New Zealand Banking Association
Te Rangapū Pēke

Submission

to the

Department of the Prime Minister and Cabinet

on the

Discussion Document: *Strengthening the Resilience of Aotearoa New Zealand's Critical Infrastructure System*

8 August 2023

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About NZBA

1. The New Zealand Banking Association – Te Rangapū Pēke (**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 following eighteen registered banks in New Zealand are members of NZBA:
   - 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.
   - KB Kookmin Bank Auckland Branch
   - Kiwibank Limited
   - MUFG Bank Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Contact details

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Introduction

4. NZBA welcomes the opportunity to provide feedback to the Department of the Prime Minister and Cabinet (**DPMC**) on the Discussion Document: *Strengthening the resilience of Aotearoa New Zealand's critical infrastructure system* (**Discussion Document**). NZBA commends the work that has gone into developing the Discussion Document and appreciates the opportunity to contribute at an early stage to this important work programme.

5. NZBA supports the DPMC exploring reforms to New Zealand's critical infrastructure system, with the aim of improving resilience to natural hazards and other threats.

6. Cyclone Gabrielle was a timely reminder of the interdependencies of critical infrastructure assets. As the Discussion Document notes, power and telecommunications outages caused by the cyclone quickly cascaded to many other critical infrastructures, including access to some banking services. The industry agrees that a more coordinated approach to critical infrastructure planning, delivery and management is likely to mitigate the impact of natural hazards and other threats.

7. To ensure that any new regulatory regime is appropriate for New Zealand, some important aspects will need to be carefully considered – in particular, a clearly defined scope and the management of overlaps with existing regulatory systems.

8. This submission focuses on:

    8.1. the existing and proposed regulatory regimes to address barriers to infrastructure resilience in the banking sector;

    8.2. how any new regime should utilise existing and proposed sector-based regulatory regimes and coordinate with existing sectoral regulators; and

    8.3. general comments regarding:

        8.3.1. the identification of specific operations and services as "critical infrastructure"; and

        8.3.2. timing considerations for implementing a new regime.

Objectives for and principles underpinning the work programme

9. NZBA supports the Government's overall objectives for the work programme. Recent experiences (including the COVID-19 pandemic, Cyclone Gabrielle, supply chain disruptions and cyber incidents) have served to highlight the importance of critical infrastructure continuing to perform during adverse events and the subsequent recovery. We agree that New Zealanders should be confident that they will have reliable access to banking services during an adverse event.

10. The objective of the work programme to "enhance the resilience of New Zealand's critical infrastructure to all hazards and threats with the intent of protecting New Zealand's wellbeing and supporting sustainable and inclusive growth" has some similarities with the purposes of the Deposit Takers Act 2023 (**DTA**) (which will replace the Banking (Prudential Supervision) Act 1989 (**BPS Act**) once fully implemented) which banks are already familiar with:

> **Section 3: Purpose**
> (1) The main purpose of this Act 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.
> (2) To that end, this Act has the following additional purposes:
> (a) to promote the safety and soundness of each deposit taker:
> (b) to promote public confidence in the financial system:
> (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:
> (d) to avoid or mitigate the adverse effects of the following risks:
> (i) risks to the stability of the financial system:
> (ii) risks from the financial system that may damage the broader economy.

11. Once fully implemented, the DTA will provide the Reserve Bank of New Zealand (**RBNZ**) with broad powers to licence, regulate and supervise banks to promote financial stability (the RBNZ currently has many of these powers under the BPS Act). The RBNZ will be required to issue prudential standards, including for risk management, business continuity planning, contingency and recovery planning that banks will be required to comply with (as is the case under the BPS Act).

12. NZBA considers that there are already existing and proposed regulatory regimes to address potential barriers to infrastructure resilience in the banking system. Any new regime should be carefully implemented to complement the existing and proposed sector-based regulatory regimes and promote coordination between any new government agency responsible for infrastructure resilience and existing sectoral regulators. In particular, we note that the Council of Financial Regulators (**CoFR**) plays an important role in coordinating the regulation of New Zealand's financial system. In our view, there would be value in engaging with CoFR when considering the implementation of any new regulatory regime.

13. In Schedule 1 of this submission, we mention some existing and proposed regulatory regimes that are relevant to the Discussion Document that already regulate and promote the resilience of critical banking infrastructure.

Potential barriers to infrastructure resilience

Minimum resilience standards

14. NZBA submits that before any minimum resilience standards are developed, careful consideration should be given to existing and proposed regulatory regimes. As outlined earlier in our submission, banks are already subject to numerous existing regulatory regimes that regulate and promote resilience in banking sector. These regimes have been designed for the unique risks and complex nature of banking operations and services.

15. Any such standards should also be flexible and able to accommodate changes over time. For instance, any standards that were to be applicable to the availability of payments should take into account the changes in this area highlighted in the RBNZ's consultation papers on the future of money and the cash system redesign.

