New Zealand Banking Association
Te Rangapū Pēke

Submission

to the

The Reserve Bank of New Zealand - Te Pūtea Matua

on the

Deposit Takers Non-Core Standards (Policy proposals) Consultation Paper

22 November 2024

NEW ZEALAND BANKING ASSOCIATION – TE RANGAPŪ PĒKE
PO Box 3043, Wellington 6140, New Zealand
www.nzba.org.nz

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 (New Zealand) Limited
   - 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

Introduction

3. NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand - Te Pūtea Matua (**Reserve Bank**) on its consultation paper "Deposit Takers Non-Core Standards (Policy proposals)" (**Consultation**). NZBA commends the work that has gone into developing this document and the technical analysis supporting it.

Contact details

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

Antony Buick-Constable
Deputy Chief Executive & General Counsel
antony.buick-constable@nzba.org.nz

Sam Schuyt
Associate Director, Policy & Legal Counsel
sam.schuyt@nzba.org.nz

Executive Summary and Key Themes: Approach to Non-Core Standards

5. NZBA supports the development of the Non-Core Standards as part of the wider modernisation of New Zealand's banking regulation, and the Reserve Bank's open engagement and workshops through the process. We have responded to relevant Consultation questions for each Chapter below, and set out in this initial section key overarching submission points. We consider these points must inform the overall development of the non-core standards, in order to establish an appropriate new regulatory regime and achieve a successful and efficient transition.

5.1. **Over-reliance on director involvement & audit requirements** – the proposed Standards currently have a considerable focus on creating additional obligations at the Board level, effectively seeking to expand the director due diligence duty under the Deposit Takers Act and requiring a range of specific matters to be the express responsibility of, or adopted by, the Board. This is contrary to the general approach contemplated by the Deposit Takers Act itself as it was developed through the Bill stages, as well as the current proposed changes to other financial laws (in particular the Credit Contracts and Consumer Finance Act 2003) to move away from focus on director liability, to free up director time to manage governance and strategy. The Standards should reflect this.

As a related point, the Reserve Bank should consider a measured approach to audit requirements (i.e. third line activities). While audit (including internal assurance) remains a key element of the prudent management of a deposit taker's obligations, care should be taken not to expand such obligations to a point where they artificially restrain business through cost and time required for such audits (including through making some assurance processes third line activities when they should in fact be second line activities). There is also a risk that a significant increase in the volume of mandatory assessments could impact on the capacity of the audit teams to undertake risk-based reviews. We welcome the Reserve Bank to provide visibility over the risks it has considered in setting the use of internal and external assurance across the different standards, including, where external assurance is used, the proportionality of the type of assurance that will be required (e.g. limited assurance compared with reasonable assurance).

5.2. **Timing & Transition** – NZBA understands that various Standards are proposed to only be available from 2027. Many of these Standards will require significant time and resource to implement/uplift systems and develop appropriate processes. The proposed timing will leave very little time for deposit takers to implement such Standards and comply, particularly as re-licensing is expected to occur at the same time. Given that standards are, in many cases, fundamentally being rewritten it is critical that exposure drafts are provided early and with ample time to review as even simple wording changes could change the intended outcomes of the new standards. NZBA submits that the Reserve Bank should focus on ways to manage this timing bottleneck, including by simplifying the re-licencing requirements as far as possible (similar to proposals to deem certified creditors to be re-licensed without additional cost). For instance, we note that some of the proposed changes may require significant system rebuilds. In particular, the proposal to include variable unfreezing capability for non-deposit liabilities in

the OBR Pre-positioning Standard would be a significant technical undertaking for deposit takers, and will require time to properly implement – and the Reserve Bank's concurrent consultation on the 'Crisis Management Issues Paper under the Deposit Takers Act 2023' (**Crisis Management Consultation**) contemplates that this may change again as the Reserve Bank's crisis management proposals are developed.

Additionally, deposit takers need clarity on how the re-licensing process for existing licenced banks will be carried out. In practice the Reserve Bank should look to clarify the steps required as part of the licencing application process and how it will be sequenced. We note this is set to occur concurrently with the introduction of many core and non-core standards, potentially putting the ability of deposit takers to proactively engage with the process under some stress.

5.3. **Overlap of obligations in different Standards** – A number of obligations in relation to a topic proposed in the Consultation are spread across a number of proposed Standards. For example:

- risk management obligations are set out in the Operational Resilience, Capital, Liquidity, Governance, Risk Management and Outsourcing Standards;

- aspects of the outsourcing requirements overlap with the Operational Resilience Standard; and

- while the majority of the branch obligations are set out in the Branch Standard, there are aspects of other standards that capture obligations for branches or which impact on branches.

We appreciate that it may not be practically feasible to have all obligations relating to a single topic in just one Standard. But given this, it is important to ensure that the relevant requirements are clear and consistent across the various Standards. The Reserve Bank should consider how these obligations work together in practice, creating efficiencies where possible and limiting compliance cost by avoiding duplication.

The same applies where there is an overlap of Standards. For example there is quite an overlap between aspects of the Risk Management Standards and the Governance Standards (e.g. Table B, Outcome 1 - requirement 3, Outcome 2 - requirement 1 on page 35 of the Consultation). We consider that a lot of the duplication could be addressed if the Risk Management Standard focussed on the *framework* for managing risk rather than providing too much detail on specific risk topics.

5.4. **Availability of guidance** – We acknowledge the Reserve Bank intends issuing guidance alongside the exposure draft standards as part of the next rounds of consultation on the prudential standards. We wish to emphasise the importance of this, so that deposit takers can appropriately design systems, whilst considering guidance as they develop their frameworks and processes for the new standards. If the guidance material is not available at the same time as exposure drafts, deposit takers will not be able to ensure their processes reflect Reserve Bank expectations (and directors will be severely limited in their ability to properly assess their due diligence obligations).

5.5. **Ensuring alignment with offshore requirements where possible –** We consider it important that New Zealand follows international best practice. So where the Reserve Bank intends to make changes as a consequence of the Consultation process (taking account, as appropriate, of the need for any such changes to be proportionate across the various groups of deposit takers), any changes that are considered appropriate for a group of deposit takers should be aligned with relevant offshore requirements wherever possible. This is particularly so in areas such as operational resilience and risk management. In addition, alignment with relevant offshore requirements will limit compliance costs. For example, those deposit takers with Australian parent entities will already have group policies that comply with APRA requirements. So, if the Reserve Bank intends to follow international best practice for a particular group of deposit takers, aligning policies with APRA requirements would lower compliance cost for those deposit takers.

5.6. **Proportionality to be considered for foreign branches** – The regulatory requirements imposed on branches of overseas banks should be proportionate to the scale of their operations within New Zealand. This approach will help minimize compliance costs while ensuring that New Zealand customers continue to have access to a diverse range of international products and services offered by these foreign branches.

Submissions on Chapter 1 (Governance Standard)

- *Q14 Do you have comments on our initial assessment of the impact of our proposals on Group 1 deposit takers?*
- *Q19 Do you have comments on our initial assessment of the impact of our proposals on Group 2 deposit takers?*
- *Q29 Do you have any comments on, or additional information relating to, the proposed requirements of the Governance Standard?*
- *Q30 Are there areas of the proposed Governance Standard that need to be further clarified in the Guidance, and how do you think these aspects can be clarified?*

Early engagement on due diligence guidance is vital

6. We understand that the Reserve Bank intends to consult on guidance in relation to due diligence duties for the directors of deposit takers (or New Zealand CEOs for branches), as required under section 97 of the Deposit Takers Act, in 2025. However, we understand that the guidance to be issued to support the Governance Standard may not be consulted on until an exposure draft of the Governance Standard is released in 2026.

7. Given the interrelationship between these two sets of guidance, NZBA strongly encourages the Reserve Bank to engage with industry on the guidance for the Governance Standard before 2026. Understanding this guidance, and how it links to the wider scheme of governance requirements, will be key to deposit takers forming and implementing policy and procedures to meet the requirements of the Standards.

8. The Consultation refers to "seek[ing] to achieve behavioural outcomes" and "communicat[ing] the outcomes that [the Reserve Bank seeks] to achieve and promote behaviour that supports these outcomes" (paragraph 143 of the Consultation). The due diligence guidance will, by its nature, be fundamental to interpreting and supporting such behavioural outcomes. This guidance should be prioritised in communications with industry.

- *Q8 Do you have comments on the proposed outcomes and requirements for the responsibilities of boards of Group 1 deposit takers?*
- *Q14 Do you have comments on our initial assessment of the impact of our proposals on Group 1 deposit takers?*
- *Q16 Do you have comments on the proposed outcomes and requirements for the responsibilities of boards of Group 2 deposit takers?*
- *Q19 Do you have comments on our initial assessment of the impact of our proposals on Group 2 deposit takers?*

The proposed Governance requirements should be flexible enough to allow Boards to manage policies and procedures as they see fit within their due diligence responsibilities

9. As the Consultation notes, the proposed governance requirements cover a wide range of policy areas, which include a focus on ensuring internal process are consistent with overarching strategy. They include a wide range of very specific requirements for actions the Board must personally take, such as due diligence standards, as we describe in more detail below. For instance (in relation to Table B on page 34 of the Consultation):

   9.1. Outcome 1, Requirement 3 provides that "the board must ensure that the deposit taker's risk management framework is consistent with the requirements of the risk management standard". The due diligence duty already addresses the Board's responsibilities regarding a deposit taker's compliance with standards. There is an implication that this requirement would increase that existing duty, requiring directors to go beyond a due diligence standard and to specifically and personally assess the risk management framework against the standard. We note a similar concern with Outcome 1, Requirement 4 which requires the board to ensure the timeliness, quality and integrity of financial and non-financial reports, and the independence of the internal and external audit.

   9.2. Outcome 2, Requirement 2 provides that "the board must ensure … that the deposit taker conducts its business lawfully…". As drafted, the Board may be seen as breaching this responsibility, and being personally liable, for any breach of law by the deposit taker. This is inconsistent with the position in the Deposit Takers Act, that personal liability of the Board is linked to a due diligence obligation in relation to prudential obligations.

10. When assessing these specific requirements the Reserve Bank should be careful to avoid overly prescriptive requirements which limit the ability of the board to manage

policies and procedures as they see appropriate to achieve relevant outcomes (and applying a due diligence standard).

11. Furthermore, as a practical matter, there is a risk that the prescriptive requirements could limit the ability of the Board to effectively govern. The proposed requirements may not be suitable at Board level and may be better suited to Senior Management. In needing to ensure that the Board complies with all of the prescriptive requirements, there is a risk that there may not be much time left to address more general governance functions. The Reserve Bank needs to be mindful to avoid this being the case, and so should limit prescriptive guidance to circumstances where it is necessary.

