Review of Policy for Branches of Overseas Banks.

Regulatory Impact Statement

7 November 2023

Non-Technical Summary

Our Review of policy for branches of overseas banks began with the publication of the first consultation paper in October 2021 which outlined the Review's objectives, problem definition, assessment principles, and some high-level policy options and questions. Following this, we published the second paper for the Review in August 2022 which set out our policy proposals.

This Regulatory Impact Statement covers the key decisions in the Branch Review and supporting analysis of the regulatory impact of those decisions.

Why Are We Making Changes to Branch Policy?

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.

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

The aim of the Branch Review is to create a simple, coherent, consistent and transparent policy framework for the regulation and supervision of branches that recognises the efficiency benefits they bring to our financial system and the economy, without imposing unnecessary impost on industry or our supervisory resources.

Counterfactual: What Happens If We Do Nothing?

Given the broader context of legislative changes that when implemented will impact the way in which branches are regulated and supervised, it is not possible to assume that the current state can continue without incurring costs to industry and to the Reserve Bank. Since the status quo cannot be maintained due to legislative changes that are exogenous to this Branch Review, it cannot be the reference point to compare the policy options' impacts.

A substitute reference point must be built: a counterfactual scenario in which the current branch regime is maintained through the implementation of the Depositor Compensation Scheme (DCS) and standards or conditions under the Deposit Takers Act 2023 (DTA). For this RIS, we consider the impacts of the policy options relative to this counterfactual option where we "do nothing" to the branch policy.

Key Policy Decisions

The key policy decisions include:

- restricting all branches in New Zealand to engaging in wholesale business (that is with corporates, institutions and other wholesale investors), meaning they could not take retail deposits or offer products or services to retail customers;
- limiting the maximum size of a branch to NZ$15 billion in total assets; and
- continuing to allow the dual registration of branches, provided:

- the relevant subsidiary and branch are sufficiently separate, and any identified risks are mitigated by specific conditions; and
- dual-registered branches only conduct business with large wholesale customers – the definition of large corporate and institutional customers is subject to a separate consultation, published alongside this document.

Implementation

The policy decisions will be implemented via a standard or conditions of licence under the DTA. This represents a change from the process stated in the second consultation paper to implement outcomes through branches' conditions of registration, and should represent a streamlining of the implementation process. We expect to consult on a standard in 2026 that will include the key decisions outlined in this document, and the subsequent decisions following the third consultation paper. These decisions will then be implemented via a standard or conditions under the DTA. Branches will need to comply with the requirements in the standard or their conditions, once they commence, which is expected to be in 2028. The Reserve Bank considers that issuing this Regulatory Impact Statement ("**RIS**") gives industry enough certainty to begin transitioning to compliance with the new regime.

This will likely represent an implementation period of around 4 years, which is longer than the 3 years we proposed in the second consultation paper. This presents a number of additional advantages relative to the previous proposals. See Section 6.1 of this RIS for more detail.

Quality assurance

The RIS has been peer reviewed by Reserve Bank staff outside of the Branch Policy Review team.

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1 Introduction

We have reviewed our policy in respect of branches[1] of overseas banks in New Zealand. We recognise that our policy towards branches has developed over time, resulting in inconsistent outcomes for branches. As a result, our existing policy on branches can be difficult to interpret, which in itself can increase regulatory burden. Therefore, the Review of policy for branches of overseas banks ("**Branch Review**") has sought to address these issues, while also taking into account the unique challenges and risks that branches present to us, as kaitiaki (guardians) of Aotearoa New Zealand's financial system.

The Branch Review has aimed to create a simple, coherent, consistent and transparent policy framework for the regulation and supervision of branches that recognises the efficiency benefits they bring to our financial system and the economy, without imposing unnecessary impost on industry or the Reserve Bank's supervisory resources. In October 2021, we published our first consultation paper of the Branch Review that set out the current branch policy, the problem definition and assessment principles for the Branch Review, and some high level policy questions and options. In August 2022, we published a second consultation paper that set out our proposed policy framework.

This document evaluates the regulatory impact of the key policy decisions made by the Reserve Bank's Board following the two rounds of consultation in the Branch Review.

We expect to consult on an exposure draft of a Branch Standard or conditions in 2026 that will include these policy decisions. These decisions will then be implemented via a standard or conditions of licence under the Deposit Takers Act 2023 (DTA). Branches will need to comply with the requirements in the Branch Standard or licence, once it commences, which is expected to be in 2028. The Reserve Bank considers that issuing this Regulatory Impact Statement ("RIS") gives industry enough certainty to begin transitioning to compliance with the new regime.

1.1 Purpose of the Regulatory Impact Statement

Under sections 255-257 of the Reserve Bank of New Zealand Act 2021 (RBNZ Act), we must assess the expected regulatory impacts of any proposed policy. Section 256 sets out the content of that assessment, which we have included in this document:

- an outline of the problem or issue that the policy is intended to address – see section 2.3;
- the objectives of the policy – see section 2.4;
- an evaluation of the costs and benefits of the policy – see section 4 and 5;
- an evaluation of alternative means of achieving the objectives of the policy – see section 3.4 and 4;
- a statement of our proposed approach to monitoring and evaluating the effectiveness of the policy – see section 6.2;

1 In this RIS 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.

- a statement that explains how the Reserve Bank Board has had regard to the Financial Policy Remit in preparing the proposed policy – see section 3.3;
- a description of any consultation or other engagement we have had with interested persons in relation to the policy and an explanation of how we have had regard to any views expressed – see section 7.

1.2 The Benchmark For Our Analysis

The counterfactual scenario forms the benchmark for the analysis of the different options considered in this document – we have considered the impacts of the policy decisions relative to the scenario where we "do nothing". Essentially, we want to ensure that the policy decisions, in aggregate, improve on the outcomes that would occur in the absence of policy change.

Given the broader context of the DTA and Depositor Compensation Scheme (DCS) that will impact the way in which branches are regulated and supervised, our current branch policy – the status quo – is expected to evolve in the absence of action. Therefore, the counterfactual scenario – the benchmark for our analysis – is where the current branch regime would be maintained through the implementation of the DCS and standards or conditions under the DTA.

The purpose of comparing the policy options and decisions to the counterfactual, rather than the status quo, is to acknowledge that it is not possible to assume the current state can continue without incurring costs to industry and to us.

Further details of the counterfactual may be found in section 2.2.

2 Problem Definition

2.1 Context

This section summarises the context necessary for the analysis in this RIS. It covers the branch policy before the Branch Review and decisions; the legislative changes that gave rise to it, including the DTA and DCS; and the broader regulatory perimeter and policy context.

Current Branch Policy

At present, our policy is that a foreign-owned bank is required to incorporate locally (ie, is not allowed to be registered as a branch) if it:

- has more than NZ$15 billion in liabilities (net of internal group liabilities) or is expected to exceed this limit in the 5 years following registration; or
- has more than NZ$200 million in retail deposits and either depositor preference applies in its home jurisdiction or it does not provide adequate disclosure; or
- is incorporated in a jurisdiction that has non-comparable supervisory arrangements and governance standards.

Our existing policy is to allow dual registration of a branch if the criteria above are met and the branch is not permitted to take retail deposits.

However, our policy on registering branches, and the conditions that should apply to them, has been applied inconsistently as it developed over time. As a result, at present different branches are subject to different conditions of registration. As such, overseas banks can be viewed as not competing with one another on a level playing field in the status quo.

Legislative Changes

In 2017 the Reserve Bank began working with the Treasury on a comprehensive review of the previous legislation: the Reserve Bank of New Zealand Act 1989. Updating and modernising the Reserve Bank of New Zealand Act 1989 has been an important step in ensuring we can fulfil our role as kaitiaki (guardians) of the financial system, promoting the prosperity and economic wellbeing of all New Zealanders.[2] Minister of Finance Hon Grant Robertson initiated the Review of the Reserve Bank Act to modernise New Zealand's monetary and financial stability policy frameworks and the Reserve Bank's governance and accountability settings.

DTA and DCS

The DTA is the final piece of legislation arising from the Review of the Reserve Bank Act, which started in 2017. The DTA creates a single regulatory regime for all bank and non-bank deposit takers.

The DTA also introduces the DCS that will protect up to $100,000 per depositor, per institution.[3] The Branch Review and the implementation of the DCS are separate but related policy questions. Given the potential cost implications of implementing the DCS for retail deposit takers, we recognise that it is desirable for the Branch Review to provide clarity on whether branches will be permitted to take retail deposits.

As baseline considerations for the Branch Review, we anticipate that:

- all retail deposit takers will be required to be covered by the DCS;
- applying the full scope of prudential regulation and supervision to all deposit takers who take protected deposits in New Zealand would reduce the cost of the DCS by providing a baseline level of assurance about the soundness of retail deposit takers in New Zealand; and
- where some form of depositor compensation and/or depositor preference exists in a branch's home jurisdiction, the ranking and status of a branch's retail depositors in New Zealand (and potentially the DCS, in the event of its subrogation in the insolvency of the overseas bank), relative to creditors in the branch's home jurisdiction, would need to be confirmed.
- under section 77 of the DTA, the Reserve Bank is required to publish a proportionality framework. The framework must set out how the Reserve Bank takes into account the proportionality principle when developing standards under the DTA.
- consistent with the legislative requirements, the purpose of the proportionality framework is to group similar deposit takers together by carefully considering these factors:
    - the size and nature of business of different deposit takers;

2 See rbnz.govt.nz/about-us/responsibility-and-accountability/our-legislation/reserve-bank-act-review.
3 See Deposit Takers Act (legislation.govt.nz).

    - their relative importance to the stability of the financial system; and
    - the extent to which a range of regulatory requirements are necessary or desirable to promote the safety and soundness of each deposit taker.
- the Reserve Bank will set out the scope of the proportionality framework. The Reserve Bank proposed in its consultation paper that branches of overseas-incorporated deposit takers would be subject to a different set of standards from those that are incorporated in New Zealand. The proposed proportionality framework would be used as a guide for developing standards for deposit takers that are incorporated in New Zealand. Standards for branches would be separately designed and tailored appropriately to branches considering the factors set out in the s77(3) of the DTA.

The Regulatory Perimeter

Policy development work as the DTA is implemented will also consider our approach to defining and policing the regulatory perimeter. Whatever work we do should align with the policy intent of our framework for branches.

For example, overseas banks that wish to undertake limited wholesale business in New Zealand may be able to do so without applying for a licence, if they are within scope of the current class authorisation.

The Branch Review has not considered changes to those activities or that class authorisation. For further information see the New Zealand Gazette and our website.

Conduct of Financial Institutions (CoFI) Legislation

The Financial Markets (Conduct of Institutions) Amendment Act 2022, also known as the Conduct of Financial Institutions legislation ("CoFI"), amends the Financial Markets Conduct Act 2013 (FMC Act) to ensure financial institutions treat consumers fairly.[4] CoFI introduces a new regulatory regime to ensure registered banks, licensed insurers and licensed non-bank deposit takers comply with the fair conduct principle when providing relevant services to 'consumers'[5].

The regime will apply to entities that are considered "financial institutions" under the CoFI legislation – those that are a registered bank, licensed insurer or licensed non-bank deposit taker *and* are in the business of providing one or more relevant services to consumers in New Zealand. Entities that meet the CoFI definition of "financial institution" will need to apply to the Financial Markets Authority for a market services licence.

The changes involved in the Branch Review do not exclude the possibility that the CoFI legislation could apply to branches of overseas banks. Once the final policy decisions of this Branch Review are implemented, branches may provide relevant services to 'wholesale investors' who are deemed to be 'consumers' under CoFI. In this case, a branch would be deemed a "financial institution" under CoFI and would therefore need to apply for a financial institution licence. If a branch does not meet the CoFI definition of "financial institution", it will not need to apply for a CoFI licence.

4 See Conduct of Financial Institutions (CoFI) legislation | Financial Markets Authority (fma.govt.nz).
5 See the definition of 'consumer' in section 446P of Financial Markets (Conduct of Institutions) Amendment Act 2022.

