



Reserve Bank
of New Zealand
Te Pūtea Matua

Review of policy for branches of overseas banks.

Consultation paper

20 October 2021

Contents

Submission contact details	2
Glossary	3
Introduction	4
Background	4
Impact of overseas banks	5
New Zealand's branch landscape	7
Diversity of branch business models and services	8
Macro considerations	9
Current branch policy	11
Purposes of bank registration and supervision	11
Review of policy for branches of overseas banks	11
Objective of the review	11
Problem definition	12
Assessment principles	14
High level policy questions and options	15
Broader context	21
Legislative changes	21
Other sectors	22
Review process	23
Annex 1 – Consultation questions	24
Questions	24
Contact details	24
Annex 2 – Legislative and policy detail	25
Statutory requirements when determining an application for bank registration	25
Local incorporation policy	26
Dual registration policy	27
Dual registration policy for small banks	28
Consultation on liquidity requirements for branches	28
Capital	29
Governance	30
Disclosure	30
Crisis management and resolution	31
Annex 3 – Application of Banking Supervision Handbook	32
Annex 4 – Branch conditions of registration	33
Annex 5 – Branch descriptions	36

Submission contact details

We invite submissions on this Consultation Paper by 5pm on 2 March 2022. Please note the disclosure on the publication of submissions below.

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Publication of submissions

All information in submissions will be made public unless you indicate you would like all or part of your submission to remain confidential. Respondents who would like part of their submission to remain confidential should provide both a confidential and public version of their submission. Apart from redactions of the information to be withheld (i.e. blacking out of text) the two versions should be identical. Respondents should ensure that redacted information is not able to be recovered electronically from the document (the redacted version will be published as received).

Respondents who request that all or part of their submission be treated as confidential should provide reasons why this information should be withheld if a request is made for it under the Official Information Act 1982 (OIA). These reasons should refer to section 105 of the Reserve Bank of New Zealand Act 1989, section 54 of the Non-Bank Deposit Takers Act, section 135 of the Insurance (Prudential) Supervision Act 2010 (as applicable); or the grounds for withholding information under the OIA. If an OIA request for redacted information is made, we will make our own assessment of what must be released taking into account the respondent's views.

We may also publish an anonymised summary of the responses received in respect of this Consultation Paper.

Glossary

The following terms and acronyms have been used in this Consultation Paper:

Act means the Reserve Bank of New Zealand Act 1989	
ANZBG means the branch of ANZ Banking Group Limited	ANZBNZL means ANZ Bank New Zealand Limited, a subsidiary of ANZBG
	BNZ means Bank of New Zealand
BoC means the branch of Bank of China Limited	BoC NZL means Bank of China (New Zealand) Limited, a subsidiary of BoC
CBA means the branch Commonwealth Bank of Australia	ASB means ASB Bank Limited, a subsidiary of CBA
CCB means the branch of China Construction Bank Corporation	CCB NZL means China Construction Bank (New Zealand) Limited, a subsidiary of CCB
Citibank means the branch of Citibank, NA	
HSBC means the branch of The Hongkong and Shanghai Banking Corporation Limited	
ICBC means the branch of the Industrial and Commercial Bank of China Limited	ICBC NZL means Industrial and Commercial Bank of China (New Zealand) Limited, a subsidiary of ICBC
JP Morgan means the branch of JP Morgan Chase Bank, NA	
Kookmin means the branch of Kookmin Bank	
MUFG means the branch of MUFG Bank Ltd	
Rabobank means the branch of Coöperatieve Rabobank UA	RNZN is Rabobank New Zealand Limited, a subsidiary of Rabobank
WBC means the branch of Westpac Banking Corporation	WNZN means Westpac New Zealand Limited, a subsidiary of WBC

Introduction

We are reviewing our policy which governs the registration of branches¹ of overseas banks in New Zealand. This review is relevant to both existing registered branches operating in New Zealand and to future applicants seeking registration.

The soundness and efficiency of the financial system is fundamental to the overall resilience of the New Zealand economy. To maintain a healthy and vibrant financial system we need *Te Pekanga* – our regulated entities, banks, insurers and NBDTs – to be sound and innovative and have constructive working relationships with us.

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, 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.

Background

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 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'). As such, branches are not subject to many of the requirements we impose on banks incorporated in New Zealand. We rely on the branch's compliance with the requirements that apply in its home jurisdiction.

If the overseas bank intends to have more than \$15 billion in net liabilities in New Zealand, we require it to incorporate a subsidiary in New Zealand, so that it is subject to our requirements. We refer to this as 'local incorporation'.

When a bank applies for registration as a branch, we assess the application against a number of criteria set out in the Act. As part of this process, we assess whether the regulatory and supervisory regime that applies to the branch in its home jurisdiction is equivalent to our own. If the equivalence assessment raises concerns, we may decide either not to grant registration or to impose conditions on the operation of the branch in New Zealand, through

Overseas banks that wish to undertake limited wholesale business in New Zealand may be able to do so without applying for registration, if they are within scope of the current class authorisation. This consultation paper does not relate to those activities or that class authorisation.

For further information see the [New Zealand Gazette](#) and [our website](#).

¹ In this consultation paper we refer to a branch to mean that part of an overseas bank that operates in New Zealand, rather than a retail location where a bank makes services available. In this context, a branch is a part of a legal entity incorporated overseas, and can be contrasted with a bank that is incorporated in New Zealand.

the branch's conditions of registration. Additional criteria apply for dual registration (see Annex 2 for further detail).

If we decide not to grant registration as a branch, it is open to the overseas bank to establish a subsidiary in New Zealand and to apply for registration as a locally incorporated bank. An overseas banking group may have a commercial preference for registering as either a subsidiary or a branch (or both) in a host country.

- Subsidiarisation, or local incorporation, tends to be associated with overseas banks with a stronger focus on establishing and maintaining a retail funding base in the host jurisdiction, 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, and differences in the economic, tax and financial systems that exist in the home and host jurisdictions.
- Branching tends to be associated with large banking groups where there are efficiency and productivity gains. These are related to the sourcing and allocation of capital and liquidity across borders, the tax implications of those decisions, the regulatory treatment and costs in different jurisdictions, and efficiency gains from the centralisation of risk management and treasury functions within the overseas bank. Operating as a branch may be a cost effective way to provide specific services to certain types of customers (for example, trade finance to large exporters or global treasury and payment services to multi-national corporate and institutional clients).

In practice, different banking groups take different approaches to registration in different jurisdictions for a variety of reasons.

Impact of overseas banks

Access to capital and financial stability risks

A diverse population of registered banks with access to capital from around the globe should reduce the risk that a domestic shock would undermine financial stability in New Zealand. It is important, however, to remain aware of the macro-economic risks (see further below) to New Zealand as a host country dominated by foreign-owned banks.

As a result we must remain aware of the risk of external shocks that could, in particular, affect the funding of our banks. Because branches are not subject to many of our requirements, and because we have less oversight of branches relative to subsidiaries, branches present a particular challenge for us as prudential regulator and supervisor.

Prudential authorities must consider the following key issues when considering the optimal settings for the regulation and supervision branches.

- Branching across jurisdictions:
 - may provide benefits to the host financial system and economy in terms of innovation, competition and cheaper funding (ie, by drawing on the overseas bank's size and rating, they may be able raise capital relatively cheaply), as well as providing credit and financial services to sectors of the economy that are neglected by the domestic retail banking system; and

- may increase diversification in terms of both the overseas bank's funding and lending profile, and the range of funding sources and expertise available to the host financial system, making both of them more resilient to domestic shocks in the host jurisdiction.
- Conversely, incoming branches may:
 - expose the host financial system to pro-cyclical cross-border movements of capital that amplify boom-bust cycles in the host economy, and increase contagion risk from external shocks;
 - threaten the stability of the host financial system over the medium to long term, if overseas banks are regulated more leniently;
 - expose the host financial system to risks related to the failure of the branch or the overseas bank, and the limited options the host authority has for resolving the branch; and
 - discourage locally incorporated banks from competing in certain sectors, or from providing certain services, thereby affecting the price, quality and distribution of banking services in the host's financial system over the long term.

We note that requiring local incorporation over branching is not necessarily a panacea for systemic risks. Evidence from crises in various countries demonstrates that, because of the structural separation of parent and subsidiary, it may be easier for the parent to allow a subsidiary to fail than it would be to withdraw support for, and close a branch. This can be compounded by restrictions on the support that a parent may be allowed to provide to its subsidiary by its home regulatory or supervisory authorities. We also note that an excessive emphasis on local incorporation may incentivise the migration of banking activities, and related systemic risk to unregulated intermediaries.

