



**RESERVE  
BANK**

O F N E W Z E A L A N D  
T E P Ū T E A M A T U A

# Summary of submissions on the Consultation Paper and policy decision: Dual Registration Policy for Small Foreign Banks

**December 2016**

## PART ONE: BACKGROUND

1. Section 73 of the RBNZ Act ('the Act') sets out the matters the Reserve Bank must have regard to when considering applications for registration as a bank, while section 73A sets out further matters if the applicant is an overseas person (i.e. a "branch")<sup>1</sup>. Policy implementing these requirements for branches is found in section C(II)(a) of the Banking Supervision Handbook document "Statement of Principles: Bank Registration and Supervision" (BS1).
2. For a branch to register as a bank in New Zealand, its overseas head office must be regulated in its home jurisdiction, and the branch must fall outside the following categories:
  - A. Systemically important banks, that is, banks whose New Zealand liabilities, net of amounts due to related parties, exceed NZ\$15bn (the 'branch cap' threshold).
  - B. Retail deposit takers<sup>2</sup> incorporated in a jurisdiction that has legislation which gives deposits made, or credit conferred, in that jurisdiction a preferential claim in a winding up.
  - C. Retail deposit takers whose home jurisdiction does not require adequate levels of information disclosure to the public.
  - D. Applicants other than those listed above where the Reserve Bank is not satisfied that supervisory arrangements (including disclosure arrangements) and market disciplines in its country of incorporation are adequate (typically with reference to IMF assessments or some other benchmark).

Applicants that fall within these categories, or that are expected to in the 5 years following registration, will be required to establish a locally incorporated entity rather than operate via a branch in New Zealand.

3. Foreign-owned banks are permitted to have "dual registration" – operating both a branch and a locally incorporated subsidiary in New Zealand - provided both entities comply with relevant prudential requirements relating to the matters listed in sections 73-73B of the Act, as set out in Conditions of Registration (CORs) for registered banks. These require dual-registered branches to fall outside of the local incorporation categories set out above (which apply to all branch operations, be they standalone or dual-registered), and not take retail deposits.
4. The local incorporation categories reflect a firm's significance in the New Zealand financial system, and the risk posed to the Reserve Bank's statutory objectives of promoting the maintenance of a sound and efficient financial system and avoiding significant damage in the event of a registered bank's failure, as set out in section 68 of the Act.
5. For example, restrictions on branch retail deposit taking (parts B and C), and a prohibition on retail deposit taking at dual-registered branches, reflect the heightened risk that retail creditors may perceive adverse outcomes arising from a bank's failure as unfair, eroding confidence in the financial system<sup>3</sup>. Part D recognises the increased risk to the Reserve Bank's objectives where regulatory, market, or self discipline at the bank is weak – for example due to non-equivalent home state supervision, uncertain legal basis, undue state influence, a lack of accountability and transparency, or distorted market signals that override commercial decision making and skew incentives as regards the foreign bank's New Zealand operations. In these instances, local incorporation can help strengthen disciplinary channels during BAU and provide local regulators greater clarity and comfort over the treatment of the bank during stress events.
6. The Reserve Bank's local incorporation policy was implemented in April 2001, and the approach to dual registration introduced in the July 2004 version of BS1. In practice, the Reserve Bank has tended to take a conservative approach to the local legal form of foreign

<sup>1</sup> The matters are set out in s73(2); s73A and 73B of the RBNZ Act detail further matters to which the Bank must have regard to if the applicant is an overseas person, or subsidiary of an overseas person, respectively.

<sup>2</sup> A financial institution that has more than \$200mn in New Zealand retail deposits on its books. Retail deposits are deposit liabilities held by natural persons, excluding liabilities with an outstanding balance of more than \$250,000. BS1(s31).

<sup>3</sup> See [RBNZ Bulletin](#), December 2006.

banks, requiring local incorporation over the registration of branches, particularly where we are unfamiliar with or have limited assurance over the home state's regulatory approach. This reflects the fact that local incorporation offers the Reserve Bank greater powers of regulatory oversight and discipline, enabling it to impose local-level capital, liquidity, governance, and disclosure requirements<sup>4</sup>. A local subsidiary will have its own board of directors subject to New Zealand law. The Reserve Bank also has more control over crisis management and operational continuity provisions at locally incorporated subsidiaries<sup>5</sup>.

7. Nonetheless, New Zealand's banking sector remains open to foreign participants. Ten foreign banking groups have had applications to register as a bank in New Zealand approved since 2001<sup>6</sup>, a demonstration of the ongoing ease of access. There are currently 15 foreign-owned banks operating in New Zealand, of which four are dual-registered<sup>7</sup>.
8. Over recent years, a number of foreign-owned banks that have previously been required by the Reserve Bank to incorporate in New Zealand have sought to register a dual-registered branch. These banks have suggested that a New Zealand incorporated subsidiary structure prevents them growing local lending activities, citing perceived high operating costs arising from local regulatory requirements.
9. The Reserve Bank acknowledges there is room to clarify criteria for making decisions on whether a branch may be permitted to operate alongside a non-systemic local subsidiary. In light of this, we have sought to develop a revised approach that will clarify the Reserve Bank's expectations of applicant banks, and support an efficient and consistent registration process. The proposal is intended to provide a flexible and pragmatic framework that limits the risks around foreign participation in the local banking system while recognising the rewards. Ultimately, our approach to dual registration - and the authorisation of foreign banks more broadly - is intended to give assurance that our statutory objectives can be achieved under all permitted legal and operational structures.
10. The Reserve Bank consulted on its approach to dual registration in June 2016, proposing an assessment framework that involved:
  - identifying the benefits of granting dual registration;
  - identifying the risks of dual registration;
  - identifying possible mitigants to these risks; and
  - assessing whether there are net benefits from granting dual registration.
11. The proposal was intended to narrowly apply to foreign-owned banks with non-systemic New Zealand operations wishing to open a New Zealand branch alongside a locally incorporated subsidiary. Neither the Reserve Bank's process for assessing standalone branch applications, nor its approach towards systemic banks, was within the scope of the consultation.
12. The rest of the paper is structured as follows: part two provides a high level summary of the key themes from submitters' feedback; part three considers the key issues raised and the Reserve Bank's responses; part four outlines our policy for the dual registration of foreign banks with a non-systemic New Zealand presence; and part five outlines the next steps.