Branches will need to do their due diligence to ascertain whether they should be considered "financial institutions" under CoFI.[6]

Broader Policy Context

Liquidity Policy Review

The Reserve Bank is undertaking a comprehensive Review of the liquidity policy (BS13).[7] The objective of our liquidity policy is to strengthen financial stability by lowering the likelihood of liquidity problems affecting banks, and improve their ability to manage such problems. As part of the Liquidity Policy Review, we plan to consider whether our liquidity policy should also capture banks that are operating in New Zealand as branches. This question is outside the scope of the Branch Review, and will be considered in the ongoing Liquidity Policy Review. The Reserve Bank will be consulting on this issue in the third consultation paper for the Liquidity Policy Review in Q2 2024.

Interaction with Outsourcing Policy for Banks (BS11)

Our outsourcing policy is relevant for some of the locally-incorporated banks of dual-registered groups, and aims to ensure that the locally-incorporated subsidiary is separable from the parent (the overseas bank of which the branch forms part) in a crisis situation.[8]

Our view is that our outsourcing policy and our policy for dual-registered branches set out in this Branch Review are both working towards the same broad objective: to reduce the impacts on NZ financial stability from stress in a cross-border banking group. Outsourcing does this by enabling separability of the locally-incorporated subsidiary, whereas branch policy does this by limiting the extent of critical banking services undertaken by the branch.

The primary motivation for the policy decision in the Branch Review regarding the large corporate and institutional customer threshold is to mitigate the risk that services that are critical to the New Zealand economy are "off-shored".

Governance Thematic Review

The Reserve Bank and FMA jointly conducted a cross-sector thematic review on governance.[9] The Review focused on the boards of regulated entities and their ability to effectively govern and provide oversight.

It is important that governance arrangements between the overseas bank and its branch, and, in the case of dual-registered branches, between the subsidiary and the branch, are properly understood by both the regulated entity and us as regulator. Where we determine that an entity is not applying appropriate governance arrangements, the supervisory approach introduced in the Branch Review outcomes will allow for the introduction of risk mitigants, such as additional reporting and disclosure, and a requirement that the branch form an audit committee.

6 See the FAQ "Who needs a financial institution licence" in Conduct of Financial Institutions (CoFI) legislation | Financial Markets Authority (fma.govt.nz), and the FMA Financial institution licence guide.
7 See Review of Liquidity Policy (BS13) - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz).
8 See Outsourcing policy for banks - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)
9 See Cross-sector thematic review on governance - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)

The Reserve Bank will also be developing a governance standard under the DTA in due course. This may consider other issues relating to branch governance that were out of scope for the Branch Review.

2.2 Counterfactual: How Is The Status Quo Expected To Develop If No Action Is Taken?[10]

Given the broader context of legislative changes that impact the way in which branches are regulated and supervised, it is not possible to assume that the current state can continue without incurring costs to industry and to us. Our starting assumption is that all retail deposit takers will be required to be part of the DCS as described in the DTA.

Moreover, the status quo has been altered by the RBNZ Act Review. The Act Review found challenges and risks to financial stability, as well as the need to align our regulatory framework with international best practice. Regarding the aim to strengthen and integrate New Zealand's regulatory and supervisory frameworks, the DTA once implemented will modify the status quo, so we have taken that into account when building the counterfactual scenario. More on this topic can be found in Section 4.4.

For the Branch Review, we consider the impacts of the policy decision relative to a counterfactual option where we "do nothing". In this counterfactual scenario, the current branch regime is maintained through the implementation of the DCS and standards or conditions under the DTA once implemented.

2.3 Problem Definition

The Problem

We set out and consulted on the problem definition for the Branch Review in the first consultation paper.[11] Most respondents to the first consultation paper broadly agreed with the problem definition, and we proceeded with using this problem definition, as set out in the first consultation, in developing this policy.

In summary, our branch policy required review because:

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

The three motivations for the Branch Review are further developed in the three following sub-sections.

10 According to the Treasury guidance, a RIS should compare options to the status quo if the situation is unchanging and expected to remain the same. If the status quo is expected to develop and change in the absence of action being taken, instead refer to it as the counterfactual. Therefore, we refer to the 'counterfactual' here.

11 See pp.12-14 of the first consultation paper.

Existing Policy Was 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.

As a result, our current policy on branch registration was 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 were 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 under the existing policy.

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.[12] 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, resolution or insolvency proceedings would be initiated in, and subject to the laws of, the home jurisdiction. This means the treatment of the assets and liabilities of the branch, and therefore the outcomes for depositors and other creditors in New Zealand, would depend on the application of overseas law and conventions. This could also affect the ability of a statutory manager in New Zealand to take control of the branch's assets.

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.

Inherent Limitations on Our Ability to Regulate and Supervise 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.

12 See Annex 3 of the first consultation for an overview of the policies that apply to branches, relative to locally-incorporated banks.

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 instance, 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 a solo basis, 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 Conflicts of Interest Between Home and Host Supervisors

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.

2.4 Objectives

The objective of the Branch 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. We set out and consulted on the objective of the Branch Review in the first consultation paper.

3 Assessment Criteria

The Reserve Bank set out and consulted on six assessment principles for the Branch Review in the first consultation paper. Most submissions to the first consultation agreed with the assessment principles, and we proceeded with those principles in developing our final policy position.

The Branch Review commenced in October 2021. The DTA was enacted in July 2023. Therefore, the Reserve Bank could not take into account the purposes and principles of the DTA during the development of, and consultation on, the assessment principles. However, the Branch Review assessment principles are consistent with the purposes and principles in the DTA. See section 3.2

of this RIS for a summary of the analysis and comparison of the assessment principles against the DTA purposes and principles.

In addition to the assessment principles, the Reserve Bank Board has also had regard to the Financial Policy Remit ("the **Remit**" or the "**FPR**") in finalising our policy position. The Minister of Finance issued the Remit with effect from 1 July 2022 under section 203 of the RBNZ Act. The Remit specifies or provides for matters that the Minister considers are desirable for the Reserve Bank to have regard to in relation to our financial stability objective, the objectives or purposes of our prudential legislation, and acting as a prudential regulator and supervisor.

Given that the Remit was issued after the Branch Review commenced in October 2021, the Remit was not specifically considered when developing the assessment principles we consulted on. For the purposes of this RIS, we have assessed our policy options against the assessment principles set out and considered by stakeholders during the first consultation. However, the Reserve Bank Board has had regard to the Remit in making the decisions in the Branch Review. We have assessed the Branch Review principles against the objectives outlined in the FPR. We consider that the assessment principles are broadly consistent with furthering some of these matters and have completed an analysis of the decisions in this RIS against the components of the FPR (see section 3.3 for a summary). Additionally, there is significant overlap between the assessment principles for the Branch Review and the Remit – for example, both capture the importance of proportionality, encouraging a competitive financial system, and recognising the Reserve Bank's low-risk appetite for outcomes that harm the health of the financial system.

3.1 Assessment Principles

In reviewing our approach to branches and the problem definition, as well as in developing policy options to address the issues identified, our branch policy should:

Principle 1	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;
Principle 2	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;
Principle 3	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;
Principle 4	result in consistent outcomes for branches in New Zealand, supporting a level playing field, while remaining flexible enough to apply supervisory adjustment;
Principle 5	be transparent, and aligned with international standards where appropriate, to allow branches (and new applicants) to understand and meet requirements cost effectively; and

Principle 6	be practical to administer and minimise unnecessary supervisory costs.

These principles are intentionally broad, to enable the Branch 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.

3.2 DTA

The Reserve Bank considered the purposes and principles of the DTA when analysing the options and making decisions on the Branch Review. For presentation purposes, and to maintain consistency with the principles already published in the first and second consultation papers, as well as the corresponding summaries of submissions, the analysis in this RIS refers to the six Branch Review assessment principles listed in section 3.1 above. However, the assessment principles are compatible with the purposes and principles of the DTA. The following tables show the equivalences between them.

The main purpose of the DTA, in section 3(1), is "to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system." This purpose is captured by Principles 1 and 3 of the Branch Review.

After establishing the main purpose's equivalence, the table below provides analysis of the additional purposes in the DTA.

Comparison Between DTA Purposes and Branch Review Assessment Principles

The DTA sets out additional purposes in Part 1, Section 3, Subsection 2. These are compared with the six principles used in the Branch Review in the table below.

DTA additional purposes	RIS Principle 1	RIS Principle 2	RIS Principle 3	RIS Principle 4	RIS Principle 5	RIS Principle 6
2 (a) to promote the safety and soundness of each deposit taker	✓✓ Principle 1 reflects this purpose, by "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" means that in some cases additional mitigants or requirements must be in place. Additionally, the local incorporation threshold aims to limit the systemic risk a single branch can present. The equivalence assessments also play a role in this issue.					

DTA additional purposes	RIS Principle 1	RIS Principle 2	RIS Principle 3	RIS Principle 4	RIS Principle 5	RIS Principle 6
(b) to promote public confidence in the financial system	✓✓ In being proportionate to the risks that branches present to financial stability, Principle 1 addresses this principle.	✓✓ To recognise the need for a credible resolution strategy for branches is key in promoting public confidence.				
(c) to the extent not inconsistent with subsection (1) and paragraphs (a), (b), and (d), to support New Zealanders having reasonable access to financial products and services provided by the deposit-taking sector			✓✓ Principle 3 reflects this purpose, in particular when stating "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)"			

DTA additional purposes		RIS Principle 1	RIS Principle 2	RIS Principle 3	RIS Principle 4	RIS Principle 5	RIS Principle 6
(d) to avoid or mitigate the adverse effects of the following risks:	(i) risks to the stability of the financial system:	✓✓ Principle 1 aims to achieve this purpose	✓✓ Principle 2 aims to achieve this purpose, via addressing the need for a credible resolution strategy		✓✓ Principle 4 aims to achieve this purpose, via maintaining some flexibility to apply supervisory adjustment		
	(ii) risks from the financial system that may damage the broader economy.	✓✓ Principle 1 aims to achieve this purpose	✓✓ Principle 2 aims to achieve this purpose, via addressing the need for a credible resolution strategy		✓✓ Principle 4 aims to achieve this purpose, via maintaining some flexibility to apply supervisory adjustment		

Comparison Between DTA principles and Branch Review Assessment Principles

In achieving the purposes of the DTA, the Reserve Bank must take into account the following principles (section 4 of the DTA) that are relevant to the performance or exercise of the functions, powers, and duties conferred or imposed on the Reserve Bank. The table below shows how the principles of the DTA are reflected in the six assessment principles of the Branch Review under section 3.1 of this RIS. It also shows when the decisions in this RIS are not expected to have a significant impact on a specific principle, thus resulting in a low weighting for consideration in our analysis.

DTA Principle	RIS Principle 1	RIS Principle 2	RIS Principle 3	RIS Principle 4	RIS Principle 5	RIS Principle 6
Desirability of taking a proportionate approach to regulation and supervision.	✓✓ By being proportionate to the risks that branches present to financial stability	✓ Due to different requirements for stand-alone and dual-registered branches		✓✓ By resulting in consistent outcomes and permitting some degree of supervisory adjustment		
Desirability of consistency in the treatment of similar institutions.				✓✓Specifically by "result in consistent outcomes for branches"		
Desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders.			✓✓ Recognise the role of branches and their contribution to a diverse and resilient financial system that caters to the needs of corporates and households			

DTA Principle	RIS Principle 1	RIS Principle 2	RIS Principle 3	RIS Principle 4	RIS Principle 5	RIS Principle 6
The need to maintain competition within the deposit-taking sector.			✓✓ Reflected by "including through competition and innovation"	✓✓ Both "consistent outcomes for branches in New Zealand" and "supporting a level playing field" are key elements of competitive markets		
The need to avoid unnecessary compliance costs.					✓✓ Principle 5 takes this directly into account: "to allow branches (and new applicants) to understand and meet requirements cost effectively"	
The desirability of maintaining awareness of, and responding to, the practices of overseas supervisors that perform functions in relation to any licensed deposit taker or any holding company of any licensed deposit taker.	✓ By having regard to the inherent disadvantages we face as a host supervisor			✓✓ Part of the supervisory adjustment relates to the assessment of home equivalence	✓✓ The branch policy should be aligned with international standards where appropriate	

DTA Principle	RIS Principle 1	RIS Principle 2	RIS Principle 3	RIS Principle 4	RIS Principle 5	RIS Principle 6
The desirability of maintaining awareness of, and responding to, guidance or standards of international organisations.					✓✓ The Branch Policy should be aligned with international standards where appropriate	
The desirability of ensuring that the following risks are managed (including long-term risks to the stability of the financial system): • risks to the stability of the financial system; • risks from the financial system that may damage the broader economy.	✓✓ "be proportionate to the risks that branches present to financial stability"	✓✓ Resolution strategies in place are key to manage risks		✓✓ Through retaining some flexibility for supervisory adjustment		
The desirability of sound governance of deposit takers.	~ The decisions in this RIS are not expected to have a significant impact on branches' governance, due to their particular legal status. This component has been given a low weighting for consideration in our analysis. This issue will be considered through the implementation of the DTA and development of standards for the regulation and supervision of branches of overseas deposit takers.					
The desirability of deposit takers effectively managing their capital, liquidity, and risk.	~ The decisions in this RIS are not expected to have a significant impact on branches' risk management, due to their particular legal status. This component has been given a low weighting for consideration in our analysis. This issue will be considered through the implementation of the DTA and development of standards for the regulation and supervision of branches of overseas deposit takers, in addition to the ongoing Liquidity Policy Review.					

