Reserve Bank of New Zealand
Te Pūtea Matua

Deposit Takers Non-Core Standards

Policy proposals

21 August 2024

CONSULTATION PAPER

Submission details

The Reserve Bank of New Zealand – Te Pūtea Matua invites submissions on this Consultation Paper by 5.00pm on 22 November 2024. Please note the disclosure on the publications of submissions below.

Submissions and enquiries

You should make your submission online at https://consultations.rbnz.govt.nz

Email enquiries: dta@rbnz.govt.nz

Publication of submissions

We will publish your submission on the Reserve Bank's website.

We will make all information in submissions public unless you indicate you would like all or part of your submission to remain confidential. Please refer to our policies on how we store and may share your information - Reserve Bank website privacy policy and the Consultation privacy information. If you would like part of your submission to remain confidential you should provide both a confidential and a public version of your submission. Apart from redactions of the information to be withheld (that is, the blacking out of text) the two versions should be identical. You should ensure that redacted information is not able to be recovered electronically from the document; the redacted version will be published as received.

If you want all or part of your submission to be treated as confidential, you should provide reasons why this information should be withheld if a request is made for it under the Official Information Act 1982 (OIA). These reasons should refer to the grounds for withholding information under the OIA. If an OIA request for redacted information is made, we will make our own assessment of what must be released taking your views into account.

We may also publish an anonymised summary of the submissions received in respect of this Consultation Paper.

Navigating this document

This Consultation Paper contains the policy proposals for the 9 non-core Deposit Takers Standards (the standards) to be made under the Deposit Takers Act 2023 (DTA).

The document begins with an Executive Summary, followed by an Introduction to provide the background to the development of the standards as a whole. It is then split into chapters, one for each non-core standard.

- Chapter 1: the Governance Standard
- Chapter 2: the Lending Standard
- Chapter 3: the Risk Management Standard
- Chapter 4: the Operational Resilience Standard
- Chapter 5: the Related Party Exposures Standard
- Chapter 6: the Open Banking Resolution (OBR) Pre-positioning Standard
- Chapter 7: the Outsourcing Standard
- Chapter 8: the Restricted Activities Standard
- Chapter 9: the Branch Standard.

Each chapter includes an introduction. The chapters then present the key policy proposals for the standard, which are organised using the Proportionality Framework. This means the chapters first cover the proposed approach for Group 1 deposit takers, then Group 2 deposit takers, then Group 3 deposit takers. The chapters also include the proposed approach for branches of overseas deposit takers, if appropriate.

Following chapter 9, the document contains a conclusion to this Consultation Paper that summarises the next steps in the development of the standards. The document ends with a glossary (Annex A) and a consolidated list of consultation questions (Annex B).

The document uses consecutive paragraph numbering throughout. Other numbered features, such as consultation questions, are also numbered consecutively. This will help us in the coordination of submissions on the Consultation Paper. You can read and respond to each chapter separately.

Contents

Executive summary

1. The Reserve Bank of New Zealand – Te Pūtea Matua (the **Reserve Bank**) is consulting on our policy proposals for new prudential standards to be made under the Deposit Takers Act 2023 (**DTA**).

2. The DTA creates a single, modern regulatory regime for all financial institutions in the business of 'borrowing and lending money' in New Zealand – this includes banks and non-bank deposit takers (**NBDTs**).

3. As the kaitiaki (guardian) of the financial system, we design rules to protect and promote the stability of the financial system. Financial stability can be considered a public good that enables communities and businesses to engage in a well-functioning financial system that allocates resources and manages risk throughout the real economy.

4. Our rules seek to avoid the major costs and disruption that could result from the failure of 1 or more deposit takers. As we saw in the Global Financial Crisis (**GFC**), failure of deposit takers can have wide ranging and long-term impacts for individuals, communities and businesses.

5. The DTA represents a paradigm shift in the way we approach financial stability. The introduction of the Depositor Compensation Scheme (**DCS**) and our new regulatory powers have come with statutory purposes that focus not just on systemic stability, but also on individual entity soundness. These features are a complementary package. The DCS provides benefits to all deposit takers and depositors through socialising the cost of failure, and this is accompanied by a new set of prudential standards to ensure entities benefiting from the DCS are individually safe and sound.