<sup>4</sup> Branches, as extensions of the foreign parent, tend to be primarily overseen by the foreign parent's home regulator, in line with the allocation of powers between home and host authorities set out in the Basel Core Principles for Effective Banking Supervision and the Principles for the supervision of banks' foreign establishments. While foreign branches require the Reserve Bank's authorisation to operate in NZ, the lack of legal separation between branch and parent places a degree of reliance on the home supervisor's consolidated supervision of the banking group.

<sup>5</sup> In general, host regulators have limited crisis management and resolution powers over the local branches of foreign-owned banks. Open Bank Resolution (OBR), for example, applies only to locally incorporated subsidiaries. While a statutory manager may be appointed to and incorporate a branch (s123, RBNZ Act), without legal separation between branch and group it is unclear what assets could actually be claimed by the newly-incorporated local entity.

<sup>6</sup> They are: St George Bank New Zealand Limited (Subsidiary); The Bank of Tokyo-Mitsubishi UFJ, Ltd (Branch); Westpac New Zealand Limited (S); JPMorgan Chase Bank NA (B); ANZ Banking Group Limited (B); Bank of Baroda (New Zealand) Limited (S); Bank of India (New Zealand) Limited (S); ICBC (New Zealand) Limited (S); China Construction Bank (New Zealand) Limited (S); Bank of China (New Zealand) Limited (S)

<sup>7</sup> They are: ANZ Bank; CBA (Trades as ASB); Rabobank; and Westpac.

## PART TWO: HIGH LEVEL SUMMARY OF SUBMISSIONS

### *Key Themes*

13. Five submissions were received, including several from foreign-owned banks with non-systemic local operations that would come under the policy's scope<sup>8</sup>. The Reserve Bank would like to thank all submitters for their feedback on this consultation.
14. Overall, the majority of submitters were supportive of increased clarity in the dual registration process, and encouraged the development of a systematic assessment framework to support consistent and transparent decision making.
15. One submitter had a fundamentally different view and did not support the proposal, arguing the Reserve Bank should not pay undue regard to the private business considerations that inform banks' branch/subsidiary preference. In response, the Reserve Bank notes our assessment of whether to permit dual registration will only have regard to considerations relevant to our statutory objectives of promoting a sound and efficient financial system.
16. What follows summarises all other submissions. In general, these showed:
  - Broad agreement that the Reserve Bank's existing dual registration policy could be clarified to avoid any impression of inconsistency in interpretation or application.
  - Strong support for the starting assumption that banks should be able to determine their own operating and legal structure, where appropriate.
  - Broad agreement that a formalised decision making framework would support transparency and clarity in the dual registration process. Nonetheless, most thought applications should still be considered on a case-by-case basis, having regard to the proposed business lines and structure of each applicant, with specific restrictions incorporated into individual CORs rather than imposed via standard requirements on dual-registered operations.
  - Broad support for the proposition that permitting branches to operate alongside existing local subsidiaries could enhance competition in the New Zealand banking sector, reducing concentration risks and promoting innovation.
  - Qualified agreement that the proposed approach could adequately mitigate risks stemming from the dual registration of small foreign banks. However, several respondents thought certain risks arising from group-level or home state arrangements may not be able to be mitigated at the branch level, and queried why the Reserve Bank would work to mitigate these risks rather than simply disallow branch operations.
  - In terms of the specific requirements and restrictions proposed to mitigate risks stemming from the dual registration of small foreign banks:
    - All respondents were supportive of restricting retail activities (both funding and lending) at dual-registered branches from non-equivalent home states.
    - Beyond a restriction on retail fundraising, most respondents opposed any further branch funding restrictions.
    - All respondents were supportive of enhanced branch governance arrangements.
    - All respondents disagreed with imposing relative size restrictions on dual-registered operations.

<sup>8</sup> They are: Bank of China (New Zealand) Ltd; Industrial and Commercial Bank of China (New Zealand) Ltd; and China Construction Bank (New Zealand) Ltd. As this consultation predated the Reserve Bank's [decision to publish consultation responses](#), we will not be publishing these submissions.

## PART THREE: KEY ISSUES AND THE RESERVE BANK'S RESPONSES

### A clear framework to support individual bank assessments:

17. Respondents were strongly supportive of increased transparency and consistency in the dual registration assessment process, whilst calling for assessments to remain specific to individual applicants. Respondents generally thought branch risks would be most effectively mitigated through bespoke restrictions imposed via individual CORs, rather than through uniform standards.
18. The Reserve Bank is cognisant that a degree of supervisory judgement will be necessary to determine whether or not to permit a branch to operate alongside a non-systemic local subsidiary. However, we want to avoid protracted consultations around bespoke restrictions and conditions. The proposal thus seeks to set out a robust framework for the Reserve Bank's decisions that will allow for a consistent implementation across banks.
19. One respondent expressed concern that providing increased clarity around the assessment process may impede the Reserve Bank's discretion to determine whether or not to permit dual registration, increasing the risks of a decision being challenged. We note the Reserve Bank will retain complete and unfettered discretion around its licensing decisions; nonetheless, having a well-defined assessment framework will support banks' understanding of our expectations and provide guidance in their preparation of dual registration applications.

### Policy concessions for non-systemic foreign banks:

20. Respondents were generally concerned about the level of restriction implied by the proposal, suggesting it was overly onerous and unfairly restrictive on dual-registered banks and may discourage foreign participation in the New Zealand banking system. Several respondents suggested that, when faced with such restrictions, they would simply apply to operate a standalone branch. This shows a misunderstanding of the proposed policy, which represents a *relaxation* in our approach to banks from non-equivalent jurisdictions, opening up branching opportunities subject to certain conditions.
21. The Reserve Bank believes giving banks flexibility to pursue the operating structure most appropriate for their particular business model and the needs of the market can encourage innovation and bolster efficiency in the banking sector. In line with this, foreign banks are, and will remain, free to apply to enter New Zealand as a branch or subsidiary, or both. Applications will be assessed against the Section 73-73B specific matters, having regard to the local incorporation and proposed dual registration policy, and approved only where they fall within the Reserve Bank's risk appetite. The proposed dual registration policy is aimed at small banks we have previously required to incorporate in New Zealand, for example due to a lack of assurance over the home state's approach to disclosure and accounting standards or bank supervision and insolvency arrangements. It would be unrealistic to expect these banks would now be permitted to operate standalone branches or, similarly, dual-registered branches without accompanying risk mitigants.
22. Notably, several respondents queried why, if our concerns around regulatory, market and self-discipline at the foreign bank warranted such restrictions, we would ever grant a branch licence to those banks. This is a valid argument, and one of the reasons for our historically conservative approach to the permitted legal form of foreign banks in New Zealand. However, the Reserve Bank is cognisant of the positive effect of openness and competition in the banking sector, and the potential benefits of branching - if done safely. These are explored below.