DTA Principle	RIS Principle 1	RIS Principle 2	RIS Principle 3	RIS Principle 4	RIS Principle 5	RIS Principle 6
The desirability of depositors having access to timely, accurate, and understandable information to assist them to make decisions relating to debt securities issued by deposit takers.	~ The decisions in this RIS are not expected to have a significant impact on this DTA principle, due to branches' particular legal status. This component has been given a low weighting for consideration in our analysis. This issue will be considered through the implementation of the DTA and development of standards for the regulation and supervision of branches of overseas deposit takers.					

3.3 Financial Policy Remit

The Minister of Finance issued the FPR with effect on and from 1 July 2022. The FPR emphasises the desirability of a strong, efficient and inclusive financial system, with a low incidence of failure of regulated entities. The FPR also signals that the Reserve Bank should encourage a competitive financial system and consider climate change, financial inclusion, cyber resilience and supporting sustainable house prices. The Board is required to have regard to the Remit when making significant policy decisions about how to achieve prudential strategic intentions, as set out in section 49(1) of the RBNZ Act.

Summary of Analysis

A key concern in developing the proposed regime has been the possibility of unintended consequences that are damaging to the soundness and efficiency of the financial system. We have been particularly conscious of the risks that we are:

- too restrictive, and unintentionally discourage the provision of specialised products and services that are only provided by branches or a small number of branches; and
- too permissive, and unintentionally encourage regulatory arbitrage and the disproportionate off-shoring of products and services that are currently provided by our locally-incorporated banks, with the result that our locally-incorporated banks no longer have the capability to fulfil key functions for our financial system and economy.

The decisions are consistent with promoting a strong and efficient financial system, limiting and managing the risks that overseas-incorporated entities present to New Zealand's financial system.

Regarding the encouragement of a competitive financial system, the policy decisions will support a level playing field for branches of overseas banks and clarify the regime for potential new entrants, thus lowering barriers to entry. Both factors foster a competitive market structure through increasing the level of competitive neutrality between overseas banks. While there could be negative first-round impacts on competition for retail banking services, we judge that the longer term and structural positive effects on competition outweigh the former. Moreover, the scale of these impacts is marginal. More on competition can be found in the relevant section of this RIS.

Additionally, mitigating the risk that services that are critical to the New Zealand economy are "off-shored" also supports financial efficiency.

The regulatory and supervisory costs component of the Remit relates directly to some of the principles of the Branch Review (Principles 5 and 6). We expect these costs to be small and proportionate to the risks and benefits that branches pose to the financial system. We also acknowledge that some level of supervisory oversight is required to support a low incidence of failure. We do not expect the decisions in the Branch Review to have a significant impact on some of the other components of the Remit. The table below describes this in further detail.

The table below outlines the components of the Remit that are relevant for this RIS and summarises the expected impacts. It outlines how the Board has had regard to these components and their relative weight for consideration.

Component of the Financial Policy Remit	Summary of analysis and relevance to decisions in this RIS
"It is desirable to have a financial system that is strong, efficient and inclusive, with a low incidence of failure of entities regulated by the Reserve Bank."	The policy decisions support the consistent supervision and regulation of branches of overseas banks. They also mitigate risks that branches present to the financial system, as well supporting the protection of retail depositors via the DCS.
"Within the appetite of a low incidence of failure, a competitive financial system should be encouraged so as to best ensure ongoing financial efficiency and inclusion."	The policy decisions will support the operation of a level playing field for branches of overseas banks. The clarification of the regime will decrease regulatory burden for potential new entrants. These two factors encourage competition through increased competitive neutrality. Mitigating the risk that services that are critical to the New Zealand economy are "off-shored" also supports financial efficiency. There are potential negative impacts on competition for retail banking services, however, our analysis suggests that the scale of these impacts is marginal.
"imposing regulatory and supervisory costs that are proportionate to the expected risks and benefits to the financial system and society"	This directly relates to some of the assessment principles applied for the analysis of options. The policy decisions aim to ensure transparency and low compliance and supervisory costs. The local incorporation threshold and the decision regarding retail customers support a proportionate approach to the regulation and supervision of all classes of deposit takers.
"encouraging new investment and financial innovation that raise the productive potential of the economy"	The Branch Review recognises that branches play an important role in the provision of specialised financial services and in supporting the economy. We judge that the impact of branches on investment and innovation in products and services for retail customers is small in magnitude. While this innovation may decrease in the short-run, this is offset by the longer-term benefits on innovation that are associated with a transparent, coherent and consistent regime that increases competitive neutrality between overseas banks.
"encouraging the allocation of financial resources in a way that maximises the sustainable long-term growth of the New Zealand economy"	The decisions in this RIS are not expected to have a significant impact on the allocation of financial resources and long-term growth. We judge that the impact of branches on the allocation of resources by and for retail customers is small in magnitude. While this may be negatively impacted in the short-run, this is offset by the longer-term benefits that are associated with a transparent, coherent and consistent regime.

Component of the Financial Policy Remit	Summary of analysis and relevance to decisions in this RIS
Sustainable house prices	The decisions in this RIS are not expected to have a significant impact on sustainable house prices. This component has been given a low weighting for consideration in our analysis.
Building resilience and facilitating adaption to climate change	The decisions in this RIS are not expected to have a significant impact on adaptation to climate change. This component has been given a low weighting for consideration in our analysis.
Improving financial inclusion	The decisions in this RIS are not expected to have a significant impact on financial inclusion. There may be a small negative effect on inclusion if branches that currently provide services to some under-represented groups withdraw from the market. However, we don't judge this to be the general case. Further, we expect that these impacts would be offset in the longer-term, due to the positive effects on competition and potential new entrants discussed in section 6.1 of this RIS.
Improving cyber resilience	The decisions in this RIS are not expected to have a significant impact on the cyber resilience of the financial system. This component has been given a low weighting for consideration in our analysis.

3.4 Scope of Options

What Scope Will Options Be Considered Within?

The Branch Review has taken a broad approach to assessing the Reserve Bank's approach to regulating and supervising branches of overseas banks. Some aspects of the Reserve Bank's regulatory regime that could impact branches have not been considered.

Some stakeholders have raised that the differential capital treatments between banks incorporated in New Zealand and other jurisdictions could results in a competitive advantage for branches over locally-incorporated banks. We have not considered capital adequacy requirements for locally-incorporated banks as part of the Branch Review.

The Reserve Bank has previously considered whether it is appropriate to require branches to be subject to liquidity requirements. This issue is being considered by the ongoing Liquidity Policy Review and has therefore not been considered as part of the Branch Review.

Some stakeholders have raised that the Class Authorisation Notice relating to restrictions on use of the word 'bank' has an impact on the landscape for overseas banks operating in New Zealand. We note that this will be reviewed as part of the implementation of the DTA and has therefore not been considered as part of the Branch Review.

Within this scope, there are some options that we have discounted at an early stage of the analysis, as they do not adequately meet the problem definition and assessment principles.

The status quo arrangements have not resulted in a level playing field for branches in New Zealand. The status quo is also not compatible with the introduction of the DCS, which socialises the cost of entity failures. While we have used the status quo as a baseline for comparison in the discussion of some policy questions, it has largely been considered to not be a viable option to address the problem definition of the Branch Review.

Some stakeholders have proposed relatively extreme options such as not permitting branches of overseas banks to operate in New Zealand. We do not consider this to be a viable option, as we recognise that branches provide benefits to the New Zealand financial system. We have therefore largely discounted this and similar options as part of the Branch Review.

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 AUD $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, inter-connectedness, and critical functions[13] in the UK), or additional mitigants are in place (for

13 '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

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.

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.

Dual Registration

An overseas bank wishing to operate as a registered bank in New Zealand can apply to register 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 a result, branches cannot be made subject to many of the requirements we impose on banks incorporated in New Zealand. We rely on a branch's compliance with regulation and supervision in its home jurisdiction

Many countries, like New Zealand, permit dual registration to recognise that locally-incorporated subsidiaries and branches from the same overseas bank can efficiently offer products and services to different customer groups while not adversely impacting financial stability. The dual registration

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).

approach allows for coordination between the host country's regulatory authority and the home country regulator, promoting cooperation, information sharing, and supervisory collaboration.

For instance, Australia[14] allows in some cases dual operation of overseas banks, meaning they simultaneously hold an authority to operate as a branch and have a subsidiary ADI. Overseas branches in Australia are not permitted to take retail deposits. Generally, entities that dual operate in Australia offer retail services through the branch and wholesale services through the subsidiary.

An important degree of separation between each operation is required, as well as making clear to customers and others their separate legal status and authorisation. Some joint functional support services such as personnel and financial controls between the two authorised entities are permitted, as well as joint treasury operations. However, requirements regarding outsourcing apply.

In the European Union[15], a variety of national approaches coexist, but most of them are either 'subsidiary-like' or 'branch-like'. The first group of regulatory regimes and supervisory practices tends to treat third country branches as subsidiaries by applying, for instance, similar capital requirements to those for locally-incorporated banks. The second one recognises that the third country branch is not a separate legal entity from the parent firm.

4 Options Analysis

In the first consultation paper, we asked for feedback on six questions. The responses to these questions are outlined in the separate summary of submissions document. The first two questions asked for feedback on the problem definition and assessment principles. We have proceeded with using this definition and these principles when considering the feedback to the four policy questions and making decisions outlined in this section. The four policy questions are:

- Should branches be permitted to take retail deposits?
- What is the appropriate threshold for local incorporation?
- Should dual registration be allowed?
- Should we pursue greater regulatory and supervisory integration?

Approach to the Options Analysis

As discussed in section 2.2, when considering the options for each of the policy questions, we have used the counterfactual scenario – where we "do nothing" – as a benchmark. Essentially, we want to ensure that the final policy decisions, in aggregate, improve on the outcomes that would occur in the absence of policy change.

Given the broader context of the DTA and forthcoming DCS that will impact the way in which branches are regulated and supervised, our current branch policy – the status quo – is expected to evolve in the absence of action. Therefore, the counterfactual scenario – the benchmark for our

14 See APRA's "Guidelines: Overseas Banks: Operating in Australia"

15 See European Banking Authority - report on the treatment of incoming third country branches.

analysis – is where the current branch regime would be maintained through the implementation of the DCS and standards or conditions under the DTA.

The purpose of comparing the policy options and decisions to the counterfactual, rather than the status quo, is to acknowledge that it is not possible to assume the current state can continue without industry and/or the Reserve Bank incurring costs.

Additionally, we have presented our analysis of the options against the assessment principles in tables. We have used ticks and crosses to indicate our qualitative judgement of whether an option effectively meets the assessment principle: a tick indicates that the option does effectively meet the principle; a cross indicates that the option does not meet the principle; and a tick and cross together indicate that an option partially meets the principle.

Incorporating Stakeholder Feedback to the Options

The questions and options presented in the first consultation paper were intended as a starting point for the Branch Review, whereas the options presented in this RIS are the more fulsome set of options considered in the Branch Review. Throughout the course of the Branch Review, many stakeholders have suggested alternative options for each of the policy questions through consultation responses and bilateral engagements, and we have also developed further options internally as the Branch Review has progressed.