12. As a more general point, the Reserve Bank should carefully consider the language it uses in relation to Board requirements, so as to preserve the Board's focus on strategic issues and oversight rather than maintaining an operational role (reflecting the design requirements the Reserve Bank describes in paragraph 125 of the Consultation). In particular, the Reserve Bank should reassess requirements for the Board to "ensure" policies are put in place and monitored. In this regard, see also our comments at paragraph 13.8 below.

Additional comments

13. We also make the below additional submissions on the proposed governance requirements:

    13.1. Outcome 1, Requirement 1 provides that the Board must set out in its charter how risks relating to conflicts are identified, reported and manged. We think the Reserve Bank should consider the practicality of this requirement, as the processes dealing with such risks are complex and detailed. Accordingly, they may be inappropriate to include in a Board charter. We suggest that a board charter should be limited to setting out that the Board must have appropriate processes in place to effectively identify, report and mange conflicts. The detailed requirements for doing so are set out in a deposit taker's policies or operating procedures.

    13.2. Outcome 2, requirement 1 appears to duplicate the Risk Management Standard requirement at paragraph 439 of the Consultation. This duplication is unnecessary.

    13.3. Outcome 4, Requirement 3 provides that the Board must set out and update Board meeting procedures and challenge senior managers in managing the deposit takers along with challenging each other's views in governing the deposit taker. We query whether this should be a requirement and question how it would be monitored. Practically speaking these requirements are general Board practice. We are unsure of the value gained by making this a requirement as it seems unnecessary.

    13.4. Outcome 5, Requirement 2 requires that the Board ensure that the remuneration strategy is aligned with the deposit taker's strategic direction, risk strategy and values, promotes good performance and reinforces the deposit taker's desired risk culture. We think the guidance should clearly articulate how the Board demonstrate this.

    13.5. Outcome 5, Requirement 3 requires that the Board ensure that recommendations relating to the remuneration strategy are free from conflicts of interest. We query how this aligns with the process in section

161 of the Companies Act, which contemplates the Board approving payment of remuneration to directors for services, along with prescriptive requirements such as the requirement for directors voting in favour to sign a certificate stating that the payment is fair to the company. The Reserve Bank should look to clarify this requirement. Additionally, this requirement reads as overly prescriptive and adverse to encouraging a principles-based approach.

13.6. Outcome 5, Requirement 4 requires the Board ensure that a regular remuneration strategy review process is conducted and that it informs on how the remuneration strategy has contributed to the performance of the individual directors, the Board and the deposit taker in achieving the outcomes outlined in the deposit taker's strategic direction. We query what this requirement would require in practice in respect of the Board and individual directors. Director remuneration is generally not performance based as this could lead to biases in decision making.

13.7. More generally in the context of Outcome 5, we note that the terms 'remuneration strategy' and 'remuneration policy' are both referred to but are not defined. We suggest remuneration policy is the more appropriate terminology, and which could then encompass a remuneration strategy. We also think that the Reserve Bank should look to clarify its references to "remuneration strategy" in relation to remuneration requirements. The strategy for employee remuneration and director remuneration are significantly different and the Reserve Bank should provide clarity to avoid confusion.

13.8. The proposed requirements introduce a number of specific requirements on deposit taker Boards. As such, it would be helpful for the Reserve Bank to clarify when Board responsibilities can (or cannot) be delegated to committees of the Board, the Board Chair or a committee Chair and/or senior managers. In this context we note the Reserve Bank's comment that Boards should be 'focused on more strategic issues and oversight of management rather than the operational detail of complying with our regulations' (paragraph 125 of the Consultation). Given the number of detailed Board responsibilities in the proposed requirements, we consider that further detail on the ability to delegate would help to give deposit takers a better understanding of the Reserve Bank's expectations, and better ensure that a consistency of approach is taken across deposit takers.

- *Q14 Do you have comments on our initial assessment of the impact of our proposals on Group 1 deposit takers?*
- *Q16 Do you have comments on the proposed outcomes and requirements for the responsibilities of boards of Group 2 deposit takers?*
- *Q19 Do you have comments on our initial assessment of the impact of our proposals on Group 2 deposit takers?*

Expanding director liability through Standards is contrary to the purpose of the Deposit Takers Act

14. The Consultation proposes a range of specific requirements to apply directly to deposit taker Boards (rather than to the deposit taker itself, as contemplated in the Deposit Takers Act). Chapter 1 (Governance Standard) does not discuss this distinction in detail, however it appears to be adopting similar reasoning to that discussed in Chapter 3 (Risk Management Standard), at paragraphs 419 of the Consultation onwards. That is, seeking to impose direct obligations on Boards even though the Deposit Takers Act expressly contemplates that the obligations apply to the deposit taker itself.

15. While NZBA acknowledges that governance requirements, by their nature, will include expectations on the running of the Board (and that Board engagement and approval/oversight of policy and compliance with risk appetite statement was included in the recommendations of the IMF's 2017 FSAP review, at principle 14). However, we consider that the proposals here:

    15.1. go further than is anticipated by the standard-setting power under the Deposit Takers Act. We note that various duties on the Board were contemplated in the exposure draft stage of the Deposit Takers Bill, but ultimately were deliberately removed and replaced with the due diligence duty. The proposals here could be read as bringing back those proposed Board duties, in an amended form, despite that deliberate removal;

    15.2. do not strike the right balance between ensuring Board oversight, and allowing the Board flexibility to effectively govern the deposit taker and its business.

16. The Deposit Takers Act was designed to reduce the relative reliance by the regulator on self-discipline and already imposes a clear avenue for director liability through the due diligence duty. Using standards in this manner, to effectively impose further liability on directors is contrary to the purpose of the due diligence duty under the Deposit Takers Act and represents a step backwards to the liability regime under the Banking (Prudential Supervision) Act 1989. This also appears run counter to the policy intent in other related areas to reduce director requirements, and, more generally, appear to go against proposals to reduce regulation in the industry. For example, we note that the Minister of Commerce and Consumer Affairs is considering under the Credit Contracts and Consumer Finance Act, where the Government has acknowledged that over-reliance on director liability has led to poor outcomes.

- *Q11 Do you have comments on the impacts of removing the independence exception*

for the chairperson of a board who is also a member of a parent board?

The allowance for a deposit taker Chairperson to also be appointed a member of a parent board should be retained

17. Current regulation generally permits the Chairperson of a New Zealand incorporated subsidiary to also sit on the Board of the parent bank. We consider this is often helpful from a New Zealand perspective, to provide a voice for the New Zealand bank at parent board level. It also helps to facilitate more frequent, direct and transparent communication between the deposit taker and the parent entity, and thus generally leads to better outcomes for the deposit taker. Given this, such arrangements should continue to be permitted where appropriate (for instance, where the Chairperson is New Zealand-based and otherwise independent of each bank). Such arrangements may continue to be subject to Reserve Bank approval/non-objection.

18. Additionally, we note the risks here are limited, and the main conflict is in situations where the parent entity is failing whilst the New Zealand deposit takers remains commercially viable. Even in this unlikely scenario, we view the risks here could be limited. Additionally in the case where a New Zealand deposit taker is failing it would be helpful for the New Zealand entity to retain a voice on the parent entity's board and would enable them to better identify support that the New Zealand deposit taker might need.

- *Q10: Do you have comments on the proposed criteria for independence of directors for Group 1 deposit takers?*
- *Q17 Do you have comments on the proposed criteria for independence of directors for Group 2 deposit takers?*

Clarity on proposed Board requirements

19. In relation to Requirement 4 of the proposed Group 1 compositional requirements for the Board, the Reserve Bank may wish to clarify whether the requirement for a majority of members to be independent also applies to establishing a quorum for a meeting. This would align with the intent of this requirement and ensure that decisions are made with sufficient independence.

20. In respect of the independence requirements at paragraph 156 of the Consultation, the Reserve Bank should consider if the Chairperson should be exempt from the term limit requirement under paragraph (e). Chairpersons are often appointed for a longer term than an independent director to reflect their initial term as an independent director prior to appointment as Chairperson. Given this, the Reserve Bank should consider if these term limit requirements should apply to Chairpersons. In addition, should the Reserve Bank proceed with the limit of 9 years for a director to be independent, we suggest flexibility is provided such that deposit takers could seek an exemption from this limit from the Reserve Bank, where it is appropriate.

- *Q12: Do you have comments on the proposed requirements for board committees of Group 1 deposit takers?*

- *Q19 Do you have any comments on our initial assessment of the impact of our proposals on Group 2 deposit takers?*

Additional comments on Board committee requirements

21. The Consultation proposes that deposit takers have separate Audit, Risk and Remuneration Committees. Whilst we agree with the need for committees to govern each of these areas, they should not be required to be separate from each other. In practice some deposit takers, particularly Group 2 deposit takers, have combined Audit and Risk Committees to prevent duplication and prevent over allocating resources. We do not think that requiring separate committees for Group 2 deposit takers is necessary, and risks substantially increasing compliance costs with little benefit being gained.

22. Paragraph 162 of the Consultation notes that Group 1 deposit takers must maintain a risk committee which must include "advising the board on the deposit taker's overall current and future risk appetite and risk management framework" in its mandate. We think the reference to "future risk appetite" should be either removed or clarified. Risk appetite reflects point in time considerations and should be reviewed regularly to ensure it remains appropriate for an organisation based on the environment at the time. Alternatively, this requirement could be amended to "overseeing the deposit taker's current and future risk position relative to its current risk appetite and capital strength". If the requirement is retained in its current form, a qualification should be added to make it clear how far into the future the board is expected to predict appetite bearing in mind that it is constrained by only be aware of those factors that exist at the time.

- *Q13 Do you have comments on the proposed fit and proper requirements for the boards and senior managers of Group 1 deposit takers?*
- *Q19 Do you have comments on our initial assessment of the impact of our proposals on Group 2 deposit takers?*
- *Q20 Do you have comments on the proposed fit and proper requirements for the boards and senior managers of Group 2 deposit takers?*

The Reserve Bank should provide clarity on the expectations for reviewing fit and proper requirements for existing directors and senior managers

23. We note the proposal at paragraph 179 of the Consultation to require deposit takers to review and undertake a fit and proper assessment for directors and each senior manager every three years. The Reserve Bank should provide more clarity on these requirements in order to enable deposit takers to manage this process.

24. If a director or senior manager is no longer considered suitable by the Reserve Bank, deposit takers will need time to manage any relevant transition, particularly as this transition will need to consider and comply with the constitution of the relevant deposit taker alongside any relevant employment requirements in the case of senior managers (both in terms of compliance with internal employment policy and the wider scheme of employment law). This process could take some time, so the Reserve Bank needs to

be clear about its expectations for how the review process will operate and its expectations for how deposit takers should manage such a transition.

25. We welcome the Reserve Bank to provide clarity on these review requirements and think the Reserve Bank should engage with industry to understand any transition requirements following an assessment that a director or senior manager is no longer considered fit and proper. We note that existing employment agreements will need to be updated once fit and proper requirements are finalised. Deposit takers will need sufficient time between the requirements being finalised and coming into effect to allow for the necessary consultation with those employees impacted.