However, there is also evidence of the reverse: of parent banks providing support to subsidiaries in times of stress. The support a parent provides to either a subsidiary or a branch may depend on a range of factors including, for example, the impact of failure on the viability of the wider group, reputational reasons, the size of the bank's market share in the host country, and/or the extent to which the bank is funded by local retail deposits.²

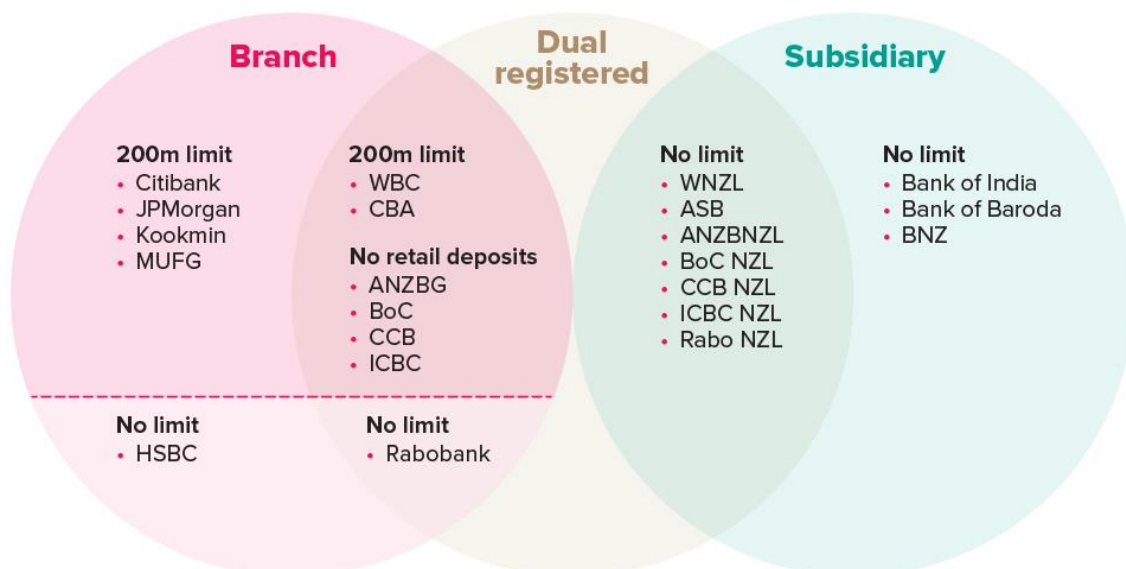
These considerations are particularly relevant for a small, open, advanced economy like New Zealand.

² For a critical assessment of the costs and benefits of foreign bank ownership, and the importance of heterogeneity when analysing the impact of foreign banks on financial stability, see S Claessens & van Horen N, Impact of Foreign Banks, DNB Working Papers 370, Netherlands Central Bank.

New Zealand's branch landscape

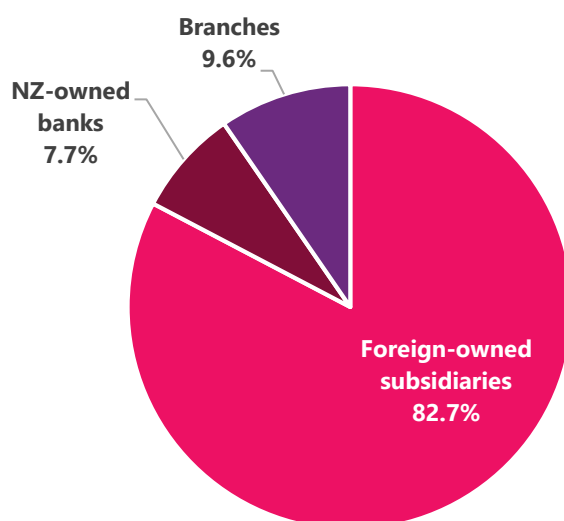
Of our 27 registered banks, 22 are foreign-owned, of which 12 are branches, with 5 stand-alone and 7 dual registered.

Figure 1: Foreign owned banks in New Zealand by form, together with their retail deposit taking limit



- Of the 12 branches registered in New Zealand, nine have their offices in Auckland and three in Wellington. While some branches engage in retail business, typically they do not have an extensive retail network in New Zealand, with some exceptions. However, the seven dual-registered branches are part of the same New Zealand banking group as a locally incorporated subsidiary that does have retail operations.
- Branches hold approximately 10% of the banking system's total assets. This is relatively small compared to the large four subsidiaries of the Australian banks, which account for approximately 85 percent of total assets. We note that branches' share of the system's total assets is larger than total assets collectively held by New Zealand owned and incorporated banks. The total assets of some branches are growing, and some branches may wish to continue to grow.

Figure 2: Total assets held by registered banks



Source: RBNZ, June 2021

Diversity of branch business models and services

New Zealand's branch population is diverse, in terms of country of origin, business models and the financial services they provide.

- The predominant focus of branches as a group is lending to businesses. Of total lending to the business sector in New Zealand, 12.9 percent is done by branches. A sub-set of our registered branches play a material role in this sector.
- As illustrated above in Figure 1, many branches are permitted to take at least a small amount of retail deposits. However, this is a material business for only a small number of branches.
- Some branches lend to the housing market. However, from a systemic perspective, branches do not undertake a material amount of housing lending.
- Some dual registered branches provide liquidity support to the related subsidiary operating in New Zealand, while other dual-registered branches exist primarily to undertake their own business lending and to provide financial services.

Branches may specialise in, and be important to particular sectors, parts of the financial system, or types of customer (including other banks).

- Branches of global or 'universal' banks offer a variety of sophisticated and, in some cases, highly specialised financial services, mainly to corporate, wholesale or institutional clients. These services include some or all of:
 - advice and execution on primary and secondary equity and debt markets, credit derivatives, secured financing, money markets, commercial papers, and commodities;
 - asset management, as well as custodial and related trustee, administration and accounting services;

- advice on mergers and acquisitions, capital markets issuance, structured finance and balance sheet restructuring; and
- trade finance for our exporters, treasury services, cash management, foreign exchange, and credit card issuance.
- Some branches issue derivative products for interest rates, foreign exchange rates, and commodities.
- Some branches focus on particular customer groups or sectors, and may provide a significant alternative to large, locally incorporated banks. For example, to the agricultural, food and agribusiness sectors.

See Annex 5 for a brief description of each of the 12 registered branches.

Macro considerations

As mentioned above, branches can facilitate the efficient allocation of capital and liquidity within banking groups and across borders. This can bring benefits to the New Zealand financial system and the economy. However, this also exposes New Zealand to risks related to our persistent current account deficit and the pro-cyclicality of cross-border lending, particularly inter-bank lending.

Net international liabilities

New Zealand's banks, whether locally incorporated or not, rely on overseas markets and funding. As a result, our financial system is potentially vulnerable to external shocks that could disrupt this funding. Branches are an important potential conduit for these shocks given the inherent limitations in our ability to regulate and supervise them.

New Zealand's net international liabilities represented 55.5 percent of our GDP as at September 2020. Borrowing from the rest of the world can lead to productive investment that enhances New Zealand's economic performance. However, debt-fuelled consumption and asset bubbles are less sustainable. Relying on overseas markets to fund our investment makes us vulnerable to changes in the availability or cost of that funding. An external shock, and a worsening of our position, could see our registered banks have to pay significantly more for their off-shore funding as it matures, or risk losing it.

That vulnerability can be exposed quickly by global or domestic shocks. For example, during the global financial crisis (GFC), sources of short-term funding for our banks dried up or became much more expensive, with knock-on implications for households and businesses in New Zealand. As a result, the Reserve Bank developed liquidity policy and requirements for locally incorporated banks in 2010. These requirements do not apply to branches.

The GFC highlighted the vulnerability of host countries to decisions by the owners of foreign banks on the most productive allocation of capital across different economies, as well as the judgements made by home country regulators and supervisors to the free flow of capital.

Pro-cyclicality of bank lending

The decade before the GFC saw an expansion in international banks, both in terms of their presence in different jurisdictions (whether as a branch or a subsidiary) and in terms of cross-border lending to other banks or corporates.³

During and after the GFC there was a contraction in global capital flows between advanced economies. This was particularly noticeable in the cross-border lending by banks to other banks. In other words, cross-border lending immediately before and after the GFC appears to have been highly pro-cyclical. This suggests foreign bank lending can be highly volatile in a crisis.⁴

For example, the Central and Eastern European (CEE) countries experienced a rapid inflow of credit prior to the GFC, resulting in rapid economic expansion and increases in asset prices. While the local financial systems were not directly exposed to toxic assets in the United States, the banking systems were exposed to the subsequent closure of financial markets led to a 'credit crunch' and the deleveraging by the owners of their foreign banks. As a result, the CEE economies experienced deep recessions in 2009 and a rapid fall in asset prices.

In the UK, it has been suggested that this pro-cyclicality affects branches more strongly than subsidiaries. During the GFC, the decline in credit offered by branches in the UK was more significant than for UK incorporated banks. Part of the explanation for this appears to have been that branches were more prone than UK incorporated banks to both a cross-border wholesale funding shock and a reduction in domestic interbank lending. It has also been suggested that branches were more likely than subsidiaries to exhibit 'home bias' and upstream lending to other parts of the banking group overseas. Another part of the explanation appears to have been that branches focused more on lending to the financial system itself, rather than to households, and the financial system is more pro-cyclical in its demand for credit than households.⁵

As a result of the GFC, regulators and commentators around the world have reconsidered the benefits and costs of foreign bank ownership.⁶ Prior to the GFC, the assumption was that cross-border capital flows diversified risks to a host financial system and provided financial stability benefits. However, the GFC revealed that cross-border flows can also make risks and financial systems more correlated, and more prone to contagion across funding markets.

Local incorporation as an important mitigant

Requiring banks to locally incorporate is one way to address risks related to our banking system's reliance on off-shore funding, and New Zealand's persistent current account deficit.

Locally incorporated banks are subject to a number of prudential requirements that mitigate funding and liquidity risks. For example, locally incorporated banks are required to maintain liquidity with an appropriate maturity profile. Branches, because they are part of a legal entity incorporated overseas, are not subject to our liquidity requirements. Further, branches are particularly prone to maturity and roll-over risk where liquidity is provided to the branch by the legal entity of which it is a part (and not by a commercial third party, on arm's length

³ S. Claessens and Van Horen, N, Impact of foreign banks, *The Journal of Financial Perspectives*, March 2013.

