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Prudential Supervision Department
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Submission on New Zealand Response to Foreign Margin Requirements for OTC Derivatives

We are pleased to set out below a submission from RITANZ (Restructuring, Insolvency, Turnaround Association of New Zealand) on the Reserve Bank of New Zealand and Ministry of Business, Innovation and Employment's Consultation Document on a New Zealand Response to Foreign Margin Requirements for OTC Derivatives.

RITANZ is a professional industry body with over 440 members throughout New Zealand, of which some 100 members have been granted the status of Accredited Insolvency Practitioner who administer formal insolvency appointments subject to accreditation criteria. Its membership includes the Accredited Insolvency Practitioners and their staff, lawyers, bankers, academics, and other individuals who work in or have an interest in the insolvency profession.

RITANZ's mission is to:

- support insolvency and recovery professionals in their quest to restore the economic value of under-performing businesses;
- assist financially challenged individuals; and
- help develop, maintain, and promote the integrity of the insolvency profession.

Our submission is simply from the perspective of an insolvency practitioner and the creditors who the insolvency practitioner will deal with. Other industry bodies may have a more informed perspective on the detail of how the proposals would operate with respect to types of derivatives etc.

Summary

1. RITANZ's views on the Consultation Document are that:

1.1 RITANZ understands the need for the legislative change proposed, in order to protect the stability of New Zealand's finance system as a whole;

1.2 The scope of any changes should be clear and the minimum required to achieve compliance with foreign rules, as the proposed changes will be inconsistent with the current order of priority with respect to preferential creditors (although preferential creditors are unlikely to be affected);

1.3 There will be practical difficulties in the event of the insolvency of a large financial institution. It is unrealistic to expect an insolvency practitioner to review the position within one business day, in what would be a highly complex situation;

1.4 The outright transfer of collateral for variation margin is not considered a security interest and, if anything, should be deemed *not* to be a security interest; and

1.5 A stand-alone Netting Act may be a clearer way to deal with the issues proposed, although we understand the timing issues driving the need for urgent change.

General Comments

2. A key principle in insolvency is that each class of creditor is treated equally or on a *parri passu* basis, sharing equally in the assets available. There needs to be a good reason to change the order of priority for one class of creditor in an insolvency because this means that another class of creditor will inevitably be disadvantaged, thus receiving less from the insolvent estate.

3. Based on the matters set out in the Consultation Document, we agree that there are compelling reasons to provide for changes in our legislation that may currently impede compliance with foreign rules and emerging market practice around margin exchange. RITANZ is supportive of legislative change that will ensure New Zealand's largest banks can comply with the margin requirements of their foreign counterparts in order to protect the stability of New Zealand's financial system as a whole.

4. RITANZ is of the view that any legislative changes should be limited to those parties needing to comply with G20 reforms outlined in the consultation document. We note that if changes were made that affected all OTC Derivative users such as other New Zealand banks, financial institutions, and even large corporates, then this would have a significantly greater effect on creditors' rights in insolvency situations.

5. It is important that creditors and others dealing with the affected banks are aware of the existence of any 'super priority' rights that creditors have. In this context, it is unclear to us whether the interests created will be on a publically available register. We think they should be, consistent with the transparency provided by the PPSR.

6. The appointment of a Statutory Manager or Voluntary Administrator to a large trading bank is a complex assignment with many issues requiring urgent attention in the first days of such an appointment. It will be critical to have unambiguous legislation that can be practically applied under these circumstances. In our experience, even with clear legislation, it can take weeks or even months to establish the facts of competing security claims and release assets subject to these claims. These practical issues will need to be considered with any legislation.

7. We consider a standalone Netting Act as discussed in paragraph 96 has the potential to be a clearer way of dealing with the issues raised and other netting issues and would support exploring this further. However, we also understand the timing issues and the need to enact legislative change quickly to ensure compliance with the G20 reforms.

Specific Feedback

8. Paragraph 52: The exclusions set out in paragraph 52 do not appear to require the registration of a financing statement. Would this not be required to give other parties notice of the security interest in the relevant entity's assets?

9. Paragraph 61: As referred to above, we believe any statutory moratoria period outlined at paragraph 61 (midnight at the end of the first full business day following the appointment of a statutory manager) should be as long as acceptable ensuring New Zealand was still compliant with requirements under the reforms. The key reason for this is that at the commencement of a statutory management, or voluntary administration, there are always a large number of issues to attend to. Ensuring the matter can be considered and actioned in such a short timeframe is likely to be challenging. Having said that, as long as the exception to the moratorium simply permits enforcement and does not require the assistance of the statutory manager or voluntary administrator, and reserves the positions of the insolvency practitioners and insolvent entity for any wrongful enforcement, this should not be have any substantive impact.

10. Paragraph 63: We agree that operational requirements would need to be implemented around pre-positioning encumbered collateral assets as outlined in paragraph 63. If they are not, the assets will likely be subject to a number of competing priorities making it difficult (if not impossible) for the Statutory Manager or Administrator to deal with in such a short timeframe.

11. Paragraph 69: We agree with comment in paragraph 69 that given the small number of entities that will be covered by the legislative change and the size and make up of their balance sheets that there is negligible risk of preferential creditors not being paid in full in the event a Statutory Manager or Administrator is appointed. However, if the legislation was to be broadened to other New Zealand banks, financial institutions and potentially large corporates, then the risk would no longer be negligible as the make-up of the balance sheets of these entities could be very different to New Zealand's largest banks.

12. Paragraph 78: We do not agree with the proposal outlined in paragraph 78 that the PPSA should be amended to clarify that an outright transfer of collateral creates a security interest. If anything it should be the reverse, as an outright transfer of collateral without an equity of redemption is generally not considered to be a security interest. Any change to deem such a transfer to create a security interest in the collateral would be a very broad change to the PPSA.

13. Paragraph 83: We agree with the Agencies that there is limited rationale as outlined in paragraph 83 for statutory amendments to address the issues raised with creditor compromises and voidable preferences. This is due to these matters not affecting a non-defaulting party's right to enforce and that there appears to be market acceptance of these provisions. As stated earlier any changes should be minimised to ensure the ongoing effectiveness of the legislation.

RITANZ would welcome the opportunity to discuss our submission with you. Please do not hesitate to contact the writer s9(2)(a) privacy should you wish to arrange a meeting or discuss any of the contents of the submission.

Yours faithfully

s9(2)(a) privacy

Nikki Kruger
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RITANZ