26. We also think the Reserve Bank should be aware of the requirements of the Protected Disclosures (Protection of Whistleblowers) Act 2022 and whether this would have any impact on the obligation to share information with the Reserve Bank, particularly if there were concerns around the fitness and propriety of individuals raised through the whistleblower channel.

27. We also think that these requirements should be consistent across regulators such as any requirements from the Financial Markets Authority. This would have the benefit of consistent regulation, whilst reducing overall compliance costs and ensuring efficiency for deposit takers.

28. Additionally in relation to the proposed requirements for approving Group 1 deposit takers' directors and senior managers, the Reserve Bank should consider:

    28.1. In relation to Requirement 2, and whether a person's financial position raises suitability concerns, clarify what a "financial position" assessment means in practice. Is this intended to just be credit checks or is additional information needed?

    28.2. In relation to Requirement 3, who should the fit and proper certificate be provided by. Should this be the board chair to ensure consistency across deposit takers? Additionally, the Reserve Bank should consider providing a template certificate to help ensure consistency across deposit takers.

    28.3. In relation to Requirement 4a, whether it is necessary for such information to be provided to the Reserve Bank. This information will be highly personal in nature, and there will inherently be privacy risks involved. The Reserve Bank should be able to rely on the fit and proper certificate given under Requirement 3 as to these matters.

    28.4. In relation to Requirement 4b, we query whether the Reserve Bank will need to interview the proposed appointee, or other directors, senior managers or employees of the deposit taker in every case. Accordingly, we suggest that this is drafted as giving the Reserve Bank a general right to interview, rather than being a default position.

29. In relation to the proposed fit and proper policy requirements the Reserve Bank should consider:

    29.1. Whether Requirement 19 should be simplified or consolidated where possible.

    29.2. Clarifying Requirement 19(f) as to how deposit takers can prove such disclosure and procedures are "adequately explained" to directors and

employees beyond simply providing them with a copy of the fit and proper policy.

- *Q26 Do you have comments on the proposed outcomes and requirements for the responsibilities of the New Zealand branch CEO?*
- *Q27 Do you have comments on the proposed fit and proper requirements for branch senior managers?*
- *Q28 Do you have any comments on our initial assessment of the impact of our proposals on branches?*

The proposed fit and proper requirements for branches should be reconsidered

30. The Consultation proposes to require the directors and senior managers of branches provide the same form of fit and proper certificate and accompanying as for New Zealand deposit takers.

31. Branches are not subject to the requirement in section 26 of the Deposit Takers Act for Reserve Bank to approve director and senior manager appointments. Provision for this was deliberately removed from the exposure draft of the Bill.

32. Requiring overseas banks to apply New Zealand fit and proper standards, in addition to the existing fit and proper requirements applied by their home jurisdictions (as acknowledged in paragraph 245 of the Consultation), effectively re-imposes Reserve Bank approval requirements on such appointment.

33. NZBA submits that the Reserve Bank should reconsider this proposal and allow branches to rely on the fit and proper requirements from their home jurisdiction.

34. Separately we note the Consultation proposes that the New Zealand CEO of a branch would be required to set a fit and proper policy. We understand that it is intended that this would not apply to the bank board. The Reserve Bank should expressly confirm this, as it is impractical (and disregards principles of governance)for the New Zealand CEO of a branch to apply and enforce the policy against the parent bank board.

Submissions on Chapter 2 (Lending Standard)

- *Q32 Do you agree with our proposed approach to carry over the existing borrower-based macroprudential policy requirements to Group 1 deposit takers (which includes a three-month measurement period)?*

35. NZBA generally agrees with the Reserve Bank's proposed approach to carry over existing macroprudential policy requirements.

36. As technical/drafting point we consider that the layout of Table I (below paragraph 301 of the Consultation) is confusing. While paragraph 301 describes that aspects of the three columns (LVR threshold, DTI threshold and speed limit) are not mutually exclusive, we consider that each column should be clearly able to be set separately for flexibility – i.e. that the LVR threshold may range between 60% and 90%, the DTI ratio

threshold may range between 5 and 8, and the speed limit may range between 0% and 30%.

- *Q34 Do you agree with not including an option to apply the Lending Standard at an Auckland/non-Auckland level?*

37. NZBA supports the proposal in the Consultation to exclude the Auckland/non-Auckland level distinction in the context of the Lending Standard.

Submissions on Chapter 3 (Risk Management Standard)

- *Q39 Do you agree with our proposed approach to developing the Risk Management Standard?*

General approach to scope

38. NZBA supports the development of risk management requirements that are consistent with international practices where appropriate (including CPS 220 in Australia). Consistent risk management approaches should be able to be applied across groups, to avoid unnecessary compliance costs.

39. For instance, for a dual-operating group, the proposals appear to contemplate management of risks, separately, at:

    39.1. a global group level (where applicable);

    39.2. an individual deposit taker level for the New Zealand subsidiary (which we understand includes its controlled entities);

    39.3. an individual deposit taker level for the New Zealand branch; and

    39.4. a 'New Zealand group' level which we understand covers both the New Zealand subsidiary and the New Zealand branch (i.e. paragraphs 39.2 and 39.3 above).

    (See paragraphs 394 and 569 of the Consultation).

40. To ensure consistency of approach, it should be made clear that the 'New Zealand group' is the same for both the subsidiary and branch and does not, for example, reflect the differing 'New Zealand banking group' concepts used between subsidiaries and branches. In this context we note that the meaning of 'New Zealand group' as per paragraph 39.4 above is different to how the 'New Zealand group' is defined for the purpose of the Disclosure Statement requirements for the overseas incorporated bank (as this would also include the fund management entity where there is one in the group).

41. NZBA also submits that, given branches are not separate legal entities, it should not be necessary to separately consider the management of risks by a branch, rather than its global group except where necessary for the New Zealand context.

42. The Consultation notes the Reserve Bank's three lines of defence model (see Table K, page 89 of the consultation). While the principles of the model are well-understood, the detail of the three lines model approach will likely vary slightly across deposit takers, and we recommend that the Standard should continue to support this flexibility. We propose this can be achieved by the Standard requiring deposit takers to operate a three lines model, with any suggested definitions or detailed criteria to be contained in the guidance material.

Approach to material risks

43. We are supportive of the hybrid principles-based approach to risk management; however we note that some of the proposals in the Consultation are prescriptive and could potentially limit deposit takers' flexibility to tailor their risk management practices to their circumstances. In particular, the proposed list of categories of risk that deposit takers must consider at paragraphs 409 and 471 of the Consultation are highly prescriptive and, as such, do not provide deposit takers with flexibility in how the requirements are operationalised.

44. Additionally, we think that these lists would fit best as part of the relevant guidance document rather than the Standard. Deposit takers may have differing ways of describing these risks and these descriptions and risks will shift over time. Including these lists as guidance would allow the necessary flexibility for deposit takers to adapt and manage risk as these changes occur.

Additional comments

45. We also note that:

    45.1. the lists at paragraphs 409 and 417 of the Consultation are inconsistent as the former refers to "credit risk, including concentration and large exposure risk" and the latter refers to "credit risk, including large exposure risk". The Reserve Bank should clarify which statement is correct.

    45.2. interest rate risk is listed as a separate risk from market risk. We think this is unusual as interest rate risk is itself generally a subset of market risk (and typically is the predominant market risk). There should be no need to split these risks out.

- *Q42 Do you agree with our proposed approach in relation to the requirement for deposit takers to have a risk management framework?*

46. Whilst we generally agree with the proposed approach and requirement for risk management, we suggest that the flexibility that is provided through the risk management framework being "commensurate with the size of the deposit taker and the complexity of its operation" may be better suited to being in the guidance material rather than in the Standard. With this in mind, it is important that the Standard itself is sufficiently principles-based to achieve this flexibility. This will, in turn, also support proportionality.

- *Q47 Do you agree with our proposed approach relating to the responsibilities of the*

board?

- *Q50 Do you agree with our proposal to require the board to establish a sound risk management culture throughout the deposit taker and to issue guidance on 104 Deposit Takers Non-Core Standards Consultation Paper the soundness and adequacy of risk management cultures? Do you think there is an alternative way we could achieve the desired policy outcomes?*

Expanding director liability through Standards is contrary to the purpose of the Deposit Takers Act

47. As noted above (at paragraph 14 onwards) in our submissions on Chapter 1 (Governance Standard), the Consultation places a strong reliance on the Board's personal involvement in setting and managing wider policies and processes, including in relation to the risk management strategy, risk appetite statements and other requirements such as requiring the board to establish a sound risk management culture.

48. This appears to overlap, and effectively extend, the due diligence duty formulated and imposed on directors through the Deposit Takers Act itself. It is not appropriate to impose additional personal liability on directors through Standards, when the Deposit Takers Act already contains a clear and direct avenue for director liability.

49. Additionally, NZBA submits that if Board requirements are too prescriptive the Board's independence and ability to effectively oversee the wider operations of deposit takers could be limited. Boards should be able to manage internal policies and risks within the existing scope of the due diligence duty. Unnecessarily expanding this risks overregulation and stepping beyond the intent of the Deposit Takers Act.

50. Whilst there is a benefit to prescribing how a Board can promote good risk management, we think the Reserve Bank should be careful to consider how such requirements would sit against the Board's role as governance stewards for the organisation, setting strategy and providing oversight. Such requirements may require the Board to become deeply involved in operational matters, rather than allowing them to focus on strategy and governance. For example, much of what the Reserve Bank proposes in terms of Board responsibilities should sit with senior management. It is not the Board's role to *establish procedures* for monitoring and reporting risk issues (see the third item in paragraph 424 of the Consultation). This is the role of senior management or second line management.

- *Q51 Do you agree with our proposal relating to risk management policies and processes?*

51. Paragraph 442 of the Consultation notes that a deposit taker's conflict of interest policy must specifically address situation where the NZ CEO of a branch is also an employee of the subsidiary. In our view this conflict is one of many that may be relevant to the deposit taker, and it is not practical for a deposit taker's conflict of interest policy to set out all potential conflicts. Instead, flexibility should be provided for deposit takers to include such detail in their policies if they wish.

52. Paragraph 505 of the Consultation Proposal requires the Chief Risk Officer (CRO) to be "operationally independent from revenue generating responsibilities and the finance function".

53. CROs are typically responsible for, and oversee, a deposit taker's credit risk function and are, therefore, operationally involved in what lending proposals the deposit taker will accept (and ultimately, generate revenue from). In addition, as a member of a deposit taker's senior/executive leadership team, CROs have a role in:

    53.1. delivering the deposit taker's strategy (which by its nature involves generating revenue to make profit); and

    53.2. making decisions about initiatives which may be revenue-generating.