Throughout this section, we discuss the alternative options raised through the consultation process and whether we have proceeded with using those options in our analysis. For a more detailed summary of stakeholder feedback and our response, see the summary of submissions published alongside this document.

Interactions Between the Policy Questions

None of the four policy questions can be considered in isolation. Each question has an interdependency with the others, and selecting one option for a given question will impact the costs and benefits of the options for other questions. For example, a liability threshold would be more relevant if branches are allowed to take a material amount of retail deposits. In turn, a decision on whether to allow branches to take retail deposits has material implications for our policy thinking on the merits of allowing dual registration. Therefore, when considering the impacts of the policy changes, the Reserve Bank has considered the entire package of decisions together.

4.1 Question 1 – Retail Deposits

Our current policy in BS1 is that stand-alone branches should be limited to NZ$200 million in retail deposits where depositor preference exists in the home jurisdiction or market disclosure is inadequate. However, as this policy has been developed over time, there are some branches that currently have no limit on the amount of retail deposits that they can take.

Additionally, our current policy is that dual-registered branches should not be allowed to accept retail deposits, in order to avoid any potential confusion for retail depositors between the branch and the locally-incorporated subsidiary. However, some dual-registered branches are permitted to take retail deposits for historical reasons, though in practice they take a minimal amount, if any.

Our starting assumption, as set out in section 2.2, is that all retail deposit takers will be required to be part of the DCS as broadly described in the DTA.

Regarding this first question, we have considered four different options, which are listed below and compared against the assessment principles of the Branch Review in the following table.

Options

- Option 1: counterfactual – a flexible approach whereby some stand-alone branches may take retail deposits if we are satisfied about disclosure and depositor preference in the home jurisdiction.
- Option 2: not allow branches to take retail deposits (**Preferred**).
- Option 3: allow stand-alone branches to take a small amount of retail deposits.
- Option 4: allow stand-alone branches to take an amount of retail deposits greater than our current limits, subject to appropriate risk mitigants (eg, ring-fencing of assets).

Do The Options Meet the Assessment Principles Effectively?

	Option 1 – counterfactual.	Option 2 – not allow branches to take retail deposits (preferred).	Option 3 – allow stand-alone branches to take a small amount of retail deposits.	Option 4 – allow stand-alone branches to take an amount of retail deposits greater than our current limits, subject to appropriate risk mitigants (eg, ring-fencing of assets).
Principle 1: 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.	✕✓ We have a more limited ability to mitigate the risks to retail depositors without local incorporation, and the availability of the full suite of prudential regulation/ supervisory tools.	✓ Local incorporation, and the application of the full suite of prudential regulation, supervisory authority, and crisis management tools in the host jurisdiction, is the surest way to protect and promote financial stability.	✓ Allowing stand-alone branches to take a *de minimis* amount of retail deposits (eg, up to $200m) does not present a material issue in terms of financial stability.	✕ Retail deposit-taking activity is critical to the real economy, and retail depositor confidence is fundamental to financial stability. There are inherent limitations in our ability to regulate and supervise branches.
Principle 2: 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.	✓✕ Scale of risk would need to be evaluated on a firm specific basis.	✓ Limits the scale of contagion and instability to a level consistent with our risk appetite.	✓✕ Limits the scale of contagion and instability to a level consistent with our risk appetite.	✕ If a branch is engaged in retail banking services and is taking a material amount of retail deposits and/or has a material number of retail depositors, the need for direct control in resolution outweighs the benefits of home-led resolution.

	Option 1 – counterfactual.	Option 2 – not allow branches to take retail deposits (preferred).	Option 3 – allow stand-alone branches to take a small amount of retail deposits.	Option 4 – allow stand-alone branches to take an amount of retail deposits greater than our current limits, subject to appropriate risk mitigants (eg, ring-fencing of assets).
Principle 3: 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;	✓ Allows a role for some branches in retail banking business.	✕ Maintains the wholesale efficiency benefits of branching, although does not allow a role for branches in retail banking business.	✓✕ Recognises a more limited role for branches in retail banking, and maintains the efficiency benefits of branching in the wholesale market.	✓ Recognises the potential role of branches in retail banking business.
Principle 4: result in consistent outcomes for branches in New Zealand, supporting a level playing field, while remaining flexible enough to apply supervisory adjustment.	✕ Our policy on retail deposit-taking by branches has evolved over time, resulting in inconsistent outcomes.	✓ Would be coherent and consistent across all branches.	✓✕ Would require us to design a clear policy for allowing retail deposit-taking and the criteria that would have to be met (eg, absence of depositor preference) and the limits that might apply in certain circumstances.	✓✕ Would require us to design a clear policy for allowing retail deposit-taking and the limits that might apply in certain circumstances.

	Option 1 – counterfactual.	Option 2 – not allow branches to take retail deposits (preferred).	Option 3 – allow stand-alone branches to take a small amount of retail deposits.	Option 4 – allow stand-alone branches to take an amount of retail deposits greater than our current limits, subject to appropriate risk mitigants (eg, ring-fencing of assets).
Principle 5: be transparent, and aligned with international standards where appropriate, to allow branches (and new applicants) to understand and meet requirements cost effectively;	✕ The counterfactual is the least transparent option and the most difficult to communicate.	✓ Would be transparent and easy to communicate.	✓✕ There would remain a degree of supervisory discretion.	✓✕ There would remain a degree of supervisory discretion.
Principle 6: be practical to administer and minimise unnecessary supervisory costs.	✕ Would require us to monitor both the amount of retail deposit-taking and the number of customers involved (for contagion reasons), and in due course the implications for the DCS.	✓ Would be more practical to administer and minimise unnecessary supervisory costs than other options because it would reduce our concern about the potential impact of branches on retail depositors and the risk of contagion to the banking system through a loss of public confidence.	✕ Would require us to monitor both the amount of retail deposit-taking and the number of customers involved (for contagion reasons), and in due course the implications for the DCS.	✕ Would entail a correspondingly higher level of supervisory cost and/or risk mitigants (eg, ring-fencing of assets) that would be more complex to administer than other options.

Policy Decision – Option 2: Not Allow Branches to Take Retail Deposits, Subject to Amending the Definition of 'Retail Deposits'

The final policy decision is to not permit branches to take retail deposits, which is consistent with the assessment principles of the Branch Review and the introduction of deposit insurance. The Reserve Bank will soon be implementing the DCS. We consider that deposit insurance is compatible with the full suite of prudential regulation. We cannot apply the full suite of prudential regulation to branches, due to the nature of their operations and legal structure. One of the potential benefits of allowing branches to provide services to retail customers could be that they contribute to innovation and price-based competition. However, our analysis has found no evidence of branches offering material price-based competition for retail customers, either in the context of deposits or loans. We judge that any competition benefits that branches could offer to retail customers would not outweigh either the risks presented by retail customers doing business with a bank outside the DCS or the costs of including a branch in the DCS.

We acknowledge that continuing to allow stand-alone branches to take a *de minimis* amount of retail deposits (eg, up to NZ$200 million) does not present a material issue in terms of financial stability (Principle 1) or the need to have a credible resolution strategy (Principle 2), because it limits the potential scale of contagion and instability. However, allowing a *de minimis* amount of retail deposit-taking is not justified when considering the limited efficiency benefits of doing so, in terms of the provision of financial services (Principle 3), the funding of branches and the additional complexity for our regime (Principles 4, 5 and 6).

There is also limited historical evidence in the New Zealand context that allowing branches to take a *de minimis* amount of retail deposits would encourage a new entrant to the retail banking market. Several submissions to our first consultation paper suggested that permission to take a *de minimis* amount of retail deposits would not create sufficient economies of scale to provide the basis for a challenger bank to engage in material price-based competition with incumbent banks. Under the proposed changes, overseas banks will still be able to offer competition and innovation in retail banking services by registering as a locally-incorporated subsidiary.

We acknowledge that this decision could have a negative effect on competition in retail banking services; and potentially result in the loss of some efficiency, in terms of cross-border services currently offered to some retail customers of those branches that take retail deposits. However, as discussed above, our analysis found little or no evidence that branches provide material price-based competition to locally-incorporated retail banks. In aggregate, the role of branches in retail banking business is immaterial: neither their retail deposit-taking nor their housing lending – whether individually or in aggregate – is material relative to the banking system. Hence, any effects on competition would be proportionate to this scale.

The counterfactual scenario presents some similarities with Option 3, discussed above. If some branches were allowed to undertake business with retail customers, the difficulties around a credible resolution strategy would still create a material issue, and we would need to evaluate the risk on a firm specific basis (Principle 2). This, in turn, would significantly increase the supervisory costs (Principle 6). We acknowledge that this option could allow a role for some branches in retail banking business, thus potentially having a positive impact on competition (Principle 3). However, the scale of this impact is assessed as being marginal, for the same reasons discussed in the preceding two paragraphs. Further, we anticipate that potential new entrants are likely to find the

regime complex to understand, thus reducing the likelihood of an increase in competition in that way.

The counterfactual scenario (Option 1) would produce significantly worse outcomes than Options 2 and 3 when compared against the remaining principles. The Reserve Bank would have a more limited ability to mitigate the risks to retail depositors without local incorporation, and lack the availability of the full suite of prudential regulatory and supervisory tools (Principle 1). Additionally, this option would keep the inconsistent outcomes of the current regime, and not create a level playing field (Principle 4), whilst being the least transparent option and the most difficult to communicate (Principle 5).

Conversely, Option 4 would allow branches to take an amount of retail deposits greater than our current limits, subject to appropriate risk mitigants. This option would recognise the potential role of branches in retail banking business, meeting Principle 3 more effectively than Option 2. However, Option 4 would fail to meet, or meet to a lesser degree, the other five assessment principles, when compared to the preferred option.

Option 4 would not be proportionate to the risks to financial stability, nor have regard to our limitations as a host supervisor (Principle 1). Furthermore, if a branch were engaged in retail banking services and taking a material amount of retail deposits (and/or had a material number of retail depositors), the need for direct control in resolution would outweigh the benefits of home country-led resolution (Principle 2).

Moreover, it would not result in entirely consistent outcomes for branches (Principle 4), since it would require us to design a clear policy for allowing retail deposit-taking and the limits that might apply in certain circumstances. In turn, this would entail a degree of supervisory discretion, thus not being entirely transparent, while also entailing a correspondingly higher level of supervisory cost and/or risk mitigants that would be more complex to administer than other options (Principles 5 and 6).

Our view is that Option 2 (not allow branches to undertake business with retail customers, subject to amending the definition of 'retail deposits' discussed below), meets the assessment principles most effectively because:

- retail deposit-taking activity is critical to the real economy, and retail depositor confidence is fundamental to financial stability. Local incorporation, and the application of the full suite of prudential regulation, supervisory authority and crisis management tools in the host jurisdiction, is the surest way to protect and promote financial stability (Principle 1);
- it will be transparent and easy to communicate (Principle 5);
- it would allow for a more consistent and level playing field between stand-alone branches (Principle 4);
- it will make the registration process more practical to administer for both branches and the Reserve Bank (Principle 6), potentially reducing the intensity of our equivalence assessments – though more ongoing supervisory resources may be required if more overseas banks decide to locally incorporate or become dual-registered; and

- in the scenario where branches are exempted from the DCS, in a domestic systemic crisis, retail deposit-taking branches may be a source of instability if they attracted an outflow of uninsured retail deposits from local deposit takers (Principle 1).

Implementation of Option 2 – Definition of 'Retail Deposits'

We have also considered different ways of defining 'retail deposits' to implement the preferred option to not allow branches to undertake business with retail customers. Three options are presented and analysed below:

- Option 1: counterfactual – the current definition of 'retail deposits' in BS1 uses an outstanding balances test whereby retail deposits are defined as deposit liabilities excluding liabilities with an outstanding balance of more than NZ$250,000.
- Option 2: align with FMC Act definition – specify that branches only undertake business with wholesale investors, as defined in Clause 3(2) and 3(3), Schedule 1 of the FMC Act **(Preferred)**.
- Option 3: create a bespoke definition of 'risky' retail products and/or customer sets for the purposes of branch policy.

Alternative Options Suggested by Stakeholders

Two of the submissions to the second consultation paper proposed that, if the restrictions were to apply, they should apply to retail deposits only, rather than any business with retail customers (as proposed in the second consultation paper). Both submissions suggested a $100,000 threshold for retail deposits to align with the DCS threshold.