### Key branching benefits:

23. Respondents highlighted several possible benefits stemming from dual registration:
- *Access to parental resources*
24. Capital was universally cited as a constraining factor for locally incorporated operations. Unlike subsidiaries, branches have no local capital requirements and, being legally-inseparable from their parent, are generally not bound by concentration or connected party exposure limits imposed on the parent by its home state regulators. This, it is argued, affords dual-registered branches greater access to parental financial resources than their parallel subsidiary, leaving them better positioned to focus on corporate and institutional banking where large funding requirements can be more effectively and efficiently met.
25. The Reserve Bank has some sympathy for this argument. While we expect banking groups to have intragroup financing arrangements in place that allow financial resources raised offshore to be channelled to the New Zealand operating entity (be it a branch or a subsidiary), we are aware that connected and large exposure rules in parent or affiliate jurisdictions may, in practice, impede the subsidiary's access to group resources in the short term.
26. Several respondents also noted that the parent's provision of capital to the local subsidiary was a long term investment decision that had to compete with alternative investment options; this meant increasing its access to capital could be difficult, time consuming, and potentially inconsistent with the strategic direction of the group, constraining the subsidiary's ability to grow local lending activities. The Reserve Bank disagrees with this argument: if the bank's local business is fundamentally viable and profitable, the parent should be willing to extend funding irrespective of whether that business is done through a branch or subsidiary. Beyond regulatory controls around connected exposures, direct parental funding to support business expansion should be achievable, irrespective of local branch/subsidiary structure.
- *Financial sector diversification*
27. Respondents suggested a more flexible approach to branching could increase innovation, competition and diversification in the local financial sector. Most indicated their intention to undertake trade, infrastructure and project finance initiatives out of dual-registered branches, if permitted, chiefly in the form of private public partnerships with local and central governments.
28. The Reserve Bank generally agrees a more flexible approach to dual registration may enhance competition in the local banking sector, reduce concentration risks, encourage innovation in banks' product offerings, and bolster the local funding base. However, we note that banks captured under the dual registration policy will, by definition, already have a locally incorporated presence in New Zealand, through which banking business such as infrastructure lending can already be undertaken. While a parallel branch operation may provide somewhat greater flexibility for an overseas parent to fund these projects, a standalone subsidiary structure does not preclude it.
- *Enhanced regulatory cooperation*
29. Respondents suggested dual-registered branches might encourage regulatory cooperation and lead to more efficient shared oversight and monitoring arrangements. The Reserve Bank strongly supports cross-border cooperation and engagement amongst regulators, but is unconvinced by the argument that dual registration will deepen such engagement, given strong incentives for cross-border cooperation already exist under a subsidiary structure, in particular as regards banking group crisis management and resolution arrangements.

30. Moreover, we note that home state cooperation is already a key input into our decisions on whether or not to approve foreign banking applications, in line with the Section 73 specific considerations<sup>9</sup>. This assessment considers, amongst other things:
- Whether legal frameworks are in place to facilitate free information sharing.
  - Any ex ante cross-border collaboration arrangements in place between New Zealand authorities and the home state, including formal information sharing or interaction protocols, Memorandums of Understanding, Co-operation Agreements, or access to bank-specific supervisory or resolution colleges.
31. Where we have limited confidence that the home state's consolidated supervision will pay sufficient regard to New Zealand interests, this has in the past been an important factor in our requirement for local incorporation. Under the proposed policy, we will now consider whether a restricted-activity branch may be permitted alongside a locally incorporated entity; however, we will continue to require the home state to demonstrate its willingness to cooperate and coordinate *before* permitting branch operations in New Zealand, rather than expecting home state cooperation to follow once a dual-registered branch is in situ.
- *Other considerations*
32. Several respondents thought the process for identifying benefits from dual registration lacked clarity and was overly subjective. These respondents called for specific examples of possible benefits, or at least more prescription around what would qualify as an 'acceptable' benefit. The Reserve Bank notes this is part of the registration process where we will require cooperation from the applicant to help us understand the nature of the business they propose to do through a New Zealand branch. The onus will be on the applicant to provide a rationale for why it is appropriate and preferable to conduct this business out of a branch, versus through the existing subsidiary or directly from the parent. The Reserve Bank will then review the branch rationale the applicant has put forward.
33. In general, we would expect that the value added by branch operations would tend to be efficiency-related, for example innovation opportunities or funding diversification. If, for example, it can be demonstrated that a bank's dual registration will enhance competitive funding sources or promote innovative product development, this is likely to qualify as a credible benefit and dual registration may be permitted, provided it can be done safely.

### **Key branching risks:**

34. Respondents agreed the key risks from branch operations stemmed from inadequate oversight and lax accounting/transparency requirements in the parent's home jurisdiction (broadly, home state non-equivalence) or weak internal governance arrangements. Several suggested there may be situations where it is not possible to adequately mitigate these risks via activity or funding restrictions, in which case branching should never be permitted.
35. Other respondents queried why we would even look to mitigate branch risks, rather than simply prohibiting branch operations where we had concerns around home state equivalence or internal governance arrangements. The Reserve Bank's proposed approach reflects our obligation to promote both the soundness and efficiency of the New Zealand financial sector. If branch operations might provide efficiency and innovation benefits that outweigh associated financial stability risks, then licensing the branch may promote our statutory objectives. This is especially the case if it is possible to limit the negative impact the branch could otherwise have on New Zealand financial stability.
36. Some respondents were unconvinced by the proposal's narrow focus, noting branch risks were common across dual-registered and standalone structures. It was unclear to these respondents how a parallel local subsidiary could give New Zealand regulators added

<sup>9</sup> Specifically, section 73A(a)(v); but in practice, a high degree of home state equivalence would be required to satisfy all factors set out in s73A(a).

assurance over the prudent operation of a branch. Still, others argued that dual-registered branches were inherently less risky than their standalone counterparts.

