

Submission

to the

Reserve Bank of New
Zealand – Te Pūtea Matua

on the

Review of policy for
branches of overseas banks

2 March 2022

About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.
2. The NZBA comprises seventeen registered banks in New Zealand:
 - ANZ Bank New Zealand Limited
 - ASB Bank Limited
 - Bank of China (NZ) Limited
 - Bank of New Zealand
 - China Construction Bank
 - Citibank N.A.
 - The Co-operative Bank Limited
 - Heartland Bank Limited
 - The Hongkong and Shanghai Banking Corporation Limited
 - Industrial and Commercial Bank of China (New Zealand) Limited
 - JPMorgan Chase Bank N.A.
 - Kiwibank Limited
 - MUFG Bank Ltd
 - Rabobank New Zealand Limited
 - SBS Bank
 - TSB Bank Limited
 - Westpac New Zealand Limited
3. As discussed below, this submission is made on behalf of certain NZBA members that operate in New Zealand as a branch only.

Introduction

4. NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand – Te Pūtea Matua (the **Reserve Bank**) on its consultation paper for the Review of policy for branches of overseas banks dated 20 October 2021 (the **Consultation Paper**). NZBA commends the work that has gone into developing the Consultation Paper.
5. This submission is made on behalf of **Citibank N.A., The Hongkong and Shanghai Banking Corporation Limited and JPMorgan Chase Bank N.A.**, each of which operates in New Zealand as a branch only. This submission does not specifically consider the position of dual-registered banks.

Contact details

6. If you would like to discuss any aspect of this submission, please contact:

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Summary of submission

7. Below we first set out our key views on the topics in the Consultation Paper, followed by responses to specific questions asked by the Reserve Bank.
8. In summary:
- (a) The aim of achieving ‘consistent outcomes for branches’ should not be confused with a ‘one size fits all’ approach. We believe the Reserve Bank’s current policy to registration of bank branches is functioning correctly. There is a wide variety of banks operating through a branch in New Zealand. These banks may perform different specialised roles and fill particular gaps in the New Zealand market, while being strongly regulated by their home jurisdiction. The current policy provides the Reserve Bank with the flexibility needed to address different situations that may arise.
 - (b) To provide clarity to existing registered bank branches, potential applicants and investors, we support the Reserve Bank setting out its policy clearly and in a single place – something that the Consultation Paper itself assists to achieve.
9. Any new rules should be very carefully thought out. There may be long-term damage to NZ’s banking system if branches are shut out of the market.
10. To the extent any changes to the Reserve Bank’s policy are proposed (whether in relation to the proposed Deposit Takers Act and depositor compensation scheme, or otherwise as part of this review), we believe it is important that the Reserve Bank continues to actively engage with the full range of existing bank branches. Any changes made may have significant impact on such banks, and may limit their ability to effectively provide services in New Zealand. As such services are often not a focus of locally incorporated banks, we are concerned that such changes could inadvertently damage the New Zealand financial system.

Current policy for branch-only banks is well-developed, tailored and flexible

11. We support a periodic review of the Reserve Bank's approach to overseas bank branch registration, particularly given the general work being done to overhaul New Zealand's current deposit taker regulation with the Deposit Takers Act. However, any such review needs to be done in the context of, and consistent with, the purposes of that new legislative framework.
12. The Deposit Takers Act is set to generally modernise bank regulation, with a focus on providing:
 - (a) the Reserve Bank with a range of powers it needs to effectively regulate the sector. As has been acknowledged in that review, the banking sector is complex and varied. The Reserve Bank needs to be able to take a tailored approach to any particular situation that arises; and
 - (b) transparency and clarity to the market.
13. The Reserve Bank's approach to branch registration already addresses the matters in paragraph (a). Over time it has developed a flexible approach to branch registration, with a set of rules and guidelines tailored to address the variety of practical situations that have arisen or may arise in the future. This approach has had a positive effect of allowing a range of bank branches to bring services, and international regulatory practices, to the New Zealand market.
14. The focus of the current branch review should therefore be on providing transparency and clarity – something which the Consultation Paper itself already goes some way to achieving, by summarising in one document the various factors taken into account by the Reserve Bank.
15. In particular, as discussed below, in our view:
 - (a) The current approach is not overly complex or ad hoc. It has developed over time to address the range of roles that branches fill in the New Zealand market.
 - (b) Taking a tailored approach to branch registration provides a range of benefits to the New Zealand market – including competition and specialist services.
 - (c) The risks of branch registration are sensibly addressed under the current policy. Allowing registration of branches in an appropriate manner (as is currently done) does not disadvantage the remainder of the market.

Current approach to branch-only registration is appropriately designed

16. We understand the Reserve Bank is concerned that its approach to branch registration is complex and ad hoc, and that it could be simplified.