⁴ E James, McLoughlin K and Rankin E, Cross-border Capital Flows since the Global Financial Crisis, Reserve Bank of Australia, Bulletin June Quarter 2014.

⁵ G Hoggarth, Hooley J and Korniyenko Y, Which way do foreign branches sway? Evidence from the recent UK domestic credit cycle, Financial Stability Paper No 22 – June 2013, Bank of England.

⁶ See Claessens and Van Horen.

terms). If a branch's funding is withdrawn, this could have rapid and important consequences for creditors in New Zealand, and confidence in our banking system.

Current branch policy

Purposes of bank registration and supervision

Bank registration policy is aimed at ensuring that only financial institutions of appropriate standing, which can comply with our regulatory and supervisory requirements, are able to become registered banks. Impediments to the entry of new registered banks are kept to a minimum as we have regard to efficiency, as well as the soundness of the financial system. This approach recognises that competition can bring significant benefits to users of the services provided by registered banks.

Current approach to registration of bank branches

We have preferred local incorporation to branching where the bank is (or is likely to become) systemically important, or where we are unfamiliar with or have limited assurance over the home state's regulatory regime or approach.

Branch registration involves an assessment of the matters specified in the Reserve Bank of New Zealand Act 1989 (the Act) and our policy in BS1 (Statement of Principles – bank registration and supervision April 2020)⁷ of the Banking Supervision Handbook.⁸ This includes an equivalence assessment of the regime that applies to the overseas bank in its home jurisdiction. See Annex 2 for more detail on both the requirements under the Act and our current policy.

Supervision of registered banks is not aimed at preventing individual bank failures or at protecting creditors.

Review of policy for branches of overseas banks

Consistent with our role as regulatory steward, we monitor and review existing prudential policies at appropriate intervals to ensure they are robust and fit-for-purpose.

We are reviewing our policy in respect of branches of overseas banks, both as it applies to existing registered branches operating in New Zealand and to future applicants for registration.

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.

⁷ See <https://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/banks/banking-supervision-handbook/BS1.pdf?revision=0e54872a-9b65-49d8-925f-178bb2183917&la=en>

⁸ See also BS3 (Application for Status as a Registered Bank: Material to be Provided to the Reserve Bank) and 'Bank registration information', 17 October 2013. See <https://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/banks/overview/2969066.pdf?la=en&revision=c60b1bc2-09ec-4767-a2b6-e15db3992ad4>

Problem definition

We have identified three key issues relating to the regulation and supervision of branches of overseas banks that merit consideration:

- current policy is not applied consistently to our branch population;
- inherent limitations on our ability to apply regulatory standards to branches, with implications for our financial stability objective; and
- inherent conflicts of interest between home and host supervisors, again with implications for our financial stability objective.

Current policy is not applied consistently

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. This permits them to undertake different activities in New Zealand subject, and in some cases by reference, to different size thresholds.

These differences are a reflection of:

- The diversity of our branch population, in terms of the financial services they provide, their business models, and how their operations are structured in New Zealand and overseas.
- The different regulatory standards and laws that apply in the different jurisdictions that our branches come from. When considering a branch's application for registration, we assess the effect those standards and laws might have on the New Zealand financial system and New Zealand depositors, and whether any identified risks can be mitigated by conditions of registration or supervisory engagement.
- Changes to our risk appetite and our policy over time. The first branches were registered in New Zealand in 1987, while the most recent was registered in 2020. The interconnectedness of the global financial system, the risks to the New Zealand financial system, and the regulatory requirements that apply to banks, have evolved significantly over that time.

As a result, our current policy on branch registration is difficult to communicate to industry. 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. Overseas banks that do not currently operate in New Zealand may want to register a branch, but may find it difficult to assess the conditions they will be subject to and the regulatory impost they will incur.

Inherent limitations on our ability to regulate branches

Because of their legal nature, branches are not subject to the same requirements as locally incorporated banks (See Annex 3 for an overview of the policies that apply to branches, relative to locally incorporated banks).

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, insolvency proceedings would be initiated in, and subject to the laws of, the home jurisdiction. This means the location of the assets and liabilities of the branch, and therefore the ability of a statutory manager in New Zealand to take control of the assets for the benefit of depositors and other creditors in New Zealand, would depend on the application of international law and conventions.

The above has important implications for our approach to promoting financial stability. It means:

- we have less ability to influence the prudent running of a branch relative to a locally incorporated registered bank; and
- we, and any appointed statutory manager, may be less able to influence the crisis management and resolution outcomes of a branch than we/they would for a locally incorporated bank.

Dual registered branches

Dual registered branches present specific challenges for prudential regulators and supervisors. The distinction between the subsidiary and the branch can often be blurred, in terms of which entity is responsible for different parts of the New Zealand business (the location of assets and liabilities), the sharing of treasury and risk management functions, as well as key staff, IT, HR and backroom functions. This complexity – the sharing of functions between the subsidiary and the branch – can be compounded by the branch’s own reliance on staff, systems and functions of the overseas bank that are located in the home (or another) jurisdiction.

This raises questions about effective governance and oversight of both the branch and the locally incorporated subsidiary. Also, it can complicate our assessment of the effective implementation of our policies as they apply to the locally incorporated subsidiary (for example, in respect of liquidity, outsourcing requirements and crisis management).

Current disclosure requirements can make it difficult to assess the New Zealand business of the branch on its own, independent of either the related subsidiary or the overseas bank that the branch is part of. This is because dual registered branches make disclosure in New Zealand on a consolidated basis, with the locally incorporated subsidiary.

Inherent limitations on our ability to supervise branches

Host country supervisors (like us) depend on home country regulators for information in respect of the entity’s operations in the home jurisdiction and globally. This is particularly important for branches because the host regulator cannot apply its own requirements to the branch, as it would to a subsidiary.

In some jurisdictions, legislation requires the regulator to take into account the impact of its decisions on financial stability in other countries. However, home regulators and supervisors are not incentivised to:

- apply a high level of scrutiny to a branch's operations in New Zealand, especially where the branch represents a relatively small or immaterial portion of the entity's global operations;
- take into account the potential economic, fiscal and social impact of a default and failure by the branch, or the bank as a whole, in New Zealand; and
- notify us of problems at the entity, for fear it would motivate us to try to ring-fence the assets of the branch in New Zealand.

Again, this has important implications for our approach to promoting financial stability.

Q1 Do you have any comments on the problem definition?

Assessment principles

In reviewing our approach to branches, the problem definition, and developing policy options to address the issues identified, 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 cost effectively; and
- be practical to administer and minimise unnecessary supervisory costs.

These principles are intentionally broad, to enable the review to be comprehensive. When thinking about a proportionate response to the risks posed by branches of overseas banks, we expect our approach will be calibrated differently to our approach in respect of branches of overseas insurers, because the risks to financial stability are of a different nature.

Q2 Do you have any comments on the proposed assessment principles?

High level policy questions and options

High level policy options

Our current approach to branches could be enhanced by applying some or all of the policy options explored below. These options are not intended to be exhaustive.

We do not have a preferred approach at this time. We welcome submissions on the policy questions and options outlined below, and any alternative options or proposals that are not set out in this paper.

Common issues and policy questions across jurisdictions

We recognise that many of the issues that we face as host regulator and supervisor of branches are not unique to New Zealand. Around the world, host regulators and supervisors face the same inherent limitations in their ability to apply their own local requirements to incoming branches, and the same inherent misalignment of incentives with home supervisors.

It is notable that different jurisdictions have taken materially different approaches in regulating and supervising branches.

Australia

In Australia, the Australian Prudential Regulation Authority has adopted a model where only branches that undertake wholesale activities are permitted to be Authorised Deposit Institutions (ADIs). The Australian Financial Claims Scheme (which provides protection to depositors of up to A\$250,000 per account holder per ADI) does not cover deposits in wholesale branches in Australia.

Australia's approach has the merit of being principled, coherent, and easy to communicate and understand.

United Kingdom

In the United Kingdom (UK), the Prudential Regulation Authority (PRA) will authorise a branch if:

- its retail activity (measured by deposit amounts and number of customers) is below certain levels, and the overseas bank as a whole meets the PRA's threshold conditions (as to capital, liquidity, governance, etc) for authorisation;
- the branch is capable of being effectively supervised by the PRA, and the PRA is satisfied about resolution arrangements; and
- the branch is either not systemically important (measured by asset size, complexity, interconnectedness and critical functions⁹ in the UK), or additional mitigants are in place (for example, restrictions on business activity, additional liquidity requirements, or additional senior management functions are required at the branch).

A branch's retail deposits are covered by the UK's Financial Services Compensation Scheme.

⁹ 'Critical functions' are defined in the UK to mean activities, services or operations (wherever carried out) the discontinuance of which is likely to (a) lead to a disruption of services that are essential to the economy of the United Kingdom, or (b) to disrupt financial stability in the United Kingdom, due to the size, market share, external and internal connectedness, complexity or cross-border activities of a bank or a group which includes a bank (with particular regard to the substitutability of those activities, services or operations).

The PRA's authorisation process involves an intensive equivalence and systemic assessment for branches, and places a high bar on a branch's, and its group's, ability to align with the UK's financial stability and resolution objectives. This requires substantive, ongoing supervisory engagement by the PRA with the branch, its home entity, and the branch's home regulator and supervisor.