37. The Reserve Bank believes the split of banking activities across a dual-registered bank, and the degree of commonality and overlap across each of its local operations, is an important determinant of the risks stemming from dual-registered banks not present in standalone counterparts. We also note the current consultation was driven by stakeholder's specific concerns around our approach to banks seeking to open a branch alongside an existing locally incorporated subsidiary: our approach to standalone branch applications was outside of the scope of these concerns, and will continue to be assessed on a case-by-case basis against the Section 73 considerations and having regard to the local incorporation policy.

**Risk mitigation options for foreign banks with small, non-systemic NZ operations:**

a) Dual-registered branch activity restrictions:

38. Respondents agreed that branch risks could be reduced or avoided by not engaging in certain activities; and that restricting retail activities, in particular, could be useful in mitigating risks stemming from inadequate regulatory or market discipline (Option A). In line with this, the Reserve Bank intends to restrict activity at the New Zealand branch of foreign-owned banks from non-equivalent home states to 'wholesale business' only - that is, business conducted with wholesale clients<sup>10</sup>. Any retail lending or fundraising should be undertaken out of the bank's locally incorporated subsidiary. Respondents recognised this restriction was broader and additional to the existing ban on dual-registered branch retail deposit taking, which will continue to apply as standard to dual-registered banks in New Zealand.
39. In general, the Reserve Bank expects 'wholesale business' at dual-registered branches will be confined to simple balance sheet activity, for example acting as a funding vehicle for public infrastructure projects or trade finance initiatives. Market making should be undertaken out of the bank's local subsidiary. Where we have concerns around specific aspects of the applicant's planned business in New Zealand and its home state's approach, the Reserve Bank may choose to strengthen this expectation by explicitly limiting the nature and scale of wholesale activities that can be conducted through the dual-registered branch. We will assess whether this is necessary on a case-by-case basis, having regard to the applicant's operational capabilities.
40. Branch activity restrictions will be incorporated into the applicant's CORs.
41. Most respondents indicated that, given the opportunity to dual register, they would continue to conduct retail activities out of the subsidiary, as well as a limited amount of SME and commercial customer banking. One respondent did suggest Treasury operations may be shifted to the dual-registered branch, however. The Reserve Bank would expect to be consulted before any decision was made to rehouse within the dual-registered branch any activity that was previously conducted out of a local subsidiary or an offshore affiliate.
42. Responses were mixed as regards the effectiveness of branch activity restrictions in mitigating concerns around branch resolution arrangements. One respondent thought uniform activity restrictions were an ineffective way to address operational continuity concerns, calling instead for permitted activities to be assessed and approved on a case-by-case basis during the application process. The Reserve Bank notes this approach would require active monitoring to ensure activities assessed as 'appropriate' at the time of licensing remained so on an ongoing basis, increasing regulatory costs. Instead, having as a starting point a limited set of permissible branch activities (i.e. wholesale banking) in cases where we have limited assurance over resolution, which can be further refined as necessary

<sup>10</sup> As defined under the Financial Market Conduct Act 2013 (Clause 3(2), Schedule 1).



to mitigate specific risks to our objectives, would reduce resource requirements for assessing applications.

43. Another respondent suggested the Reserve Bank's concerns around branch resolution could be addressed by having an 'RBNZ-endorsed' parent resolution policy. However, where New Zealand operations are small relative to the overall banking group, we are unlikely to qualify as a key host jurisdiction material to the effective resolution of the bank as a whole, giving us limited opportunity to participate in its resolution planning. In any case, it is not the Reserve Bank's policy to 'endorse' banks' recovery and resolution strategies.
44. Several respondents noted that having a dual-registered branch would allow them to intensively grow their infrastructure lending operations. However, the Reserve Bank is conscious that wholesale business can become systemic above a certain size, and requires a high degree of assurance that any entity providing large scale lending activities is being run in a safe and sound manner. We believe the local incorporation policy's existing size limits address this in the near term. Going forward, we intend to augment the policy by developing a framework for assessing a bank's importance to New Zealand in-the-round, ensuring all systemically important banks are captured.

b) External funding considerations:

45. As noted, all respondents saw funding as a key benefit from dual registration. While this was primarily due to the ease with which branches can access central group funding, several also cited the branch's ability to directly access capital markets more cheaply and easily than a local subsidiary, given a branch shares the parent's (typically higher) credit rating. Beyond a retail funding ban to mitigate concerns around oversight, transparency and resolution arrangements at branches from non-equivalent home states, respondents generally disagreed with further funding restrictions, arguing blanket external funding restrictions would be 'too restrictive' and run counter to promoting a competitive market.
46. The Reserve Bank acknowledges that local branch debt issuance may assist in the development of the New Zealand domestic corporate bond market, which has grown slowly and remains small by international standards. Encouraging a deeper domestic bond market may improve the functioning and efficiency of local financial markets more broadly. We thus agree that dual-registered branches should be able to issue unsecured debt to investors subject to certain limitations set out below. This is in contrast to the proposals that were consulted on, which would have restricted all types of external branch debt issuance.

*i) Prohibition on branch retail debt issuance at dual-registered banks from non-equivalent home states*

47. New Zealand-based branches can and do issue debt to local retail investors. This may lead to uncertainty around the relevant jurisdiction in which creditors can make and enforce claims against the banking group in the event of insolvency. For example, if a New Zealand-based branch issues debt against a parent bank operating under its home state's law via an instrument governed in a third (unrelated) jurisdiction's law, where subscribing creditors' claims lie - and how they would go about enforcing their rights in the event of insolvency - will be complex and potentially unclear. For retail creditors, a lack of clarity may result in outcomes being perceived as unfair, undermining their confidence in the financial system.
48. To avoid this outcome and reinforce the previously discussed retail activity restriction at dual-registered banks from non-equivalent home states, their branch debt issuance and subsequent sale/transfer will be explicitly restricted to wholesale (i.e. sophisticated) investors.