These are two interconnected issues. First, the question on why restrictions will apply to retail business generally, and not just retail deposits. Second, the question of the $100,000 and its link to the DCS.

On the first issue, there are several reasons why the restrictions will apply to retail businesses in general. This decision mitigates risks to financial stability, including exposure to global risks, and preserves the confidence of retail customers in our banking system. It also creates a simpler distinction between classes of overseas banks and the associated requirements for each type of business. Further, the line between deposits and lending can sometimes be somewhat blurred, since a customer's credit balances (positive balances) represent a liability for the bank. This creates challenges under the forthcoming DCS. These and other considerations are discussed in further detail in the following section.

On the second issue of a $100,000 threshold, it must be noted that under the DCS "protected deposits" (whether retail or wholesale) of over $100,000 can still be covered. The DCS will cover these larger protected deposits up to the $100,000 limit. Therefore, this alternative proposal would not achieve the policy intent, as deposits larger than $100,000 are still defined as "protected" for purposes of the DCS.

Furthermore, there is no justifiable reason to depart from the already established and used definitions of retail customers and build a bespoke one. That would also add unnecessary complexity, being less transparent and more costly to administer and to supervise (Principles 5 and

6). Additionally, using the FMC Act definition is in line with the feedback we received in the first consultation. A complete analysis of this proposal can be found in the summary of submissions in response to the second consultation paper, which is published alongside this document.

The options considered regarding the definition of ‘retail deposits’ are reviewed and compared using the assessment principles of the Branch Review in the below table, and further analysed in the following sub-section.

Do The Options Meet the Assessment Principles Effectively?

	Option 1 – counterfactual (BS1)	Option 2 – FMC Act definition (Preferred)	Option 3 – bespoke definition
Principle 1: 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.	✕✓ We have a more limited ability to mitigate the risks to retail depositors without local incorporation, and the availability of the full suite of prudential regulation/supervisory tools.	✓ Would further mitigate risks to financial stability, in terms of the confidence of retail customers in our banking system.	✕✓ We have a more limited ability to mitigate the risks to retail depositors without local incorporation, and the availability of the full suite of prudential regulation/supervisory tools.
Principle 2: 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.	✕✓ Scale of risk would need to be evaluated on a firm specific basis.	✓ If a branch is not engaged in retail banking services, the need for direct control in resolution is greatly diminished.	✕✓ Depends on the definition, but if a branch is engaged in retail banking services and is taking a material amount of retail deposits and/or has a material number of retail depositors, the need for direct control in resolution outweighs the benefits of home-led resolution.

	Option 1 – counterfactual (BS1)	Option 2 – FMC Act definition (Preferred)	Option 3 – bespoke definition
Principle 3: 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;	✓ Allows a role for some branches in retail banking business.	✕✓ Restricts the provision of broader retail services (other than retail deposit-taking) to retail customers. However, our assessment is that the nature and aggregate scale of these retail services across the current branch population is limited.	✓ May allow a role for branches in retail banking business.
Principle 4: result in consistent outcomes for branches in New Zealand, supporting a level playing field, while remaining flexible enough to apply supervisory adjustment.	✓ Would be coherent and consistent across all branches.	✓ Would be coherent and consistent across all branches.	✓ Would be coherent and consistent across all branches.
Principle 5: be transparent, and aligned with international standards where appropriate, to allow branches (and new applicants) to understand and meet requirements cost effectively;	✕✓ Given customer balances fluctuate, this can cause confusion, and impose higher compliance costs.	✓ More transparent than the status quo, and aligns with our approach to overseas banks that rely on the Class Authorisation. This would reduce complexity and compliance costs across the regulatory landscape by using an established definition.	✕ Creating a bespoke definition of retail services and/or customers would introduce a level of complexity that is difficult to communicate.

	Option 1 – counterfactual (BS1)	Option 2 – FMC Act definition (Preferred)	Option 3 – bespoke definition
Principle 6: be practical to administer and minimise unnecessary supervisory costs.	✕✓ Given customer balances fluctuate, this would be less practical to administer and impose higher supervisory costs.	✓ Would reduce the need for ongoing monitoring of customer balances.	✕ Would be complex to administer and impose higher supervisory costs.

Policy Decision: Option 2 – FMC Act Definition

The final policy decision is that branches only undertake business with wholesale investors, as defined in Clause 3(2) and 3(3), Schedule 1 of the FMC Act. Our view is that Option 2 will be more transparent and practical to administer (Principles 5 and 6). This approach would reduce the need for ongoing monitoring of customer balances (relative to Option 1) and reduce complexity across the regulatory landscape by using an established definition (relative to Option 3). We note that this implementation option will not only restrict branches' ability to take retail deposits, but also restrict their ability to engage in other retail activities (eg, the provision of derivatives to retail customers) (Principle 3).

However, in our view this broader restriction is justified under the principles, as it would further mitigate risks to financial stability, in terms of the confidence of retail customers in our banking system (Principle 1). Furthermore, the need for direct control in resolution would be greatly diminished if a branch were not engaged in retail banking services (Principle 2). All three options meet Principle 4, as they would result in consistent outcomes for all branches.

The decision to restrict branches from being able to conduct retail lending will lead to consistent outcomes for branches and recognise the role of branches in the provision of financial services. Branches currently deliver benefits to the financial system through providing large and/or sophisticated transactions to wholesale customers. Limiting branches to only conducting business with wholesale customers creates a distinction between classes of overseas banks that is simpler, more consistent and more transparent than alternative options, including the status quo. Regarding some specialised services like derivatives and foreign exchange (**FX**) products, we judge that there is material competition offered in these services by FMA-regulated entities that are outside of the Reserve Bank's regulatory perimeter.

Both the counterfactual (Option 1) and Option 3 show similar outcomes when compared against the assessment principles 1, 2 and 3. The two options imply that the Reserve Bank would have a more limited ability to mitigate the risks to retail depositors without local incorporation, and would face limitations as host supervisor (Principle 1). Regarding the need for a credible resolution strategy the scale of the risk would need to be evaluated on a firm specific basis for Option 1, while a bespoke definition under Option 3 may result in a branch taking a material amount of retail deposits (and/or customers), in which case the need for direct control in resolution outweighs the benefits of home-led resolution (Principle 2). Furthermore, both Options 1 and 3 may allow a role for branches in retail banking business, effectively meeting Principle 3.

Option 1 presents an additional complexity since customer balances fluctuate. This could cause confusion and impose higher compliance costs, thus only partially meeting Principle 5. Therefore, this would be less practical to administer and impose higher supervisory costs (Principle 6).

On the other hand, creating a bespoke definition of retail services and/or customers (Option 3) would introduce a level of complexity that is difficult to communicate, and hence would be complex to administer and impose higher supervisory costs (thus not meeting Principles 5 and 6).

The impact of this decision in relation to Principle 1 can be analysed with regard to both the liability and asset sides of bank's balance sheets. On the liability side, the position of New Zealand creditors in the event of a failure would be uncertain, and the Reserve Bank would have limited

ability to influence the outcomes of such an event, having to rely on the branch's home supervisor. For instance, some jurisdictions have depositor preference settings. While branches' market share of retail deposits is small, the event of a failure could have a contagion effect on the financial system. There are also interactions with the forthcoming DCS: a branch taking retail deposits outside the DCS could undermine the credibility of the scheme (Principle 1), while a retail deposit-taking branch's inclusion in the DCS would be less practical to administer (Principle 6) and would be consistent with the full suite of prudential regulation.

On the asset side of the balance sheet, the lending activities of branches may pose a smaller risk to financial stability. However, branches also expose New Zealand's financial system to particular risks, including making access to credit more 'pro-cyclical' (ie, more prone to what we colloquially describe as "boom and bust" cycles) and potentially increasing the magnitude of global economic impacts on New Zealand. While this risk could be partially mitigated using tools such as loan-to-value ratio (LVR) restrictions, this does not eliminate the aggregate 'pro-cyclical' effect.

Moreover, drawing a clear line between deposits and lending is challenging. Credit balances (positive balances) represent a liability for banks, creating challenges for a post-DCS scenario and the possibility of unintended consequences. In this sense, the decision to not permit retail lending is linked to the decision to not allow branches to take retail deposits, given the challenges of drawing a clear line between deposits and lending. Considering this, the decision focuses on resulting in consistent outcomes (Principle 4), transparency (Principle 5) and practicality (Principle 6), as well as financial stability (Principle 1), considering both 'direct and indirect' risks – that is, public confidence in depositor protection as well as in the regulatory and supervisory role of the Reserve Bank.

The negative score on Principle 3 for the policy decision reflects the core impact of the decision, which is to not allow branches to undertake business with retail customers. We acknowledge this would affect some households, particularly if they need to switch to a different entity.

4.2 Question 2 – Local Incorporation Threshold

Our existing policy in BS1 is to require local incorporation when a branch exceeds NZ$15 billion in liabilities (net of amounts due to related parties), or is expected to do so within five years. In considering what the appropriate threshold for local incorporation is, we have developed four options. These are reviewed and compared using the assessment principles of the Branch Review in the below table, and further analysed in the following sub-section.

When the existing threshold was developed, it aligned with the approach at the time for identifying systemically important banks. The approach for identifying domestic systemically important banks[16] (**D-SIBs**) has since evolved and now uses a framework with four dimensions. The chosen metric for the size dimension in the D-SIB framework is total assets, as it is the most direct way of measuring a bank's share in the banking system.

We will consider the merits of maintaining coherence between the method for setting the local incorporation threshold for branches and identification of D-SIBs through the course of the implementing the DTA.

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16 rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/requirements-for-domestic-systemically-important-banks

Options

- Option 1: counterfactual – threshold based on net liabilities.
- Option 2: threshold based on total assets (**Preferred**).
- Option 2.5: threshold based on net assets.
- Option 3: a combination of thresholds or indicators, such as the D-SIB framework.

Alternative Options Suggested by Stakeholders

One submission to the second consultation paper suggested that, if derivatives are to be included in the calculation of the threshold, they are captured on a net asset basis. Similarly, another submission suggested that the threshold exclude a branch's intra-group lending. We have included the option of a net asset threshold in our analysis.

Interdependencies

An asset threshold complements the changes to retail deposit-taking set out in section 4.1 of this RIS. Net liabilities is more appropriate for monitoring retail deposit-taking activity, whereas total assets is more appropriate for monitoring wholesale activity.

Do the Options Meet the Assessment Principles Effectively?

	Option 1: counterfactual – net liabilities threshold	Option 2: asset threshold (preferred)	Option 2.5: net asset threshold	Option 3: combination of thresholds and indicators
Principle 1: 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.	✗✓ Depends on quantum. Net liabilities is more appropriate for monitoring retail deposit-taking activity. The threshold is not an effective limit to the balance sheet size of branches because it is net of related party liabilities (intra-group funding).	✓ Assets are more appropriate for monitoring wholesale activity. Places a firm ceiling on branch size which limits the systemic importance of a single branch, and hence, contagion risks. Aligns more closely with our existing and proposed monitoring and assessment of financial stability risks.	✗✓ Assets are more appropriate for monitoring wholesale activity. We consider that changing the threshold to net assets would effectively increase the threshold, and would not capture the systemic importance of individual branches as effectively as total assets.	✗✓ Depends on the balance of indicators and supervisory discretion.
Principle 2: 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.	✓ Quantum can be set at a level that reflects risks to the system from a failure of a branch.	✓ Quantum can be set at a level that reflects risks to the system from a failure of a branch.	✓ Quantum can be set at a level that reflects risks to the system from a failure of a branch.	✓ Indicators could include assessments of inter-connectedness to related subsidiary and/or the financial system.

	Option 1: counterfactual – net liabilities threshold	Option 2: asset threshold (preferred)	Option 2.5: net asset threshold	Option 3: combination of thresholds and indicators
Principle 3: 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;	✕✓ Relevant to retail deposit-taking, but not to the provision of financial services more broadly.	✓ Relevant to an assessment of the importance of branches to the needs of corporates.	✓ Relevant to an assessment of the importance of branches to the needs of corporates.	✓ Depends on the balance of indicators.
Principle 4: result in consistent outcomes for branches in New Zealand, supporting a level playing field, while remaining flexible enough to apply supervisory adjustment.	✓ Would result in consistent outcomes for branches.	✓ Would support a level playing field and result in consistent outcomes for branches	✕ Would lead to inconsistency between different branches – effectively increasing the threshold for some branches.	✕ Implies a differentiated approach.