    We believe that the RBNZ's principles-based policy intent is to maintain independence between the risk management function and the business functions. If the Standard is too prescriptive it could create obstacles to the smooth running of the business.

- *Q52 Do you agree with our proposal that the risk management framework be regularly reviewed and adjusted?*

54. We assume the Reserve Bank's intent is that the risk management framework is regularly reviewed rather than regularly adjusted. We agree with the proposal that it is regularly reviewed, with adjustments only made if needed.

- *Q53 What do you consider to be appropriate for the breadth and frequency of the review?*

55. Whilst we do not oppose an annual review requirement for risk appetite and strategy, the frameworks, policies and processes underlying this should only be subject to a once in every three year review (noting that a holistic review can be carried out yearly and necessary policies can be adjusted as part of this). This will ensure that unnecessary compliance costs are not incurred whilst allowing sufficient timeframes for review.

- *Q54 Do you agree with our proposal to require deposit takers to have appropriate internal processes for assessing their overall capital adequacy?*

56. Paragraph 464 of the Consultation notes that "the Capital Standard proposes to continue the existing requirement for deposit takers to have an ICAAP and to determine an internal capital allocation for each risk deemed to be material." Whilst this is true for Group 1 deposit takers, the core standards consultation did not contain any ICAAP proposals for Group 2 or 3 deposit takers. In the first instance it should be clarified whether this is an error or if the Risk Management Standard will require Group 2 and 3 deposit takers to have an ICAAP. Also, ICAAP requirements should be either complete within either the Capital Standard or the Risk Management Standard, not spread across both.

- *Q60 Do you agree with our proposal to restrict the linking of a deposit taker's financial performance to any discretionary benefits that might apply to members of the risk management function?*

Restrictions on Risk Management Function need to be carefully considered

57. We note that the Consultation proposes to restrict deposit takers from any linkage between the financial performance of a deposit taker and discretionary benefits (bonuses) paid to any member of the risk management function (paragraphs 499 and 518 of the Consultation). This is potentially overly prescriptive, and various complexities need to be considered, such as differing role definitions, approaches to discretionary benefits, structuring of risk management functions etc, across each organisation. .

58. We consider that the imposition of a generalised restriction along the lines proposed raises a number of, potentially complex, issues in relation to the remuneration of the risk management team. It would be difficult to ensure consistent application of such a binary requirement across the sector given the variety of approaches that deposit takers take to remuneration. Moreover, such a requirement would appear to be at odds with giving a deposit taker's Board flexibility as to how it sets the remuneration strategy for the deposit taker (see Outcome 5 : Remuneration in Table B on page 37 of the Consultation).

59. We understand that the Reserve Bank's policy intent is to ensure that the risk management function is "an appropriate check and balance to risk-taking taking functions, supporting sound governance and prudent risk-taking by deposit taker" (see paragraph 508 of the Consultation). We consider that such a prescriptive requirement as proposed in paragraphs 499 and 518 of the Consultation is inconsistent with a principles-based approach to the standard.

60. Should the consultation proposal be ultimately adopted, the Standard should explicitly state that members of the risk management function will still remain eligible for discretionary benefits.

- *Q61 Do you agree with our proposal that the risk management function be subject to regular review by the internal assurance function?*

61. We consider that the regular review of the risk management function by third line proposed in paragraph 502 of the Consultation is unnecessary. Adequate oversight is provided as part of senior management and Board committee governance, as well as existing, targeted review activities. Such a review obligation would be onerous, labour-intensive, a distraction from useful risk management activities and would add significantly to compliance costs. We envisage this could create a large compliance burden with no apparent benefit.

Submissions on Chapter 4 (Operational Resilience Standard)

- *Q84 Do you have comments on our proposed definition of 'critical operations'?*

The definition of "Critical Operations" needs refinement

62. The Consultation proposes to define critical operations as "activities, functions and services undertaken by a deposit taker or any of its service providers which, if disrupted or suddenly discontinued, could be reasonably expected to have a material impact on the continued operation of the deposit taker and its role in the financial system."

63. NZBA considers that this definition may need refinement. It applies to services that are material to the deposit taker, and its specific role in the financial system. However it does not include any requirement that such services are core services from a financial system perspective (such as basic banking services and other matters captured by outsourcing standards), or that they are material to the New Zealand financial system – we submit that such requirements should be added to the definition. Additionally references to supporting assets are currently unaddressed by the Consultation.

64. For instance, deposit takers provide many services that generate revenue material to the deposit taker, or are important to attracting and retaining customers. This may include, for instance, loan origination and market making activities. Such services may also be material to "its role in the financial system", particularly if only offered by that deposit taker or a few deposit takers. However, they are not necessarily core to New Zealand financial system, and ceasing them would not be expected to affect New Zealand's financial stability.

65. We note that the proposed definition goes on to state: "Critical operations include but are not limited to transactional, savings and deposit accounts, credit services, payment clearing and settlement services". We consider that there is a risk that by adding this additional detail the definition creates a level of prescriptiveness, whereas we suggest that the Reserve Bank take a more principles based approach to defining the term "critical operations", so that deposit takers can develop their own framework for how operations are assessed (i.e. critical or non-critical).

66. The comments that we make at paragraphs 127 and 128 below, are equally applicable in the context of needing to clarify the definition of "critical operations". The definition of "critical operations" (as per the Operational Resilience Standard) has overlaps with the definition of "basic banking services" (as set out in the current BS11). This overlap reinforces the point that the independent third party (**I3P**) requirements of BS11 should be incorporated into the Operational Resilience Standard and removed from BS11, otherwise many I3P suppliers will be covered by both standards with different requirements.

67. The Reserve Bank should also consider aligning the definition of "critical operations" with the CPS 230 definition. This would ensure consistency with international best practice and would reduce compliance costs for those deposit takers who have Australian parent entities who are subject to the CPS 230 definition. In particular, the Reserve Bank should consider the following changes to the definition of "critical operations" to align it with the CPS 230 definition:

    67.1. The definition should be clarified to explicitly consider customer impact;

67.2. The definition should be clarified to include a reference tolerance levels (i.e. if a change disrupts beyond that tolerance level it would be included); and

67.3. The reference to "credit services" should be deleted from the definition.

- *Q85 Do you have comments on our proposed operational risk management requirements for Group 1 deposit takers?*
- *Q91 Do you have comments on our proposal to apply the same requirements for Group 1 deposit takers to Group 2?*

Overlap with other standards and laws should be carefully managed

68. The proposed Material Service Provider (MSP) requirements overlap significantly with the Risk Management Standard and Outsourcing Standard requirements, and the proposed Information and Communications Technology (ICT) incident notification requirements will continue to overlap with existing privacy breach reporting requirements.

69. NZBA appreciates that the purpose of such other standards and laws can be different to the purpose of the Operational Resilience Standard. However, as has been discussed previously in relation to the Reserve Bank's existing cyber resilience guidance, a priority for the development of an Operational Resilience Standard should be to ensure consistency as far as possible with those existing requirements. Ideally we consider this should be closely integrated with the Outsourcing Standard in particular; while BS11 includes a focus on recovery and resolution, in a broader sense it relates to supervision of outsourcing generally (see A1.2 of BS11).

70. Contradictory requirements, or requirements to perform similar actions (or agree similar but different arrangements with providers) will materially increase compliance costs and increase risks of inadvertent non-compliance if there is confusion about which requirements may apply in a given situation, particularly given the potentially wide breadth of coverage of this standard.

71. The proposed "critical operations" definition takes a horizontal view of critical processes and their dependencies on each other. Taking such a view also requires understanding the risk view across all these processes, however in practice deposit takers may not take a horizontal view to risk management across the organization. Given this the Standard should provide sufficient flexibility to allow this.

- *Q85 Do you have comments on our proposed operational risk management requirements for Group 1 deposit takers?*
- *Q91 Do you have comments on our proposal to apply the same requirements for Group 1 deposit takers to Group 2?*
- *Q96 Do you have comments on our proposed operational resilience requirements for branches?*

Support for consistency between operation resilience requirements and CPS 230 and 234

72. NZBA supports the Reserve Bank's intention to ensure that operational resilience requirements are consistent with international standards including CPS 230 and 234.

73. We agree that minimising inconsistencies will minimise compliance costs, particularly for those banks who are part of groups that operate in both New Zealand and Australia. In order to support this the Reserve Bank should look to ensure that any requirements are designed to be consistent and not go further than existing requirements under CPS 230 and 234.

Testing requirements in relation to operational risk management should be clarified

74. In relation to the proposed operational risk management requirements, we note the proposed outcome and requirement that a "deposit taker must regularly monitor, review and test controls for effectiveness. The frequency of this testing must be commensurate with the maturity of the risk being controlled" (requirement 1.4 of Table O on page 146 of the Consultation).

75. The testing frequency for these controls should be commensurate with the "materiality" of the risk being controlled in addition to being commensurate with the maturity of the risk being controlled. We also suggest incorporating flexibility within guidance in relation to this Standard to allow for modern control testing methods, such as real-time continuous monitoring and data analytics.

Clarity required as to the intended outcome of the independent review of "operational risk management processes and systems"

76. The Reserve Bank should provide clarity on what is the intended outcome of an independent review of "operational risk management processes and systems" (requirement 1.5 of Table O on page 146 of the Consultation). Is it intended that the review be of the processes and controls that mitigate operational risk, or is it intended to be more extensive and include a review of the design of the overall operational risk management framework and systems.

Proportionality to be considered for branches of overseas banks

77. In considering the imposition of the same operational resilience requirements on branches of overseas banks, the Reserve Bank should carefully evaluate the challenges these requirements will present, particularly in relation to their proportionality to the risks posed by the New Zealand operations of such branches. It is important to note that the scale of a branch's operations in New Zealand is expected to be significantly smaller than its equivalent operations in Australia, especially following the implementation of the Restricted Activities Standard and the Branch Standard. This discrepancy in operational size means that the costs and resources necessary to achieve compliance with these regulations could be disproportionately high for the New Zealand branch. Consequently, the financial burden of meeting these requirements may make it economically impractical for the branch to continue its operations in New Zealand. As some entities only operate as a branch in New Zealand, this could have broader implications for the availability of banking services and competition within the New Zealand market.

Other comments on the proposed operational risk management requirements

78. In relation to Table O in the Consultation:

78.1. The wording of Outcome 1 requires the Board to establish processes to detect, mitigate and respond to operational risks. It is not appropriate to require the Board to "establish" such processes, as for existing deposit takers there will already be a policy or framework for doing so.

78.2. In relation to Outcome 1.2 deposit takers are required to maintain a "comprehensive assessment" of their operational risk profile. In our view the word "comprehensive" is unnecessary here as it could add unnecessary obligations and it is unclear what benefit it adds.

78.3. Outcome 1.5 requires that a deposit taker's operational risk management processes and systems must be subject to annual review by external or internal auditors or by a suitably qualified independent reviewer. In our view this requirement is unnecessary and deposit takers should be able to take a risk based approach (rather than it being a requirement). More broadly, this requirement risks compromising internal audit function as it integrates internal audit into the operational matters of the deposit taker.