*ii) Disclosure requirements*

49. As a locally incorporated subsidiary operates under New Zealand law, it is required to be solvent at all times and have at least one resident director able to be held accountable if it is found to be trading whilst insolvent. These same protections don't necessarily apply for branches; they operate under the parent's home state law, leading to inherently heightened legal risks for New Zealand interests.
50. As discussed, where the Reserve Bank has concerns about market and regulatory discipline stemming from home state non-equivalence, the dual-registered branch will be restricted to wholesale funding sources only. Although wholesale investors should be more capable than retail investors of 'looking through' the legal complexities of branch-based issuance, it is nonetheless important they have sufficient information to be able to assess branch risks accurately, and any resulting implications for their interests. At a minimum, branch investors should be made aware of any concerns the Reserve Bank has regarding weaknesses in self, market and regulatory discipline at the dual-registered branch stemming from a lack of equivalence in its home state's approach to oversight, transparency, or resolution arrangements.
51. To facilitate this, any conditions for registration the Reserve Bank has imposed on a dual-registered bank to mitigate these weaknesses should be clearly detailed in disclosure documents accompanying branch debt market issuance, either in an issuance prospectus or accompanying information memoranda. In practice, the FMA would need to agree in consultation with the Reserve Bank that these documents adequately disclose all relevant information.

*iii) Enforceability of claims*

52. One respondent felt the consultation document didn't pay due regard to the legal enforceability of local claims in the foreign bank's home state. The respondent noted cross-border enforceability would help to prevent the parent bank "cutting loose" New Zealand creditors in the event of insolvency, and so mitigate risks from allowing dual-registered branches to fund externally.
53. The Reserve Bank agrees that the judgements of New Zealand courts may be difficult to enforce offshore. While there are robust reciprocity arrangements in place for judgements between Australia and New Zealand<sup>11</sup>, elsewhere cross-border enforceability is inconsistent and jurisdiction-specific. It is hard to generalise, but in general judgements handed down in Commonwealth countries are typically enforceable on a reciprocal basis<sup>12</sup>.
54. Completely removing uncertainty around cross-border enforceability is unrealistic. However, the Reserve Bank notes that the clarity, predictability, and robustness of the home state's legal framework is already considered as part of the branch application process under section 73A of the Act<sup>13</sup>, and serves as an input into our home state equivalence assessment (see **Annex 2**). In particular, consideration is given to the home state's insolvency and creditor rights system, and whether the chance of pay-out for New Zealand investors might be less than for home state investors either due to an ex ante domestic creditor preference or the risk that its courts will treat foreign creditors unfavourably during the wind-up.

<sup>11</sup> The Trans-Tasman Proceedings Act 2010, which applies reciprocal arrangements for both judgements and enforcing that judgement.

<sup>12</sup> Under the Reciprocal Enforcement of Judgements Act 1934, it is possible to enforce in New Zealand the judgement of foreign courts from certain jurisdictions prescribed in the Act; and money judgements in Commonwealth Countries are further covered under the Judicature Act 1908. Note this doesn't cover actually applying for judgements in those jurisdictions.

<sup>13</sup> Specifically 73A(a)(i) – the recognition and priorities of claims of creditors or classes of creditors in the event of the insolvency of the applicant.

55. Where we find the legal risks posed by a dual-registered branch would be too great, having considered the legal system in the home country, we would likely prohibit the branch's operation in New Zealand.

c) Buttressed branch requirements:

56. The location of assets will also impact the likelihood of pay-out to local creditors by a foreign-owned bank. Even though New Zealand law allows a statutory manager to incorporate a foreign-owned branch<sup>14</sup>, without legal separation between branch and group it is likely only those assets physically present in New Zealand at the time of incorporation will be available to service local debts. This could create a 'race to enforce' before the branch's local assets are repatriated to the parent's jurisdiction.
57. To avoid this, one respondent suggested local liabilities and corresponding loan assets could be 'ring-fenced', as an alternative to requiring branch external debt to be secured (Option B). Alternatively, the Reserve Bank could require the branch to maintain a minimum amount of assets in New Zealand which are preferentially available to pay out local creditors in the event of the banking group's insolvency<sup>15</sup>.
58. Beyond requiring segregated, local assets to service local liabilities, one respondent further suggested that, where regulatory and market discipline was insufficient, the Reserve Bank might impose local capital adequacy requirements on New Zealand branches.
59. While we note that several other jurisdictions do impose quasi-capital requirements on foreign bank branches<sup>16</sup>, this approach arguably makes the branch a subsidiary in all respects other than legal form. The Reserve Bank considers this is a complex and inefficient method of protecting local interests that may have tax implications and other unintended consequences, as well as requiring active monitoring by New Zealand authorities. We would instead prefer to limit branch activities and enhance disclosure requirements rather than imposing an additional layer of financial resource requirements on local banks.

d) Governance arrangements:

i) *Enhanced branch governance and accountability arrangements*

60. Respondents agreed the branch Chief Executive should play a key role in ensuring its affairs were being conducted prudently, and should have sufficient delegated authority to effectively carry out that role. The Reserve Bank's disclosure and attestation regime has applied to branch CEOs since 2003<sup>17</sup>, requiring them to annually attest to the adequacy of local risk management systems and controls as well as the branch's compliance with its conditions for registration. These attestations will be most effective where the bank's organisational and governance structure gives the branch CEO clear responsibility for the its day-to-day operations; otherwise, CEO attestations will be less effective in aligning incentives to promote prudent behaviour, and more difficult to enforce in the event they are proved false.
61. Several respondents suggested delegating governance of all of the New Zealand business to the local subsidiary board was one option for strengthening local governance and accountability arrangements. However, the Reserve Bank believes this approach fails to recognise the separate legal status and authorisation of the branch and subsidiary, and may cloud where individual responsibility for the management and operation of each actually lies: rather than providing greater assurance over the governance of the branch, it may actually

<sup>14</sup> Under s117 and s123 of the RBNZ Act.

<sup>15</sup> We note this is similar to the requirement under the Australian Banking Act that the Australian assets of insolvent branches be available to meet the group's Australian liabilities in priority to other liabilities.

<sup>16</sup>For example, foreign bank branches must hold a 'capital equivalency deposit' with a US depository institution equal to 1% of the branches average liabilities for the previous months; and, [under the Bank of Thailand's implementation of the Basel III capital framework](#), foreign bank branches are required to maintain a minimum total capital ratio of 8.5% (requirement 4-2556).

<sup>17</sup>Implemented as part of the RBNZ Amendment Act 2003; see also [RBNZ Bulletin Vol 67](#). Previously, only the overseas directors of branches were required to sign disclosure statements.

compromise the ability of the subsidiary's directors and senior managers to exercise independent judgement and control.