	Option 1: counterfactual – net liabilities threshold	Option 2: asset threshold (preferred)	Option 2.5: net asset threshold	Option 3: combination of thresholds and indicators
Principle 5: be transparent, and aligned with international standards where appropriate, to allow branches (and new applicants) to understand and meet requirements cost effectively;	✕✓ Clear and easy to communicate, however there are some definitional issues: "related party" is not defined in BS1, but is taken to include the head office of the legal entity of which the branch forms part.	✓ Would be clear and easy to communicate.	✕✓ Would create complexities for how netting would be applied and/or defined.	✕✓ Could introduce a level of complexity that is difficult to communicate, although the D-SIB framework is already communicated and understood by stakeholders.
Principle 6: be practical to administer and minimise unnecessary supervisory costs.	✓ Subject to unwinding of any double counting for dual-registered groups and a clear meaning of 'related party'.	✓ Subject to unwinding of any double counting for dual-registered groups.	✓ Subject to unwinding of any double counting for dual-registered groups and clear definitions for any netting applied.	✕✓ Would be more complex to administer than a single metric, although aligning with the D-SIB framework would mitigate some of this complexity.

Policy Decision: Option 2 – Move to a Total Assets Threshold

The final policy decision is that the local incorporation threshold will be based on total assets, instead of net liabilities, because:

- it complements the policy decision outlined in section 4.1 to restrict branches to wholesale business only. Net liabilities is more appropriate for monitoring retail deposit-taking activity, whereas total assets is more appropriate for monitoring wholesale activity and systemic importance;
- it aligns more closely with our existing monitoring and assessment of the financial stability risks (Principle 1) and benefits that branches bring to the financial system and the economy (Principle 3);
- it places a firm ceiling on branch size which limits the systemic importance of a single branch (Principle 1);
- it is the clearest and most transparent option (Principle 5), meaning it would also be practical to administer and minimise supervisory costs (Principle 6); and
- it would support a level playing field for branches (Principle 4).

A key motivation for the threshold to be based on total assets was to limit the systemic importance of a single branch. We consider that changing the threshold to net assets would effectively increase the threshold for some branches, and would not capture the systemic importance of individual branches as effectively as total assets.

The option of basing the threshold on net assets (**Option 2.5**) is similar to our policy decision, in particular regarding the assessment under Principles 2, 3, and 6. However, this option would effectively increase the threshold and would not capture the systemic importance of individual branches as effectively as total assets (Principle 1). Moreover, it would lead to inconsistency between different branches, effectively increasing the threshold for some branches, thus not meeting Principle 4. Finally, a net asset threshold would create complexities for how the netting would be applied and/or defined, hence being less transparent (Principle 5).

Regarding the counterfactual (Option 1), we acknowledge that this option would meet Principle 6, subject to unwinding of any double counting for dual-registered groups and a clear meaning of 'related party'. It would also result in consistent outcomes for branches (Principle 4), and would meet Principle 2 if the quantum were set at a level that reflected risks to the system from a failure of a branch.

However, a threshold based on net liabilities is more appropriate for monitoring retail deposit-taking activity, instead of wholesale. Besides, it is not an effective limit to the balance sheet size of branches because it is net of related party liabilities (intra-group funding). Hence, it would only partially meet Principle 1.

Furthermore, a net liabilities threshold would be relevant to retail deposit-taking, but not to the provision of financial services more broadly, so it would partially meet Principle 3. In a similar way, it would be relatively clear and easy to communicate, but there are some definitional issues. For

instance, "related party" is not defined in BS1, but is taken to include the head office of the legal entity of which the branch forms part. This means that Principle 5 is only partially met.

In contrast, a combination of thresholds and indicators (**Option 3**) fails to meet, or only partially meets, more principles than the other three options considered above. It would imply a differentiated approach for branches (Principle 4), introduce a level of complexity that is difficult to communicate (Principle 5) and consequently be complex to administer (Principle 6). It would only partially meet Principle 1, depending on the balance of indicators and supervisory discretion. Still, it would meet Principle 2, since the indicators used to build the threshold could include assessments of inter-connectedness to the related subsidiary and/or the broader financial system. It could also meet Principle 3, depending on the balance of indicators used. We also note that aligning fully with the D-SIB framework may mitigate some of the costs under Principles 5 and 6.

Implementation – Quantum

Taken alongside the proposed changes to permitted business activity, we do not expect the NZ$15 billion asset threshold to constrain any existing branches in the short term.

We acknowledge, based on analysis of branch balance sheet data, that moving from a threshold of NZ$15 billion in net liabilities to one of NZ$15 billion in total assets will, in practice, represent a lowering of the local incorporation threshold for most branches. However, given the potential growth in aggregate branch assets as a result of the decisions of the Branch Review, we judge that the NZ$15 billion quantum is appropriate to keep the scale of the overall branch population within our risk appetite, at least until the new policy is fully implemented. This approach also mitigates the risk of regulatory arbitrage.

We define regulatory arbitrage in this context as the risk that dual-registered groups move assets from their subsidiary to their branch, thereby putting some of their New Zealand business beyond the full scope of our regulation and supervision (eg, reducing the subsidiary's capital requirements under our rules). This risk could have a mixed impact on both New Zealand financial stability and a level playing field for overseas banks operating in New Zealand. At the margin, the transfer of assets from a subsidiary to a branch also results in the transfer of credit risk to the balance sheets of the overseas bank, which can be associated with less regulatory capital needing to be held in New Zealand. However, at the extremes, this would have a negative impact on the aggregate capitalisation of New Zealand's financial system and would erode the level playing field for overseas banks if branches are able to access cheaper funding than locally-incorporated banks due to regulatory constraints. The quantum of the local incorporation threshold acts as a constraint on the magnitude of this risk. It also limits the potential impacts of the pro-cyclicality risk discussed in the previous section.

We expect the quantum for the local incorporation threshold to be reviewed at least once every 5 years. As a result, it may be amended. This will depend on our assessment of the risks and benefits to the financial system stemming from the implementation of the Branch Review, and consider our financial stability and prudential objectives. A complete description of the expected reviews can be found on section 6.2 Monitoring and Evaluation.

4.3 Question 3 – Dual Registration

We first adopted a dual registration policy in 2004 and updated it for small foreign banks in 2016. The main features of our current dual registration policy are that:

- a dual-registered branch should not be permitted to accept retail deposits; and
- for small foreign banks from non-equivalent regimes, we impose activity restrictions and relative size constraints (total assets of the branch must not exceed those of the locally-incorporated subsidiary – this is also known as the '1:1 ratio').

Options

- Option 1: counterfactual – maintain our current dual registration policy.
- Option 2: not allowing dual-registered branches.
- Option 3: allowing dual-registered branches, subject to potential further mitigants.
- Option 4: allowing dual-registered branches to conduct business with large corporate and institutional customers, subject to potential further mitigants. **(Preferred).**

Potential Further Risk Mitigants

The potential further risk mitigants are set out in our supervisory approach (see section 4.5), and 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; and
- imposing quasi-capital or quasi-liquidity requirements on the branch (eg, requiring a dual-registered branch to maintain a minimum amount of ring-fenced assets in New Zealand).

Large Corporate and Institutional Customer Threshold

In our second consultation paper, we introduced the concept of the 'large corporate and institutional customer threshold' for dual-registered branches. This threshold aims to address the specific concerns associated with dual-registration, in particular:

- the potential off-shoring of critical functions and services for the economy that are currently maintained in the locally-incorporated subsidiary (eg, FX and interest rate products and services); and

- the possibility that these functions and services would become unavailable in the event of:
  - disruption at the branch;
  - a re-allocation of resources at the overseas bank; or
  - a change in regulatory or supervisory approach in the bank's home jurisdiction (Principle 1).

Alternative Options Suggested by Stakeholders

Some submissions to the second consultation paper provided alternative options for the definition of the 'large corporate and institutional customer' threshold. This is considered in the consultation paper we have released relating to implementation considerations for the Branch Review alongside this document.

The four options listed above, regarding dual registration, are presented and compared against the assessment principles of the Branch Review in the table below.

Do the Options Meet the Assessment Principles Effectively?

	Option 1 – counterfactual	Option 2 – not allowing dual-registered branches	Option 3 – allowing dual-registered branches, subject to potential further mitigants	Option 4: allowing dual-registered branches to conduct business with large corporate and institutional customers, subject to potential further mitigants (Preferred).
Principle 1: 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.	✕ The current dual registration policy is applied unevenly, and some dual-registered branches are permitted to take retail deposits.	✕ Would represent a substantial opportunity cost to the economy for relatively small reduction in financial stability risk (ie, would be disproportionate).	✕✓ Proportionate, subject to additional risk mitigants. However, there may be potential off-shoring of critical functions and services for the economy.	✓ Proportionate to risks to financial stability – the possibility that critical functions and services for the economy could become unavailable.
Principle 2: 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.	✕✓ Dual-registered groups in general – and particularly those outside the scope of Outsourcing (BS11) – could face additional challenges to delivering a credible resolution strategy.	✕ Dual-registered branches do not necessarily present issues to resolution in isolation. The potentially more challenging cases could relate to dual-registered banking groups that are outside the scope of Outsourcing (BS11).	✕✓ Dual-registered groups in general – and particularly those outside the scope of Outsourcing (BS11) – could face additional challenges to delivering a credible resolution strategy.	✓ This option preserves the ability of the locally-incorporated subsidiary to provide products and services that may be important to small- to medium-sized wholesale customers that play an important role in our financial system and our economy.

	Option 1 – counterfactual	Option 2 – not allowing dual-registered branches	Option 3 – allowing dual-registered branches, subject to potential further mitigants	Option 4: allowing dual-registered branches to conduct business with large corporate and institutional customers, subject to potential further mitigants (Preferred).
			Applying appropriate risk mitigants can reduce the challenges presented by dual-registered groups.	
Principle 3: 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;	✕✓ Some dual-registered branches are permitted to take retail deposits.	✕ Would likely reduce the number of branches operating in New Zealand and the ability of some key players to access wholesale markets.	✕✓ Would mostly allow banks to access wholesale markets as easily as at present, though greater delineation of branch and subsidiary may limit this.	✕✓ Would mostly allow banks to access wholesale markets as easily as at present, though greater delineation of branch and subsidiary may limit this.

	Option 1 – counterfactual	Option 2 – not allowing dual-registered branches	Option 3 – allowing dual-registered branches, subject to potential further mitigants	Option 4: allowing dual-registered branches to conduct business with large corporate and institutional customers, subject to potential further mitigants (Preferred).
Principle 4: result in consistent outcomes for branches in New Zealand, supporting a level playing field, while remaining flexible enough to apply supervisory adjustment.	✕ The current dual registration policy is applied unevenly.	✕✓ Would be somewhat consistent, but with no flexibility.	✕✓ Would partially mitigate the risk of regulatory arbitrage.	✓ Mitigates the risk of regulatory arbitrage.
Principle 5: be transparent, and aligned with international standards where appropriate, to allow branches (and new applicants) to understand and meet requirements cost effectively;	✕✓ Current dual registration policy lacks transparency.	✕ Would be unusual when compared to other jurisdictions.	✓ The supervisory framework will provide clarity on when additional mitigants would be applied.	✓ The supervisory framework will provide clarity on when additional mitigants would be applied.
Principle 6: be practical to administer and minimise unnecessary supervisory costs.	✕ The uneven conditions for different branches impose a higher supervisory cost relative to a level playing field would.	✕✓ Would have spillover effects to the rest of the supervisory approach that are challenging to quantify.	✕✓ Would imply more supervisory costs than Options 2 and 4, but less than Option 1.	✓ Restricting to large corporate and institutional customers would minimise supervisory costs (even though they would not be zero).

