



Reserve Bank
of New Zealand
Te Pūtea Matua

Review of policy for branches of overseas banks.

Non-technical summary

20 October 2021

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Introduction

We are reviewing our policy which governs the registration of branches of overseas banks in New Zealand. The review covers both existing registered branches and future applicants seeking registration.¹

Once we have considered submissions to this consultation we will develop a policy approach. A second consultation paper will consult on our proposed approach.

In this consultation paper when we refer to a 'branch', we mean the part of an overseas bank that operates in New Zealand, rather than a retail location where a bank makes services available.

Branches of overseas banks can be an important link between our economy and global financial markets. They often provide valued services to New Zealand businesses and households. They may provide benefits to our financial system in terms of innovation, competition and cheaper funding for our businesses, as well as providing greater diversity to our banking system. Greater diversity may be beneficial for financial stability in New Zealand – it may make our financial system more resilient to domestic or economic shocks in New Zealand. However, branches of overseas banks may:

- expose us to the risk that we come to rely on credit and funding that may not be available tomorrow if credit conditions worsen overseas, or there is a crisis overseas;
- threaten the stability of our financial system over the medium to long term, if overseas banks are regulated more leniently; and
- expose us to risks related to the failure of the branch or the overseas bank, and the limited options we have for resolving the branch.

Subsidiary or branch?

An overseas bank wishing to operate as a registered bank in New Zealand can apply as either a locally incorporated subsidiary, or as a branch of the overseas bank. In some cases we allow an overseas bank to register both as a subsidiary and a branch (this is referred to as 'dual registration').

The key difference between a locally incorporated subsidiary and a branch is that the branch is part of a legal entity incorporated overseas. The branch operates its banking business in New Zealand (the 'host jurisdiction') but the legal entity of which it forms part of is incorporated in another country (the 'home jurisdiction').

- Local incorporation (as a subsidiary) tends to be associated with overseas banks with a stronger focus on establishing and maintaining a retail funding base in New Zealand, justifying the allocation of capital by the overseas bank to the subsidiary. It comes with greater costs relative to branching – in terms of establishment and ongoing regulatory costs as well as investment in local infrastructure and staffing – but also has benefits depending on the nature of the bank's business.
- Branching tends to be associated with large global banking groups that wish to leverage efficiency gains from raising and allocating capital across borders, or from centralising their

¹ This consultation does not relate to overseas banks that undertake limited wholesale business in New Zealand under the terms of the Reserve Bank of New Zealand Act (Overseas Banks) Class Authorisation Notice 2019.

management and treasury functions. Operating as a branch may be a cost effective way of providing specific services to certain types of customers (for example, trade finance to large exporters or global treasury and payment services to multi-national corporates).

Our equivalence assessment

Because they are incorporated overseas, branches are not subject to many of the requirements we impose on our locally incorporated banks.

When a bank applies to us for registration as a branch we conduct an 'equivalence assessment' to establish whether we can rely on the bank being effectively regulated and supervised in its 'home' country, and whether this meets our own standards and expectations.

If we decide to grant registration to the branch we can apply restrictions on the business the branch can do in New Zealand, whether in terms of the scale of that business or the type of business. This may help to address some concerns we may have about the branch operating in New Zealand.

It is important that we are confident that we understand the risks that a branch poses to our financial system, and that we can mitigate those risks effectively. This enables us to promote financial stability, and avoid significant damage to the financial system that could result from the failure of a branch, or the overseas bank it forms part of.

Local incorporation

Our current policy is to cap the size of a branch at \$15 billion in liabilities (which includes for example deposits). If a branch is likely to grow above this level, we will require it to incorporate in New Zealand. In practice the overseas bank will establish a subsidiary in New Zealand. Once this happens, the subsidiary becomes subject to all of our requirements.

A threshold test is necessary because the larger the branch becomes the more significant it becomes for our financial system. The threshold thus mitigates risks to the financial system and helps us to meet our financial stability objective.

Some of our branches are subject to asset threshold tests – either in addition to, or instead of, the liability threshold – which means they cannot grow larger than we have specified, in terms of their lending or their acquisition of assets. These thresholds are also intended to mitigate risks to the financial system and help us to meet our financial stability objective.

Our branch landscape

New Zealand's branch population is diverse, in terms of country of origin, business models and the financial services they provide. Their main focus is lending to businesses in New Zealand. However, some branches also take retail deposits. Some branches are specialised and provide sophisticated financial services to specific sectors of our economy.

Seven of our 12 branches are 'dual registered'. This means they belong to a banking group that has both a subsidiary and a branch that are registered as banks in New Zealand.

Dual registered branches present a unique set of factors for us to consider as regulator and supervisor. The subsidiary and the branch often share staff, IT, premises and customers. In the event of a crisis this interconnectedness may present challenges in terms of dealing with either or both the subsidiary and/or the branch.

Objective of the review

The objective of the review is to create a simple, coherent and transparent policy framework for branches of overseas banks that promotes financial stability through a sound and efficient financial system in New Zealand, and avoids significant damage to the financial system that could result from the failure of a registered bank.

Problem definition

We have identified three key issues relating to the regulation and supervision of branches of overseas banks and how we promote financial stability.