The UK's approach is principled, coherent and transparent, but more complex, and more resource intensive, to apply than our current approach, or Australia's.

Basel Concordat on cross-border supervision

The Basel Committee on Banking Supervision is the primary global standard setter for the prudential regulation of banks. The committee's position on home-host responsibilities with regard to the supervision of branches is set out in the Basel Concordat and summarised in the Core Principles for Effective Banking Supervision. These are based on the assumption that a bank's core activities take place in its home jurisdiction and that activities in host jurisdictions are relatively minor. As a result it places a strong emphasis on regulation and supervision by the home authority. The 1992 version of the Concordat placed responsibility on the host authority to challenge this balance of oversight, if necessary, and to specify an alternative allocation of supervisory responsibilities.

Policy questions

What is the appropriate threshold for local incorporation?

Our current policy in BS1 is to require local incorporation when a branch exceeds \$15 billion in liabilities (net of amounts due to related parties), or is expected to do so within five years. Below are some relevant considerations for our review:

- The liabilities threshold was set by reference to the size of the financial system that existed in 2007. Prior to 2007, the local incorporation threshold was \$10 billion.
- The value of certain types of liabilities (for example, derivatives contracts) can be volatile. There is a risk that a branch may unintentionally cross the threshold for local incorporation.
- Several dual registered branches are subject to limits that refer to their assets, whether on a stand-alone basis or by reference to the assets of the related registered subsidiary.

Options

One option would be to maintain the liabilities threshold, whether at \$15 billion or a different amount.

Another option would be to move to an asset threshold test. An asset threshold test is arguably more relevant than a liability test if, for example, branches are not permitted to take retail deposits, and/or if our over-riding concern is the macro financial impact of branches withdrawing their lending to New Zealand businesses and/or households.

A further option is a combination of different thresholds or a set of indicators related to, for example, size of the branch, interconnectedness with the financial system, substitutability of services provided to the financial system (whether by lending to a particular sector, or

payment services provided), and complexity of the branch's exposures and business operations. This would incorporate elements of supervisory judgement.

Should branches be permitted to take retail deposits?

In theory one might expect retail banks to have a preference for local incorporation, and wholesale funded banks, and investment banks, to have a preference for branching.

Retail funding implies a commitment to the establishment costs related to being a retail bank: investing in the infrastructure for retail customer relationships, and building a good understanding of local credit risk. It also implies a need for local supervisory oversight and compliance with the host regulator's prudential policies, including alignment with the host's approach to crisis management and resolution.

Below are some relevant considerations for our review:

- In practice, some of our branches do take retail deposits. Most are limited to taking a maximum of \$200 million (see Figure 1) because, for example, depositor preference applies in the home jurisdiction and it is difficult for New Zealand creditors, particularly retail depositors, to assess their position if the bank were to fail. However, some branches take a material amount of retail deposits.
- Our current policy is that dual registered branches should not take retail deposits given the risk of confusion with the locally incorporated subsidiary. However, this policy is applied unevenly – some dual registered branches are permitted to take retail deposits, though in practice they take a minimal amount, if any.
- The full scope of prudential regulation and supervision is expected to reduce the cost of providing deposit insurance when it is introduced (see further below, under 'Broader context'), by providing a baseline level of assurance about the soundness of the deposit taker in New Zealand.
- Retail deposits are defined in BS1 as deposit liabilities held by natural persons, excluding liabilities with an outstanding balance of more than \$250,000. Deposit insurance is expected to apply to 'eligible products' up to an amount of \$100,000 per depositor, per institution.
- Branching, with its lower start-up costs relative to the parent bank establishing a subsidiary, may provide an attractive pathway for new entrants to the New Zealand retail banking market. This might enhance efficiency by introducing more competition for retail deposits and encouraging innovation in retail product offerings.

Options

One option would be to not allow branches to take retail deposits. This option would be simple to communicate and easy to understand. It would reduce our concern at the existence of depositor preference for retail deposits in overseas jurisdictions. And it would align us more closely with the approach taken in Australia, where authorised branches are wholesale funded.

Another option would be to allow branches to take a small amount of retail deposits, by setting a maximum amount. This would be consistent with the current approach for a number of our branches and our current risk tolerance for depositor preference regimes in overseas jurisdictions. It would potentially facilitate new entrants to the retail deposit taking market.

Yet another option would be to allow branches to take an amount of retail deposits greater than the current limits we impose, but subject to appropriate risk mitigants. For example, we might require branches with more than \$200 million in retail deposits to hold assets in New Zealand of at least the value of the branch's deposit liabilities in New Zealand (this is sometimes referred to as 'ring-fencing').

If branches are allowed to take retail deposits, we expect they would be covered by the deposit insurance scheme to be introduced by the DTA (see further below, under 'Broader context'), to the extent that they are eligible products under the scheme. We expect that we would have the ability under the DTA to impose licence conditions that could restrict an individual branch's ability to take deposits if we were not satisfied with the branch's safety and soundness. Further policy work would be required to address situations where a branch's home jurisdiction had depositor preference (whether applicable to the whole deposit or just the insured amount), and/or a deposit insurance scheme that covered third country depositors (ie, that purported to cover New Zealand depositors with the branch).

Should dual registration be allowed?

As highlighted above, dual registered branches present specific challenges for prudential regulators and supervisors. The distinction between the subsidiary and the branch can often be blurred. This complexity – the sharing of functions between the subsidiary and the branch, which itself often relies on staff, systems and functions of the overseas bank that are located in the home jurisdiction – creates difficulty and costs in terms of developing and implementing crisis management and resolution policies that promote our objectives.

Options

One option is to not allow dual registered branches. This would be unusual when compared to other jurisdictions, for example Australia. However, it would be simple to communicate and to apply, subject to a transition period to allow for existing New Zealand groups to re-arrange their operations. It would reduce complexity for crisis management and resolution policy. And it would support the effectiveness of existing prudential policies for locally incorporated banks, including governance, liquidity, capital adequacy and crisis management and resolution.

An alternative would be to allow dual registered branches, but to limit their activities in New Zealand to wholesale funding and lending. This would be consistent with current policy to not allow dual registered branches to take retail deposits. It would also have the merit of aligning with the position in Australia.

Further risk mitigants could be needed, depending on the relative size and importance of the subsidiary and our assessment of the home jurisdiction's regime. These mitigants could include:

- limiting the branch's size by reference to assets or another threshold; and/or
- developing and implementing policies that achieve:
 - greater operational separation between branch and subsidiary;
 - improved governance arrangements and risk management controls; and
 - clear and effective crisis management and resolution plans for the branch and the subsidiary.

- imposing quasi-capital or quasi-liquidity requirements on the branch, for example, requiring a dual registered branch to maintain a minimum amount of ring-fenced assets in New Zealand.

Greater regulatory and supervisory integration?

One approach to addressing issues related to home-host supervision is greater integration with international regulatory standards and/or greater engagement with home supervisors, whether bilaterally or in supervisory colleges. This can:

- reduce the regulatory burden on entities operating across borders; and
- result in better information sharing between home-host authorities, and promote greater understanding of competing objectives, and potentially lead to the pre-positioning of actions and outcomes in the event of a stress at the entity or system level.

This might allow us to take a different view on the policy options described above; be more permissive in terms of the thresholds and prudential requirements we impose on branches, and the types of business we allow branches to undertake.

However, we are already active on this front. We take international standards into account when developing our policies. We engage closely with international partners through the Trans-Tasman Banking Council, the International Monetary Fund (IMF), the Bank for International Settlements (BIS) and the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP).

When assessing the equivalence of a branch's home jurisdiction, we draw on a number of international sources (for example, Financial Stability Board peer reviews, the IMF's Financial Sector Assessment Programmes, and World Trade Organisation status).

International standards and assessments may not always be relevant to a sound and efficient financial system in New Zealand. They may add regulatory burden and complexity without commensurate benefits. International standards may also come with built-in national discretions that limit the reliance we can place on the standards that apply in the branches' home jurisdictions.

Further, greater alignment with international standards and more intensive cross-border engagement:

- comes with greater supervisory resource and co-ordination costs;
- does not guarantee that information home authorities share with us about branches or systemic risks in New Zealand will be given greater weight than at present;
- cannot overcome differences between jurisdictions, in terms of company and insolvency law, and property rights; and
- cannot resolve inherent conflicts of interest between sovereign jurisdictions, as to who bears the costs of failure in a crisis and associated social and economic harm.

The leverage that we can be expected to bring to bear in our engagements with home supervisors is necessarily limited, given the relatively small scale and importance of our financial system to most of the banking groups that operate here, some of which are global systemically important banks (G-SIBs).

Interplay between the different policy options

As already suggested above, the different policy questions and options outlined should not be considered in isolation. For example:

- If branches were not permitted to take retail deposits, the threshold for local incorporation might be set by reference to assets, or another test that takes into account a branch's systemic importance.
- A more permissive approach to branches taking retail deposits might imply enhanced prudential requirements for branches, whether in terms of liquidity, risk management, or the ring-fencing of assets in New Zealand, and increased supervisory engagement.

Costs

All prudential measures have costs, which must be weighed against the benefits for a sound and efficient financial system.

This consultation paper sets out a problem definition, assessment principles and some high level policy questions and options. We do not have a preferred approach at this time. We intend to conduct a cost-benefit analysis and to publish a Regulatory Impact Assessment in due course.

