Review of Policy for Branches of Overseas Banks.

Summary of Submissions

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Reserve Bank of New Zealand
Te Pūtea Matua

Contents

1 Background

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 the wider economy, and are an important segment of our regulated bank population.

We recognise that our policy towards branches has developed over time, resulting in inconsistent outcomes for branches. As a result our policy on branches can be difficult to interpret, which in itself can increase regulatory burden.

This review of policy for branches of overseas banks seeks to address these issues, while also taking into account the unique challenges and risks that branches present to us, as *kaitiaki* of Aotearoa New Zealand's financial system.

In October 2021, we published the first of two consultation papers that set out the current branch policy, the problem definition of the review, assessment principles, and some high level policy questions and options.

2 Consultation Process

The first consultation for our review of the policy for branches of overseas banks opened on 20 October 2021 and closed on 2 March 2022. We received fifteen substantive submissions to the consultation paper, comprising of:

- fourteen submissions from industry – ANZ, BNZ, BOC, CBA, CCB, HSBC, ICBC, Kookmin, MUFG, NAB, Rabobank, Westpac, KPMG, and the New Zealand Bankers Association (NZBA) on behalf of HSBC, Citibank and JPMC; and
- one submission from a member of the public.

These submissions can be found on our website.

We have also engaged in bilateral discussions with industry stakeholders during the consultation period, and since it closed to clarify points raised in their submissions.

This document provides a summary of the submissions received in response to our consultation, as well as a brief response to those submissions. This document is not intended to be an exhaustive summary and response to all points raised. We focus on the common themes and views raised in the submissions. We have considered this feedback in developing the accompanying second consultation paper, which consults on our proposed policy approaches.

3 Summary of Submissions

In the first consultation paper, we asked for feedback on six questions. The first two questions asked for feedback on the problem definition and assessment principles. We have proceeded with using these when considering the feedback to the other four policy questions and putting forward our policy proposals. For more comprehensive explanations of our policy proposals, please see Section 3 of the second consultation paper.

3.1 Problem Definition

Most respondents broadly agreed with the problem definition.

- Many respondents highlighted that the current branch policy is not applied consistently and called for greater transparency.
- These respondents also emphasised the need to create a level playing field.

However, while some respondents acknowledged the different outcomes for branches, they highlighted that the diversity of branches and business models meant that a flexible and risk-based approach was more appropriate.

- These respondents suggested that greater regulatory equivalence (particularly with APRA) or status as a Global Systemically-Important Bank (G-SIBs)[1], could mitigate any potential concerns.
- Some respondents emphasised that achieving consistent outcomes should not be confused with a "one-size-fits-all" approach.

Reserve Bank Response

We have proceeded with using the problem definition in developing our policy proposals. We recognise that our policy towards branches has developed over time, resulting in inconsistent outcomes for branches. Moving to a more coherent, consistent and transparent regime, that is more accessible to existing branches and potential new entrants, aligns with industry feedback.

We acknowledge that achieving consistency and transparency should not entail a "one-size-fits-all" approach. For example, the balance between the consistency and flexibility was central in our design of the equivalence assessment and supervisory framework. See Section 5 of the second consultation paper for more detail.

3.2 Assessment Principles

Most submissions explicitly agreed with the proposed assessment principles, and provided similar feedback to the first question on the problem definition.

The majority of the feedback we received was around Principles 3 and 4. Many submissions highlighted the benefit branches bring in providing access to sophisticated advice and products, particularly to large corporate and institutional customers (Principle 3). Additionally, some submissions agreed supporting a level playing field, but also emphasised a preference for retaining the status quo, and retaining flexibility in our approach (Principle 4).

Reserve Bank Response

We have proceeded with using the assessment principles in developing our policy proposals in the second consultation paper (see Section 3). We acknowledge the efficiency benefits that branches bring to our financial system and the economy (Principle 3). Additionally, we note that Principle 4 emphasises the need for our policy to remain flexible enough to apply supervisory adjustment.