78.4. Outcome 1.7 requires that materiality for operational incidents "should be interpreted consistent with tolerance thresholds for critical operations". It is unclear how such "tolerance thresholds" for critical operations would be relevant to materiality.

- *Q86 Do you have comments on the proposed material service provider management requirements for Group 1 deposit takers, in particular relating to potential interactions with our proposed Outsourcing Standard?*
- *Q91 Do you have comments on our proposal to apply the same requirements for Group 1 deposit takers to Group 2?*

Other comments on MSP requirements

79. The definition of MSP is unclear in the Consultation (see paragraph 606 of the Consultation). In particular, we are unsure whether the definition is intended to cover any supplier contributing to a critical operation rather than just where all or part of critical operation outsourced (similar to BS11). We consider that it should be the latter, as this would avoid having to apply the MSP requirements to arrangements where it is not practical to do so, for example, in the case of financial markets infrastructure arrangements. The need for material service providers to be defined by reference to 'outsourcing' again highlights the benefits of replacing (or combining) the I3P aspects of BS11 with the MSP requirements, as discussed in paragraph 66 above. The Reserve Bank should look to clarify this definition.

80. In relation to Table P in the Consultation (page 147):

80.1. Outcome 2.3 requires deposit takers to "ensure that orderly exit from the arrangement is practicable" in relation to each MSP arrangement. We think this could be difficult to comply with in practice, noting the varying types of

MSPs. Additionally, the requirement being framed as in respect of "each MSP arrangement" means there is a risk of technical non-compliance for a failure to ensure that orderly exit from the arrangement is practicable in relation to even a single MSP arrangement. Given the broad nature of such definition, some compliance threshold should be included here. Lastly, the use of "is practicable" differs from the BS 11 wording of "appropriate and adequate". Ideally terminology should be made consistent to duplication of compliance work.

80.2. Outcome 2.6 requires a deposit taker's internal audit to review any proposed MSP arrangement that involves the outsourcing of a critical operation. As a general point, this seems excessive, particularly if internal audit is required to review *all* proposed arrangements, given that there could be many arrangements. At a practical level, such an approach would materially increase the remit of internal audit teams, which in turn will have resource implications. It could also potentially compromise internal audit's ability to be able to perform independent reviews.

80.3. Outcome 2.7 requires a deposit taker's internal audit to provide reporting to the board (or Audit Committee) on compliance of MSP arrangements with the service provider management policy every 3 years or after a material incident with an MSP has occurred. Involving internal audit functions here seems excessive and a regular review requirement seems more appropriate here.

- *Q89 Do you have comments on our proposed business continuity planning and management requirements for Group 1 deposit takers?*
- *Q91 Do you have comments on our proposal to apply the same requirements for Group 1 deposit takers to Group 2?*

Comments on Business Continuity Planning

81. In relation to Table S in the Consultation:

81.1. Outcome 4.1 requires a deposit taker to develop and maintain a board-approved business continuity plan which sets out how the deposit taker identifies, manages and responds to a disruption outside tolerance thresholds. It is noted that this plan must be regularly tested with severe but plausible scenarios, in relation to this requirement further clarity will be required on what is the minimum requirement here is for "regular" testing.

81.2. In relation to Outcome 4.4, we would suggest clarifying that the business continuity plan's actions / arrangements should be proportionate to the Board-approved risk tolerance thresholds.

81.3. In relation to Outcomes 4.9 and 4.10 we question the need to involve internal audit in such cases. As noted above, including such requirements may compromise the internal audit function, as it integrates internal audit into the operational matters of the deposit taker.

82. We also note that the Consultation uses the terminology "a business continuity plan", and assumes that this is a single document or similar. However, many deposit takers

will have a number (and in some cases many) of business continuity plans for different component parts of their operating models. The Standard will need to be drafted to contemplate such cases, and avoiding layering on requirements that would need to be individually applied across such plans, or would otherwise substantially duplicate or unnecessarily increase operational requirements across such plans.

Submissions on Chapter 5 (Related Party Exposures Standard)

- *Q98 Do you agree with the proposed approach for Group 1 deposit takers?*
- *Q100 Do you agree with the proposed approach for Group 2 deposit takers?*
- *Q101 Do you agree with the preference for Option A, that is, adopting the BS8 definition?*

NZBA supports aligning the definitions of "Related Party" and "Related Party Exposures" across all groups of deposit takers, based on the current BS8 definition of "connected person" and "connected exposures"

83. We support the preferred option in the Consultation to align the Related Party Exposures Standard definition of "related party" across all groups of deposit takers (based on the current BS8 definition of "connected person" and "connected exposures").

84. Carrying these definitions over from BS8 will ensure definitions are both clear and consistent. Additionally, the current BS8 definition of "connected party" was formulated to align with the Basel Core Principles. We consider it is desirable to maintain this alignment with international standards in relation to the "Related Party" definition under the Related Party Exposures Standard.

85. Additionally, as noted in the Consultation the BS8 requirements have already been reviewed in the context of the Deposit Takers Act. We agree that BS8 remains appropriate in the context of the Deposit Takers Act and associated legislative framework.

86. As a drafting point, care should be taken to avoid confusion between the "related party" concept here (i.e. connected persons) with separate "related party" concepts used elsewhere (e.g. for financial reporting purposes).

Submissions on Chapter 6 (Open Bank Resolution Pre-positioning Standard)

- *Q108 Do you have views on whether and how we should rename 'OBR pre-positioning' to better reflect the aims of the policy?*

NZBA supports renaming 'OBR pre-positioning'

87. NZBA supports reviewing and re-naming the term 'OBR pre-positioning'. In particular:

87.1. More broadly, the terms 'Open Bank Resolution' and 'OBR' are frequently not well-understood by the public, and in more recent times are also subject to confusion with the separate 'open banking' proposals. Given the more tailored purpose of this Standard, and interaction with the new Depositor Compensation Scheme (**DCS**) to provide a broader resolution tool-set, NZBA supports a re-naming of the concept.

87.2. The term 'pre-positioning' is currently used in a way that implies automation of all processes to achieve the outcome being sought. While automation is supported in principle, wherever practicable, there will inevitably be aspects that cannot be entirely automated in advance and will require some manual application – such as breaking/unwinding complex products and applying any haircut. The use of the word 'pre-positioning' in any Standard and guidance should be reviewed.

- *Q109 Do you agree with the proposal to retain OBR pre-positioning requirements under the new OBR Pre-positioning Standard for Group 1 deposit takers*
- *Q120 Do you agree with our proposal to remove the threshold of $1 billion in retail deposits and apply OBR pre-positioning requirements to Group 2 deposit takers, potentially with exceptions?*

The Reserve Bank should further consider timing requirements and provide open and clear communication on expectations for deposit takers

88. Considerable work will be required to implement resolution-related Standards over an 18 month period from 2027 to mid-2028.

89. NZBA understands that the following timing is proposed:

89.1. In January 2027, most new standards, including the new OBR Pre-positioning Standard, Outsourcing Standard and SDV file requirements, will be issued. Re-licensing will run from January 2027 to mid-2028.

89.2. The Reserve Bank is also developing its orderly resolution plans for each deposit taker. As it continues to develop those plans, the Consultation notes that "[b]efore finalising the new OBR Pre-positioning Standard, [the Reserve Bank] will confirm whether or not [Group 2 deposit takers] will be exempt from applying it" (paragraph 854 of the Consultation).

89.3. A Crisis Preparedness Standard is to be finalised in 2028 or 2029, and subject to a legislative backstop of July 2029 (as described in the Crisis Management Consultation).

89.4. The Crisis Management Consultation notes that, at a later stage, the Reserve Bank may look to consolidate the OBR Pre-positioning Standard, Outsourcing Standard and Crisis Preparedness Standard together into a single 'Crisis Management Standard'.

Proposed changes will be very difficult to achieve over an 18 month transition period

90. One outcome of the above timing is that considerable work will be required to implement resolution-related Standards over an 18 month period from 2027 to mid-2028.

91. In addition, at the same time banks will be focusing on re-licensing work and implementing other standards (including the DCS Standard). This will result in considerable workloads for deposit takers, putting them under significant time pressure to ensure that the re-licensing process and introduction of resolution-related Standards can be successfully implemented on time.

92. As a particular example, the introduction of the SDV file requirements will require significant work to implement. This includes:

92.1. changing banks' existing OBR pre-positioning (based on an accounts view) to also incorporate an SDV-based view to determine insured amounts, noting the expectation that OBR pre-positioning files continue to cover products outside scope of the DCS (such as foreign currency accounts); and

92.2. the Reserve Bank's expectation that OBR pre-positioning files be able to identify all direct insured deposits by end of day.

93. Such changes will have varying impacts across the industry depending on the deposit taker's current state OBR pre-positioning solution.

94. In any event, the accuracy of the information in the OBR pre-positioning and SDV files will be dependent on information provided by customers. As noted in paragraph 794 of the Consultation, deposit takers may not always be aware of all look-through accounts. As previously submitted in relation to DCS consultations, deposit takers can only work with the information they have received from depositors.

95. In addition, NZBA has significant concerns with the Reserve Bank's preferred approach in the OBR Pre-positioning Standard. It is our view that the timeframes for implementing the preferred approach may not be achievable, given the complexity of the work that is required to be undertaken. We are also concerned that Reserve Bank's preferred approach may result in significant effort and cost, only for potential substantial re-work to be required in line with a new Crisis Management standard.

Reserve Bank should, from the outset, be working towards a single Crisis Management Standard

96. We support the Reserve Bank's proposal of a longer term project to move all tools to pre-position for a bank resolution together into a single 'Crisis Management Standard'

rather than spread across multiple standards as proposed. As discussed in NZBA's submission on the Crisis Management Consultation, we consider that the Crisis Management Standard should be developed as a single Standard that, as overarching principles:

96.1. brings the current requirements together in order to reduce duplication and potential for inconsistency between the relevant Standards; and

96.2. otherwise maintains consistency with the OBR Pre-positioning Standard, Outsourcing Standard and Crisis Preparedness Standard.

97. NZBA submits that it is not desirable to maintain separate OBR pre-positioning, Outsourcing and Crisis Preparedness Standards in the longer term. With this in mind, any changes to OBR pre-positioning made now should be done as part of a planned shift towards a single Crisis Management Standard. In particular:

97.1. Resolution outcomes for OBR and DCS (as described in the Consultation) are better considered and pre-positioned for as part of a single Crisis Management Standard. Spreading resolution pre-positioning across multiple separate Standards has proved, historically, very challenging to align. Splitting resolution requirements across separate standards increases the risk of unforeseen conflicts between Standards given the complexity involved. It also appears to potentially reduce (rather than increase) flexibility and optionality (i.e. opening and closing of a deposit taker assumes operation of the DCS under the proposed new OBR Pre-positioning Standard).