62. Instead, the Reserve Bank believes having a governance framework that clearly sets out delegation processes from the parent to the local bank, and details how managerial and operational responsibilities are split across local operations, will emphasise individual accountability and help align private incentives with public policy objectives. The Reserve Bank will require a high degree of assurance that any interlinkages between the bank's New Zealand entities are appropriately managed and controlled to avoid possible conflicts of interest between local and parent interests. Where there is overlap, the subsidiary's board should maintain a clear differentiation between its roles in relation to the parent's New Zealand business (i.e. simple wholesale banking conducted through the branch), and the subsidiary's standalone activities (including market making activities and retail banking).
63. Respondents all identified robust self discipline as being integral to a bank's sound and prudent operation. Reflecting this, and as discussed in the consultation, the Reserve Bank intends to impose branch governance and accountability requirements as standard on all dual-registered banks captured under this framework, irrespective of the risk they may otherwise pose to our statutory objectives.

*ii) Relative size constraints*

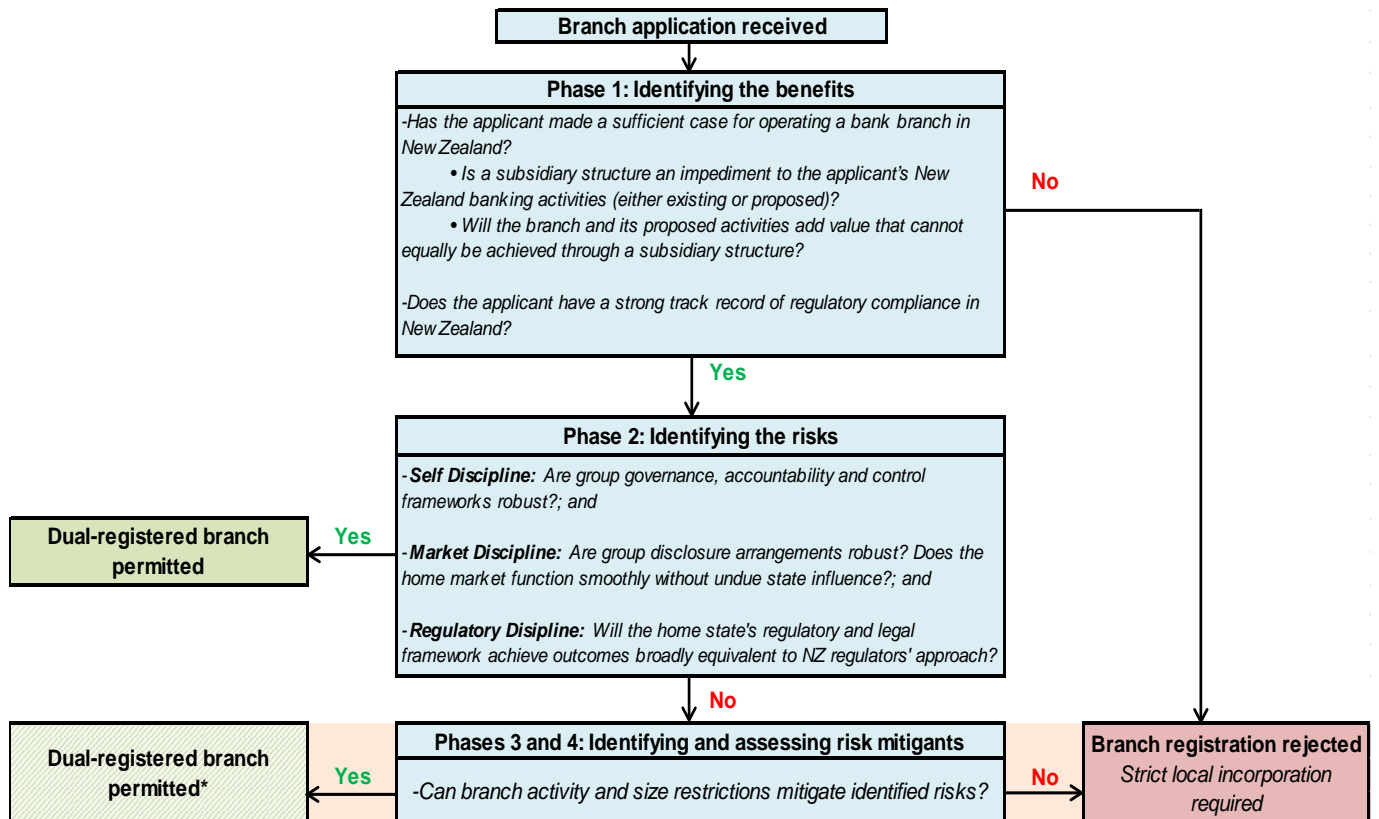
64. Requiring dual-registered branches to have assets no greater than their parallel local subsidiary (Option B) was widely opposed. Respondents agreed operating a branch alongside a subsidiary could impact local governance arrangements, but argued relative size constraints were unnecessary as a robust local governance structure – including local directors subject to New Zealand laws, and local controls, policies and procedures approved by the Reserve Bank - would limit the chance of the subsidiary unduly coming under the group's control and potentially acting at odds with local interests. The Reserve Bank is unconvinced by this argument, and believes that where a branch is large or in other ways dominant relative to its dual-registered subsidiary, there is increased risk this will compromise governance arrangements and impede due process at the subsidiary.
65. The Reserve Bank is also conscious that dual registration may give rise to a situation where the banking group's material New Zealand activities are migrated to the branch - over which local regulators have limited oversight or control - leaving behind a shell subsidiary company. Although several respondents suggested a significant investment in their local subsidiary operations to date demonstrated their ongoing commitment to maintaining them even where dual registration is approved, the Reserve Bank needs stronger assurance that the subsidiary will remain the most substantial part of the bank in New Zealand. We see no reason to depart from the 1:1 relative branch/subsidiary size constraint proposed in the consultation<sup>18</sup>. As we intend to apply this restriction to banks that have been, or would be required to, operate through a locally incorporated subsidiary (as opposed to a branch) under the current registration process, it represents a concession for affected banks, opening up branching opportunities currently unavailable to them.

**PART FOUR: POLICY DECISION - DUAL REGISTRATION FRAMEWORK FOR SMALL, NON-SYSTEMIC FOREIGN BANKS**

66. Where an application to register a branch alongside a non-systemic subsidiary is received, the Reserve Bank will undertake a phased assessment to determine whether to grant the licence. This assessment will have regard to the Reserve Bank's statutory objectives set out in Section 68 of the RBNZ Act, as well as the specific matters the Reserve Bank must have regard to when assessing banking applications under Section 73 of the Act.