1. Current policy is not applied consistently to our branch population

Our policy on registering branches, and the conditions that should apply to them, has developed over time. As a result, different branches are subject to different conditions of registration that permit them to undertake different activities in New Zealand.

The basis for being allowed to conduct the business of borrowing and lending in New Zealand as a registered branch should be as transparent as possible. Some of our branches may want to grow and evolve, and to compete with other registered banks and financial service providers across a broader range of activities, or to a greater extent than they are currently permitted to do. Overseas banks may want to establish a registered branch, but may find it difficult to assess the conditions they will be subject to and the regulatory costs they will incur.

2. Inherent limitations on our ability to regulate branches

Because of their legal nature, branches are not subject to many of our requirements. This reduces our ability to mitigate risks to our financial system and to promote financial stability in New Zealand.

For example, it is challenging to design liquidity policies that can be applied to branches in the same way they are applied to locally incorporated banks because the branch is legally part of the overseas bank.

In the event of the failure of the branch, or the overseas entity of which it forms part, its insolvency would be managed in, and subject to the laws of its home jurisdiction. This means the location of the assets and liabilities of the branch, and the treatment of depositors and creditors in New Zealand, would depend on the laws of that country and the application of international law and conventions.

Even if we can satisfy ourselves that under current rules New Zealand depositors and creditors would be treated fairly, there remains a risk that, during a crisis, the home jurisdiction changes its legislation to favour depositors and creditors in that country.

3. Inherent limitations on our ability to supervise branches

As a 'host' country we rely on the regulators and supervisors in the branch's 'home' country for information about the overseas bank and its activities both here in New Zealand and around the world. This is important because we cannot apply many of our own requirements to the branch and we have limited visibility on the wider banking group, which we do not supervise. There is therefore an inherent limitation on our ability to mitigate risks to our financial system and to promote financial stability in New Zealand.

Home regulators and supervisors may not:

- apply a high level of scrutiny to a branch's operations in New Zealand, especially where the branch represents a very small part of the bank's operations around the world;
- take into account the potential economic, fiscal and social impact in New Zealand of the branch's failure, or the bank's as a whole; and
- notify us of any problems at the branch or the wider bank, for fear it would motivate us (or a statutory manager) to take control of the assets of the branch in New Zealand.

Assessment principles

In thinking about the problem definition, and the policy options, we propose that branch policy should:

- be proportionate to the risks that branches present to financial stability, having regard to the inherent limitations in our ability to address risks at branches through prudential standards, and the inherent disadvantages we face as a host supervisor;
- recognise the need for a credible resolution strategy for branches and, in the case of dual registered branches, the locally incorporated subsidiary, in order to promote financial stability;
- recognise the role of branches in the provision of financial services; their value in supporting the economy in good times and bad; and their contribution to a diverse and resilient financial system that caters to the needs of corporates and households (including through competition and innovation); and thereby promote financial stability;
- result in consistent outcomes for branches in New Zealand, supporting a level playing field, while remaining flexible enough to apply supervisory adjustment;
- be transparent, and aligned with international standards where appropriate, to allow branches (and new applicants) to understand and meet requirements in a cost effective way; and
- be practical to administer and minimise unnecessary supervisory costs.

Policy questions and options

Policy questions	Options
What is the appropriate threshold for local incorporation?	<ul style="list-style-type: none"> • Maintain the liabilities threshold test, whether at \$15 billion or a higher amount, and apply it to all branches • Move to an asset threshold test for all branches • Move to a combination of thresholds and/or indicators (for example, size, interconnectedness, substitutability of services, complexity)
Should branches be permitted to take retail deposits?	<ul style="list-style-type: none"> • Not allow any branches to take retail deposits • Allow all branches to take a defined amount of retail deposits

Policy questions	Options
	<ul style="list-style-type: none"> • Allow all branches except dual registered branches to take a defined amount of retail deposits
Should dual registration be allowed?	<ul style="list-style-type: none"> • Not allow dual registration • Allow dual registration but limit branch activities to wholesale funding and lending • Allow dual registration but apply risk mitigants (for example, size limits, greater separation from the subsidiary, and/or ring-fence assets in New Zealand)
Should we pursue greater regulatory and supervisory integration?	<ul style="list-style-type: none"> • Maintain existing coordination with international agencies and home supervisors • Invest more resources in greater integration

The different policy questions and options outlined should not be considered in isolation. For example, a more permissive approach to retail deposit taking might imply more intensive regulation and supervision; or a more restrictive approach to retail deposit taking might imply a different threshold for local incorporation.

What do you think?

If you would like to contribute to the consultation, we want to hear from you by 5pm on 2 March 2022.

Please send us your thoughts either by:

- E-mail to BranchPolicyReview@rbnz.govt.nz with the subject line: Review of policy for branches of overseas banks

or

- Hard copy to:

Review of policy for branches of overseas banks, Dynamic Policy
Financial System Policy and Analysis Department
Reserve Bank of New Zealand
PO Box 2498
Wellington 6140

Summary of questions

Questions

Question 1: Do you have any comments on the problem definition?

Question 2: Do you have any comments on the assessment principles?

Questions

Question 3: Do you have any comments on the main policy options?

3.1 What is the appropriate threshold for local incorporation?

3.2 Should branches be permitted to take retail deposits?

3.3 Should dual registration be allowed?

3.4 Should we pursue greater regulatory and supervisory integration?