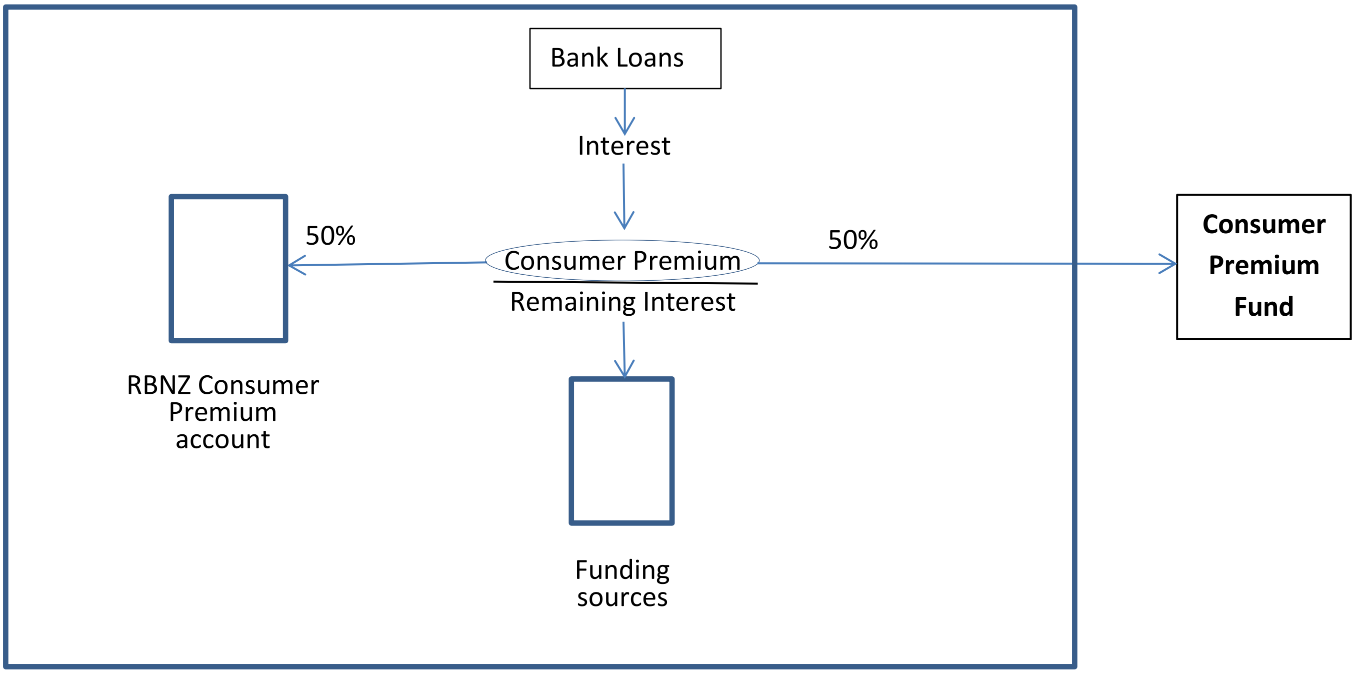
   100.2. offering an alternative investment (for some people) rather than buying rental properties

   100.3. supplementing retirement income with interest that would otherwise be lost to overseas investors

   100.4. increasing superannuation savings by individuals, again by utilising interest payments that would otherwise be lost to overseas investors

## Consumer Premium

101. Consumer Premium is an interest rate levy on all lending secured by residential property or for the purchase of residential property




102. RBNZ have carried out studies on interest rate levies in the past (2005 Supplementary Stabilisation Instruments project). Consumer Premium is a variant of an interest rate levy as described by the RBNZ

103. There are three purposes of the Consumer Premium. In priority order they are:

103.1. Fund the new Consumer Deposit Insurance scheme (refer to Consumer Deposit Insurance (CDI) on page 40)

103.2. Provide funding for the Government Superannuation Fund

103.3. Provide support to the Super Saver scheme if the Home Equity Fund scheme is not implemented

104. Funds raised by the Consumer Premium will be collected by the institution and distributed as follows:

a) 50% of the collected levy will be paid into the RBNZ Consumer Premium account at that institution

b) 50% will be paid to the Government Superannuation Fund Authority for crediting to the Consumer Premium Fund. The GSFA will manage these funds as they do for the GSF. No fees will be payable to the GSFA, however, income derived from the Consumer Premium Fund will be split 50/50 between the Consumer Premium Fund and the GSF

105. Redistribution differences:

105.1. OCR redistributes income between borrowers and savers (foreign & domestic)

105.2. RBNZ discretionary mortgage Interest Levy redistributes income from (some) borrowers to the Government (tax)

105.3. Consumer Premium redistributes income from (some / most) borrowers to (most) domestic savers over time, and to all consumers, eventually, if surplus interest & contributions to the RBNZ Consumer Premium account are credited to the Government Super Fund

106. Ideally, Consumer Premium would be introduced prior to the launch of the Super Saver scheme to begin accumulating funds into the RBNZ Consumer Premium account. It also benefits the institutions to implement early as it starts to provide a cheaper, and therefore, more profitable funding source. The disadvantage is that it will increase the loan rates slightly and may be less competitive

107. While the interest generated by Super Saver accounts (the margin between the Deposit rate and Funding rate) as well as the interest generated on the RBNZ Super Saver account itself will become a very significant contribution to the funding of the RBNZ Super Saver account, this may not be sufficient in itself to grow the level of funds required to make the Super Saver scheme self-reliant. It is not feasible to expect the Government to fund the Super Saver scheme nor is it desirable to use tax payer's funds for this purpose. It is also not feasible for funding from traditional depositor & funding means, especially as in times of low interest rates, the return on investment may be zero i.e. all interest earnt is redirected to support the 6% interest rate of the customer Super Saver accounts. It is, therefore, necessary to fund the Super Saver scheme, at least partially and at the introduction of the scheme. If the Home Equity Fund scheme is not implemented, then this Consumer Premium will be used to support the funding of the Super Saver scheme

108. It is applied to all loans secured by residential property or for the purpose of purchasing a residential property. This includes mortgages and other forms of personal lending. Regardless of the entity borrowing the money e.g. applied to individuals, partnerships, companies, trusts etc.

109. There is no exemption for new home buyers or for low income earners. However, everyone has the ability to have a rebate on the Consumer Premium paid on their own home mortgage as follows:

109.1. For every $1 saved using a Super Saver A/T, it will be matched by $1 funded from the RBNZ account up to a maximum of 50% of the Consumer Premium paid per week on the home mortgage

109.2. Conditions:

a) Only one property per Super Saver account (as there can only be 1 main home)

b) Property must be main private residence and the customer's name must be on the title i.e. property must not be owned by a company, trust etc.

c) Rebate may be applied across multiple mortgages on a property, but the total rebate for the property is a maximum of 50% of the Consumer Premium paid and a minimum of $1 per week

d) Where the loan and property are in more than one name, the rebate will be split evenly across those that have a Super Saver account

e) The rebate deposit in the Super Saver account is flagged to restrict withdrawing until the account holder reaches 65 years old

f) If withdrawals are made from the Super Saver account, rebates less than 5 years old are reversed dollar for dollar with the withdrawal. This is not only a disincentive to withdraw funds but also to stop those that deposit funds to obtain the rebate with no intention of leaving the funds in this account

110. Excludes commercial loans that are using residential property for collateral if the lending rate is already greater that the equivalent residential rate that includes the consumer premium

111. Consumer premium range set by government legislation i.e. range from 10 to 200 basis points

112. The Reserve Bank will determine independently what rate to set the Consumer Premium and is used solely as a Macro-Prudential tool for stabilisation. Accumulation to the RBNZ Consumer Premium account or Consumer Premium Fund is not a consideration unless stabilisation or protection is sought by modifying these funding levels

113. The Consumer Premium rate is announced with the OCR announcement

114. It is envisioned that the Consumer Premium would be implemented with a rate of 10 basis points (0.1% p.a.). While it may be desirable to introduce the Consumer Premium at a higher rate for macro-prudential reasons, the lower rate at implementation would:

114.1. reduce the impact of the introduction

114.2. reduce distortions between those institutions that are implementing the Super Saver scheme and those that aren't

114.3. be more tenable for the public

115. The same Consumer Premium rate would apply to loans of all terms, i.e. same rate for floating as that used for fixed period loans

115.1. While a stepped approach of implementation of the Consumer Premium would have the benefit, especially as the OCR was rising, to influence consumers to fix for shorter periods, and therefore, enable the OCR rises to take effect more quickly, this is not recommended as it would be:

- more complex to implement
- more complex to manage
- harder to explain to the public
- less tenable to the public
- disadvantageous to low income households, where rate certainty for the longest possible time may be paramount

116. When taking out a fixed interest rate loan, the Consumer Premium rate applied to the loan will act like a capped rate i.e. the Consumer Premium portion of the loan's interest rate may go down, but will not rise beyond this rate i.e.