<sup>18</sup> By way of comparison, of the four dual-registered banks currently operating in New Zealand, subsidiary assets are on average 12 times greater than New Zealand branch assets.

**Branch registration decision tree for locally incorporated non-systemic foreign banks**



\*Subject to branch risk mitigants identified in phase 3.

The dual registration assessment process will involve:

- Phase 1: Identifying the benefits of granting dual registration:

67. The applicant should describe its intended New Zealand branch activities, and provide a clear rationale for why it is appropriate to undertake these through a branch, rather than a subsidiary or directly from the parent. The Reserve Bank will review the case made by the applicant to assess whether its dual registration will add value that cannot equally be achieved through the existing subsidiary structure. Branch value added will tend to be efficiency-related, for example enhanced product innovation or funding diversification.
68. The track record of regulatory compliance at the applicant's existing New Zealand operations - in particular the performance of internal controls and risk management systems and policies - will also be considered during this phase of the registration process. The applicant's past compliance performance, as well as remedial action to address non-compliance (where applicable), will indicate whether the applicant has in place the systems and controls necessary to safely operate a branch in New Zealand.

- Phase 2: Identifying the risks of dual registration:

69. If the Reserve Bank is satisfied there is a case for the New Zealand branch operations, we will assess whether the branch falls within our risk appetite. This will broadly consider the effectiveness of arrangements around:
- self discipline (group and branch governance arrangements and control frameworks); and
  - market discipline (group reporting arrangements, home state market function); and
  - regulatory discipline (home state regulatory equivalence, home state legal framework)

Assessments will be conducted on an applicant-specific basis, having regard to the applicant's planned local operations and the strength and capacity of its home regulator. Where possible, well-defined and publicly available information set out in **Annex 2** will help inform supervisory judgement around potential risks stemming from home state arrangements.

70. In practice, this assessment will draw on work done during the registration of the applicant's existing New Zealand subsidiary, when the Reserve Bank considered the adequacy of the legal framework, supervisory and disclosure arrangements, and market disciplines in the applicant's home state, before ultimately concluding local incorporation was required.

- Phase 3: Identifying risk mitigants:

- a) *Standard risk mitigants for dual-registered banks:*

71. *Activity restrictions:* Any bank that is granted dual registration in New Zealand will not be permitted to take retail deposits through the branch. This is unchanged from existing policy.

72. *Governance and accountability arrangements:* Banks applying to open a branch alongside an existing New Zealand subsidiary should prepare a 'responsibilities map' detailing how managerial and operational responsibility will be delegated from the parent bank and delineated across its New Zealand operations. Matters reserved for the branch Chief Executive, as delegated from the parent, should be clearly defined. These should cover, at a minimum, day-to-day operations.

73. The Reserve Bank will take into account this proposed split of responsibilities when assessing the suitability of the New Zealand Chief Executive as part of the [bank registration process](#). The Reserve Bank would be unlikely to register an applicant that cannot satisfy us its branch Chief Executive will have the necessary range of delegated responsibilities to effectively carry out and be held accountable for that role.

74. The applicant should detail the controls and processes in place to ensure any subsidiary/branch overlap is appropriately overseen and managed to avoid conflicts of interest, and clarify how these controls and processes fit together within the wider banking group. Possible conflicts arising from the differing treatment of the branch and subsidiary in resolution should also be clearly dealt with, for example by identifying a separation point in a situation where the subsidiary is being placed into statutory management.

- b) *Additional non-standard risk mitigants for dual-registered banks from non-equivalent home states:*

75. *Additional activity restrictions:* Where we judge that weaknesses in branch discipline stemming from the home state's approach to oversight, transparency and resolution arrangements (broadly, home state non-equivalence) may pose a risk to our statutory objectives, the Reserve Bank may explicitly restrict certain branch activities<sup>19</sup>.

76. As a general rule, any dual-registered bank whose home state is assessed by the Reserve Bank as 'non-equivalent' may not conduct any retail banking business (i.e. either lending or fundraising) out of the branch. For these banks, eligible branch customers will be limited to 'wholesale investors' under the Financial Market Conduct Act 2013<sup>20</sup>. Further, the Reserve Bank expects branch activities to be confined to balance sheet business only - for example acting as a funding vehicle for public infrastructure projects or trade finance initiatives - and may, at its discretion, reinforce this expectation by explicitly restricting wholesale activities at any given dual-registered branch.

<sup>19</sup>These restrictions will apply in addition to the standard ban on retail deposit taking at dual-registered branches.

<sup>20</sup> Clause 3(2), Schedule 1.

77. *Relative size constraints:* To promote strong local governance and accountability arrangements and provide assurance the bank's interests and incentives are well aligned with New Zealand public interest objectives, New Zealand branch assets may not exceed those of the bank's New Zealand incorporated subsidiary. This constraint will apply on any day of the year from the point of branch registration for all banks from non-equivalent home states.
78. This policy may be subject to future review once the Reserve Bank has had time to gauge the robustness of operational and governance arrangements at local banks registered under this framework (but not before a period of 5 years from today's date).
- Phase 4: Assessing whether the benefits from granting dual registration outweigh mitigated risks:
79. Where the Reserve Bank judges branch risks can be adequately mitigated and New Zealand interests sufficiently protected and promoted, the application will be approved. Our assessment of the adequacy of proposed risk mitigants will have regard to the Reserve Bank's statutory objectives, and be weighed against the branching benefits identified in Phase 1 of the assessment process.
80. Any restrictions deemed necessary by the Reserve Bank to adequately mitigate branch risks will be reflected in individual branch CORs. This will include a ban on retail deposit taking that will continue to apply as standard to dual-registered bank branches. Where additional non-standard restrictions are in place (as set out in paragraphs 76-80), these must be fully disclosed to external branch investors in documentation accompanying capital market issuance<sup>21</sup>.
81. If weaknesses in self, market and regulatory discipline or resolution arrangements at the branch cannot be adequately mitigated through activity, size, and/or governance restrictions, the branch will fall outside the Reserve Bank's risk appetite and the application will be rejected.
82. Whether or not to permit a branch application is ultimately at the Reserve Bank's discretion.