17. However, an undue focus on simplicity is likely to materially reduce the Reserve Bank's ability to address specific circumstances.
18. A branch registration policy needs to account for a range of different factors, balancing the benefits of branch participation in the market while mitigating risks involved. A 'one size fits all' approach cannot be applied. In particular:
 - (a) Branches fulfil a smaller, more segmented role in the New Zealand market than the larger full-service locally incorporated banks. This may be providing limited specialist services that are not otherwise available in the New Zealand market, or that are not well served. This may include clearing or custodial services, institutional and trade support, and links to international networks. It may also include 'end to end' services for customers with global banking needs.

For many branches, this may mean that retail customer access is not a concern. Other branches may provide tailored services to retail customers.
 - (b) The features of home jurisdiction regulation will differ between different branches. For instance, as acknowledged in the current policy, some jurisdictions may give preference to home jurisdiction depositors in liquidation, or the Reserve Bank may have a more limited relationship with the home jurisdiction regulator.¹ On the other hand, other jurisdictions may provide depositor compensation or similar customer protections that apply globally, giving New Zealand customers additional protections.
19. The Reserve Bank's branch policy needs to be flexible enough to assess and mitigate the risks of particular home jurisdictions, while acknowledging and allowing the key benefits of particular branches to be provided in New Zealand.
20. While some time and analysis may be required by potential applicants considering whether to establish a branch in New Zealand, it is expected that any application would involve significant engagement with the Reserve Bank in any event. Overly simplifying the rules is likely to increase costs (potentially requiring significant, unnecessary changes to business models to comply) rather than improving efficiency. We are not aware of any market concerns that potential applicants are unable to manage the complexity of the Reserve Bank's approach – although there may be discussion of the weight or interpretation given to various factors in any particular factual circumstances, this is a matter that can generally be addressed bilaterally in the context of the particular case.
21. Therefore, we do not believe that the current approach is overly complex. It has been designed over time to address the different factors above, which will apply differently to each branch or applicant. A focus on simplicity is likely to materially reduce the Reserve Bank's ability to effectively respond to the circumstances of particular branch registrations.

¹ As discussed below, we agree that the Reserve Bank's relationship with home state regulator is a key factor, but one that should be reassessed over time.

22. While, at the edges, there are some technical definitions that we believe could be considered further (see our comments on the definition of retail deposits in paragraph 39 below), the key focus should be on improving transparency.
23. For existing branches and future applicants, such transparency would be relatively straight-forward to achieve, by setting out the current rules and guidelines in one, easily accessible place (and, in the future, taking a consistent approach as is used for disclosure and transparency under the Deposit Takers Act). As mentioned above, the Consultation Paper already goes some way to providing a relevant summary.
24. For investors and customers, transparency is effectively addressed through the current approach of disclosure in semi-annual bank disclosure statements, combined with (where applicable – that is, where particular risks are identified) limiting the ability for branches to deal with a wide range of retail customers.

Market benefits of continuing to allow tailored branch registration in New Zealand

25. We strongly agree with the ‘positive’ issues identified on pages 5 and 6 of the Consultation Paper – branches provide innovation, competition and different financial services. They provide a number of key benefits to the New Zealand market, while being limited in their overall size domestically. As the Consultation Paper notes, branches make up less than 10% of the New Zealand market (including dual-registered banks). However, they provide outsized benefits to the market:
 - (a) Branch registration provides important competition to the larger locally incorporated banks. Smaller locally incorporated banks fulfil important functions, but often do not have the resource to compete with the larger banks in more technical or complex areas, such as institutional banking. Branches often form part of very large international banks, meaning that (despite their small size in New Zealand) they are often able to provide competition in such resource-intensive areas.
 - (b) In some cases (such as various custodial and clearing services), bank branches provide services that even the large locally incorporated banks do not offer. These services may not be economic without considerable scale, which is only effectively achieved through a global branch approach.
26. As global banking continues to become more interconnected, retaining a tailored approach to branch registration in New Zealand allows access to international developments and best practice techniques, while reducing potential over reliance on large domestic banks to provide technical and bespoke services (at the same time as focusing on servicing the general New Zealand population).