Q3 Do you have any comments on the main policy questions and options?

Q 3.1 What is the appropriate threshold for local incorporation?

Q 3.2 Should branches be permitted to take retail deposits?

Q 3.3 Should dual registration be allowed?

Q 3.4 Should we pursue greater regulatory and supervisory integration?

Broader context

Legislative changes

Deposit Takers Act and deposit insurance

The Government has undertaken a review of our legislation, with a view to creating a modern monetary and financial policy framework. The Minister of Finance has announced that the Parts of the current Act that relate to the prudential regulation and supervision of banks will be replaced by a Deposit Takers Act (DTA).

The DTA will create a single regulatory framework for all banks (including branches) and non-bank deposit takers. It will provide the framework for regulating and supervising deposit takers, including managing and resolving any deposit taker in distress. The DTA will also introduce a new deposit insurance scheme that will protect up to \$100,000 per depositor, per institution, in the event of a deposit taker failure.

- 'Standards', a form of secondary legislation to be administered by us, will become the primary tool for imposing prudential requirements on banks. There will be a high degree of flexibility to tailor standards to individual deposit takers and classes of deposit takers. For example, branches might be treated as a class of deposit takers.
- The framework will provide us also with the discretion to calibrate institution-specific requirements with a given standard through licence conditions (or exemptions) to reflect the underlying risk profile of that institution ('supervisory adjustment').
- We will be required to publish a statement of approach to resolution, including resolution strategies for different types or classes of deposit taker. We expect that resolution plans will need to set out how a deposit taker would be resolved.

It is anticipated that a Bill for the DTA will be introduced to Parliament in 2022. Measures related to deposit insurance are expected to be prioritised in order for the scheme to be operational in 2023.

New Conduct of Financial Institutions (CoFI) regime

The Government is introducing a new regulatory regime to govern conduct in the financial sector. The Financial Markets (Conduct of Institutions) Amendment Bill will amend the Financial Markets Conduct Act 2013 to require all banks (as well as insurers and non-bank deposit takers) to be licensed in respect of their general conduct towards consumers and to have systems and processes in place to ensure they treat consumers fairly. The licensing regime will be monitored and enforced by the Financial Markets Authority (FMA).¹⁰

The regime will apply to branches of overseas banks that provide products and services to consumers in New Zealand (it does not apply to wholesale-only business). If the regime applies, branches will need to have systems and controls in place to ensure good conduct and fair treatment of consumers. They will also need to ensure that their products and services are clearly understood by consumers and suited to their needs.

The concept of 'consumer' is expected to be broadly consistent with similar concepts in the Financial Markets Conduct Act 2013 and other consumer legislation. Broadly speaking this

¹⁰ See <https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/conduct-of-financial-institutions-review/>

covers general consumers in relation to credit and general insurance services, and extends to small businesses with assets or turnover of up to \$5 million in a financial year for other types of financial services.

The licensing regime is expected to be applied on a proportionate basis, having regard to factors like the risk of harm and market impact.

Other sectors

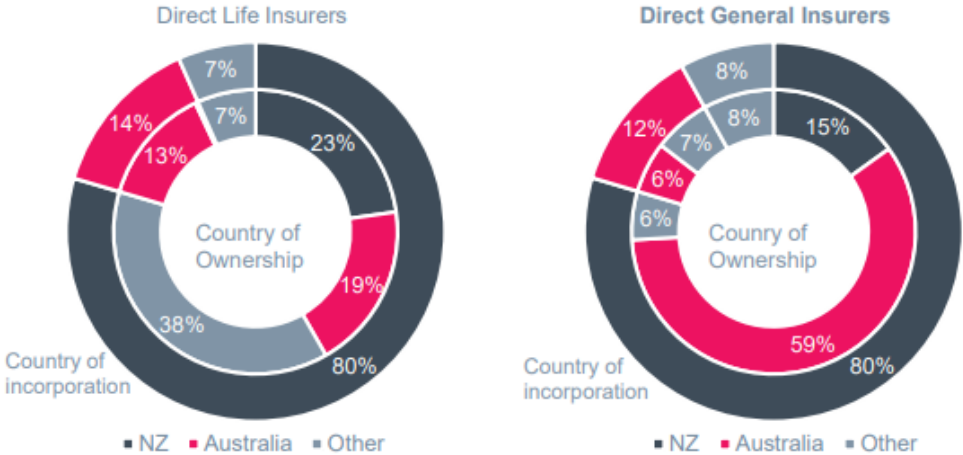
We are conscious of the benefits that branches bring not only to the banking sector, but also the insurance and financial market infrastructure sectors. Applying one approach to branches across all sectors is not possible, given the different nature of the businesses and the risks that apply in each case. Our regulatory settings for branches can therefore be expected to differ across different sectors.

Insurance

Insurance business presents a different balance of risks to banking: the systemic risk considerations are different and the consumer and policy holder relationship is more complex than that between banks and retail depositors.

Branches are an important feature of our insurance sector and account for approximately 20 percent of insurance business in New Zealand in each of general and life insurance. There is no local incorporation threshold for insurance companies and we allow branches of non-life insurers to operate in New Zealand without needing to hold assets based in New Zealand. For life insurers we require a local statutory fund, unless they are domiciled in an exempt jurisdiction (for example, Australia).

Figure 3: Insurers’ country of ownership and country of incorporation



Source: Review of the Insurance (Prudential Supervision) Act 2010 – Options Paper 1: Scope of the Act and Overseas Insurers, RBNZ, November 2020

Some branches are eligible for exemptions from parts of the Insurance (Prudential Supervision) Act 2010 (IPSA), including fit and proper certificates for directors and officers, the maintenance of a solvency margin, and the maintenance of at least one statutory fund (in the case of life insurers). Exemptions are granted based on regulatory equivalence tests which can be used to ‘prescribe’ certain jurisdictions where these conditions have been met.

Insurers from overseas jurisdictions which have policy holder preference in insolvency are allowed to operate in New Zealand provided the preference is clearly disclosed to policy

holders and rating agencies. However, in these circumstances, life insurers are not eligible for an exemption from the requirement to maintain a statutory fund in New Zealand.

We are currently reviewing our approach to regulating and supervising overseas insurance branches as part of the IPSA review.¹¹

Financial Market Infrastructure

We oversee major payments systems, and jointly with the Financial Markets Authority, other types of financial market infrastructures (FMIs) such as settlement systems and central counterparties. An enhanced regulatory framework for FMIs (including payment systems) was introduced by the Financial Market Infrastructures Act 2021.

New Zealand's financial system relies in part on overseas FMIs that often will not have any meaningful physical or legal presence in New Zealand. This makes it difficult to compel compliance with our own requirements. However:

- Our regime relies on international standards – the Principles for Financial Market Infrastructures (PFMIs) issued by the Committee on Payments and Market Infrastructure (CPMI) and the Technical Committee of the International Organisation of Securities Commissions (IOSCO). These are almost universally used as the basis for regulatory requirements in other jurisdictions as well.
- Our regime places heavy weight on our relationships with overseas regulators like the Reserve Bank of Australia, and the Bank of England, and international fora, like EMEAP. Importantly, New Zealand's partial reliance on overseas FMIs is not uncommon, and large globally important FMIs such as CLS and LCH have supervisory (and sometimes resolution) colleges chaired by home country regulators with host countries acting as participants. Participation in these colleges provides an alternative means of overseeing some overseas FMIs.

We are currently developing more detailed policy on the treatment of overseas FMIs and have consulted on a number of options. One of the issues we are considering is the extent to which we can rely on substitute compliance (that an FMI's compliance with rules in its home jurisdiction will mean it has complied with standards in New Zealand), subject to meeting equivalence and cooperation conditions in New Zealand.

Review process

The consultation period runs until 5pm on 2 March 2022. We expect to publish a summary of submissions in Q2 of 2022.

We will facilitate workshops and other meetings during the consultation period, to discuss the issues presented in this paper, subject to demand. Please email us at BranchPolicyReview@rbnz.govt.nz if you would like to arrange a meeting.

A second Consultation Paper will set out our preferred approach to the regulation and supervision of branches. We expect this second Consultation Paper will be published in mid-2022.

¹¹ See <https://www.rbnz.govt.nz/regulation-and-supervision/insurers/consultations-and-policy-development-for-insurers/active-policy-development>

Following consultation on our preferred approach, any changes to our policy would be implemented by amending BS1 of the Banking Supervision Handbook and changes to banks' conditions of registration.

Annex 1 – Consultation questions

Your feedback is important. This consultation provides you with the opportunity to give your views on, and any information relevant to, the registration, regulation and supervision of branches of overseas banks.

The main text of this Consultation Paper includes some questions you may wish to respond to. A consolidated list of the questions is set out below. Comments do not need to be made in respect of all the questions. You may focus on those areas that are of most importance to you. Comments are welcome on any other matters you consider relevant to the review of policy for branches of overseas banks.

Submissions that provide commentary in support of your views are particularly helpful, including the linkage to the objectives and principles of the legislation.

Questions

The following questions are included in the main text of this Consultation Paper.

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

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

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?

Contact details

All responses should be emailed to BranchPolicyReview@rbnz.govt.nz or sent 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

We welcome submissions until 5pm, 2 March 2022.