Policy Decision: Option 4 – Allow Dual-Registered Branches, Subject to Further Risk Mitigants, Including Only Being Permitted to Conduct Business With Large Corporate and Institutional Customers

The policy decision is to allow dual-registered branches, subject to further risk mitigants, including only being permitted to conduct business with large, corporate and institutional customers (Option 4). We judge that this most effectively meets the assessment principles, because:

- dual registration offers efficiency benefits to New Zealand's financial system, in terms of diversifying the sources of funding available to the financial system, including to other registered banks (Principle 3);
- the scale of the risks presented to financial stability can be appropriately mitigated by the implementation of a proportionate, transparent and consistently applied supervisory approach (Principles 1, 4 and 5);
- from a resolution, or crisis management, perspective (Principle 2):
  - dual registration does not necessarily present additional risks, in part due to the implementation of BS11 (Outsourcing) policy for some of the relevant locally-incorporated banks of dual-registered groups, which aims to ensure that the locally-incorporated subsidiary is separable from the parent (the overseas bank of which the branch forms part) in a crisis situation; and
  - the preparation of resolution plans for all registered banks (including branches) by the Reserve Bank and resolution requirements on locally-incorporated deposit takers, as established by the DTA, may give us an opportunity to further address any specific concerns about the separability of dual-registered banks in a crisis situation.
- restricting dual-registered branches to conduct business with large, corporate and institutional customers:
  - preserves the ability of the locally-incorporated subsidiary to provide products and services that may be important to small- to medium-sized wholesale customers that play an important role in our financial system and our economy; and
  - mitigates the risk of regulatory arbitrage by requiring assets of customers below the threshold to be retained within the locally-incorporated subsidiary.

Option 2, not allowing dual-registered branches, would represent a substantial opportunity cost to the economy for a relatively small reduction in financial stability risk, being disproportionate (Principle 1) and unusual compared to other jurisdictions (Principle 5). Moreover, it would likely reduce the number of branches operating in New Zealand and the ability of some large corporate and institutional customers to access wholesale markets (Principle 3). This option wouldn't meet Principle 2 either; the potentially more challenging cases could relate to dual-registered banking groups that are outside the scope of Outsourcing (BS11).

On the other hand, Option 2 would be somewhat consistent, although with no flexibility (Principle 4) and it would entail no supervisory costs (Principle 6). However, the potential costs discussed above significantly outweigh the benefits regarding these two principles.

In contrast, both Options 1 and 3 present some similarities. They respectively don't meet, and only partially meet, Principles 1, 4 and 6. Furthermore, both options only partially meet Principle 2, since dual-registered groups in general – and particularly those outside the scope of BS11 (Outsourcing) – could face additional challenges to delivering a credible resolution strategy. Similarly, they only partially meet Principle 3, since some dual-registered branches would be permitted to take retail deposits (counterfactual) and banks would have access to wholesale markets as easily as at present, though greater delineation of branch and locally-incorporated subsidiary may limit this (Option 3).

In contrast, the counterfactual (Option 1) would lack transparency (Principle 5), while Option 3 would meet this principle provided the supervisory framework gives clarity on when additional mitigants would be applied.

Implementation of our Dual Registration Policy – the Large Corporate and Institutional Customer Threshold

To implement our dual registration policy, we need to define the 'large, corporate and institutional customers' with whom dual-registered branches may conduct business with.

The aim of the large corporate and institutional customer threshold is to:

- preserve the ability of the locally-incorporated subsidiary to provide products and services that may be important to small- to medium-sized wholesale customers that play an important role in our financial system and our economy – our assumption is that smaller entities are likely to have fewer banking relationships than large corporate and institutional entities; and
- mitigate the risk of regulatory arbitrage by requiring assets of customers below the threshold to be retained within the locally-incorporated subsidiary.

We received a substantial amount of feedback on this topic in response to the second consultation paper. As we aim to properly reflect this feedback in the final decisions, a revised definition of large corporate and institutional customers is proposed in the consultation paper on implementation considerations that is published alongside this RIS. We will consider whether it is necessary to publish a supplementary RIS once a decision has been made in response to the third consultation paper.

Implementation of our Dual Registration Policy – Reporting, Governance and Disclosure

Currently, branches are required to disclose on a consolidated New Zealand group basis. Where the branch is part of a New Zealand group that includes a material number of other entities, this presents a challenge in terms of easily understanding the importance of the branch and its activities on an unconsolidated (or 'solo') basis. This is particularly important and challenging for the dual-registered banks currently operating in New Zealand. This issue weakens both market discipline and our ability to effectively and efficiently supervise some of our branches.

The previous requirement for dual-registered branches to produce a 'solo' disclosure statement was removed as part of the regulatory stocktake[17] that concluded in 2015. We do not intend to reintroduce this requirement, as we judge it represents a disproportionate cost to regulated

17 Regulatory stocktake of prudential requirements - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)

entities for the benefits it achieves in improving market discipline. However, we judge that reporting of a small number of metrics on a 'solo' basis will be of low cost to regulated entities and have a material positive impact in supporting effective supervision of branches.

Additionally, in our second consultation paper, we noted that we will be undertaking further policy work to clarify whether a dual-registered branch's disclosure statement can be signed by any director, officer or employee of the locally-incorporated registered bank. This will likely take place when we develop DTA standards relating to governance, risk management and disclosure.

4.4 Question 4 – Greater Supervisory and Regulatory Integration

In the first consultation paper, we presented the question: *should we pursue greater regulatory and supervisory integration?* In the context of this RIS, the counterfactual and the option to pursue greater regulatory and supervisory integration are essentially the same. This is because, since the 2017 International Monetary Fund (IMF) Financial Sector Assessment Program (FSAP) of New Zealand, the Reserve Bank is aiming to strengthen and integrate its regulatory and supervisory frameworks.

The status quo, addressed by the IMF report, presents challenges and risks to financial stability, and is not aligned with international best practice. This is why it will be changed by the DTA once implemented, increasing the Reserve Bank's ability to set and supervise compliance with prudential requirements – regardless of the final policy decisions of this Branch Review.

Pursuing greater supervisory and regulatory integration will:

- enhance our awareness and understanding of home authorities' approaches, with benefits for both our regulation and supervision of branches (Principle 1);
- support the evaluation of home resolution plans and application of appropriate risk mitigants, particularly for dual-registered groups (Principle 2); and
- support alignment with international standards without compromising our flexibility to address specific risks, but does not in itself lead to more consistent and transparent outcomes (Principles 3 and 4).

Implementation of this decision would mean pursuing greater engagement with relevant home authorities, both bilaterally and in supervisory colleges. However, we are not suggesting that we move towards full regulatory alignment with international standards. In practice, this greater integration and cooperation will need to be progressed on an *ad hoc*, institution and jurisdiction specific basis as opportunities arise.

We note there are likely to be limits to the extent we can implement this decision. There are inherent asymmetries in the home-host relationship, and practical constraints in terms of our resourcing. As a result, pursuing greater integration is a medium- to long-term aim that is unlikely to change our policy stance on the first three policy questions.

Implementation – Notification of Any Material Changes to Home Regulatory Regime

Under their current Conditions of Registration, branches are not required to notify us of any material changes in the home regulatory or supervisory regime that would impact the overseas bank, and by extension the branch and its customers and creditors in New Zealand.

Therefore, to complement the policy of greater supervisory and regulatory cooperation, branches will be eventually required through a standard or conditions under the DTA to notify us of any material changes to the home regulation and supervision of the overseas bank. Examples could include changes to capital, liquidity, governance or resolution requirements or how connected exposures are treated by the home regulator.

The determination of what constitutes a material change may be seen as a slightly subjective judgement, but should be considered in the context of its potential effect on the creditors of the branch in New Zealand and the broader implications for financial stability in New Zealand.

4.5 Supporting Policy – Supervisory Approach

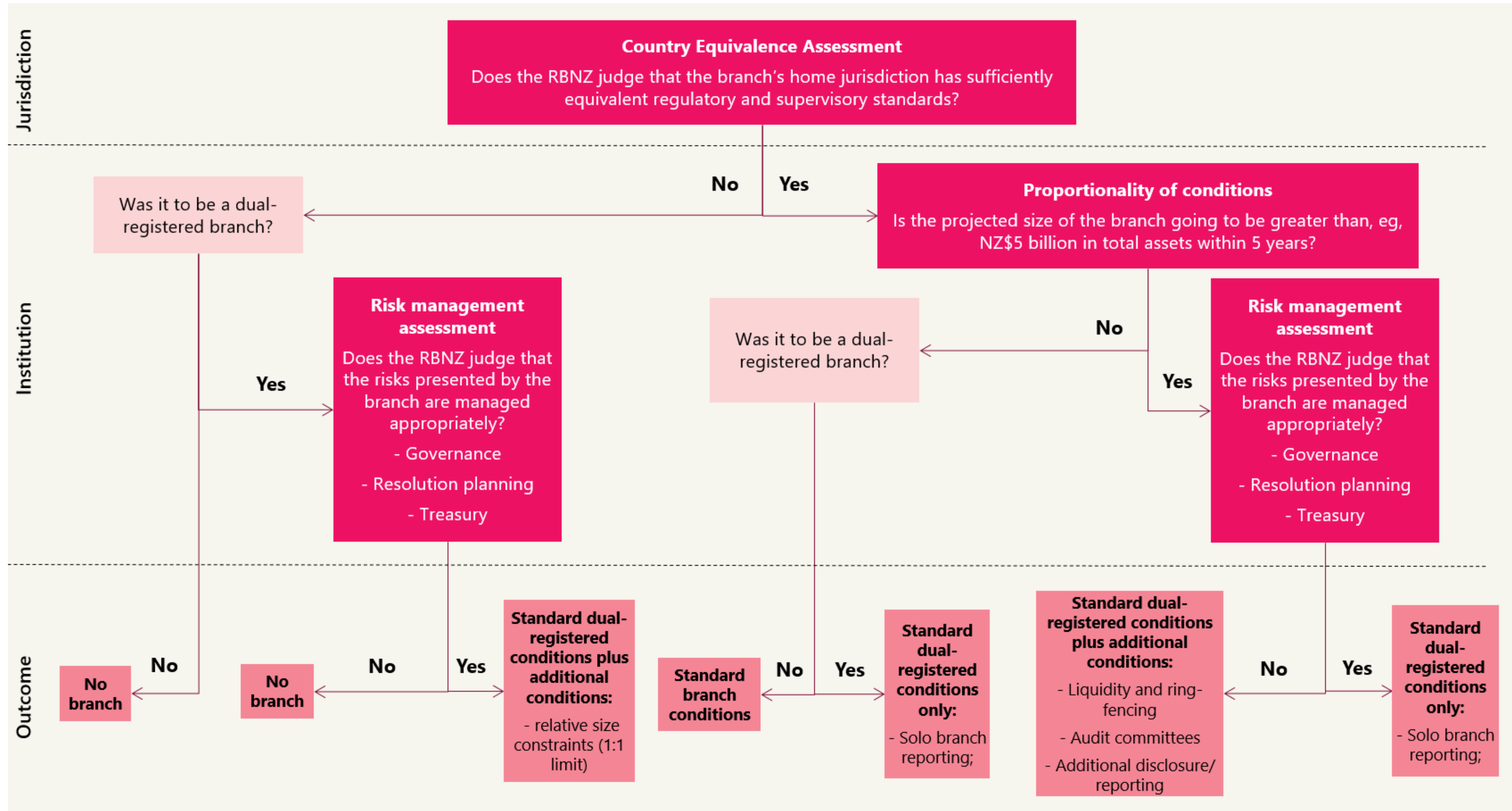
We recognise that, in addition to the decisions outlined in this RIS, we should offer more clarity on our supervisory approach: how we assess whether or not the home jurisdiction of the branch has equivalent regulatory and supervisory standards; and what conditions or supervisory measures might be applied to branches to mitigate the risks associated with non-equivalence.

Clarifying our supervisory approach promotes consistent outcomes (Principle 4), transparency (Principle 5) and will minimise cost for industry and us as supervisor (Principle 6).

Figure 1, illustrates the framework for determining whether additional risk mitigants are required, with two separate assessments: one for the jurisdiction, and one for the institution. The assessments will occur on application for registration (as at present) and then at least once every 5 years thereafter, to ensure that issues are identified and remain within our risk appetite, and that any risk mitigants remain appropriate and proportionate.