116.1. RBNZ increases to the Consumer Premium will effect floating rate loans and new fixed term loans. It will not effect existing fixed term loans that were taken out with a lower Consumer Premium rate than this new rate

116.2. RBNZ reductions in the Consumer Premium will not only effect floating rate loans and new fixed term loans, but will also effect those fixed term loans that were fixed with the previously higher Consumer Premium rate. These loans will also have their existing Consumer Premium rate reduced to the new level. This will affect those people who took loans out most recently first, reducing their repayments rather than having to wait until their term expires

117. Differences between the Consumer Premium as described here and the RBNZ discretionary mortgage levy as described in the RBNZ 2005 report include:

| **RBNZ mortgage interest levy** | **Consumer Premium** |
|---|---|
| • Levy imposed by all lenders | • Levy only imposed by those institutions that participate in the Super Saver scheme |
| • Able to be triggered | • Not Triger-able as it is permanently in place, however, rate is maintainable |
| • Lowers returns to saver | • Redistributes |
| • Significant issues with new legislation around ability to delegate authority to trigger the levy | • New legislation would not have trigger-able issue as levy is not trigger-able. The levy range would be mandated and the mandate for stability would apply |
| • Difficulty of enforcement by IRD | • IRD would not be required to enforce this as levy is not collected for remitting to IRD. Arguably, providing the levy is not redistributed to the government, it is not a tax, just as the OCR does not incur a tax |
| • Inconsistent with general principal that taxes cannot be imposed (or increased) without the explicit involvement of Parliament | • If the above argument holds that this is not a tax as it is a redistribution between borrowers and savers and/or consumers, regardless of timeliness of that distribution, then the tax issues do not apply |

| | |
|---|---|
| • Enforcement would be a continuing challenge | • It is in the best interest for the institutions to impose this as it generates a source of lower cost funding for that institution. Monitoring & enforcement is limited to those participating institutions, i.e. the biggest 5 or 6 banks, |
| • Apply to all outstanding loans, regardless of whether they are on a fixed interest rate term or not | • Would not apply to existing fixed rate loans. Would apply to floating rate loans, new loans & only to existing fixed term loans as they end their fixed term period |
| • A “predominant use” test is required | • As above, beneficial to the institution to collect the levy, so a predominant use is more likely to be applied. A blanket approach used wherever a residential property is used as collateral |
| • Levy removed when conditions warranted it | • Levy not removed, just the rate reduced |
| • Suggested statutory levy cap of 200 basis points (2.0% p.a.) | • Statutory cap may not need to be this high |
| • Levy could be applied in reverse, as a subsidy | • Levy cannot be used in reverse |
| • Avoidance efforts and tax planning activity would be likely to increase | • The less exceptions the less avoidance possibility. As stated above, it will also be in the lenders best interest not to enable avoidance |
| • Risk of significant proportions of mortgages conducted offshore, including by the parents of the NZ banks | • As above, beneficial to NZ banks to collect the levy |

118. Many of the benefits of the RBNZ levy documented in their 2005 report also apply to the Consumer Premium levy, e.g. less upward pressure on the exchange rate, less spill-over pressure onto the tradeables

119. Increasing lending rates at participating institutions by applying the Consumer Premium rate levels the playing field with those institutions that don’t have access to the cheaper source of funding provided by the Super Saver and RBNZ Consumer Premium accounts, especially as these funds grow over time

120. The bank may request for excess funds to be transferred from the RBNZ Consumer Premium account held at the bank. If acceptable to the RBNZ, excess funds may be transferred to the Consumer Deposit Fund administered by the GSFA. However, once transferred, they are not permitted to be transferred back to the bank at a later time

121. Interest paid by institutions on funds in the RBNZ Consumer Premium account will be at the Super Saver Funding rate, calculated on a daily balance and paid to this account monthly

## Consumer Deposit Insurance (CDI)

Safety and prosperity go together hand-in-hand. You can't have one without the other and it must include everyone.

122. **CDI on Super Saver accounts**

122.1. Customers (Consumers) will have been heavily encouraged and incentivised to make long term savings into their Super Saver account. There are significant and deliberate financial impacts should customers withdraw funds to move to another institution, so they are more likely to keep their funds in an institution even when known stresses on the institution are building. This may even be a desirable outcome for the RBNZ to help provide stabilisation to the financial system as a whole

122.2. However, by consumers not withdrawing funds, and as described above, being actively discouraged to withdraw their funds, they are putting these savings at a greater risk. These are savings that may have taken a lifetime to build up and for where losses may never be able to be recouped, especially the older and closer to retirement the consumer gets

122.3. The Government wants consumers to make long term savings. The vast majority of consumers know that they need to save, however, "need to" and "doing" can be quite different and might be a matter of how and where

122.4. So Super Saver savings need to be protected. Super Saver accounts need to be safe and secure. In this context, the definitions used for safe and secure are:

a) Safe = the deposits are protected from danger or harm

b) Secure = the consumer feels that their money is not in danger of being lost or taken away

122.5. The OBR does not provide this, as:

a) OBR only covers transactional on-call accounts, so long term savings in the Super Saver will not qualify

b) Even if the OBR was changed to include Super Saver accounts, the amount of the Government Guarantee is unknown, and unknowable, until the OBR is invoked. This does not provide security to the customer (by the above definition) and will place an unknown limit on the amount that is safe

122.6. The Consumer Deposit Insurance scheme is not a Government Guarantee, nor is it backed by Government funding. It is funded by consumers for the sole benefit of consumers (Super Saver account holders)

123. **CDI workings**

123.1. If an institution gets into severe financial difficulties, the RBNZ will invoke the OBR. This will freeze all funds apart from funds below a determined threshold (de minimis) in transaction and on-call accounts. Therefore, funds in the Super Saver account will be frozen as these are not on-call funds

123.2. The amount frozen is an estimate of the funding required to cover all loses incurred by the institution

123.3. During the OBR, the RBNZ will determine the size of the "haircut" required i.e. the amount of money each depositor is going to lose. However, instead of the haircut being deducted from the customer's Super Saver account, it would be funded by a call on this Consumer Deposit Insurance fund

123.4. When the CDI is called upon, funds will come from, in order:

a) The RBNZ Consumer Premium account held at that institution until exhausted

b) The Consumer Premium Fund administered by the Government Superannuation Fund authority. The amount of funds available for the institution from this Fund will be determined by the RBNZ, as funds may be required to be kept to service other institutions should other institutions be severely stressed or already in OBR

123.5. It will be paid out to the Super Saver accounts in customer age order – oldest to youngest i.e. people that have retired and currently relying on this fund get paid out first, then those that are about to reach 65 etc.