97.2. In line with United Kingdom and Australian resolution approaches, we recommend that the Reserve Bank develops a single standard approach to resolution (to meet the Part 7 purposes set out in section 259 of the Deposit Takers Act). This would mean efficiently repackaging continuing tools with new tools into a single well-aligned and harmonious resolution framework. We query why the 'business as usual' resolvability requirements referred to in paragraph 229 of the Crisis Management Consultation would not cover all resolution pre-positioning (including that under the proposed new OBR Pre-positioning Standard if retained).

97.3. Given the scale of change across all the Standards, any interim steps in relation to crisis management, where deposit takers may be required to significantly amend or build systems for an initial/temporary OBR Pre-positioning Standard before rebuilding them for a Crisis Management Standard, should be avoided.

98. To be clear, NZBA is not advocating that there is a delay in starting work on drafting the OBR Pre-positioning Standard (or other Standards that are to be consolidated into the Crisis Management Standard) in order to have these finalised in line with the current proposed timeline (i.e. by January 2027). Rather, we submit that the Reserve Bank should bring forward the start of the work on the proposed Crisis Management Standard so that it runs in tandem with the work on the other Standards. This will help the Reserve Bank to identify, and deal with, at an early stage, possible scenarios where there may be a need for a substantial implementation re-work to move from the preferred approach in relation to the "interim" Standards to the longer term Crisis Management Standard.

Extension of the OBR-DCS interim solution

99. We note the Reserve Bank has proposed an "interim" approach to the integration of OBR and the DCS to cover the time period between the commencement of the DCS in 2025, through to the implementation of the standards in 2028, (as per "Box A" on page 196 of the Consultation).

100. Given the comments above, we suggest that the time frame for the "interim" approach be extended until the Crisis Management Standard is finalised in full. During this extended period deposit takers would have the option to continue to use existing OBR functionality or use an integrated OBR-DCS solution. We acknowledge there may need to be some amendment to the OBR functionality/processes when the Single Depositor View Standard comes into force in 2028. However, the extended time frame would give deposit takers a more appropriate transition period to implement the new requirements for an integrated OBR-DCS solution (and complete any resulting technology builds as required). It would also reduce the risk of any double up of technology build and cost due to changes in the OBR Pre-positioning Standard occurring as a consequence of it being moved into the longer term Crisis Management Standard.

Further clarity on engagement with home regulators

101. NZBA notes that paragraph 772 of the Consultation explains that the Reserve Bank and APRA would work together to obtain 'parental support' before the point of non-viability is reached. The Crisis Management Consultation also refers to Group led resolution as being an option. A diagram outlining the resolution hierarchies would be helpful to understand how the tools are intended to operate together.

- *Q110 Do you support the integration of DCS with OBR and the proposed solution?*

Interaction of OBR and the DCS

102. At this stage NZBA is not in a position to provide a view on whether DCS and OBR should be integrated. However, significantly more information is needed on how the integration of the two regimes will occur, and further engagement with industry is required, before NZBA is in a position to provide a clear view on the issue.

103. As general points, if the DCS and OBR are integrated:

    103.1. As discussed above, OBR pre-positioning requirements to support resolution strategies should be considered and developed holistically, to reduce complexity and lower the risk of conflicts during implementation.

    103.2. NZBA notes that the relationship between the DCS and OBR regimes is very complex. Accordingly, NZBA submits that it is important that the Reserve Bank ensures that its messaging about the interaction between the DCS and OBR , including how the DCS fund could be utilised when OBR is triggered, is clear and concise, and easily understood by customers.

104. It is critical that public confidence in the DCS is maintained, and that depositors understand that the DCS will be used to protect them, including in an OBR scenario. The risk of customers removing their deposits and creating a run on the bank because

they do not understand the role of the DCS needs to be minimised. Relevant in this context is whether there will be a government guarantee for any new and unfrozen liabilities of the deposit taker in OBR (where there has been an integrated solution), and if so how it would operate. We note the Consultation does not discuss this. This is also relevant in the context of our comments at paragraph 123.1 below in relation to the residual risks associated with enabling depositors to have continued access to their deposits.

105. We have the following more specific points on the integration solution:

105.1. Paragraph 799 of the Consultation says that other balances that are not accessible could be made visible as a "*frozen amount*". Implementing this may require additional technical work from deposit takers, particularly as some deposit takers use debits against an account to "freeze" funds (and as such they will not show in the account at all). In any event we think the Reserve Bank should clarify that this would not be required of deposit takers.

105.2. In paragraph 806 of the Consultation there is reference to a template being provided for reporting. We submit that any expectations that the Reserve Bank has in relation to reporting (whether in a template or otherwise), must be provided at the same time as other requirements. Industry needs this so that appropriate fields can be built to provide information.

105.3. Paragraph 815 of the Consultation states "The costs of the proposed solution primarily relate to deposit takers' upgrading and maintaining their IT systems and associated processes. Most of the system changes required to achieve the proposed outcomes described above are likely to be incurred in implementing DCS requirements, such as the SDV". We do not agree with these assumptions. In many cases the proposed DCS/OBR integrated solution would require a complex and potentially novel/unproven solution rebuild (rather than an upgrade).

- *Q111 Are there any other solutions that would achieve the same outcomes (or better) for depositors?*

Other solutions to depositor protection

106. It is unclear what depositor outcomes are being referred to in question 111 – for instance it could be:

106.1. protecting depositors covered by the DCS;

106.2. enabling access to deposits;

106.3. ensuring protection provided by the NCWO rule;

106.4. closing and opening a deposit taker in an orderly fashion; and/or

106.5. ensuring continuity of critical services and banking functions (including access to deposits).

107. Existing OBR achieves some but not all of the above outcomes for depositors; OBR/DCS integration may achieve other outcomes, but may also undermine the

delivery of some outcomes (by introducing unnecessary uncertainty and operational risk in the operation of the DCS and OBR more broadly).

108. As discussed above, it is vital that clear messaging is provided, and a holistic approach is taken to crisis management requirements.

- *Q112 Do you agree that the compendium of liabilities will need to be updated to reflect DCS-eligible products?*

Compendium of liabilities

109. NZBA agrees that it is a logical step in the integration of the DCS with OBR that the OBR compendium of liabilities will need to align with DCS-eligible products (i.e. the products covered by the DCS should match the OBR compendium of liabilities from the outset). This assumes the Reserve Bank considers that a compendium of liabilities is still required on the implementation of the DCS; noting that there is still some uncertainty as to how the DCS is to be implemented.

- *Q113 What is the estimated cost of integrating DCS requirements (for example, calculation of insured deposits under the SDV) with OBR? Do not include the cost of setting up and maintaining the SDV file.*

Reliance on SDV files and incorporation into systems need to be carefully managed

110. As mentioned in paragraph 92.2 above, the Consultation proposes that OBR pre-positioning files should be able to identify all direct insured deposits by end of day, and in a way that links with banking systems (paragraph 789 of the Consultation onwards).

111. Deposit takers are also expected to implement automated systems that operate during the deposit taker's resolution to provide "customer-level reporting on the amounts depositors were given access to in resolution", together with a reconciliation against SDV files, for a resolution manager to apply (paragraph 804 of the Consultation).

112. Currently, OBR pre-positioning files are generally constructed as an output, taking data from different relevant systems and collating it into a file as needed. They generally are not, and are not required to be, integrated with banking systems in a way that allows those systems to access and use such data (or to be automatically applied in resolution). We are concerned that the scope of the current proposals may effectively require such integration. This would be complex.

113. Existing systems would need to be substantially reworked in order to take SDV file data as an input, reconcile this with the amounts that depositors have actually had access to and then provide an automated output. It is expected that this would take substantially longer than the approximately 18 months proposed under the Consultation. Additionally, this is likely to result in time delays to complete data collation and reconciliation. This could impact the ability of the OBR deposit taker to ensure it is able to open by 9am the next day as per current policy.

- *Q114 Do you agree with the proposal to update OBR pre-positioning to enable next-day reopening on any calendar day?*
- *Q115 Are there operational challenges in reopening the bank on a weekend or on a public holiday, and are there measures that could be undertaken to manage these challenges?*

Care should be taken if referring to a deposit taker re-opening on the next calendar day after resolution days

114. The Reserve Bank is proposing to change OBR pre-positioning requirements to be based on "calendar days", rather than carrying over the "business day" concept from BS17. In practice this would mean that a deposit taker would need to be able to be resolved overnight on a Friday for opening on a Saturday morning.

115. At this stage NZBA is not in a position to provide a view on whether it supports the proposed change. However care should be taken if the Reserve Bank goes ahead with the proposed change. In particular, we are not aware of any other jurisdiction that has successfully implemented a bank resolution scheme that allows payout on the next calendar day during a weekend. International best practice recommendations are to achieve a payout timing of 7 working days (see IADI Core Principles for Effective Deposit Insurance Systems, principle 15). The United States Federal Deposit Insurance Corporation (**FDIC**), which has considerable experience resolving bank failures, aims for payments within two business days (https://www.fdic.gov/bank-failures/payment-depositors), with Silicon Valley Bank for example resolved over a weekend for the following Monday. In this context, we consider that many resolutions are implemented on a Friday night *because* it allows resolution to be completed over the weekend, in time for the next business day. Complex resolution situations may benefit from such breathing space to assess options and implement.

116. We consider that, if the Reserve Bank intends to proceed with this change, it should be clear that:

    116.1. the Reserve Bank preserves the flexibility for the process to take longer depending on the situation for the deposit taker (i.e. the change is not used to evidence or imply that a deposit taker would generally be re-opened on the next calendar day); and

    116.2. it should be clear that the Reserve Bank does not require banks to make more services available than would normally be the case on the relevant day.

117. We also note for completeness that OBR pre-positioning (like the later Crisis Preparedness Standard) will effectively need to link into the availability of the DCS. If OBR timing is amended to be based calendar days, then we consider that the DCS will need to be ready to payout across non-business days as well given the interconnection between the DCS and OBR. In such a case, industry and the Reserve Bank would need to engage on this to ensure that OBR pre-positioning files are matched to DCS availability.

118. As a final point, if the Reserve Bank intends to go ahead with its proposal, the Reserve Bank will need to engage closely with industry to ensure that the final proposals meet OBR's principle of speed of access to funds.

- *Q116 Do you agree that the variable unfreezing capability for non-deposit liabilities should be included in the OBR Pre-positioning Standard, given potential linkages to other OBR capabilities?*
- *Q117 What further cost would be incurred in having a variable unfreezing capability for non-deposit liabilities?*

Variable unfreezing would be a significant additional technical undertaking

119. NZBA notes the proposal to require variable unfreezing capability for non-deposit liabilities as part of the OBR Pre-positioning Standard.