Annex 2 – Legislative and policy detail

Statutory requirements when determining an application for bank registration

Branch registration involves an assessment of the matters specified in sections 73 to 73B and 78 of the Act. We are required:

- to satisfy itself that the applicant's business will substantially consist of the borrowing and lending of money, or the provision of other financial services, or both;
- to have regard to the following matters:
 - the incorporation and ownership structure of the applicant;
 - the size and nature of the applicant's business or proposed business or any part of the applicant's business;
 - the ability of the applicant to carry on its business or proposed business in a prudent manner, by reference to:
 - capital in relation to the size and nature of the business;
 - loan concentration and risk exposures;
 - separation of the business from other interests of the owner;
 - internal controls and accounting systems;
 - risk management systems and policies;
 - outsourcing arrangements;
 - the standing of the applicant in the financial markets;
 - the suitability for their positions of the directors and senior managers of the applicant;
 - the standing of the owner of the applicant in the financial markets; and
 - policies, systems and procedures to detect and deter money laundering and the financing of terrorism.
- If the applicant is an overseas person we are required to have regard to the following additional matters:
 - the law and regulatory requirements of the applicant's home jurisdiction that relate to:
 - the recognition and priorities of claims of creditors or classes of creditors in the event of the insolvency of the applicant;
 - the disclosure by the applicant of financial and other information of the kind that a registered bank must disclose under section 81 of the Act;
 - the accounting and auditing standards applicable to the applicant;
 - the duties and powers of directors of the applicant; and

- the licensing, registration, authorisation and supervision of the applicant,
- the nature and extent of the financial and other information disclosed to the public by the applicant.
- If the applicant is a subsidiary of an overseas person we are required to have regard to the following additional matters:
 - the law and regulatory requirements of the home jurisdiction of the overseas person that relate to:
 - the disclosure by the overseas person of financial and other information of the kind that a registered bank must disclose under section 81 of the Act;
 - the accounting and auditing standards applicable to the overseas person;
 - the duties and powers of the directors of the overseas person; and
 - the licensing, registration, authorisation and supervision of the overseas person,
 - the nature and extent of the financial and other information disclosed to the public by the overseas person.

Local incorporation policy

Our local incorporation policy was implemented in April 2001. A foreign owned bank is required to incorporate locally as a subsidiary, rather than operate as a branch, if it:

- has more than \$15bn in external liabilities or is expected to exceed this limit in the five years following registration;
- has more than \$200m in retail deposits¹² in New Zealand and:
 - depositor preference applies in its home jurisdiction; and/or
 - it does not provide adequate disclosure in its home jurisdiction;
- is incorporated in a jurisdiction that has non-comparable supervisory arrangements (including disclosure arrangements) and governance standards.

The different grounds for requiring local incorporation reflect how we think about the risks that branches pose to the financial system. A restriction on the amount of retail deposit taking is intended to limit the risk that the confidence of retail depositors in the financial system, and in our regulatory and supervisory regime, is undermined by the failure of a branch.

Local incorporation provides us with a degree of assurance that we will have the ability to both mitigate the probability of a default by a bank, and to manage a bank failure, which could have flow on effects to the banking system and the wider economy.

¹² For the purposes of BS1, "retail deposits" are defined as deposit liabilities held by natural persons, excluding liabilities with an outstanding balance of more than \$250,000.

Depositor preference

Where legislation in a branch's home jurisdiction gives depositors or creditors in that country a preferential claim on assets, it is very difficult for New Zealand depositors to assess their likely position, if the bank were to fail.

In a failure situation, New Zealand depositors, depositors in the home jurisdiction, New Zealand creditors and creditors in the home jurisdiction would each have different ranking claims on the same legal entity. Neither the legal entity accounts nor the branch accounts, nor both sets of accounts taken together, provide sufficient information for depositors and creditors to determine their position relative to other classes of creditor and depositor. The situation is even more complex when the legal entity has branches in other jurisdictions as well.

Thus our policy is that a branch from a jurisdiction with home depositor preference, and that intends to take more than \$200m in retail deposits, should incorporate locally. To allow the branch to take more than a de minimis amount would potentially undermine the confidence of New Zealanders in the banking system, should the bank fail.

With a locally incorporated bank, depositors will have access to current financial statements prepared in accordance with New Zealand generally accepted accounting principles (GAAP) for the legal entity with which they are dealing. They will also have assurance that, in a winding up, their claims would rank equally with those of other unsecured creditors (other than priority creditors such as the Inland Revenue Department and employees).

Disclosure

Adequate disclosure is important because it allows depositors and other stakeholders to assess the financial strength of the bank as a whole, and supports market discipline. When assessing the adequacy of disclosure, we take into consideration a range of factors.¹³ For branches, these factors include whether the accounting standards being used to prepare accounts for the legal entity are sufficiently similar to accounting standards used in New Zealand. Users of the accounts should be able to make an assessment of the entity's financial condition that would not differ materially from that which the user would make, if the accounts were prepared using New Zealand GAAP.

Wholesale branches

Wholesale depositors and creditors, while faced with the same information gap as retail customers, are generally able to understand the deficiencies in disclosure information and/or their position in the creditor hierarchy, and can take them into account when making investment decisions. Thus we do not require branches which deal with wholesale clients to incorporate locally purely on the basis of inadequate disclosure or depositor preference legislation in the home jurisdiction.

Dual registration policy

We first adopted a dual registration policy in July 2004. The main features of our dual registration policy are that:

- a dual registered branch should not be permitted to accept retail deposits; and

¹³ See paragraph 33 of BS1 for the complete list of considerations.

- where we have concerns about the approach to supervision, disclosure, accounting, auditing standards and/or insolvency and resolution arrangements in the home jurisdiction, total assets of the branch must not exceed those of the locally incorporated subsidiary.

Taking deposits through both the branch and the subsidiary might lead to retail depositors being confused about the entity they were dealing with. This could lead to a loss of confidence in the financial system and our regulatory and supervisory approach. We note that, contrary to our current policy in BS1, the conditions of registration for some existing dual registered branches permit them to take retail deposits. However, in practice, the amount of retail deposits taken by dual registered branches is immaterial.

Retail deposits are defined, for the purposes of BS1, as deposit liabilities held by natural persons, excluding liabilities with an outstanding balance of more than \$250,000.

Dual registration policy for small banks

In 2016 we consulted on our dual registration policy for small banks. This was in response to suggestions from industry that local incorporation prevented some banking groups from growing their lending business in New Zealand, due to high regulatory and operating costs.

The resulting policy position was intended to provide a flexible and pragmatic framework for assessing applications for dual registration as a branch with non-systemic New Zealand operations.¹⁴ This did not affect either our local incorporation policy or our policy towards stand-alone branches.

Where the home jurisdiction was deemed non-equivalent, the dual registered branch was restricted to business with 'wholesale clients'.¹⁵ This could include lending to public infrastructure projects or trade finance initiatives. Any retail lending or deposit taking had to be undertaken by the subsidiary.

We expect to be consulted before a decision is made to relocate functions or activities from the subsidiary to the dual registered branch.

Consultation on liquidity requirements for branches

BS13 (Liquidity policy) applies to locally incorporated banks

Liquidity policy aims to contribute to the smooth functioning of the financial system by increasing the likelihood that banks can meet their obligations as they fall due, and helping banks identify, measure, monitor and measure their liquidity risk appropriately.

BS13 (Liquidity Policy) of the Banking Supervision Handbook sets out our expectations of locally incorporated banks for managing liquidity risk.

Branches are not subject to liquidity requirements in their conditions of registration. The entity they form part of will be subject to liquidity requirements in the home jurisdiction. However, we retain the right to impose quantitative or qualitative liquidity requirements on branches.

¹⁴ See <https://www.rbnz.govt.nz/regulation-and-supervision/banks/consultations-and-policy-initiatives/completed-policy-development/dual-registration-policy-for-small-foreign-banks>

¹⁵ As defined in clause 3(2), schedule 1 of the Financial Markets Conduct Act 2013.

BS13 sets out the factors we will consider when determining the need to impose liquidity requirements, and liquidity reporting requirements, on branches, including the significance of the branch's role in the financial system; whether the branch has net liabilities that exceed \$10 billion; and whether the branch is dual registered, and the impact this may have on the liquidity requirements that apply to the locally incorporated bank.

Consultation on liquidity requirements for branches

We consulted on a liquidity requirement specifically designed for branches in January 2012.¹⁶ Our view was that there was a good argument that branches should be required to hold an adequate stock of (mainly NZD) liquid assets in New Zealand against some metric of the potential short-term claims. A default by a branch could undermine confidence in New Zealand's financial system as a whole, just as a default by a locally incorporated bank could do.

A liquidity requirement for branches would be in addition to the standard condition of registration that the bank (of which the branch forms part) complies with prudential requirements (including liquidity requirements) in its home jurisdiction.

The consultation was intended to address scenarios where the branch might be faced with a sudden call on NZD cash in New Zealand. Inability to meet those demands could create fears about systemic illiquidity in New Zealand.

The branch's ability to meet its NZD obligations in New Zealand may depend on treasury functions that are overseas, and funding markets in a number of other jurisdictions being open. Various types of friction might hinder the branch from accessing the necessary liquidity, including disruptions in FX markets, or uncertainties in the home jurisdiction – whether at the bank's head office or at the home supervisor – about where liquidity is most urgently needed across the banking group. If the bank (of which the branch forms part) is under stress, the bank may decide to prioritise creditors in its home jurisdiction, and either repatriate funding from its overseas branches or cease to roll-over maturing funding to its branches.