## **PART FIVE: NEXT STEPS**

83. The proposed approach to the dual registration of small, non-systemic foreign banks clarifies the Reserve Bank's existing process for assessing banking applications under the Act, so implementation will require no legislative change.
84. Enhanced branch governance requirements will be implemented via our existing policies in respect to directors' and senior managers' suitability (BS10) that apply to all registered banks and their nominated office holders. However, modifications will need to be made to the Reserve Bank's Statement of Principles (BS1) to clarify how branch activities may be restricted at non-systemic dual-registered banks from non-equivalent home states. Changes to section C(II)(a), presented in **Annex 1**, will be incorporated into a revised BS1.
85. The standard Conditions of Registration for overseas incorporated registered banks (BS1 Appendix One, part II) may also be augmented to reflect the standard risk mitigants for small, non-systemic dual-registered banks set out in paragraphs 71-74. These will be consulted on in due course.
86. Going forward, any small, non-systemic bank that applies to open a branch alongside an existing subsidiary will be assessed in accordance with the framework set out in Part 4

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<sup>21</sup> Branch fundraising in interbank money markets (i.e. deposits, repos) will be exempt from disclosure requirements. Note the Reserve Bank expects these dual-registered branches will not engage in any market making activities.

above. We consider this approach to dual registration will support applicants in understanding the Reserve Bank's expectations of them, adding transparency to the assessment process whilst maintaining flexibility in order to promote a level playing field across applicants and support sector efficiency.

87. For the Reserve Bank, the approach will provide additional assurance that dual-registered branches are being run in a prudent manner in line with our statutory objectives. In the longer term, we expect that a revised approach to assessing banks' systemic importance for the purposes of our local incorporation policy will provide further assurance that local branch operations are being run in accordance with promoting a sound and efficient New Zealand financial sector.



## Annex 1: Summary of changes to the Banking Supervision Handbook (BS1):

### (II) Incorporation and ownership structure

#### a) Branches of overseas banks **persons**

##### 39. Dual registration

Overseas ~~banks~~ **persons** may be permitted to ~~have dual registration (ie to operate both a branch and a bank subsidiary in New Zealand)~~ provided both entities comply with relevant prudential requirements relating to the matters ~~that the Reserve Bank is required to have regard to when assessing an application~~ listed in sections 73-73B of the RBNZ Act. The operation of a branch and a New Zealand incorporated subsidiary is referred to as “dual registration” and a person applying to register a branch operation alongside a registered bank subsidiary is called a “dual registration applicant”. ~~Banks with dual registration will not be permitted to take retail deposits through the branch operation. If banks with a dual registration were able to take deposits through both entities it is likely that depositors would be confused about which entity they were dealing with.~~

39A. Where the New Zealand operations of a dual registration applicant are not systemically important to New Zealand, the following requirements and restrictions may apply. These will be incorporated into the bank’s Conditions of Registration.

- Standard requirements for non-systemic dual-registered banks: The New Zealand branch operation ~~is not permitted to accept retail deposits~~. If banks with a dual registration were able to take deposits through both ~~entities~~ **the branch and the bank subsidiary** it is likely that depositors would be confused about which entity they were dealing with.

*From the point of applying to commence business in New Zealand as a dual registration bank, the applicant will have a clear governance framework in place detailing how managerial and operational responsibilities are delegated to the New Zealand office and delineated across its local operations. The applicant must satisfy the Reserve Bank these arrangements give the branch Chief Executive adequate responsibility and accountability over the branch’s prudent operation.*

- Non-standard restrictions for non-systemic dual-registered banks (to be applied in addition to the standard requirements for non-systemic dual-registered banks): Where the Reserve Bank has concerns about the approach of the applicant’s home state to supervision and oversight, disclosure, accounting and auditing standards, or bank insolvency and resolution arrangements (broadly ‘home state non-equivalence’), total New Zealand assets of the branch must not exceed those of the New Zealand incorporated subsidiary on any day of the year.

*The New Zealand branch operation must undertake wholesale business only - that is, business transacted with ‘wholesale investors’ defined under the Financial Market Conduct Act 2013 (Clause 3(2), Schedule 1). The Reserve Bank would expect wholesale business to be limited to simple balance sheet activities, and for any market-making activity to be conducted out of the New Zealand subsidiary. Where necessary to reinforce this expectation, permitted wholesale business at the branch operation may be further restricted at the Reserve Bank’s discretion by amended condition of registration.*

- Disclosure requirements: Where non-standard restrictions have been imposed on a New Zealand branch operation, there must be processes in place to ensure branch investors are made aware of this.

39B. Where the New Zealand operations of a dual registration applicant are systemically important to New Zealand, these banks will not be permitted to take retail deposits through the branch operation. Where appropriate, further requirements and restrictions on the bank’s New Zealand operations will be considered by the Reserve Bank on a case-by-case basis.

## Annex 2: Inputs into the Home State Equivalence assessment:

The Reserve Bank's assessment of whether an acceptable degree of discipline will be imposed on a dual-registered branch applicant will consider, amongst other things, the equivalence of the parent bank's home state jurisdiction – for example, whether its approach to consolidated supervision and resolution achieves the same outcomes as our regulatory regime, and the strength of legal framework to impose regulatory requirements. Inputs into this assessment will include:

- a. **FSB peer reviews.**
- b. **IMF Financial Sector Assessments.**
- c. **WTO Market Economy Status:** The home state should be a WTO [member](#) without transitional Non-Market Economy (NME) provisions.
- d. **IMF Reports on the Observance of Standards and Codes:** Joint [IMF/World Bank](#) ROSCs consider the extent to which the home state observes internationally recognised standards and codes in AML/CFT; banking supervision; corporate governance; data dissemination; fiscal transparency; insolvency and creditor rights; monetary and financial policy transparency; payments systems; and securities regulations. Reports are published at the request of the member country.
- e. **Legal Framework Assessment:** The home state's legal infrastructure for financial systems [forms a part](#) of the IMF's Financial Sector Assessments. In addition, the World Bank's [assessment framework](#) for considering the legal treatment of infrastructure projects may assist in an assessment of the general strength and transparency of the rule of law in the home state.
- f. **Information sharing and co-operation arrangements** on BAU, crisis management, and resolution matters.
- g. **Evidence of equivalence assessments from other jurisdictions.** This will be used as a supplement only to the Reserve Bank's equivalence assessments, as the experiences of other jurisdictions will not necessarily reflect the degree of cooperation and coordination New Zealand authorities can expect to achieve from the applicant's home state authorities.