120. This will be a significant technical undertaking for many deposit takers and will require significant time and resources to implement, and we expect that the process of unfreezing non-deposit liabilities would be largely manual (not automated).

121. Therefore, any pre-positioning must be minimal (if at all) and would need to reflect the complexity and manual nature of unfreezing non-deposit liabilities. NZBA considers that this should not be part of OBR pre-positioning, particularly noting the Standard's focus on providing depositors with access to deposits in resolution (i.e. DCS insured deposits at the minimum) and stabilising the deposit taker.

122. If the Reserve Bank is to require such capabilities, it should consider this in its proposed timing (as discussed above), particularly given the significant amount of work that teams will be carrying out implementing SDV requirements at the same time.

- *Q118 What residual risks do you see to depositors having continued access to their deposits in resolution (notwithstanding any sale, transfer or disposition of the business of the failed deposit taker)?*
- *Q119 Do you think that the broader requirements to address these risks should be considered as part of some future resolution-related standard (if relevant) rather than in the OBR Pre-positioning Standard?*

Residual risks to be considered when planning for depositors to have continued access to their deposits in resolution

123. We note the following residual risks associated with enabling depositors to have continued access to their deposits:

    123.1. An increased potential for a run on the bank after resolution occurs, effectively limited to the amount of the unfrozen insured deposits. (Depending on the size of the non-insured deposit base it may also increase the risk of a run in the lead-up to resolution, as non-insured depositors will expect to lose access to their deposits.) In this regard we note that paragraphs 782 to 788 of the Consultation, and Appendix 1, indicate only a small contribution from the DCS, to 'top up' the differential between insured balances and remaining bank assets (consistent with the mechanics for us of the DCS set out in the Deposit Takers Act). If it is considered that only a small portion of cash has been injected via the DCS (the Consultation uses an example of a contribution of 5% of overall deposits, at paragraph 785 of

the Consultation), there may be an incentive on customers to withdraw their deposits and access that liquid 5% contribution, rather than being left needing to access funds from the bank's possibly illiquid remaining assets. (And, although deposit takers are required to maintain liquidity ratios, this may be complex for customers to assess, particularly in a resolution context.)

Such risks will need to be managed through clear Reserve Bank communications around approach and mechanics, to ensure depositors understand how DCS works and that they will be fairly compensated as relevant.

123.2. Systems and process challenges when identifying customers, relevant deposits, freezing and unfreezing deposits.

123.3. Maintaining systems to facilitate customer payments (e.g. ATM, customers' planned payments).

123.4. Risk of depositor claims and complaints where a customer receives insufficient access or where the access is appropriate but doesn't align with stakeholder expectations

123.5. Potential claims from institutional customers / bond holders (noting that the moratorium would delay such claims).

124. As noted above, we would expect that actions required to remove barriers to the execution of resolution options or mitigate execution risks should be considered holistically under a Crisis Management Standard and not under separate Standards, because the same or similar risks are likely to apply across a range of resolution strategies.

Submissions on Chapter 7 (Outsourcing Standard)

- *Q122 Do you agree with the general approach of not making major changes to the Outsourcing Policy for Banks (BS11) in converting it to a standard?*

125. We broadly agree with the general proposal to retain BS11 requirements and carry them over into the Outsourcing Standard. However this subject to our comments below, including at paragraph 127 below (regarding the overall treatment of the I3P and Related Party aspects of BS11).

126. NZBA submits that this would be an opportune time to address some aspects of BS11 that are challenging to apply (and which could be improved) without materially contributing to the purpose of BS11. NZBA notes that any changes to the Outsourcing Policy reflected in the Outsourcing Standard, whether suggested below or otherwise proposed by the Reserve Bank, may require the Reserve Bank to provide an appropriate transition approach and timeframe to enable deposit takers to implement the change. In particular:

126.1. *Absence of materiality or criticality thresholds*: The practice of all Outsourcing being by default in-scope unless there is a specific exemption category is problematic. This has the consequence of introducing (as a default) a considerable number of outsourcing arrangements which might broadly be considered as "in relation to a particular outcome" but are not material to the

deposit taker's ability to achieve that outcome should the outsourcing arrangement fail. The Reserve Bank's comments in the Consultation (such as at paragraphs 885, 868 and 888 of the Consultation) imply that the Reserve Bank's intended focus is on outsourcing arrangements that are "critical or important for the deposit taker to be able to deliver the desired outcomes", and that some level of outsourcing is not considered problematic. This should be reflected in the Standard.

126.2. *PCTs:* The concept of "statutory management" is replaced with "resolution manager' by the Deposit Takers Act. This may necessitate changes to section B2.9 of BS11 and resulting changes to banks' PCTs and existing contracts. As referred to above, the Reserve Bank should provide an appropriate transition approach and timeframe to allow deposit takers to update existing contracts to account for this change. In addition, the changes should apply from the time that the new Standard comes into effect, and not be retrospective.

126.3. *Compendium fields:* Some of the required Compendium fields specified in BS11 would not be relevant for a statutory/resolution manager, i.e. the physical address or historic, upfront and ongoing costs. Maintenance requirements for these Compendium fields can be burdensome relative to the risk profile (and it has proven difficult for deposit takers to keep this data up-to-date consistently across services). Given this, these fields should be optional requirements, rather than mandatory.

Operational Resilience Standard

127. Given the overlapping but inconsistent requirements between requirements in BS11 for independent third party (**I3P**) outsourcing and the new requirements for material service providers, we consider that the I3P obligations in BS11 should be removed and be replaced by the material service provider requirements of the Operational Resilience Standard. This approach is consistent with APRA's approach in replacing CPS231 with CPS230. The requirements for material service providers under the Operational Resilience Standard will be much more comprehensive and relevant in supporting deposit taker activities than the narrowly focussed I3P requirements in BS11, rendering the I3P requirements unnecessary.

128. If the I3P requirements of BS11 are to remain in addition to the requirements in the Operational Resilience Standard, the concept of 'critical service provider' in BS11 should be removed. The concept of a 'critical service provider' list has been developed based on the reference in a guidance note in the definitions of BS11. The critical service provider list is a list of suppliers that need to be paid to 'keep the lights on'. Many of the critical service providers are not in-scope for BS11. Given the focus in the Operational Resilience Standard on material service providers, and the more comprehensive requirements in relation to those providers (as opposed to the BS11 obligation to maintain a list), the reference to critical service providers in BS11 is obsolete and should be removed.

Outsourcing and the Crisis Management Standard

129. NZBA has previously requested greater alignment between OBR pre-positioning and the outsourcing requirements, which is not currently reflected in the Consultation. It is vital that such alignment is considered and applied to the new Standards.

130. As indicated above, the separation/related party aspects of BS11 should be incorporated into a single Crisis Management Standard as another tool for use in crisis management (if appropriate in the circumstances). Creating a holistic and integrated Crisis Management Standard reduces the likelihood of overlapping but inconsistent requirements between standards, which causes issues with implementation and may result in reduced flexibility in a crisis. NZBA acknowledges that the timeframe for the Crisis Management Framework is different to the proposed Standards and so the separation/related party aspects of BS11 will need to remain in a separate standard until a comprehensive Crisis Management Standard is ready.

131. We note that footnote 255 (at paragraph 888 of the Consultation) outlines that the Reserve Bank will need to consider how "systematically important activities" might intersect with "critical operations" in the context of the Crisis Preparedness Standard. We would welcome the Reserve Bank providing further information on this intersection in the crisis management and crisis preparedness context, particularly given the significant changes to the deposit taking sector scheduled to occur in 2027-2028.

Reasonable assurance as an audit standard is not appropriate

132. Industry is currently in discussion with the Reserve Bank on the reasonable assurance requirement in section D2.1 (1) of BS11. Industry has indicated to the Reserve Bank that reasonable assurance as an audit standard is not an appropriate audit standard to apply to the BS11 Policy, rather it should be an advisory review. We understand the Reserve Bank has indicated that it cannot make any changes ahead of the next review, but that it will look to review the reasonable assurance wording for future reviews. Industry requests that they are consulted on these changes, and that this update is included as part of the DTA changes.

- *Q124 Do you agree with replacing the term 'business day', as used in BS11, section B1.1(3), with 'calendar day' in the future Outsourcing Standard?*

Care should be taken if the outsourcing requirements are to be amended to be based on calendar days

133. At this stage NZBA is not in a position to provide a view on whether it supports an amendment to the outsourcing requirements to be based on calendar days (rather than business days). However, if the Reserve Bank does intend to proceed with the change, it should do so cautiously, and note the following points:

133.1. the outsourcing requirements apply more broadly than the making of retail payments (which SBI365 applies to). We note that retail payments are only one aspect of 'basic banking services' in Outcome D, BS11 requirements;

133.2. applying a 7-day banking standard to all BS11 in-scope activities means the scope of activities deposit takers will need to have ready by 9am on a weekend day will be much broader than the services that deposit takers offer on non-business days under normal operations (and would effectively mean that services that are not currently required to recover on a non-business day would be subject to a 7-day banking standard);

133.3. BS11 already requires robust back-ups to be available withing six hours on the day of failure (for example, paragraph B2.8(5)(c)(i)). That is, the

outsourcing requirements already specifically address situations where an outcome is required more quickly than the next business day; and

133.4. seeking to re-open a deposit taker over a weekend may introduce further risk that the separation does not occur as quickly as intended, and as has been announced to the public. We consider it likely that any separation activity would be implemented on a Friday night *because* it allows separation (and any other parallel resolution activity) to be completed over the weekend, in time for the next business day. Separation will always be an extremely complex situation, which would benefit from having this time to assess options and implement.

- *Q125 Do you agree to including, where appropriate, supervisory expectations, FAQs, letters, etc issued during the transition period as part of the guidance document that will accompany the Outsourcing Standard?*

BS11 guidance should be separated from the outsourcing standard

134. NZBA generally supports the proposal in the Consultation that the core requirements of BS11 will be carried into a new Outsourcing Standard, whilst guidance from BS11 will be moved into a separate non-binding document.

135. NZBA notes that BS11 (and its supporting materials) has a complex structure that has been developed over time, including various interpretational aids (such as FAQs) that are not published in the policy. Given this, we emphasize the need for the Reserve Bank to use care, and exercise judgment, when moving the existing BS11 guidance into a separate non-binding document.

136. In light of the comments above, NZBA submits that the Reserve Bank should engage with industry prior to issuing any draft guidance document to discuss the information that the Reserve Bank proposes to incorporate into the guidance (including any changes to the existing BS11 guidance as part of the new guidance document), how that information will be presented and to ensure that any proposed changed do not have unintended consequences (for example, changes should apply on a forward looking basis only).