123.6. If the CDI runs out of available funds before all consumer frozen funds in the Super Saver accounts have been released, then the remaining funds will remain frozen and be released as CDI funds become available. Frozen funds still attract interest and in all other respect are treated the same as unfrozen funds, apart from being prevented from being withdrawn. As CDI is paid out in age order, and Super Saver accounts are long term savings, the frozen funds have little or no impact on younger savers

124. **CDI funding**

124.1. The Consumer Premium paid on residential mortgages. See Consumer Premium on page 35

124.2. A CDI premium of 0.01% p.a. (1 basis point) on the total balance of the Super Saver accounts held at the institution. This is on top of the Funding rate. It is calculated on a daily balance and is paid into the RBNZ Consumer Premium account at that institution monthly

124.3. The CDI Premium is not paid on funds held in the RBNZ accounts

124.4. When the OBR is invoked for an institution, all institutions will be required to divert the total Consumer Premium to the Consumer Premium Fund managed by the GSFA. They will no longer split 50% of the Consumer Premium into the RBNZ Consumer Premium account held at their institution. This is to build funds in this Fund in preparation for a potential call on the CDI. Losing funding due to the OBR being invoked at a different institution may impact on profits, as more expensive funding may be required at a time when funding may be getting expensive. This risk to institutions will help to combat moral hazard, as institutions will be more likely to look for moral hazards occurring in fellow institutions

124.5. As the total funds in the RBNZ accounts and the Consumer Premium Fund grow as a percentage of funds held in Super Saver accounts, the risk to the Government from having to do any form of bailout diminishes

**CDI rolled out to cover all consumer deposits**

125. Should this Consumer Deposit Insurance be rolled out to cover all consumer deposits?

126. The CDI could be rolled out to cover all consumer deposits at participating institutions. However, there is a long standing argument of:
    a) "Consumer deposits should be guaranteed Vs. Guaranteeing deposits creates moral hazard"
    b) Both arguments are right, but which one is more right?

127. In order for markets to flourish, participants must feel safe and secure. This is fundamental to the development of any market, and of society itself. That is why we have laws, and that is also why we have insurance

128. Consumers can, generally, insure all their assets – houses, contents, cars etc. Contents insurance can also cover small amounts of cash. Therefore, it may seem logical that consumers should be able to insure their money held in banks

129. The RBNZ stance is, and I believe in the most part correct, that the public should determine the risk of an institution themselves and base their investment decisions on their own particular risk tolerance, and that Guarantees "blunts the incentives for both financial institutions and depositors to monitor and manage risks properly", and recommends the public to "consult a registered financial adviser" or review the RBNZ Financial Stability Report and institution's disclosure statements

130. However, a distinction needs to be made between an Investor, with say $100,000 to invest, and a Saver, who may be struggling to save $5 per week. The RBNZ stance assumes that a saver will have the same level of acumen & impetus as investors, both professional and private. It is unrealistic to expect a person struggling to save $5 per week to be able to consult a registered financial adviser or to assimilate the RBNZ Financial Stability Report, to enable them to "choose their bank carefully"

131. The Consumer Guarantees Act acknowledges that consumers require greater protection than other participants in the market place, and that some of these consumers are the most vulnerable. Therefore, greater protection should be accorded consumers within the financial system

132. As per the Consumer Guarantees Act, the same level of onus should not be placed upon consumers within the financial system, but nor should consumers be exonerated from all responsibility to safeguard their money

133. So, are consumers able to assimilate the information available currently to enable them to fulfil their obligation, as the RBNZ sees it, in choosing their bank carefully to match their willingness to take risk? A good case study may be South Canterbury Finance (SCF), as follows:

133.1. At the time of SCF's request to join the Government Wholesale Funding Guarantee facility (GWFG) in Nov 2008, SCF still:

a) Had a Standard & Poor's Rating Services (S&P) credit rating of BBB-

b) Was not in any breach of the RBNZ act

c) Was a huge company from a NZ consumer's perspective with substantial deposits and lending operations in New Zealand

d) Had a 6.73% tier 1 capital (6% recommended for banks & 8% recommended for non-banks at that time)

133.2. A highly skilled team at RBNZ estimated that the tier1 capital could devalue to 5%, and based on this, the application to join the GWFG was denied by Treasury

133.3. The explanation reported to SCF was that its Tier 1 capital margin of 0.73% above the requirements on banks was insufficient, and the Tier 1 capital should be around 8%. There was no comment that their S&P credit rating was unsatisfactory

133.4. So the RBNZ judged SCF too risky for tax payers. Would a consumer, say a person in their early 20s saving to get married or for a deposit on a house, who can no more afford to lose their savings than tax payers collectively and therefore is risk adverse, come to the same conclusion as the RBNZ. If this consumer had contacted a financial adviser, as recommended by the RBNZ, how likely would it have been for the adviser to come to the same conclusion as the RBNZ? (ignoring for the moment that the Government Deposit Guarantee was in place so may have influenced the consumer's or financial advisor's decision)

133.5. The consumer and / or advisor would have seen in Nov 08:

a) A BBB – Stable rating

“An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation” – S&P

b) SCF ratings & comments by S&P

| | | | |
|---|---|---|---|
| Dec 2006 | BBB- | | “rating assigned … on strong business profile” |
| Feb 07 | Affirmed at BBB- | Stable | |
| Aug 07 | Affirmed at BBB- | Stable | “Unchanged after strong operating performance” |
| Apr 08 | Affirmed at BBB- | Stable | |
| Jun 08 | Affirmed at BBB- | Stable | “… sound business profile and good domestic operational geographic diversity, which underpins its market position as one of the largest New Zealand-owned finance companies. The company’s stable profitability track record and sound credit-loss experience, combined with its improved funding and liquidity diversification over the past year also support the rating” |

c) A 6.73% Tier 1 capital, when banks only required 4% with 6% as a recommendation. How much weight would a consumer place on the difference between a bank and one of the largest NZ-owned finance companies, especially when comparing interest rates between the two and considering interest rates are supposed to reflect the level of risk

d) In perspective, Kiwibank currently has an S&P rating of A+ and is on credit watch negative. To a consumer, there doesn’t sound a whole lot of difference between BBB- & A+ (5 notches)

e) SCF accounts had been audited with no major issues

f) In summary of the RBNZ Stability Report released in November 2008, Governor Bollard commented that “with the domestic economy softening, structural weaknesses in some non-bank financial institutions have been revealed over the past year. These have been exacerbated by slowing property markets, resulting in a large number of failures of non-bank deposit takers and a flow of funds away from investments exposed to this sector. With guarantees now in place, the non-banks have the opportunity – which will be reinforced by the new Reserve Bank prudential regime – to consolidate their balance sheets while improving systems and risk management practices." This would indicate an improvement rather than a deterioration

g) Within the RBNZ Stability report, it states in relation to interest rates: "In a market with sufficient transparency and analysis by informed investors, these should generally be expected to offer a fair return for risk" and "Together, these extraordinary actions appear to have restored a degree of stability to the financial system. Although markets remain highly volatile, there are some welcome signs that inter-bank lending markets are becoming slightly more functional, though still nowhere near 'normal' conditions." BBB- appears to be RBNZ minimum "investment" credit rating criteria, as evident as entry criteria to the retail deposit guarantee. These would lean towards investing in SCF rather than away from it

133.6. It is doubtful that either the customer or financial adviser would have had the resources to determine that the Tier 1 capital should really be 5%. How likely then would it have been for the customer or their adviser to recommend not to deposit their funds in SCF? And this is assuming that the customer engaged a financial adviser, or understood the meaning of credit ratings and Tier 1 capital. Customers who may only have a few hundred dollars in a Term Deposit are even less likely to be able to perform the required analysis

133.7. Would the inclusion of the SCF in the Retail Deposit Guarantee scheme available at that time influence their decision in a moral hazard disregard? Or would the customer have made the same decision based on the information above regardless?

133.8. And what about the customer with $100 of savings in a Term Deposit (in a TD to try to stop themselves from spending it)? The very nature of these savings being of long term by definition may put these funds outside the scope of the Open Bank Resolution (OBR) of transactional & on-call accounts, thereby putting this $100 beyond the protection of the OBR's de minimis and the Government Guarantee invoked under the OBR

133.9. $1.58 billion was paid out to GFC debenture holders covered by the retail deposit scheme. The GFC receivers clawed back $774.4m (49%) over 2.5yrs of administration. Therefore, even the 8% Tier 1 capital would have been woefully inadequate. Under the OBR, it would have been one hell of a haircut!

133.10. Once downgraded one notch from BBB- to BB+, SCF was then downgraded to a CC & put into receivership 12 months later. The falls are always fast. Would this have been enough time for customers to react? Would customer's reacting early have caused the demise earlier and perhaps during a period when SCF was still recoverable?