3.3 Threshold for Local Incorporation

The majority of submissions supported the status quo of a net liability threshold.

[1] 2021 List of Global Systemically Important Banks (G-SIBs) - Financial Stability Board (fsb.org)

- Some submissions supported a review of the level of the threshold to ensure it remains appropriate as indicator of a bank's importance relative to the market, noting that the registered bank assets have doubled since 2007 when the $15 billion net liabilities threshold was introduced.
- One submission suggested calculating the net liabilities threshold by reference to an average over three consecutive financial years.

There was some support for an asset threshold.

- Two submissions noted that asset size is a better reflection of a branch's systemic importance, if branches are to be wholesale.
- Another submission supported an asset threshold, whether branches were limited to wholesale or not. Some submissions suggested that if an asset threshold is implemented, it should exclude derivatives because of their volatility.
- Additionally, we did not receive any feedback that moving to an asset threshold would be too costly for industry.

Some submissions supported a combination of tests, however, other submissions raised concerns that a combination of thresholds may be too complex.

Reserve Bank Response

Our view is that monitoring net liabilities is more appropriate for considering risks that entities present to retail depositors, whereas total assets are a better metric for monitoring risks to the financial system in terms of wholesale activity. Additionally, a net threshold does not effectively limit the size of branches as it allows branches to grow with intra-group funding, potentially exacerbating the system's exposure to off-shore risks. See Section 3.3 of the second consultation paper for more details.

An asset threshold would be transparent, practical to administer and allow for a more consistent and level playing field for branches. We acknowledge that using a rolling average could mitigate some of the volatility in asset prices, however, it introduces additional complexity and may lack transparency.

We acknowledge the potential benefits of using a combination of tests. However, this option implies a differentiated approach which would not result in consistent outcomes, would lack transparency, and would be impractical to administer.

3.4 Retail Deposits

The majority of submissions agreed that branches should not take retail deposits or expressed indifference, noting that not allowing retail deposit-taking activity would:

- make it simpler to operationalise the depositor compensation scheme;
- allay concerns about depositor preference in the home jurisdiction;
- reduce systemic risk; and
- align with APRA's approach to regulating branches of overseas banks in Australia.

One submission suggested that branches should not engage in any form of retail activity, including not allowing the provision of payment and settlement facilities to third parties that provide services to retail customers.

One submission suggested that retail deposits are a source of stable funding to which locally-incorporated banks should have preferential access, to optimally manage their core funding and moderate their need for off-shore wholesale funding. This submission also highlighted that retail customers face difficulty accessing and understanding information about branches' home regulatory regimes, and assessing risks to their deposits.

There were concerns from some submitters about the option to disallow retail deposit-taking for all branches.

- These submissions highlighted the consumer benefits of branches taking retail deposits and facilitating cross-border transactions for retail customers.
- One submission highlighted the funding benefits of retail deposits (without which branches become more reliant on off-shore wholesale funding) and their ability to provide retail competition to locally-incorporated banks.

There was some support for allowing a small defined amount of retail deposit-taking to allow new entrants and encourage competition.

Two submissions suggested we consult on aligning the definition of retail deposit in BS1 with the wholesale/retail distinction in the Financial Markets Conduct Act 2013.

Reserve Bank Response

In our view, disallowing branches to take retail deposits is proportionate to the financial stability risks of retail deposit-taking by branches. See Section 3.2 of the second consultation paper for more details.

We acknowledge there are some efficiency benefits of retail deposit-taking by branches and that disallowing retail deposit-taking would have at least a transitional impact on a defined segment of our registered branch population and some of their customers. However, there is limited evidence that branches provider material competition for retail banking services in New Zealand. Industry and the public will have the further opportunity to provide evidence on this point in response to Section 6 of the second consultation paper.

We acknowledge that allowing a small defined amount of retail deposit-taking would not present a material issue in terms of financial stability or having a credible resolution strategy. However, we do not consider the limited efficiency benefits of allowing a de minimis amount of retail deposit-taking to justify the additional complexity for our regime (see Section 3.2 of the second consultation paper for more details).