For dual registered branches, requiring a branch to maintain a stock of high quality liquid assets in New Zealand dollars would mitigate the risk of contagion (the possibility that the loss of confidence in the branch spreads to the subsidiary) and potentially address intra-group maturity transformation (for example where the branch lends at long maturities to its subsidiary while funding itself at shorter maturities (whether from head office or from third parties) and thereby potentially undermine the effectiveness of the Core Funding Ratio imposed by us on locally incorporated banks.

To date we have not implemented a liquidity requirement for branches. We will be revisiting the case for applying liquidity requirements to branches as part of the forthcoming liquidity policy review. The liquidity review will take into account the conclusions of this review of our policy towards branches.

Capital

In assessing an application for branch registration, we will pay close attention to the adequacy of the capital standards applied in the home jurisdiction. These must be broadly

¹⁶ See [Liquidity: branches - Reserve Bank of New Zealand](#)

comparable to the capital standards in New Zealand, and subject to adequate supervision by the home supervisor.

Branches are not subject to a minimum size requirement, in recognition that the branch will be operating in New Zealand on the basis of the bank's global balance sheet. However, we expect that the global bank has a level of capital that exceeds \$30 million, and that it has sufficient capital to carry on its business in a prudent manner.

If an application is successful, branches are typically subject to conditions of registration that specify that:

- the bank must comply with its prudential requirements, including capital requirements, in its home jurisdiction; and
- the operation of the New Zealand branch will not constitute a predominant proportion of the business of the bank.

Governance

Locally incorporated banks have their own boards of directors, with duties under the Companies Act to act in the best interests of the company, and to only authorise distributions to shareholders if the company is solvent (among other duties). We consider that these directors' duties increase the likelihood that value will be retained in the local bank.

The forthcoming Deposit Takers Act is expected to augment these duties by imposing an on-going duty on directors of deposit takers (including registered banks) to ensure that there are adequate systems, processes and policies in place to ensure that the entity complies with its prudential obligations.

Branches do not have their own board of directors, distinct from the legal entity it is part of. However, branches are required to have a New Zealand chief executive officer and are subject to disclosure requirements that require sign off by its directors (or their delegate(s) in New Zealand).

Disclosure

Branches, like locally incorporated banks, are required to publish disclosure statements with appropriate attestations by directors. A branch is required to disclose information for both the branch and for the overseas bank of which it is part. This includes the financial statements for their overseas banking activities as a whole, and information on the bank's compliance with capital requirements in the home jurisdiction.

We permit the directors of the overseas bank to appoint another person to sign off the disclosure statements on their behalf, although the directors retain legal responsibility for the accuracy of the information. In some case the directors of the overseas bank appoint the CEO of the locally incorporated bank to sign on their behalf.

A branch's disclosure statements must contain an attestation, signed by or on behalf of each director of the overseas bank, as well as the branch's New Zealand CEO, that:

- the disclosure statement contains all the required information, and is not false or misleading;
- the branch has complied with its conditions of registration; and

- the branch (unless dual registered) had systems in place to monitor and control adequately the branch's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, and other business risks, and that those systems were being properly applied.¹⁷

In the case of dual registered branches, the directors of the overseas bank and the CEO of the branch must make an attestation that both the branch and the subsidiary (and any other members of the New Zealand banking group) had systems in place to monitor and control adequately the risks listed in the third bullet point above, and that those systems were being properly applied.¹⁸

Crisis management and resolution

Under the Act, we have the power to appoint a statutory manager in respect of a branch.¹⁹ The statutory manager would have the power to transfer the assets of the branch to a newly incorporated New Zealand registered company.

However, this power has never been tested in practice. The ability of a statutory manager to determine what assets are, or would be, available in a failure, and which liabilities could be attributed to the branch, would depend on private and international law.

Some progress has been made internationally in developing crisis management frameworks that apply across jurisdictions. However, at the same time, global banks have tended to centralise and integrate their cross-border activities, making the issue more acute.

Where the New Zealand operations of the branch are small relative to the overseas bank's global operations, we are unlikely to qualify as a key host jurisdiction material to the effective resolution of the branch or the bank it forms part of. This gives us limited opportunity to participate in resolution planning.

¹⁷ Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended), Schedule 2, clause 19(2) and Schedule 3, clause 14(2).

¹⁸ Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended), Schedule 2, clause 19(3) and Schedule 3, clause 14(3).

¹⁹ Section 123 of the Act.

Annex 3 – Application of Banking Supervision Handbook

Banking Supervision Handbook	Locally incorporated banks	Branches of overseas banks
BS1 (Statement of Principles – bank registration and supervision)	✓	✓
BS2A or BS2B (Capital adequacy framework)	✓	✗
BS3 (Application for status as a registered bank)	✓	✓
BS4 (Audit obligations)	✓	✓
BS5 (Guidelines on Anti-Money Laundering and Countering Financing of Terrorism)	✓	✓
BS6 (Market risk guidance notes)	✓	✗
BS7 (Registered bank disclosure regime)	✓	✓
BS8 (Connected Exposures)	✓	✗
BS9 (Application for consent to acquire or increase significant influence over a bank)	✓	✓
BS10 (Suitability of Directors and Senior Managers)	✓	✗
BS11 (Outsourcing)	✓ (subject to threshold)	✗
BS12 (Internal Capital Adequacy Assessment Process)	✓	✗
BS13 (Liquidity Policy)	✓	✗
BS14 (Corporate Governance)	✓	✗
BS15 (Significant Acquisitions)	✓	✗
BS16 (Capital recognition, repayment and notification)	✓	✗
BS17 (Open Bank Resolution)	✓ (subject to threshold)	✗
BS18 (Registration of Covered Bonds)	✓	✗
BS19 (LVRs)	✓	✓

Annex 4 – Branch conditions of registration

Branch Conditions of registration	ANZ	BoC	CBA	CCB	Citibank	Rabo-bank	HSBC	ICBC	JP Morgan	Kook-min	MUFG	WBC
That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
That the banking group's insurance business is not greater than 1% of its total consolidated assets.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Business of the branch in New Zealand does not constitute a predominant proportion of the total business of the bank.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
We must have received a CV of the NZ CEO applicant and have no objection to the appointment of the NZ CEO.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
That the bank complies with the requirements imposed on it by its home regulator.	✓ (Australian Prudential Regulation Authority)	✓ (China Banking and Insurance Regulatory Commission)	✓ (Australian Prudential Regulation Authority)	✓ (China Banking and Insurance Regulatory Commission)	✓ (Office of the Comptroller of the Currency)	✓ (De Nederlandsche Bank N.V and the ECB)	✓ (Hong Kong Monetary Authority)	✓ (China Banking and Insurance Regulatory Commission)	✓ (Office of the Comptroller of the Currency)	✓ (Financial Supervisory Service of Korea)	✓ (Japanese Financial Services Agency)	✓ (Australian Prudential Regulation Authority)

Branch Conditions of registration	ANZ	BoC	CBA	CCB	Citibank	Rabo- bank	HSBC	ICBC	JP Morgan	Kook- min	MUFG	WBC
<p>The bank's capital adequacy ratio must be equal to or greater than the minimum requirements, as administered by the home regulator:</p> <ul style="list-style-type: none"> • Common Equity Tier 1 (CET1) – 4.5% • Tier 1 Capital – 6% • Tier 2 Capital – 8% 	✓	✓ (Except CET1 – 5%)	✓	✓ (Except CET1 – 5%)	✓	✓	✓	✓ (Except CET1 – 5%)	✓	✓	✓	✓
<p>Liabilities of the branch, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the branch), must not exceed NZ\$15 billion.</p>	✗	Not permitted to incur liabilities except specified exceptions (tax, trade creditors and staff, etc)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
<p>Retail deposits permitted</p>	✗	✗	✓ (up to \$200 million)	✗	✓ (up to \$200 million)	✓	✓	✗	✓ (up to \$200 million)	✓	✓ (up to \$200 million)	✓ (up to \$200 million)

Branch Conditions of registration	ANZ	BoC	CBA	CCB	Citibank	Rabo- bank	HSBC	ICBC	JP Morgan	Kook- min	MUFG	WBC
Business restriction	✓ May only acquire up to \$15 billion of mortgages originated by ANZ BNZL	✓ May only undertake wholesale business in New Zealand	✗	✓ May only undertake wholesale business in New Zealand	✗	✗	✗	✓ May only undertake wholesale business in New Zealand	✗	✗	✗	✗
That any derivative contracts entered into may only be for the purposes of hedging a customer's positions with the branch, or the branch's own risk positions.	✗	✓	✗	✓	✗	✗	✗	✓	✗	✗	✗	✗
That the New Zealand assets of the branch do not exceed the consolidated total assets of the corresponding subsidiary.	✗	✓	✗	✓	✗	✗	✗	✓	✗	✗	✗	✗
Loan to Value Ratio restrictions on mortgage lending	✗	✗	✓	✗	✓	✓	✓	✗	✓	✓	✓	✓

“banking group” is defined to mean the New Zealand business of the registered bank and its subsidiaries as required to be reported in group financial statements for the group’s New Zealand business under section 461(B)(2) of the Financial Markets Conduct Act 2013.

“retail deposits” are defined as deposits by natural persons, excluding deposits with an outstanding balance which exceeds \$250,000.

“wholesale business” is defined to mean business transacted with “wholesale investors” defined under the Financial Market Conduct Act 2013.