133.11. What does that mean to Kiwibank? It is on a negative watch. If it drops 3 rating notches to BBB+, should this signal to customers to move their banking away from Kiwibank in case the financial situation moves quickly? Kiwibank's Tier 1 capital is 10.7% (regulatory minimum is 6%). Is a 4.7% margin enough? Would 10.7% have been enough for SCF to avoid receivership? Is it reasonable to expect a consumer to know? And if the public did decide it was time to move due to the risk, regardless of whether the risk has been correctly calculated or not, do we really want everybody to make the move? If the bank & public were expecting the bank to experience a bit of stress, say due to a correction in the property market and the effect on Kiwibank due to their higher percentage of residential mortgages to total loans than other banks, a consumer community that is too sensitive to fluctuations could cause issues to the financial system where little exist

133.12. In the likes of the ASB disclosure statement, it states BBB is medium grade (lowest investment quality /adequate). The RBNZ literature states BBB- as the lowest level of recommended investment

133.13. Yet moral hazard is a real and significant issue. The GFC is testament enough. It wasn't so much the FDIC deposit guarantee that exists in the US, but the ability for lenders to move loans off their balance sheet, therefore, reducing risk so much that lending went so far beyond just "bad practice". And perhaps the expectation that there would be a bail-out with or without the FDIC guarantee also contributed

133.14. Does a level of expectation, either consciously or not, already exist in NZ? After all, we have the OBR, which includes a Government Guarantee (although exact amount unknown), and precedent of institutional and consumer bailouts. Therefore, moral hazard may already exist and this may actually diminish with the introduction of this CDI

133.15. In the auditor-general review, GFC was accused of taking advantage of the scheme by increasing its debenture base by 25% and ramping up its lending over risky property developments. Was this actually moral hazard or was it an effect of ingrained poor lending practises or even of an honest attempt to trade their way through / out of the middle of the GFC? Was this before or after being denied permission to join the Government Wholesale Funding Guarantee? And does the reason behind it actually matter? Whatever the cause, the effect was a big hit to tax payers

133.16. The crown paid out about $2 billion under the retail deposit scheme & expects to write off $1.1b. How much of this is due to moral hazard, bad banking practices, bad luck or mismanagement?

134. Therefore, on balance, consumers should be afforded more protection than other depositors and their deposits should be insured against loss

**What would it look like if the CDI was rolled out across all consumer deposits?**

135. The Consumer Deposit Insurance premium would be collected and paid by the institution (compulsory). This would not be visible to the consumer, however, the interest rate on deposits would likely be slightly lower than would otherwise be if no insurance scheme existed

136. All retail deposits would be included in the calculation of the CDI premium, regardless of entity i.e. companies, trusts, individuals etc. This is because it can be difficult to ascertain exactly who the underlying customer is, and therefore, funds could easily be moved from non-consumer entities (where CDI premiums hadn't been collected) to consumer entities as the customer got nervous. Likewise, this prevents customers from choosing to deposit into accounts excluded from the CDI to avoid the CDI premium so as to attract a higher interest rate and then transfer them to a covered account later

137. Therefore, the CDI premium rate is levied across all deposits. However, the premium rate is reduced. For example, if the CDI premium rate was 0.01% p.a. on Super Saver accounts, and it was estimated by the RBNZ that consumer deposits made up 50% of all retail deposits in NZ institutions, then the CDI premium would be changed to 0.005% p.a. when rolled out across all deposits

138. The big difference between CDI, FDIC deposit guarantee in the US and other government guarantees around the world is that the CDI has an excess limit. All other schemes have 100% guarantee, usually up to a specified amount

139. Consumers are familiar with the concept of an excess in insurance. The slight variation is that typically in insurance, an excess is a set amount, and the customer decides whether it is worth making a claim or not. The CDI excess is a percentage limit. The customer has no control over whether a claim is to be made or not, so the limit states that the customer's loss in the event of a claim will be from 0% to a maximum of the excess limit. For example, if the excess limit for a bank is 10%, then the customer's exposure is up to a maximum of 10% of the balance of their account

140. The CDI will also only be available to NZ citizen & permanent resident consumers. It is only available for accounts in individual's name (individual & joint accounts). It does not include the RBNZ Super Saver or Consumer Premium accounts, even though these hold consumer funds

141. Like any insurance, the premium and excess to be applied is subject to the risk that the asset is placed under

142. The RBNZ would set premium and excess levels for the participating institution based on the RBNZ risk assessment, the institution's credit rating and the institution's Tier 1 Capital Ratio

143. Wherever the institution displays / notifies their deposit interest rates, they will be required to display/notify the consumer's excess limit. For the most part, New Zealand banks will, due to their credit ratings and Capital ratio, have a 0% consumer excess limit (see below for an example of how the premium and excess limit is calculated). The Super Saver account will always have a 0% excess limit, regardless of what the excess limit is for the other accounts at the institution

144. This Consumer Deposit Insurance is in addition to a Government Guarantee given, if any, under the Open Bank Resolution (OBR) when the OBR is invoked

145. As stated above, it is a deposit insurance scheme for NZ consumers only, and is funded by consumers. It is not a Government Guarantee nor is it funded or underwritten by the Government. It is proposed, however, that it be administered by the RBNZ on behalf of the Government and as part of the OBR framework

146. As per the Super Saver accounts, immediate cover for consumers is limited to the funds available in the RBNZ Consumer Premium account and the Consumer Premium Fund, and paid out in that order

147. There is no sum insured limit per person

148. Unlike the Super Saver account, pay-out will be paid out equally to all, rather than on an age-related basis

149. The Moral risk of having depositor's funds guaranteed is reduced by:

149.1. Capital Ratios and other regulatory oversights currently in place

149.2. Having the excess recorded as a contingent liability of the institution (refer to 167 below)

149.3. RBNZ performing risk analysis and increasing premiums and / or excess rates if the risk levels increase. The increase in premiums will impact on the institution's profit margin if they are unable to pass this increase on to customers. The increase in excess level will deter depositors, which will increase funding costs

149.4. The risk of the RBNZ restricting the volume of additional funds into the Super Saver accounts. This would send a major message to the market regarding the risk level of the institution

149.5. Super Saver accounts, at least initially, will represent only a small proportion of the institution's funding

149.6. Industry oversight, as an institution may incur costs if another institution makes a call on the CDI

150. A limited number of participating institutions will enable more oversight & risk analysis by the RBNZ. Therefore, at least initially, the CDI may be restricted to the larger banks

151. A simplified example of how premiums and excess levels may be set:

151.1. Tier 1 capital margins based on Credit Ratings (S&P ratings used in example):

| | | |
|---|---|---|
| AAA | 1.25% | Allows a safety margin and moral risk factor of having deposit insurance |
| AA+ | 2.0% | |
| AA | 2.25% | |
| AA- | 2.5% | |
| A+ | 2.75% | |
| A | 3.0% | |
| A- | 3.25% | |
| BBB+ | 4.0% | |
| BBB | 4.25% | |
| BBB- | 4.5% | Adequate capacity. Investment grade – lower / medium grade |
| BB+ | 5.0 | Non-investment grade / speculative |
| BB | 5.5 | |
| BB- | 6.0 | |
| B+ | 8.0 | |
| B | 10.0 | |
| B- | 12.0 | |
| CCC+ | 17.0 | Substantial risk |
| CCC | 22.0 | |
| CCC- | 27.0 | |
| CC | 37.0 | |
| C | 50.0 | |
| D | 100 | |

151.2. For calculating the premium and excess levels for an institution, the above margins are added to the Tier 1 capital regulatory requirement of 6%. Therefore, calculation for a AAA institution would be based on a Tier 1 capital CDI target of 7.25%, an AA- institution (the big 4 banks in NZ) would be based on a Tier 1 capital CDI target of 8.5% (current recommended buffer level for banks by RBNZ). An A+ (Kiwibank) would have a CDI target of 8.75%, while A- (TSB) would have CDI target of 9.25%. Currently, all these banks have Tier 1 Capital Values well above these Capital targets