3.5 Dual Registration

The majority of submissions supported dual registration and were concerned about the possibility of disallowing it, citing (in aggregate):

- the potential implications for the financial system and the economy in terms of access to funding and liquidity; and the ability to leverage the balance sheets of global banks;
- the potential implications in terms of promoting diversity and competition; access to sophisticated products, overseas markets and knowledge, skills and expertise; ease of business for customers from their home jurisdiction; and job creation;
- that disallowing dual registration would be unusual internationally;
- that BS11 should provide comfort in respect of dual-registered banks and that disallowing dual-registered branches would be a significant additional cost on top of BS11/existing outsourcing and intra-group arrangements; and
- the availability of risk mitigants where there are concerns.

One respondent expressed concern that dual-registered branches may be used for regulatory arbitrage, creating an uneven playing field to the detriment of locally-incorporated banks.

Some respondents stated that the current 1:1 limit on the assets of some dual-registered branches relative to their subsidiaries contravenes the principle of fairness. Some respondents called for clarity in how non-equivalency is mitigated in our approach (see Section 5 of the second consultation paper for further discussion on this).

Reserve Bank Response

We acknowledge the benefits of dual registration, and that disallowing dual registration would not be proportionate to the risks to financial stability. However, our view is that additional risk mitigants are required for our dual registration policy to align with our risk appetite (see Section 3.4 of the second consultation paper).

We acknowledge the risk of regulatory arbitrage by dual-registered groups, and this has informed our policy proposals, both in terms of the local incorporation threshold and a customer threshold for dual-registered branches. See Sections 3.3 and 3.4 of the second consultation paper for this policy proposal.

In regards to additional risk mitigants for non-equivalency, the enhanced equivalence assessment and supervisory framework set out in Section 5 of the second consultation paper will provide clarity around the considerations for applying risk mitigants via additional conditions of registration.

3.6 Greater Regulatory and Supervisory Integration

Some respondents recognised the additional costs greater regulatory and supervisory integration would create for the Reserve Bank. A sub-set of these respondents believed it would be worthwhile, while others recognised the limitations.

Some respondents suggested that continued cooperation and dialogue with home regulators is essential to the effective and efficient supervision of the financial system.

Reserve Bank Response

We acknowledge the benefits of greater integration with international regulatory standards and/or home authorities, and our view is that the cost of implementation to us would be marginal. However, we acknowledge that pursuing greater integration is a medium to long-term goal, and given the inherent limitations (in terms of asymmetrical incentives and information sharing) that it is unlikely to change our policy stance on the first three policy questions.

3.7 Other Key Points Emphasised

Several submissions called for a robust cost-benefit analysis of our policies. Additionally, some submissions also called for a general cost-benefit analysis of allowing branching in New Zealand.

- The second consultation paper sets out our approach to conducting a cost-benefit analysis of the policy proposals. In the consultation, we invite industry and wider stakeholders to provide details on specific impacts of our policy proposals. We will publish a complete cost-benefit analysis of the changes alongside the final policy position, likely in early 2023.
- While we acknowledge that a detailed assessment of the macro-economic benefits and risks of overseas bank branches to the New Zealand economy would have merit in building our understanding of the New Zealand financial system, this would be a substantial project. Completing this as part of the Review would delay the publication of the final policy settings, which would cause uncertainty for branches that may have to change their operating models ahead of the introduction of the DCS. Therefore, we have judged that this analysis is beyond the scope of this Review.

There were differing submissions on the merits of efficiency (allowing branches to leverage cheaper funding and lower capital requirements off-shore) against the desirability of supporting locally-incorporated banks and by extension financial stability (not allowing regulatory arbitrage by branches).

4 Next Steps

Thank you to everyone who submitted on the first consultation paper. The full list of substantive submissions can be viewed on our website.

Alongside this document, we have published a second consultation paper that sets out our proposed policies for branches of overseas banks. The consultation period closes on 16 November.