Submissions on Chapter 8 (Restricted Activities Standard)

- *Q131 Do you agree with our proposal to restrict the conduct of material nonfinancial activities by deposit takers?*
- *Q132 Do you agree with our proposal to maintain a materiality threshold? If so, what kind of materiality threshold would be more appropriate for achieving our policy intent, and what would be an appropriate measure?*

Clarity is needed to ensure the "material non-financial activities" definition does not unnecessarily restrict deposit taker's ability to provide new, ancillary and adjacent services to customers

137. NZBA notes the proposal in the Consultation to carry over the existing BS1 restrictions on the ability of deposit takers to conduct material non-financial activities. Given the

evolving nature of the deposit taking sector, both internationally and domestically, we consider that more certainty should be provided on what "material non-financial activities" entails, with the focus on ensuring deposit takers have comfort that:

137.1. there is flexibility to adopt changing practices and innovation; and

137.2. the definition will not be re-evaluated over time to take a more restrictive view than what applies when a new business line is commenced, or if the definition is re-evaluated that any existing material non-financial activities are allowed to continue (or depending on the circumstances allowed to continue but closed to new business following an adequate transition period).

138. Industry will need certainty that the scope of "financial activities" provides sufficient flexibility to allow deposit takers to provide a range of ancillary and adjacent services.

139. Additionally deposit takers need certainty that the scope of "material non-financial activities" will not be narrowed in the future, and that activities which are considered "financial activity" when a business line is commenced will not be determined to be "non-financial" in future.

140. Uncertainty around this definition could artificially restrict the ability of deposit takers to offer new or ancillary products and services, as deposit takers would be less willing to invest where there is a risk they may become restricted in the future.

- *Q135 What criteria do you consider would be appropriate in our assessment of whether to grant approval for a deposit taker to establish an overseas branch or subsidiary?*

The proposed requirement to notify the Reserve Bank before approaching a host supervisor may be difficult to comply with and should be reconsidered

141. The Consultation proposes that any deposit taker seeking to set up a branch or overseas subsidiary must notify the Reserve Bank before approaching the relevant host jurisdiction. This requirement may be difficult to comply with, and in particular may be contrary to the requirements in the host jurisdiction.

142. For example, if a deposit taker seeks to acquire an existing offshore regulated business there may be a requirement (whether legal or practical) in that jurisdiction to inform the host supervisor first.

143. In our view, this requirement should be reframed to require a deposit taker seeking to set up a branch or overseas subsidiary to notify the Reserve Bank promptly once it has contacted the host supervisor. This would prevent the timing mismatch discussed above whilst still supporting the ability of the Reserve Bank and host supervisor to establish effective cooperation as the Reserve Bank would be able to contact and engage with the host supervisor very shortly after the deposit taker has approached them.

Existing overseas branches and subsidiaries should not be reassessed

144. Paragraph 975 of the Consultation notes that approvals for existing overseas branches and subsidiaries "would need to be reassessed in a DTA context". NZBA strongly

submits that existing approvals for overseas branches and subsidiaries are carried through to the new regime.

145. Reassessment is likely to incur significant compliance cost, and unnecessarily creates uncertainty around the investment that deposit takers have put into such branches and offshore subsidiaries.

146. These branches and offshore subsidiaries have been assessed under the existing legislation and conditions of registration, and we are not aware of any material concern with existing operations. The additional compliance costs of re-evaluating them at this stage would be inappropriate.

Submissions on Chapter 9 (Branch Standard)

- *Q150 Do you have any comments on the proposal to use the 'wholesale clients' definition as per section 459(3) of the DTA, and its implications for branches and their customers?*

The Reserve Bank should urgently provide clarity on the definition of "wholesale business"

147. Given the significant implications of the Branch Standard to branches of overseas banks operating in New Zealand, NZBA submits that the Reserve Bank should urgently clarify the following matters. Such clarification is required for branches to manage the transition of their businesses in the lead up to implementation of the Branch Standard.

148. Customers who are subsidiaries of (or otherwise controlled by) "wholesale clients" should also be deemed to be "wholesale clients" under the Standard. For example, if a large overseas corporation has a smaller New Zealand subsidiary the local subsidiary should also be considered a "wholesale client", similar to equivalent provisions in other contexts including:

    148.1. clause 9 of Schedule 1 of the Financial Markets Conduct Act, in relation to offers of financial products; and

    148.2. regulation 237B of the Financial Markets Conduct Regulations 2014, in relation to 'conduct of financial institution' laws.

149. Section 49(2)(g) and 49A of the Financial Service Providers (Registration and Dispute Resolution) Act 2009 provide for certified "eligible investors" to be wholesale clients. It is expected that branches may need to start arranging such certificates for relevant clients shortly, in order to fit with any corresponding exclusion from the DCS by mid 2025. The Reserve Bank should clarify whether or not any additional elements (such as references to exclusion from the DCS) will be requested for such certificates, so that branches can prepare one form of certificate for both the DCS exclusion and the Branch Standard.

150. It is not clear from the Consultation what ongoing testing requirements branches will be required to carry out to ensure clients are considered "wholesale clients". The Reserve Bank should clarify any such testing requirements and, if ongoing testing is required, clear transition allowances should be provided to allow branches to off-board customers who may no longer be considered "wholesale clients".

151. In relation to any bond issuances or similar, the Standard should be clear that issuers only need to ensure that the bonds are issued on a wholesale basis (and issuers do not have ongoing obligations to ensure that bondholders meet the "wholesale client" definition). Bonds are generally issued on a freely transferable basis and issuers do not have control over the sale of bonds on the secondary market.

- *Q151 Do you have any comments on the proposed definition of large corporate and institutional client and its implications for branches and their customers? Please provide details on the impact of the different limbs of the definition.*

The Reserve Bank should provide clarity on the application of the definition of "large corporate and institutional clients"

It is not clear how the definition is to apply

152. For dual-operating banks, it is not entirely clear how the definition of "large corporate and institutional client" is intended to apply to counterparties/investors rather than customers. The Reserve Bank should clarify whether it intends to have a specific definition for counterparties (such as linking to the "investment business" and other wholesale investor tests in the Financial Markets Conduct Act). In any event, the definition should not unduly limit the ability of branches to transact with counterparties/investors meeting the relevant size definitions. Additionally, any customer that meets one of the tests should be eligible to do business with a dual-operating branch regardless of the nature of their business, for example government agencies may not be considered a "corporate or institutional client" but could meet one of the tests.

153. The Reserve Bank should provide clarity on how the limbs of the "large corporate and institutional clients" should be applied in these scenarios:

153.1. Where a large overseas corporation has a smaller New Zealand subsidiary, should the global turnover or New Zealand turnover be used to determine if the customer meets the definition of a large corporate and institutional client. We understand the Reserve Bank's intent is for the New Zealand turnover to be used for dual operating branches. However, we note that this approach raises a number of issues, and could have unintended consequences:

- it could limit the availability of the product or service in the market where the product or service is not offered by the locally incorporated subsidiary;
- in some cases, local financial information may not be available to enable the assessment to be made;
- New Zealand subsidiaries of multinational companies (**MNC**s) would expect themselves to be considered as sophisticated large corporates, so to not treat them as such results in an asymmetric treatment if the MNC were to be the direct customer with the branch.

153.2. In the case of New Zealand subsidiaries that are part of a bigger New Zealand group/reporting entity where consolidated financial statement is the only source of total assets or turnover information. An example of this is the "Financial Statements of the Government of NZ" for government agencies

whereby this is the only source of total assets or turnover information for certain Crown entities and SOEs. The consolidated financial statement does not provide a breakdown of the individual Crown entities and SOEs. This scenario may also apply to some corporate entities as well.

153.3. In the case of a special purpose vehicle (**SPV**) that has been set up solely for an infrastructure or a securitisation deal, how should the total assets test be applied as the SPV grows (i.e. the total assets of the SPV are less than $75m while it is growing to its required size) and then conversely amortises down. For example an SPV may be established for a construction project, which is planned over a 5-year period. The SPV has a planned debt drawdown profile that is aligned to the planned construction activity, such that the total assets at day one financial close are $30m and total assets only reach $75m after 3-months into the construction period. We consider that dual operating branches should be able to transact with these customers moving forward.

153.4. In the case of determining total assets under management (**AUM**) for fund management entities, we think the Reserve Bank should clarify if the intention is to provide guidance on the required source(s) for determining the AUM for these entities and whether there would be restrictions on qualifying entities (i.e. situations where fund management is not the entity's core business/ANZSIC code, overseas managers).

Additionally, we submit that the Reserve Bank should consider reducing the minimum AUM for funds management entities to be classed as a "large corporate and institutional client" from $1b to $250m as to not exclude a number of large fund managers in New Zealand, including some KiwiSaver funds.

154. For dual-operating deposit takers, bond issuances and similar activities by the relevant overseas parent bank should also be explicitly excluded from the additional "large corporate and institutional client" requirements. Global bond issuances by the parent bank may typically allow for subscription by New Zealand investors meeting standard "wholesale investor" tests under the Financial Markets Conduct Act. It would not be practical to further limit such global bond issuances to "large corporate and institutional clients" in New Zealand, as this would add unnecessary administrative burden (and may in many cases lead to New Zealand investors being excluded entirely).

More clarity on the ongoing testing requirements is required

155. It is not clear from the Consultation what ongoing testing requirements dual operating branches will be required to carry out to ensure clients are considered "large corporate and institutional clients". The Reserve Bank should clarify any such testing requirements and, if ongoing testing is required, clear transition allowances should be provided to allow branches to off-board customers who may no longer be considered "large corporate and institutional clients". For example, would dual operating branches be able to rely on a "safe harbour certificate" or "self-certification" from the customer confirming that they meet the definition of a large corporate and institutional clients. Furthermore, guidance should be provided on the timing and frequency of the assessment because it may not be practical for branches to perform the assessment every time the customer enters into a transaction if they transact regularly with the branch.

156. The Reserve Bank should also seek to provide guidance to support dual operating branches in complying with the “large corporate and institutional client” definition, for example, in situations where the customer no longer meets the “large corporate and institutional client” criteria after entering into the transaction. In these situations it would be practical to restrict any new/future transactions with the customer, but existing transactions should be able to remain until maturity.

Some forward looking element to the definition is needed

157. The definition of “large corporate and institutional client” should be sufficiently flexible to allow for a forward-looking element to the definition, so that clients that are reasonably expected to meet the financial thresholds within a certain period of time (e.g. on or before the maturity date of any transactions entered into with the branch, or two years from the date of the certification (whichever is later)) are also covered. This would allow for a range of appropriate newly established clients to be covered by the definition. This would avoid requiring the newly established client having to first be a customer of the locally incorporated subsidiary deposit taker, for example, in the case of project financing entities, in order to enter into non-disclosure agreements and open bank accounts etc before the entity has acquired any assets. And then, once it has acquired the assets, to be subsequently transferred to the branch, with the consequential costs and administrative time that this could involve.

158. This seems especially unnecessary in a scenario where the overseas parent of the newly established client is banked by the branch and already meets the threshold. In this regard our comments at paragraph 148 above are equally relevant in the context of dual-registered branches.