152. The RBNZ would set a risk analysis margin. It is likely to be 0% for the above banks

153. If The RBNZ detected stresses or heightened risk exposures that were considered to be not adequately reflected in the institution's Credit rating or Capital ratio, then the RBNZ would add a margin. In the case of South Canterbury Finance, the RBNZ would most likely have set a margin of 1.75%, being the difference between SCF's reported Capital ratio of 6.73% and RBNZ's analysis of a 5% Capital ratio. The RBNZ may have applied a higher margin than this, if it also felt that the lending was particularly risky or had a likelihood of deteriorating due to market conditions, or due to SCF having been declined entry to the wholesale funding program

154. If CDI was rolled out to a larger number of institutions, then the RBNZ may set a default margin e.g. 2% on those institutions that they do not do the same level of risk assessment on as they do for the main banks

155. The RBNZ, obviously, is well versed in determining risks and risk related spreads. Now that they also provide Prudential Supervision of the Insurance industry, their access to actuaries for determining insurance premiums and excess levels would have presumably increased. Therefore, the CDI is a natural progression in insurance

156. The RBNZ may use a negative margin. This may be due to the institution adequately ring-fencing risky loans against specific high risk taking accounts / deposits, or where the RBNZ assesses that the credit rating and capital ratio overstates the likely risk to consumers e.g. due to the high percentage of owner occupied properties on their loan book &, therefore, lower exposure to rental properties, the effect on TSB in the event of a major property value shift downwards may not be as great as the drop in property prices or a subsequent drop in TSB's credit rating may suggest. Another example may be that the RBNZ wants to use the excess limit as a stabilising tool for the financial market in times of turmoil i.e. another GFC

157. The CDI premium is set at 0.01% (1 basis point). For every 1 basis point that the institution's Capital Ratio is below the CDI target, the premium rate is increased by 0.001% (0.1 basis point). The limit for the CDI premium is 0.025% (2.5 basis points)

158. For the CDI excess limit, for every 1 basis point that the institution's Capital ratio is below the CDI target, the excess amount increases 0.01% (1 basis points)

159. For example, changes to South Canterbury Finance excess as their credit rating fell (assuming that their Capital ratio remained unchanged at 6.73% and a Tier 1 Capital regulatory requirement of 6%):

| | S&P rating | Ratings based margin | RBNZ margin | Tier 1 Capital CDI target | CDI Premium | Customer's excess on their accounts |
|---|---|---|---|---|---|---|
| Dec 2006 | BBB- | 4.5% | 0% | 10.5% | 0.025% | 3.75% |
| Nov 08 | BBB- (RBNZ review) | 4.5% | 1.75% | 12.25% | 0.025% | 5.5% |
| Aug 09 | Downgraded to BB+ | 5.0% | 1.75% | 12.75% | 0.025% | 6% |
| Mar 10 | Downgraded to BB | 5.5% | 1.75% | 13.25% | 0.025% | 6.5% |
| May 10 | Downgraded to B- | 12.0% | 1.75% | 19.75% | 0.025% | 13% |
| Aug 10 | Downgraded to CC | 37% | 1.75% | 44.75% | 0.025% | 38% |

160. Now a consumer wanting to deposit $1,000 in SCF in November 2008 (if SCF was included in the CDI scheme) would see that an excess of 5.5% applied to this deposit, so up to $55 was at risk. This would provide the customer with more, easily obtainable and understandable, information in which to make their investment decision. It should be more meaningful, and to most should have been a greater deterrent, therefore, pushing up the interest rates of SCF to reflect the risk that depositors were taking

161. The risk analysis has been performed for the consumer and combined with an assessment of possible financial loss in a single, clear indicator. For the consumer, like all things when it comes to insurance, it is not so much about the likelihood of an event occurring as much as their ability to cope with the impact should that event occur. The consumer can then make their own judgement as to how much loss they are prepared to incur for the extra interest rate received compared to other institutions

162. The excess limit is not designed to substitute/reduce a customer's loss with funds from the CDI. Ideally, any loss incurred by the institution will be met within the excess limit, and not by other consumers or the tax payer. However, as well as providing clarity to consumers of how much of their funds are at risk, it also puts a floor under it. This is important, especially if the market moves faster than the consumer can reasonably be expected to react. For example, with SCF, it would have been expected that consumers would have wanted to remove funds when they were notified of SCF's downgrade to CC (excess limit of 38% from 13%), if they hadn't already done so. For those consumers that had their funds on call but did not remove them before SCF was placed into receivership (or OBR these days), they would have lost 38% of their funds and the CDI would have covered the remaining (approximately) 12% of their balance (assuming a 50% OBR haircut). The speed at which SCF went from a downgrade to CC into receivership would not have allowed another excess limit to have been notified and implemented. For those customers that had their funds on a fixed term, their excess level would have been whatever was current at the time the fixed rate was taken e.g. 5.5%. In the event of SCF's receivership, these consumers would have lost 5.5% of the balance of their funds and the CDI would have covered the difference (approximately 44.5%). This is important for stability of the financial system

163. In the SCF example in 162 above, it is likely that the RBNZ would have increased their margin significantly either at the time of or prior to the downgrade to BB+. This would have prevented consumers from continuing to deposit into SCF, or at least, from depositing without a clear understanding of how much of their funds were at risk and with the clear understanding that there would be no CDI cover or government bailout for those funds within the excess limit

164. The CDI premium and excess is borne by the customer, in that:

164.1. CDI premium via interest rate

164.2. Excess as percentage of account balance

165. When a customer fixes the interest rate e.g. a Term Deposit, the excess limit applicable at that time is also fixed

166. The institution is able to determine the amount of the premium to be borne by the customer, by:

166.1. Redistributing the CDI premium cost across other depositors or borrowers, or

166.2. Reducing the institution's profit margin

167. Accounts at an institution may have different excess levels, so that customers with a propensity for risk are able to obtain a higher rate of interest, knowing that the funds were being invested in a higher risk category e.g. development projects, and having a greater amount of their funds at risk. Specific lending, or type of lending, could then be linked to certain accounts (or types of accounts), thus insulating other customers. These accounts are likely to be restricted by minimum deposits e.g. $50,000. This is moving private financing into the mainstream. (The CDI premium is still paid on these accounts)

167.1. When an institution reallocates some or all of this excess value to other accounts, a contingent liability (CDI excess) for this amount will be added to the institution's balance sheet. This is because these funds assuming to take this extra risk are a flight risk

167.2. The CDI excess contingent liability must be reported as a note to the financial statements regardless of its value (to be a RBNZ mandatory requirement)

168. The excess applicable to an account must be highly transparent to the customer, and will be one of:

168.1. A percentage, clearly defining that up to this % of the balance of the account is payable as an excess. Where the participating institutions offer higher risk accounts that will not be covered by the CDI at all, they will display an excess limit of 100%

168.2. "Non-participant" if the institution is not eligible to belong to the scheme or has decided to opt out

169. The customer must be notified if their excess changes

170. If the RBNZ instigates the OBR, then the de minimis threshold would still be applied to the account, regardless of the CDI excess limit on that account. This is imperative to enable the OBR to work efficiently. Therefore, funds between the de minimis threshold and the excess amount, if any, are still frozen under the OBR

171. If the institution is placed into receivership, or depositors are required to be given a haircut under the OBR , then the amount of the loss to the depositor is limited to their excess amount and the remainder is made up by a claim on the CDI fund, which, in the first instance, will be on the RBNZ Consumer Premium account at the institution

172. If the institution participates in the Super Saver scheme, then the CDI premiums will be:

    172.1. deposited into the RBNZ Consumer Premium account at that institution, otherwise,

    172.2. paid to the Government Superannuation Fund managers for depositing into the Consumer Premium Fund

173. Institutions that participate in the Super Saver scheme will, by default, also participate in the CDI program. They are not permitted to opt out while participating in the Super Saver scheme

174. The RBNZ will determine which institutions not participating in the Super Saver scheme are eligible to participate in the CDI scheme. Eligible institutions are permitted to opt in and out of this scheme

175. If the Government (taxpayer) Is required to fund a loss due to the Government Guarantee invoked by the OBR, then the consumer portion will be funded in full or in part, by the RBNZ Consumer Premium account at the failed institution and/or Consumer Premium Fund

176. Where an institution has been placed into receivership, any consumer funds that remain frozen (due to depletion of available funds from the Consumer Premium Fund), will be transferred to remaining institutions in the numbers / values as determined by the RBNZ. They will be non-interest bearing (except for Super Saver accounts) and have an excess limit of 0%. They will remain frozen and be released as funds become available from the Consumer Premium Fund