Much of the activity outlined in the framework is already ongoing as part of our existing supervisory approach. This framework formalises our approach and thus provides a benchmark for consistency of approach across our branch population. It also provides greater clarity to existing branches on the basis for which we impose any additional conditions, and to prospective new entrants as to what their likely conditions of licence would be.

Figure 1: Supervisory Approach



5 Marginal Costs and Benefits of the Policy Package

This section considers the costs and benefits of the policy decisions – as a policy package – on the stakeholders of the Branch Review.

Section 257(2) of the RBNZ Act states that in the published report on the assessment of regulatory impacts, the Reserve Bank may omit information if it is satisfied on reasonable grounds that it is proper to omit the information on the grounds of commercial confidentiality.

In analysing the costs and benefits of the policy decisions, we have considered evidence from stakeholders that has been provided to us confidentially. Where confidential information has factored into our assessment of the costs and benefits, we have indicated this in the table below.

Affected groups	Comment	Impact.	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Existing stand-alone branches	Transitional costs associated with restructuring business models. Potential transitional costs associated with local incorporation.	Medium on average. Noting that the costs will be higher for some entities to transition than others, depending on each entity's specific circumstances.	Medium Based on evidence from consultation responses and bilateral engagements with stakeholders
Existing dual-registered branches	Transitional costs associated with restructuring business models to implement large corporate and institutional customer threshold. Ongoing costs associated with greater reporting and disclosure.	Medium Noting that the costs will be higher for some entities to transition than others, depending on each entity's specific circumstances. Low	Medium Based on evidence from consultation responses and bilateral engagements with stakeholders
Potential new entrants	N/A	N/A	N/A
Existing retail customers of branches*	Potential cost of being transferred between branch and subsidiary	Medium-low	High
Existing wholesale customers of branches	Cost of moving business for wholesale customers of dual-registered branches that don't meet	Low	High

Affected groups	Comment	Impact.	Evidence Certainty
	the large corporate and institutional customer threshold		
Locally-incorporated banks	Cost of receiving the transferred customers	Low	Medium
Reserve Bank	Initial additional supervisory resource to implement the policy.	Low	High
Wider NZ public	Costs of competition, although as discussed, impacts on competition would be minimal, and this could be countered by an increase in the likelihood of new entrants	Low	Medium
Additional benefits of the preferred option compared to taking no action			
Existing stand-alone branches	Level playing field	Medium	High
Existing dual-registered branches	Level playing field	Medium	High
Potential new entrants	Increased clarity on branch requirements, reduced barriers to entry.	Medium	High
Existing retail customers of branches	Depositor protection	High	High
Existing wholesale customers of branches	Increased clarity	Medium	Medium
Locally-incorporated banks	Retail remains in locally-incorporated. Critical functions in subsidiary of dual-registered branch.	Low	Medium
Reserve Bank	Simpler and more transparent regime likely to be easier to operate,	Medium	High

Affected groups	Comment	Impact.	Evidence Certainty
	supervise, and engage with industry on. Avoid the cost of delivering DCS to branches.		
Wider NZ public	Benefits of financial stability	Medium	High
Total monetised benefits			
Non-monetised benefits		***High***	***Medium***

*Regarding the marginal costs to existing retail customers of branches, we have developed a scenario analysis to further analyse the different potential effects of the decisions. The two main scenarios that form the framework of this analysis are:

1. deposit-taking branches choose to incorporate; and
2. deposit-taking branches choose to exit the market.

The different scenarios entail different costs for the existing retail customers of branches. In scenario i), we assume that existing branches would incorporate. This would mean that existing clients would be transferred from the branch to the existing subsidiary or newly-incorporated bank, but most of these costs would be absorbed by the bank. While this would still entail some costs for the customers, these would be mainly administrative – not directly monetary – and one-off, hence we assess these as 'low'. The evidence certainty for this assessment is high, and comes from the consultation process and in particular from bilateral engagements with entities. In aggregate, there were limited responses to the second consultation paper on the costs of transferring retail customers from a branch to a subsidiary.

In the second scenario (ii), deposit-taking branches choose to exit the market. This would have differential effects on different client groups. Customers of stand-alone branches would need to move to a different entity (eg, a locally-incorporated bank, or a dual-registered bank) to maintain access to the retail services they use. This cost is higher than the one faced by existing customers of dual-registered branches, who would have to move from the branch to the subsidiary (within the same entity/group), although is not entirely 'high' because they would be likely to be able to maintain access to the retail services through a different bank. Hence, we assess the overall cost of this scenario as 'medium', also with high certainty for the reasons stated in the above paragraph.

We can also divide existing customers of branches into three broad groups for the purpose of analysing the impacts of the key decisions in the Branch Review: retail customers; small- and medium-sized enterprises (**SMEs**); and large corporate and institutional customers (**LCICs**).

For retail customers, we judge that branches of overseas banks have not had a material impact on competition for both deposits and lending. Further, on specialist products, such as spot FX and derivatives, there is already material competition for these products among FMA-regulated entities. The main costs for retail customers would come from transitioning to a new entity, as discussed above. These "set up" costs would be one-off.

For SMEs, the impacts are likely to be minimal. SMEs will continue to be able to do business with standalone branches, although under the proposals SMEs will no longer be able to do business with dual-registered branches. Feedback from regulated entities suggests that relatively few SMEs currently do business with dual-registered branches and, for the most part, those SMEs should be able to access the same products and services from the locally-incorporated subsidiary.

Through the consultation we have identified that the primary benefit that branches bring to the New Zealand economy is the ability for LCICs to be able to access large and/or sophisticated products and services from all branches. We have proposed to retain this, and we expect that all LCICs would be sophisticated enough to be multi-banked and therefore be able to access the required scope and scale of products and services. Therefore, we do not anticipate that LCICs would be materially impacted by the exit of one or more branches if there was a systemic stress event.

The two scenarios presented above represent the two possible opposite outcomes for stand-alone branches. There could be, of course, intermediate scenarios where some deposit-taking branches choose to incorporate, while others choose to exit the market. Since it is difficult to predict the effect of the policy decisions on different branches, due to its links to other variables, such as exogenous factors (ie, restructuring of business models, global strategies, etc.) we assign a 50% probability to each scenario.

Given this setting, the overall assessment (in the table above) of the costs for existing retail customers of branches equals 0.50*Low + 0.5*Medium. If the 'low, medium and high' were a '1, 2, 3' scale, the result would be 0.5*1 + 0.5*2 = 0.5 + 1 = 1.5. This is an intermediate point between low and medium, hence it is 'medium-low'.

6 Delivering the preferred options

6.1 Implementation

We intend to implement the policy decisions through a standard or conditions under the DTA. This represents a change from the process stated in the second consultation paper to implement outcomes through branches' conditions of registration, and should represent a streamlining of the implementation process. We expect to consult on an exposure draft of a standard or conditions in 2026 that will include the key decisions outlined in this document, and the subsequent decisions following the third consultation paper. These decisions will then be implemented via a standard or conditions under the DTA. Branches will need to comply with these requirements, once the DTA is fully implemented, which is expected to be in 2028.

This will likely represent an implementation period of around 4 years, which is longer than the 3 years we proposed in the second consultation paper.

This presents a number of advantages relative to the previous plan, including that it will:

- be simpler for the Reserve Bank to implement, by removing the step of issuing new conditions of registration to all of the existing branches, which will reduce supervisory costs;
- be simpler for industry to implement, relative to issuing them with new conditions that are subsequently replaced by a standard or conditions;
- increase the duration of the implementation period from 3 years to around 4 years, in response to feedback to the second consultation paper.

The exposure draft of the standard or conditions is expected to be published after responses to the third consultation paper have been considered as part of the wider programme of work to implement the DTA. This will also represent a further opportunity for industry to engage in the implementation process for the Branch Review. We may publish a supplementary RIS after we announce decisions in response to the third consultation paper. We consider the certainty offered by this RIS and the supplementary consultation paper give industry sufficient certainty to begin the process towards complying with these new requirements.

Implementation Risks

The key decisions in this Branch Review present an opportunity to modernise the regulation and supervision of a key component in New Zealand's financial system. While we acknowledge there could be a first-round negative effect on competition in retail banking services, in aggregate the role of branches in retail banking business is not material. In other words, while – all else equal– having more market participants would foster competition, the key feature of a competitive market is not just the number of market participants, but their market share, and hence the market power (pricing power) they hold.

For this reason, the Herfindahl-Hirschman Index (HHI) is a widely used measure of market concentration. Its calculation takes into account both the number of firms and their market share or relative size distribution. For instance, the HHI is used by antitrust regulators to assess whether a market is competitive enough. In the United States, the Federal Trade Commission (FTC) and the

Department of Justice (DOJ) use the HHI to determine whether a merger will significantly reduce competition. The Reserve Bank has also used this index to assess market concentration (see for instance, the May 2022 Financial Stability Report).

Moreover, the first-round effect entails a short-term view, and we judge that it is offset by the longer-term benefits associated with having a consistent, coherent and transparent approach for regulating and supervising overseas banks operating in New Zealand. These benefits will also encourage competition and innovation, by lowering barriers to entry and supporting a level playing field. This is consistent with the problem definition of the Branch Review that there is currently an uneven playing field, which discourages prospective new entrants that can offer competition for wholesale banking services.

From an economic theory perspective, removing barriers to entry and levelling the playing field affects the market's structure, whereas materially impacting the current operations of some registered branches affects individual agents, or market participants. The former concepts are at a structural level, which is more strongly related to our purpose as kaitiaki (guardians) of the financial system and the principles under the DTA (eg, consistency in the treatment of similar institutions, the need to maintain competition), while the latter is at an individual level, related to market dynamics.

While these changes will materially affect the operation of some branches, that is a direct and unavoidable consequence of levelling the playing field; we would be removing competitive advantages for some entities that have been created by the uneven development of regulations over time. This will provide certainty to prospective new entrants and support a more competitive and efficient market structure.

6.2 Monitoring and Evaluation

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 aim to evaluate primary policy issues such as the quantum for the local incorporation threshold on a 5-yearly cycle. We will complete the equivalence assessments for all registered branches at least once every 5 years and also keep the process for these equivalence assessments under review.

On a more frequent basis, the Reserve Bank’s regular supervisory engagement with branches will provide us with valuable and timely information on the ongoing impacts of the policy decisions.

7 Consultation

7.1 Consultation Process

The Review of policy for branches of overseas banks has been ongoing since 2020. We have completed two public consultations, engaged extensively with external stakeholders through bilateral meetings and regularly consulted internal steering groups, roundtables and committees.

The first consultation paper in the Branch Review was published in October 2021 and set out the current branch policy and proposed the problem definition of the Branch Review, six assessment principles, and some high level policy questions and options that would create a level playing field

while recognising the role that branches play in the provision of financial services. See the summary of submissions for the first consultation paper.

The second consultation paper was published in August 2022 and put forward a set of policy proposals. The second consultation closed on 16 November 2022. We received fifteen submissions that gave us a better understanding of branches' business models, how the proposals would affect branches, and impacts on the wider financial system and economy.

We have also engaged in bilateral discussions with industry stakeholders during and after the consultation periods, to clarify points raised in their submissions.

7.2 Stakeholder Feedback

In the first consultation paper, we asked for feedback on six questions. The first two questions asked for feedback on the problem definition and assessment principles. We then proceeded with using these when considering the feedback to the other four policy questions and putting forward our policy proposals.

The first consultation for the review of the policy for branches of overseas banks closed on 2 March 2022. We received fifteen substantive submissions to the consultation paper from entities, plus one submission from a member of the public.

These submissions can be found on our website. We have also engaged in bilateral discussions with industry stakeholders during the consultation period, and since it closed to clarify points raised in their submissions. For a summary of the submissions received in response to our consultation, as well as a brief response to those submissions, see the summary of submissions to the first consultation paper.

In the second consultation paper, we asked for feedback on eight questions. Most of the submissions generally supported the proposals, with some amendments and clarifications sought. However, some submissions strongly opposed the proposal to restrict branches to conduct wholesale business only.

The points we received the most feedback on were:

- the proposal to restrict branches to only conduct wholesale business;
- the proposed $15billion asset threshold for local incorporation;
- the proposed definition of the large corporate and institutional customer threshold for dual-registered branches; and
- the proposed length of the transition period.

See the summary of submissions to the second consultation paper published alongside this document for more detail.