Risks are mitigated given the role of branches in the New Zealand market

27. We strongly disagree with the four 'negative' issues referred to on page 6 of the Consultation Paper, particularly given the role of branches in the New Zealand market,
28. Home jurisdiction regulation on bank branches registered in New Zealand is rigorous (and the Reserve Bank is able to assess this when considering whether to register future applicants). Global banks in particular operate in many jurisdictions around the world, and so are incentivised to adhere to international best practices and to devote significant resource to compliance. This focus on compliance, and branches' limited size and focus in New Zealand means that they do not materially expose the domestic financial system to boom-bust cycles and contagion risk, or threaten stability of the financial system. In many cases they reduce reliance on large domestic banks and assist to spread risk. Any practical concerns around the limited ability of the Reserve Bank to resolve a branch are mitigated by the current approach to branch registration, which limits the size and nature of the branch's business where necessary where applicable, and the Reserve Bank's resolution tools including incorporation of a New Zealand company.² Further, while we appreciate the identification and focus on these risks following the Global Financial Crisis (including the working paper at footnote 2 of the Consultation Paper), bank regulation as a whole has significantly advanced since that time to respond to and mitigate those risks.
29. Further, as discussed above branches do not discourage competition from locally incorporated banks, and often address gaps in the market instead. Given the extent of home jurisdiction regulation, overall branches do not have a material competitive advantage when operating in New Zealand.
30. By contrast, imposing significant further limitations on branches in New Zealand risks putting branches at a significant disadvantage – requiring compliance both with international regulation and New Zealand regulation. Given the small size of branches in New Zealand, such additional limitations can involve a disproportionately high cost and effectively discourage global and specialist offshore banks from operating in New Zealand and bringing such international regulatory experiences to the market.

Responses to specific questions

31. In line with our key comments and views above, we set out below brief answers to the specific questions raised by the Reserve Bank. Our responses should be read in the context of our more detailed comments above.

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

32. As discussed above, in our view the 'problem definition' for the review should be focused on maintaining flexibility and ensuring adequate transparency, following the modernisation being taken for the Deposit Takers Act. These are the key factors to

² Refer to section 123 of the Reserve Bank of New Zealand Act 1989 and clauses 291 and 297 of the exposure draft Deposit Takers Bill.

ensure that New Zealand remains positioned to receive the benefit of bank branches while mitigating risk.

33. In relation to the proposed problem definition in the Consultation Paper:
- (a) For the comment that current policy is not applied consistently, we do not believe there is material inconsistency in relation to branch-only banks – different outcomes reflect different circumstances. To the extent inconsistency is a concern in this context, this would be a matter of application of the policy rather than an issue with the policy itself.
 - (b) For the comment that there are inherent limitations on the ability to apply regulatory standards, as discussed in paragraphs 27 to 30 above we do not believe this materially affects financial stability in practice (and in fact brings in innovation that may improve stability).
 - (c) For the point that there are conflicts of interest between home and host supervisors, this is a common point for any international bank group regardless of structure. We note this is currently addressed where relevant in aspects of the Reserve Bank’s policies, such as in relation to dual registration.

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

34. We are generally supportive of the proposed assessment principles, noting they take into account that the Reserve Bank’s approach should be and remain proportionate.
35. Determining whether there is a ‘credible resolution strategy’ should take into account the home jurisdiction regulator, any limits on the size of a branch’s business in New Zealand, and other risk-based assessments (as it currently does).
36. As discussed above, the aim of achieving ‘consistent outcomes for branches’ should not be confused with a ‘one size fits all’ approach, as discussed above.

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

Q 3.1 What is the appropriate threshold for local incorporation?

37. We believe the current thresholds for local incorporation continue to be appropriate. Branches make up a small percentage of the New Zealand market, and in practice do not seek to compete with the ‘full service’ New Zealand incorporated banks for depositors and business.

Q 3.2 Should branches be permitted to take retail deposits?

38. We strongly support continuing a tailored approach to allowing retail deposits, based on factors including a risk assessment of the home jurisdiction (including risks and protections for depositors from outside the jurisdiction). While many

branches do not seek to take retail deposits, flexibility should be retained to cater for a range of branch businesses.

39. For completeness we note that, where full or partial restrictions are placed on a branch taking retail deposits, the definition of “retail” used in BS1 (that is, natural persons with deposits of no more than \$250,000) differs from that used in comparable legislation (such as the Financial Markets Conduct Act 2013 (*FMCA*)). At a high level, we think there would be benefit in consulting with the industry on this definition in particular to consider whether it can be aligned (where applicable) with the wholesale/retail distinction in the *FMCA*. This could help reduce complexity and minimise the different categorisations and considerations required for different customers. We would be happy to discuss this further with the Reserve Bank.

Q 3.3 Should dual registration be allowed?

40. We do not have a strong view on dual registration, but support it as part of the Reserve Bank’s toolkit for appropriate flexibility.

Q 3.4 Should we pursue greater regulatory and supervisory integration?

41. We strongly support open and active engagement between New Zealand and home jurisdiction regulators. While we are comfortable that lack of interaction or familiarity with home jurisdiction regulators is a suitable factor to take into account in the near term, measures should be put in place to strengthen the relationship between regulators over time.