177. While a Deposit Insurance would normally increase the amount of passive foreign investment, this scheme would not, as it only applies to NZ consumer deposits i.e. citizens and permanent residents

178. The Moral Hazard is addressed from multiple angles:

    178.1. The risk based premiums (as seen in the Retail Deposit Scheme and the Bibby Plan)

    178.2. The customer excess level

    178.3. Potential costs to other institutions if the CDI is called upon

## Further Super Saver details

179. The intent is to:
    a) Focus on increasing the number of regular long term savers, rather than the amount being saved by the individual. Increasing the dollar amount of regular savings comes later
    b) Ensure that institutions are advantaged by providing Super Saver accounts, not disadvantaged. It is imperative that lending made against these funds not only cover the interest paid on Super Saver accounts (at the Funding rate), the Consumer Deposit Insurance premium and the account maintenance costs, but also provide a greater profit than using overseas funding. If, however, the reserve bank increases the CDI premiums for an institution due to a change in its risk assessment, then this would eat into that profit margin

180. The 5% market share participation threshold will include the ANZ, ASB, BNZ, Kiwibank & Westpac. Should all 5 institutions decide to participate, that would cover approximately 90% of the personal / residential market. The RBNZ will be able to vary this threshold up or down. Additional institutions will be eligible to join the Super Saver scheme when they reach the threshold. Once an institution has joined the scheme, falling below the threshold will not effect their eligibility status

181. The RBNZ Super Saver account will be on the Reserve Bank's balance sheet rather than directly on the Government's to provide separation & prevent confusion with the Government's Superannuation Fund and other Funds

182. Simple to implement, simple to manage, simple to monitor, and simple for the public to understand

183. There are no minimum deposit amounts or frequency for deposits into the Super Saver account (other than for the Super Saver A/T). This better suits people with irregular income & those that receive lump sums

184. As the Super Saver fund grows (over many decades):
    184.1. The Funding rate will have more impact on fixed lending rates
    184.2. It will replace more overseas funding
    184.3. It will improve the security and strength of the banking system

185. The transferring of excess funds from the RBNZ Super Saver account to the Government Superannuation Fund is part of the move from a Pay as you go (PAYGO) system to a Save as you go (SAYGO)

**Deceased account holder**

186. Upon the death of the account holder, the account is subject to probate as per current probate rules for deceased accounts

187. RWT is deducted from those interest transactions that have deferred RWT before distribution

188. Restrictions on transactions from being withdrawn i.e. restrict for 5 years, restrict until the age of 65 etc. are removed

**Collateral & borrowings**

189. Customers will not be able to use funds in their Super Saver account as collateral for lending. The exception to this may be for first home buyers due to political reasons

190. There is no restriction or attempt to restrict the borrowing of money to deposit into a Super Saver account

**Kiwi Saver**

191. Not part of Kiwi Saver, so there is no employer contribution or other concessions / allowances that are available to Kiwi Saver either now or in the future

**Student Loans**

192. The Super Saver account holder has the option to have some or all of their Super Saver interest paid to the IRD for crediting against the account holder's student loan
    - 192.1. Tax is not deducted from the interest
    - 192.2. Is optional. Any attempt to force payment of the student loan from this scheme may be a disincentive to contributing to this Super Saver scheme, and any diverted contributions may not end up being saved elsewhere or paid towards the student loan either
    - 192.3. Interest recalculation & RWT deduction would still occur on deposits withdrawn within 5 years
    - 192.4. While reducing debt is an important part of long term savings, this interest payment is only permitted for student loans, not other personal loans or mortgages. This is because the Government, and therefore the taxpayer, is bearing the cost of providing an interest free student loan, so all efforts should be made to encourage its repayment in the shortest time practical

**Customer transfers**

193. Customers cannot transfer their Super Saver account to another institution. They would need to withdraw their funds and deposit this as a new deposit at the other institution. This reduces administration and also prevents institutions from enticing customers to transfer their funds. Depositors are, however, permitted to hold Super Saver accounts at more than one institution

**Withdrawal from or limitation to scheme by institution**

194. If an institution wants to leave the scheme, they are required to:
    - 194.1. Obtain permission from the RBNZ to stop accepting deposits
    - 194.2. Negotiate with another institution(s), approved by the RBNZ to take over the Super Saver accounts
    - 194.3. Transferred accounts will retain aging information so that the depositor does not lose their bonuses
    - 194.4. RBNZ Super Saver balance is transferred to the new institution, or proportioned if multiple institutions
    - 194.5. Home Equity Fund accounts would also be required to be transferred to the new institution(s)

194.6. An interbank loan for the combined Super Saver and RBNZ Super Saver account balances would be set up to replace the funding. The banks may negotiate the interest rate, as it may be different to the Funding rate i.e. may be the Funding rate plus a margin

195. An institution is not permitted to restrict or prohibit deposits into the Super Saver scheme without obtaining permission from the Reserve Bank

**Bonus draws & other campaigns**

196. The institution contributes 10% of the non-multiplier value of bonus draw funding from their own funds. This equates to $34k per annum based on up to $700k of Super Saver automatic transfers per month

197. On implementation of the Super Saver scheme, the institution contributes 0%, then it gradually increases over a number of years to the 10% level

198. As well as the 10% contribution, the individual institutions run, promote, manage and design campaigns for the Super Saver bonus draw and other campaigns at their discretion. The institution contribute to this scheme because this scheme will become a major source of stable domestic funding for the institution and cheaper than overseas funding

199. The institution is permitted to run marketing campaigns at their discretion to encourage the uptake of this scheme

199.1. Any such promotion may include prize money which up to 80% will be funded from the RBNZ Super Saver account up to an annual quota

199.2. Any campaign that is run by the institution where RBNZ account funds are contributing to have the following entry restrictions for customer eligibility:

a) Must have an active Super Saver A/T

b) Super Saver A/T must have continuous transfers for at least the previous 12 months (except for those monthly Bonus drawer and campaigns specifically aimed at increasing new enrolments)

c) Customer may not have any withdrawals during the period of the campaign (except for over 65 year old's automatic withdrawal)

**General**

200. There is unlikely to be anything about this scheme that a customer would complain about i.e. fairness, false advertising, or enticement causing financial hardship. Any complaint is unlikely to be upheld by the banking ombudsmen, as there is no financial loss to the customer

201. In times of hardship, encourage the customer to reduce the savings amount if they have to, but not to stop saving altogether i.e. crawl if they have to but keep them going

201.1. [include example demonstrating why it is better to keep saving a little bit into the Super Saver scheme even while paying off high interest bearing debt – as this does not align with Marry Homes advice in RBNZ booklet]

202. The biggest long term impact to NZ's household savings rate may lay in encouraging parents & caregivers to set up a regular savings amount for a child from birth. Parents & caregivers, who, no matter what, cannot be enticed to save for themselves, may be willing to save a little bit regularly for a child. The amount is not important. $1 per week would be fantastic. It is the regularity that is important. The child is more likely to continue this regular savings when they take over the payments from their parent / caregiver, almost automatically. Once they have the habit of saving regularly, then the amount of savings can be targeted

203. Five years is used as a lot of cut offs i.e. restriction on withdrawals, reductions & RWT payments on withdrawals, to ensure that customers have still got financial records and time to dispute any of these time constrain transactions, as customers are only required to keep financial records for 7 years for tax purposes

**Customer communication**

204. Paperless communication. All statements and communications by email and/or secure bank electronic mail i.e. messages when logged on to online banking

**Impacts**

205. It is extremely, extremely unlikely to have any detectable effect on institutions like The Lotteries Commission, Kiwi Bonds or on GDP. At most the likely impact will be 10% of the impact caused by the introduction of Kiwi Saver. However, if by some improbable stroke of fortune, it did impact on:

206. The lotteries commission

206.1. Reducing Kiwi's gambling could hardly be considered an undesirable effect. It is also inconceivable that Kiwis have such a propensity to gamble that having the Super Saver Monthly Bonus draw is going to coerce people to save more than they can really afford just to be able to enter the draw, or that entering or even winning the draw would entice them to take up other forms of gambling