Annex 5 – Branch descriptions

This annex provides a brief description of each of the 12 registered branches of overseas banks currently operating in New Zealand. For each branch, we have included data on total assets and liabilities of the relevant New Zealand banking group, unless otherwise indicated. We note that for dual registered branches, the numbers for the New Zealand banking group exclude the registered subsidiary.

ANZBG

ANZBG is incorporated in Australia. ANZ is dual registered: it operates in New Zealand through its subsidiary, ANZBNZL, and ANZBG as a registered branch. ANZBNZL shares some staff with the branch, although the subsidiary and the branch have separate CEOs. ANZBNZL also provides IT infrastructure and certain other services to the branch.

The ANZBG branch was established to acquire residential mortgage loans from ANZBNZL and to undertake other business approved by us. It is not permitted to engage in retail business, or in wholesale or corporate lending. The branch had approximately \$2.6 billion in total assets (including \$0.3 billion of residential mortgage loans, and \$2.1 billion of additional tier 1 capital instruments issued by ANZBNZL) and \$2.4 billion in total liabilities, as at 30 June 2021.

Bank of China

Bank of China Limited is incorporated in China and is one of the world's largest banks, with overseas branches and subsidiaries in 61 countries. Bank of China is dual registered in New Zealand, having both a registered subsidiary, BoC NZL, and BoC as a registered branch. Consistent with our dual registration policy for small foreign banks, the branch's operations are restricted to non-retail business and the branch is required to be smaller than BoC NZL, by reference to total assets.

The branch and BOC NZL share the same staff and senior management team, and operate from the same premises in Auckland and Christchurch. The branch is predominantly involved in lending to large New Zealand corporate clients. The majority of the lending by the Bank of China's New Zealand banking group (including both CCB NZL and the branch) is to New Zealand based customers. The group also supports bi-lateral business and trade opportunities for New Zealand businesses with China. The branch had approximately \$2.15 billion in total assets and \$2.13 billion in total liabilities, as at 30 June 2021.

CBA

Commonwealth Bank of Australia is incorporated in Australia. CBA is dual registered in New Zealand, having both a registered subsidiary, ASB, and CBA as a registered branch. The branch manages the largest institutional lending relationships of the CBA group in New Zealand, with ASB focusing on the rest of the New Zealand business, as well as the agricultural and retail sectors. The branch is permitted to take up to \$200m in retail deposits but does not have retail operations.

The branch has its own senior management and its operations are co-located with ASB. ASB is contracted to provide certain services to the branch, including property, finance, HR, etc.

The branch undertakes treasury functions in New Zealand, including issuing CBA securities. However the branch does not have any treasury staff and outsources its treasury functions to ASB's group treasury. Note the branch is responsible for CBA's New Zealand based AML/KYC call centre for Australian customers (but not ASB's customers). The branch had approximately \$12.4 billion in total assets and \$9.1 billion in total liabilities, as at 30 June 2021.

CCB

China Construction Bank Corporation was established in 1954 in China. China Construction Bank is dual registered in New Zealand, having both a registered subsidiary, CCB NZL, and CCB as a registered branch. Consistent with our dual registration policy for small foreign banks, the branch's operations are restricted to non-retail business and the branch is required to be smaller than CCB NZL, by reference to total assets.

The branch focuses on providing wholesale banking services. This includes bilateral and syndicated lending, trade finance, FX transactions, and deposit taking for business, corporate and institutional clients. The branch had \$1.56 billion in total assets and \$1.54 billion in total liabilities, as at 30 June 2021.

Citibank

Citibank, NA is incorporated in the United States of America. The ultimate holding company is Citigroup, Inc., a global financial services holding company. In the event of the bank's insolvency, the rights of creditors in New Zealand would be governed by the US Federal Deposit Insurance Act 1950: depositors in the New Zealand branch would be subordinate to insured deposits held in the US, secured creditors and administrative expenses. The branch has been a registered bank in New Zealand since 1987 and a settlement bank, and thus a direct participant in the New Zealand clearing system, since 1990.

The branch offers financial markets services, including foreign exchange, rate derivatives, and commodities, and provides custodial and clearing services to global and local corporations, financial institutions and government bodies. It offers treasury and investment and corporate banking services to institutional investors. It also issues branded credit cards. Citibank does not provide residential mortgage loans in New Zealand.

The branch had approximately \$1.95 billion in total assets and \$1.76 billion in total liabilities, as at 31 March 2021.

HSBC

HSBC operates in New Zealand as a branch of The Hongkong and Shanghai Banking Corporation Limited, incorporated in Hong Kong SAR. The branch has been a registered bank since 1987. HSBC initially opened its head office in New Zealand in Wellington, but moved it to Auckland in 1989 while retaining an office in the capital.

The branch provides a wide range of banking services in New Zealand via three global businesses: Commercial Banking, Wealth and Personal Banking, and Global Banking and Markets. The branch had approximately \$6.83 billion in total assets and \$6.79 billion in total liabilities, as at 31 March 2021.

ICBC

Industrial and Commercial Bank of China Limited is incorporated in China. ICBC is dual registered in New Zealand, having both a registered subsidiary, ICBC NZL, and ICBC as a registered branch. Consistent with our dual registration policy for small foreign banks, the branch's operations are restricted to non-retail business and the branch is required to be smaller than ICBC NZL, by reference to total assets.

The purpose of the branch is to complement and expand on wholesale banking services provided by ICBC NZL. The branch is predominantly focused on loan syndications and trade finance. The branch intends to extend core banking services, including savings and lending, cash management, international and RMB settlements. The branch had approximately \$1.64 billion in total assets and \$1.55 billion in total liabilities, as at 30 June 2021.

JP Morgan

JP Morgan Chase Bank NA is incorporated in the United States of America. Its ultimate holding company is JPMorgan Chase & Co. In the event of the bank's insolvency, the rights of creditors in New Zealand would be governed by the US Federal Deposit Insurance Act 1950: depositors in the New Zealand branch would be subordinate to insured deposits held in the US, secured creditors and administrative expenses.

The branch's acting CEO is also the COO of JP Morgan Australasia. In New Zealand, the branch primarily operates a global custody business for securities financing, cash and foreign exchange along with a wholesale payments business. The branch does not provide mortgage loans. The banking group in New Zealand (including the branch and J.P. Morgan Securities Australia Limited) had approximately \$1.78 billion in total assets and \$1.78 billion in total liabilities, as at 30 June 2021. The branch alone had \$356 million in total assets and \$356 million in total liabilities, as at 30 June 2021.

Kookmin

Kookmin Bank was established in 1963 in the Republic of Korea. It is part of KB Financial Group, one of South Korea's largest financial services groups. The bank is required by the Korea Reserve Bank Act to maintain reserves in Korea to cover deposit liabilities in Korea. This requirement has the potential to impact on the management of the liquidity position of the branch. Kookmin's Auckland branch has a material retail business and takes household deposits.

The branch had approximately \$711 million in total assets and \$704 million in total liabilities, as at 30 June 2021.

MUFG

MUFG Bank Ltd is incorporated in Japan, and is the commercial banking subsidiary of Mitsubishi UFJ Financial Group, Inc, the largest financial group in Japan. Deposits in the New Zealand branch are outside the scope of Japan's deposit insurance scheme. In the event of the bank's default, New Zealand creditors would rank equally with all other creditors. The bank is required by Japanese law to maintain reserves in Japan based on the amount of

deposits. This requirements has the potential to impact on the management of the liquidity position of the branch.

MUFG's New Zealand branch was established as a support function for Japanese corporates in New Zealand. Its focus has expanded to New Zealand's largest corporates and institutions. The branch's regulatory affairs, compliance, risk and Treasury teams are based in Sydney. MUFG's Treasury function manages the Sydney and Auckland branches together on a consolidated basis.

The branch had approximately \$6.46 billion in total assets and \$6.20 billion in total liabilities, as at 31 March 2021.

Rabobank

Coöperatieve Rabobank UA is incorporated in the Netherlands. It is structured as a cooperative and is one of the world's leading specialists in food and agribusiness banking. Rabobank is dual registered in New Zealand, having both a registered subsidiary, RNZL, and Rabobank as a registered branch. Rabobank's banking group in New Zealand comprises the branch, RNZL, De Lage Landen Limited and AGCO Finance Limited. The New Zealand banking group is one of the leading agricultural lenders in New Zealand and a significant provider of business and corporate banking and financial services to the New Zealand food and agribusiness sector. RNZL has 29 offices throughout New Zealand. RNZL and the branch share the same CEO and staff, and operate from the same premises and IT.

RNZL takes retail deposits and does most of the New Zealand banking group's lending. The branch undertakes some wholesale lending. The branch also provides funding for RNZL from the head office in the Netherlands. The branch had approximately \$10.70 billion in total assets and \$10.34 billion in total liabilities, as at 31 March 2021.

Westpac

Westpac Banking Corporation is incorporated in Australia. Westpac is dual registered in New Zealand, having both a registered subsidiary, WNZL, and WBC as a registered branch. The branch is permitted to take up to \$200m in retail deposits, though it takes very little in practice.

The branch primarily provides wholesale banking services (foreign exchange and interest rate derivatives, trade finance, correspondent banking, international payments and some debt origination), while WNZL provides consumer, business and institutional banking services. A small number of WNZL employees are seconded to the branch to perform management, treasury, and payment functions. The branch is notable for being more inter-connected with the New Zealand banking system than other registered branches. The branch had approximately \$12.09 billion in total assets and \$9.66 billion in total liabilities, as at 31 March 2021.