New government agency

16. Careful consideration should be given to how any new government agency with responsibility for the resilience of New Zealand's critical infrastructure will coordinate with existing sectoral regulators (for example, the RBNZ for banks). Any new government agency should not attempt to replicate the expertise and experience with the RBNZ and should work alongside other experts in this area, such as, currently, the National Cyber Security Centre (**NCSC**) and the Computer Emergency Response Team (**CERT NZ**).

Compliance and enforcement mechanisms

17. NZBA submits that before any compliance and enforcement mechanisms can be considered further the content of any minimum resilience standard needs to be determined.

18. Consideration should also be given to how any compliance and enforcement mechanisms will work alongside and complement existing regulatory regimes. As discussed earlier in our submission, banks are currently subject to the BPS Act, and soon will be subject to the DTA, which both contain supervisory and enforcement mechanisms. These include broad information gathering powers, on-site inspection powers, remedial notices, investigations, voluntary undertakings, pecuniary penalties, infringement notices and ban orders.

General comments on the Discussion Document

Scope of services identified as critical infrastructure

19. The scope of what will constitute "critical infrastructure", a "critical infrastructure entity" and a "critical infrastructure sector" is important to understand – particularly how this will apply to banks. We understand that the definition of "critical infrastructure" is set out in the draft Emergency Management Bill (**EM Bill**) and that the Discussion Document is asking for broader feedback on the regulatory reforms that will apply to critical infrastructure (as opposed to what will be treated as critical infrastructure).

20. However, we are concerned that it is difficult to engage meaningfully with the 'how' (in other words, how critical infrastructure should be managed) without knowing 'who' and 'what' will be deemed critical infrastructure. NZBA plans to submit on the EM Bill. However, in relation to the Discussion Document, we note our view that not all of a bank's services and operations should be treated as critical infrastructure and that any such determination could change over time (see our earlier comment about future of money). Consideration should also be given to dependencies amongst the various participants in an infrastructure system. For instance, the availability of payments methods can be dependent on the availability of electricity and data, which are beyond the control of banks. For cash delivery to impacted communities, the assistance of the National Emergency Management Agency and the New Zealand Police may be required in certain circumstances.

21. We consider that this delineation should be drawn early in the process, and that the RBNZ, which already has programmes of work underway that intersect and my overlap with this, should be involved in any discussions on this with the sector and the DPMC.

Existing regulatory regime

22. As recognised in the Discussion Document and as mentioned above, there is potential for cross over and regulatory duplication, particularly for those sectors that are already highly regulated, such as the banking sector. We emphasise that any solution would therefore need to consider existing and proposed requirements on the banking sector in this area. For instance:

    22.1. In terms of the infrastructure needed to support cash and payments as critical services, the Financial Markets Infrastructures Act (**FMI Act**) currently has five key, systemically important payments operating systems that may fall within scope.

    22.2. The Commerce Commission is focusing on resiliency in the context of the Retail Payments System Act.

    22.3. The RBNZ is looking at establishing an industry wide business continuity plan for the supply of cash, and has been working with the sector to explore bank resiliency, with a focus on branches, ATMs, cash-in-transit and the associated response options required to support the ongoing services related to cash and payments.

22.4. In respect of our APRA-regulated members, the final APRA Prudential Standard CPS 230 *Operational Risk Management* (**CPS 230**) sets out minimum standards for managing operational risk, for example through the strengthening of operational risk management and the improvement of business continuity planning to ensure entities are positioned to respond to severe disruptions.

23. As mentioned above, it is important that any approach to enhancing New Zealand's resilience carefully considers what regulation and other measures already exist, so that an industry does not face a situation where further duplicative regulation is developed. This could result in an unnecessarily burdensome, confusing regulatory landscape for entities subject to these requirements, as well as their customers.

24. Banks, in particular, are already thoroughly well-regulated for resilience. Rather than introducing additional regulation, we submit that the focus of reforms in this space should be focused on better coordinating the various currently existing regulatory requirements. Further, it is in our view important that a clear, simple and effective response can be taken in the face of an emergency, threat or shock to ensure services can be delivered to customers. Multiple layers of overlapping regulation could have a detrimental effect on such a response. We agree in principle with the commentary at paragraphs 88-92, which highlights the gaps in the current regulatory landscape, and the lack of a coordinated approach to set, monitor and enforce standards across the entire critical infrastructure system. This was seen during recent climate events such as Cyclone Gabrielle.

25. We also submit that regulations on the resilience of an entity should not be overly restrictive. Critical infrastructure entities will know their business best, and it is important that they retain decision-making control in the event of a crisis.

Implementation and timing considerations

26. We suggest that any regulatory reforms are implemented in stages. In our view, the initial focus should be on those critical infrastructures that are unregulated (or lightly regulated) before critical infrastructures that are currently subject to a greater degree of regulation.

27. Critical infrastructures that are currently unregulated (or lightly regulated) represent the greatest opportunity to enhance the resiliency of New Zealand's critical infrastructure. Many unregulated critical infrastructures are also relied on by other critical infrastructures.