207. GDP

207.1. By definition, savings is a reduction in consumption. However, the turnaround required in NZ's household savings rate to make a detectable impact on GDP is unimaginable. While there is a limit beyond which saving may become too much for the balance of the economy, it's not something even remotely foreseeable for NZ

208. The stock exchange & housing market

208.1. While for some this scheme may offer a viable alternative to those other investment types, again, it is extremely unlikely to make a detectable impact. The people that it does attract away from those markets may, in fact, be better suited to the security and stability of this scheme. It is unlikely that the Super Saver scheme would encourage investment in these other markets. Any effect, whether detectable or not, if perceived as a negative impact is unlikely to outweigh the positive benefits of increasing the household savings rate. The Super Saver scheme is not designed to be a fix for the housing market

209. Kiwi bonus bonds

209.1. This will depend entirely on the individual, their tolerance for risk and their assessment of the likelihood and frequency of winning the bonuses in either scheme or the pay-out values. However, introducing this scheme will not reduce the savings rate of those that invest in the Kiwi bonus bond scheme and may help to increase their savings rate

210. The Japan effect

210.1. Where Kiwis follow the Japanese example and are so intent on saving that they cannot be enticed to increase their consumption. Yeah right!

211. Heart Foundation Lottery and other such lotteries, raffles and fund raising may be impacted by a reduction in disposable income

## Other Super Saver benefits

212. Depositors don't always want to lock up funds in Kiwi Saver until retirement. While there is a significant disincentive to withdraw funds early from this Super Saver scheme, there are many reasons why people will want to retain access e.g.

212.1. For security:

a) In case of a change in needs / circumstances, medical needs (may not be severe enough to permit funds withdrawal from Kiwi Saver e.g. elective surgery), care needs, kid's education or helping them into their first home, early retirement

b) As well as security, the sense of ease in knowing that funds are accessible if the want / need arises without having to ask permission & being at risk of being denied

c) Against job loss

212.2. A sense of Freedom:

a) The thought that you really could chuck your job if you wanted to, or go overseas on holiday to get away from the cold. You are not going to, but it would be nice to be able to tell yourself that you could, if you really wanted to!

212.3. If it is expected that funds will be required within five years, other investments i.e. Term Deposits, will provide a better return. However, some people may accept the lower rate (or even the zero rate) of return on early withdrawals to have the security of the Consumer Deposit Insurance (if the CDI is not rolled out across all deposits)

213. This scheme would work alongside Kiwi Saver rather than as an alternative. It would also be a good option for those that have already opted out of Kiwi Saver and that do not intend to ever opt back in

214. As the OCR drops, pensioners will still have a reasonable return on their investment. As the population ages, and pensioners increase as a percentage of consumers, dropping the OCR rate & reducing disposable income for pensioners will have a larger impact on the total value of consumer spending, thus accentuating a slowing economy. Therefore, making an income level of 6% less tax, will help to safeguard pensioner's living standards (with the political benefits this brings) as well as assisting the economy by ensuring a continued level of consumer spending

215. While returns on interest bearing deposits are low, as they are currently, having a minimum of 6% p.a. and a Consumer Deposit Insurance will reduce the pressure on people to move to appreciating assets in order to maintain their savings momentum or to higher yielding/risk investments to maintain their incomes. This helps to reduce pressure on assets such as housing as well as protecting people from themselves

216. Conversely, when returns on other asset classes begin to exceed that of a Super Saver account, the withdrawal restrictions & penalties as well as the Consumer Deposit Insurance and tax incentive give people an excuse to use to other people as well as to themselves as to why they have to leave their funds in the Super Saver account instead of chasing the favoured investment of the month. This will help to minimise the level of bonus interest required to keep people in the scheme, which in turn, limits the amount of inflationary pressure

217. Easier for people to plan for retirement, as they know what minimum level of income they will get from a targeted investment amount

218. Consumer Deposit Insurance on deposits – provides security to the older population who are no longer in a position to recoup financial losses. Provides direction for the public as to where to invest for security. As only the biggest institutions participate, it is very unlikely that the Government would be required to act to underwrite the CDI, so presents minimal practical risk. It would also prevent the government from having to implement another Retail Deposit Guarantee Scheme covering a large number of institutions as happened in 2008. The Government will now have a legitimate reason why not to bail out other financial institutions. The public will also be less tolerant of government bailouts to non-CDI schemes

219. As well as a greater number of older people cashing up their property, there will also be an increase in funds becoming available from Kiwi Saver. This too will add price pressure to assets such as housing. Super Saver may provide an alternative investment

220. This scheme does not detract from the work previously done to encourage people to invest in assets, as this scheme will more closely resemble and, therefore, be a substitute for other types of assets i.e. housing, for some people

221. Home Equity Fund – This scheme offers a more viable alternative to Reverse Mortgages, which may assist the Government in their objective of keeping people in their own home for longer

222. This Super Saver scheme may also facilitate others to downsize or relocate earlier than they currently would, freeing up housing stock in high demand areas, as there will be a viable option for safely investing their surplus and generating a satisfactory income. However, the impact of this on the housing market would most probably be undetectable

223. Keep it separate from Kiwi Saver. They are similar in their goals but target different types of savings. Kiwi Saver for the earnings based and regular contributions, with its employer contribution, contribution based member tax credit & tight withdrawal restrictions. Super Saver to fill the gap between Kiwi Saver and other investment types, with its deposit guarantee, guaranteed minimum return, tax exemption and withdrawal penalty to promote long term savings

224. Monthly reporting to the Reserve Bank / Statistics NZ by IRD# by the institution allows for detailed analysis to determine impact & effectiveness of environmental & regulatory changes. By supplying IRD#, funds are able to be categorised for further analysis e.g. by location, age bracket, gender & be tracked over time to determine how people save. May be desirable to report new withdrawal requests weekly, so that Reserve Bank can head off any destabilising change in environment

225. When interest rates on home loans are lower than the minimum 5% p.a. Super Saver interest rate, people could borrow money against their home & deposit it into their Super Saver account. The funds in the Super Saver account would compound at 5% p.a. for 5 years and then at 6% p.a. while they repay their mortgage at the lower interest rate. This could be a form of self-enforced savings. No point in restricting this as it is not very likely and would unlikely have negative impacts anyway

226. For customers under the age of 65, this scheme is a Tax, Exempt, Exempt (TEE) based scheme. Once 65yrs old, the scheme changes to a Tax, Tax, Exempt (TTE) based scheme for that customer

227. Long Term savings will increase the size of NZ's Capital market. The size of NZ's Capital market has long been criticised as being a constraint to growing NZ's economy. The more that the Government and businesses are able to raise long term funds from within NZ instead of from overseas borrowing, the stronger & more secure the NZ economy will be

228. It is widely reported that home ownership level is falling and also that those people relying on NZ Super that own their own home have a higher standard of living than those that do not own their own home. This alternative offering may help to remove the smaller property investors (1 or 2 properties) from the market, not only freeing up properties but also removing anomalies that are causing a distortion in this market. One of the main distortions is between rent returns and property values. It is unlikely, however, that this effect would be detectable

229. Still not as good a return as property, but for many it may be good enough given its low effort, low risk, satisfactory rate of return and liquidity, especially the ability to access smaller amounts of funds at a time as the need arises

## How to get there

230. The sooner we start, the sooner we will get there

231. Once the necessary planning, legislative changes, agreements, procedures and infrastructure have been completed, implement the Super Saver scheme with participating institutions with the Consumer Deposit Insurance and tax exemptions in place.

232. The existing bank funding rates, Term deposit rates and lending rates at the time of implementation will determine what the Deposit rate will be for depositors. If these rates have risen back to more historically average rates, then the Super Saver scheme could be launched with the minimum rate levels of 5% p.a. Base rate and 1% p.a. (or higher) Bonus rate. Bearing in mind that it will be 5 years after implementation before any deposits will be eligible for the Bonus rate current at that time.

233. If the bank rates are still lower at implementation time, then a staggered interest rate could be used. For example, Base rate could be set at 3% and gradually increased to 5% as the OCR and bank interest rates rise. Alternatively, implement the Home Equity Fund scheme prior to the Super Saver scheme to supplement the interest to be paid to the Super Saver accounts. The Super Saver scheme can then be launched with a higher Base rate depending upon the uptake of the Home Equity Fund scheme. This could also be achieved using the Consumer Premium if the Home Equity Fund scheme is not implemented

233.1. The faster the RBNZ account can be funded, the more resilient the scheme. It is not justifiable for the Government to incur interest costs to borrow money to increase the RBNZ account in order to subsidise private savings

233.2. It may be beneficial to have additional Bonus draws for a limited period to attract savers during the launch phase e.g. special introductory Bonus draw of $2k for 6 months of automatic savings run for the first few years of this scheme

## The numbers

### Consumer Premium

234. Assuming the five main banks participated in the Consumer Premium scheme:

| Bank | Total residential mortgages ($m) | @ 0.1% p.a. (10 basis points) ($m) | Monthly ($m) | Maximum rebate per month ($m) | 50% transferred to Consumer Premium Fund managed by GSFA ($m per month) | 50% retained at bank in the RBNZ Consumer Premium account ($m per month) |
|---|---|---|---|---|---|---|
| ANZ | 69,000 | 69 | 5.75 | 1.77 | 1.99 | 1.99 |
| ASB | 46,500 | 46.5 | 3.88 | 1.18 | 1.35 | 1.35 |
| BNZ | 32,000 | 32 | 2.67 | 0.81 | 0.93 | 0.93 |
| Kiwibank | 15,500 | 15.5 | 1.3 | 0.4 | 0.45 | 0.45 |
| Westpac | 51,000 | 51 | 4.25 | 1.29 | 1.48 | 1.48 |
| **Total** | **214,000** | | **17.85** | **5.45** | **6.2** | **6.2** |

a) RBNZ April 2016 (S8) Residential mortgages total (all registered banks) $220.6b. 60% floating or fixed for less than 1 year. 35% fixed less than 3 years. Therefore, Consumer Premium would be applied to 95% of residential mortgages within 3 years

b) RBNZ April 2016 (C22) Household mortgages $135.5b (61.5% of total mortgages at registered banks). In the above example, ANZ with total residential mortgages of $69b at a Consumer Premium rate of 0.1% p.a., would collect $5.75m per month. With 61.5% being household mortgages (mortgages on owner occupied residential properties), the monthly household portion of the collected $5.75m Consumer Premium is $3.54m. If everybody earnt the maximum 50% rebate, this would be a total rebate of $1.77m, leaving $3.98m per month to be split 50/50 between the RBNZ Consumer Premium account held at the ANZ and the Consumer Premium Fund managed by the GSFA

c) The RBNZ will determine what total level of funding to maintain across the RBNZ Consumer Premium accounts at the participating banks and the Consumer Premium Fund managed by the GSFA to ensure adequate funds are available for the Consumer Deposit Insurance scheme. Funds surplus to this requirement may be transferred from the Consumer Premium Fund to the Government Superannuation Fund

### Super Saver

235. As at 30th June 2015, Kiwi Saver had 2.5m active members, 64.5% of the population under 65, with $5.3b contributions per year. Kiwi Saver was started in 2007 and has $25b in total contributions

a) An uptake rate of 10% of existing Kiwi Saver contributors in the first year would be 250,000 customers

b) With an average savings rate of 0.5% of the average wage as a weekly contribution ($5 per week), would equate to $1.25m per week, $5.4m per month, $65m in the first year

c) The minimum retained Consumer Premium amount, even at the minimum rate of 0.1% as used in the above example, of $12.4m per month is over twice this $5.4m monthly savings amount, so would provide more than adequate Consumer Deposit Insurance coverage for the Super Saver account as it grows. This Consumer Premium amount would also be enough to provide funding for the Super Saver accounts should the Super Saver scheme be launched with a 5% base rate and a funding rate of 2% and if the Home Equity Fund scheme was not implemented to provide the additional funding

236. At this $5.4m savings per month, this would enable (approximately):

a) 9x draws of the $10,000 Super Bonus 1 draw, if this level of savings was unchanged after 5 years (eligibility for Super Bonus 1 is regular savings for at least 5 years)

b) 9x draws of $5,000 Super Bonus 2 draw (once scheme has been running for 2 years)

c) 27x draws of $1,000 Major Bonus 3 draw (once scheme has been running for 12 months)

d) 54x draws of $500 Major Bonus 4 draws (once scheme has been running for 12 months)

e) $54,000 Bonus pool

f) Total prize draw of $243k per month, spread across the 5 participating contributing institutions

g) Funded by $5.4m @ 1% p.a. for 5 years = $275k (Bonus interest rate not paid out on deposits for first 5 years)

237. If the long term target was set at 2m people and a 3% of average income savings rate, then:

a) Weekly savings rate of $30 would equate to $60m per week, $3.12b per year

b) If the Consumer Premium was set at 0.5%p.a., this would enable customers with a mortgage of $312,000, by saving $15 per week into their Super Saver account by way of a Super Saver Automatic Transfer, and having this matched with their $15 rebate (50% Consumer Premium rebate), to achieve this target savings rate of $30 per week. After allowing for adequate CDI coverage for the growth in savings, over $400m p.a. would be available for transferring to the GSF (about 3% of the annual Superannuation pay-out)

## Consumer Deposit Insurance

238. If only applied to the Super Saver account, the Consumer Deposit Insurance premium would be calculated at 0.01% p.a. on the daily balance of the Super Saver accounts and paid monthly to the RBNZ Consumer Premium account held at the institution

239. If rolled out across all consumer deposits, then the monthly CDI premium would be applied at 0.005% p.a. of the daily balance across all deposits and paid monthly to the RBNZ Consumer Premium account at the institution (i.e. household / consumer deposits make up about 50% of total deposits), as follows:

| Bank | Total Short term & on-demand deposits ($m) | Total Term deposits ($m) | Monthly (@ 0.005% pa) |
|---|---|---|---|
| ANZ | 51,000 | 37,500 | 370,000 |
| ASB | 29,000 | 22,500 | 214,500 |
| BNZ | 22,000 | 25,000 | 196,000 |
| Kiwibank | 14,500 | | 60,500 |
| Westpac | 44,000 | 12,000 | 233,000 |
| Total | 160,500 | 97,000 | 1,074,000 |

240. Combined with the Consumer Premium on mortgages and with the Consumer Premium rate at 0.1% p.a., this would provide between $7m and $9m per month (depending upon the rebate amount claimed) to the Consumer Premium Fund. If the RBNZ set the Consumer Premium rate at 1% p.a., then the transfer to the Consumer Premium Fund would increase to between $62m and $85m per month. Therefore, depending upon the Consumer Premium rate set by the RBNZ, it could take as little as 1.5 years or as much as 17 years to recoup the $1.2b loss under the Retail Guarantee Scheme due to the failed financial institutions

241. If the CDI is rolled out across all consumer deposits, and with having had to pay out $2b under the Retail Deposit Scheme, the RBNZ may want to keep $3 - $4b available across the RBNZ Consumer Premium accounts and the Consumer Premium Fund. This would be 2% to 3% of total consumer deposits

## What if it doesn't work?

- If it doesn't increase household savings level, or
- has unexpected and untenable effects

242. Close down Super Saver & transfer funds to a term deposit / bank account – worst case scenario the account holder still has more money than they began with

243. Remove Consumer Premium from loans once RBNZ Consumer Premium account has been funded (if depleted while topping up Super Saver accounts). Transfer any remaining balance to the Government Superannuation Fund

244. Repay Home Equity Fund mortgages and discharge mortgages

245. There is no other apparent loss to the customer

246. Any manipulation to the financial system, whether by policy, intervention or otherwise, will always cause anomalies – some detectable, some not. It is whether the anomalies created by this scheme have undesirable effects which outweigh the positive benefits obtained by this scheme

247. If undesirable effects of anomalies cannot be compensated for by manipulation of this scheme's few parameters e.g. interest rates, participation constraints, then this scheme must be terminated. If policy changes are required, or extra conditions need to be added onto here and there, then it has failed and no attempt to correct it will compensate for the fundamental flaw in its design and it will become a burden to the wellbeing & operation of the financial system