Proportionality

28. NZBA submits that any approach to enhance New Zealand's infrastructure resilience is proportionate in terms of the contributions and/or requirements that affected entities are subject to. The systemic importance of an entity, its size and resources should be considered when setting any requirements so that smaller, less systemically-important entities are not disproportionately burdened.

SCHEDULE 1

Regulatory regimes relevant to banks

This schedule summarises some of the existing and proposed regulatory regimes that are relevant to the Discussion Document that that address barriers to infrastructure resilience in the banking system.

Information sharing and public disclosure

Under the BPS Act, and once fully implemented the DTA, the RBNZ has broad information gathering powers. The RBNZ uses this power to require banks to supply it with internal board and management reports, statistical information and surveys for the purposes of prudential supervision and monitoring the financial system. The RBNZ also has the power to instruct banks to commission independent reports on governance, risk management and internal controls. Banks are also required to publish half-yearly disclosure documents that must contain descriptions of the bank's risk management objectives, policies, strategies and processes across a number of key risk categories.

Outsourcing Policy (BS11)

The RBNZ's Outsourcing Policy requires "large" banks (with liabilities, net of amounts owed to related parties, of $10 billion or more) to have the legal and practical ability to control and execute outsourced functions that are critical to the operation of the bank. Contractual arrangements with third parties are required to contain certain prescribed contractual terms to ensure the continuation of service in the event the bank is put into administration. Banks are also required to have in place robust back-up capability and / or alternative arrangements for critical functionalities (eg clearing and settlement, monitoring their financial positions, provision of basic banking services to customers).

Climate resilience and reporting

Part 7A of the Financial Markets Conduct Act 2013 (**FMCA**) requires banks with assets greater than $1 billion to prepare and publish annual climate-related disclosures. The disclosure requirements are set by the External Reporting Board (**XRB**) and require banks to disclose their governance arrangements, strategy, risk management and key metrics and targets to manage climate-related risk. Banks are investing heavily in uplifting their climate-modelling ability to understand the climate-related risks they face.

In June 2023 a RBNZ consultation on proposed guidance for the financial sector on managing climate-related risks closed. The draft guidance will require regulated entities to manage climate-related risks within their broader risk management framework.

Cyber resilience

The RBNZ is progressing a three-pronged strategy to uplift the financial sectors capability and cyber resilience:

- The RBNZ has issued guidance to its regulated entities on how they should be managing cyber-related risks. The guidance now forms the basis of supervisory engagements on cyber-related risks with regulated entities.
- In July 2023 an RBNZ consultation on cyber resilience data collection closed. In the consultation the RBNZ is proposing two new statistical returns: (i) a 'cyber incident report' that will require regulated entities to report all material cyber-incidents to the RBNZ within 72 hours and to report all cyber-incidents periodically (e.g. each quarter); and (ii) a 'periodic cyber resilience survey' which will require regulated entities to self-assess their cyber capabilities.
- Enhancing coordination across the financial sector, regulators and government agencies (e.g. NCSC and CERT NZ) on collective responses to cyber incidents.

Industry stress testing

Banks are subject to annual stress tests by the RBNZ. The stress tests require each bank to model the impact of severe, but plausible, events such as economic downturns. More recently, the stress tests have required banks to model the impact of natural disasters and cyber incidents. The results of the stress test are reported to the RBNZ and anonymously published in bulletin articles. Banks' board and management use the stress test results as an input to set capital and liquidity buffers.

In 2023, the RBNZ plans to publish its climate-related risk assessment on the impact of drought and emissions pricing on the largest banks' agricultural loan book. In 2024, the RBNZ plans to publish the results of an industry stress test focussed on the impact of climate-related risks on the five largest banks.

Prudential requirements

Banks operating in New Zealand are required to be registered by the RBNZ and are subject to a range of prudential requirements related to capital adequacy, liquidity, corporate governance, suitability of directors and senior management, significant acquisitions etc. In particular, the RBNZ requires banks to hold sufficient capital buffers to manage credit, operational and market risks. The RBNZ recently completed a review of capital settings in New Zealand and banks are working to build their capital buffers to comply with the new minimum capital requirements which will be effective from 2028.

Future of money (RBNZ consultation)

The way New Zealanders are paying for goods and services is changing rapidly. Use of cash is declining, while new forms of digital payments are becoming increasingly common. The RBNZ currently has a large programme of work underway to consider the future of money and payments in New Zealand. This is a large work programme that is considering the need for a central bank digital currency and the RBNZ's regulatory approach to new forms of private money. This work programme is still at an early stage, but the implications and consequences are likely to be significant and will have implications for the banking system.

Cash system redesign (RBNZ consultation)

The RBNZ currently has a programme of work underway considering how the cash system could be better designed to account for declining public use of cash and to ensure that cash remains widely available for members of the public who choose to use it. While this programme of work is still at an early stage, there is general support for taking a merchant-centric approach. The eventual solution could include innovative solutions, including the use of smart machines, dispensing of cash in the community and seeing banks pay merchants who provide cash withdrawals services for their customers.