6. The Deposit Taker Standards (the **standards**) will replace our existing prudential requirements that are currently contained in several different sets of documents.[1] Importantly, the standards will be secondary legislation unlike most of our existing non-legislative prudential requirements. The standards will set the rules that deposit takers must meet to be safe and sound enough to take deposits from the public and benefit from the DCS.

7. **We**, the Reserve Bank, may issue standards if we are satisfied they are necessary or desirable to achieve one or more of the purposes of the DTA. The main purpose of the DTA is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system. There are also 4 additional purposes of the DTA, which are:

    - to promote the safety and soundness of each deposit taker
    - to promote public confidence in the financial system
    - to the extent not inconsistent with the main purpose or the other three additional purposes, to support New Zealanders having reasonable access to financial products and services provided by the deposit-taking sector
    - to avoid or mitigate adverse effects of the risks to the stability of the financial system and risks from the financial system that may damage the broader economy.

[1] These documents include the Banking Supervision Handbook, Banking Prudential Requirements, disclosure Orders in Council and notices made under section 80 of the Banking (Prudential Supervision) Act 1989.

8. The main purpose is relevant to our proposed standards, as are one or more of the additional purposes: to promote the safety and soundness of each deposit taker; to promote public confidence in the financial system; and to avoid or mitigate the risks to the stability of the financial system and the risks from the financial system.

9. This Consultation Paper is the second in a series; the first related to the four 'core' standards (capital, liquidity, DCS and disclosure) used for licensing existing deposit takers. This second paper sets out our key policy proposals for nine 'non-core' standards. These are the standards that all deposit takers will need to comply with when the DTA standards regime starts, likely in 2028, but will not be used for licensing existing deposit takers. However, all new entrants will need to demonstrate their ability to comply with all standards applicable to their presumptive Group to receive a licence under the DTA. Our nine proposed non-core standards are listed in Table A below, which also shows which standard is applicable to which Group of deposit takers.

Table A – Application of the standards to Groups of deposit takers

Non-Core Standard	Group 1 applicable?	Group 2 applicable?	Group 3 applicable?	Branches applicable?
Governance	✓	✓	✓	✓
Lending	✓	✓	✗	✗
Risk Management	✓	✓	✓	✓
Operational Resilience	✓	✓	✓	✓
Related Party Exposures	✓	✓	✓	✗
Open Bank Resolution (**OBR**) Pre-positioning	✓	✓[2]	✗	✗
Outsourcing	✓	✗[3]	✗	✗
Restricted Activities	✓	✓	✓	✓
Branch (Branches of Overseas Deposit Takers)	✗	✗	✗	✓

10. Work is also under way on a crisis management framework that may lead to new crisis preparedness standards, but this will be subject to a separate process as it is on a longer

[2] The OBR Pre-positioning Standard will only apply to Group 2 deposit takers that are already subject to Open Bank Resolution (OBR) Pre-Positioning Requirements Policy – *see* the Open Bank Resolution (OBR) Pre-positioning Chapter for more detail.

[3] The Outsourcing Standard will only apply to the small number of Group 2 deposit takers that are already subject to BS 11: Outsourcing Policy – *see* the Outsourcing Chapter for more detail.

timeline. Crisis management is closely connected with our proposed OBR Pre-positioning and Outsourcing standards. This is outlined in more detail in the Crisis Management Issues Paper.[4]

11. The policy proposals for each of these standards are set out consistently with the Proportionality Framework,[5] which categorises locally-incorporated deposit takers into 3 Groups, depending on their size.

12. This Consultation Paper seeks feedback on the proposed requirements under each standard for all 3 Groups, as well as for branches of overseas deposit takers (**branches**) where appropriate. For ease of reference, Table A above lists the proposed standards of this consultation that are relevant to branches.

The Governance Standard

13. Effective governance of deposit takers is essential to ensure that they operate safely and soundly. Governance requirements are necessary to ensure that deposit takers are appropriately managed within the context of protecting and promoting the stability of the New Zealand financial system.

14. Our existing governance requirements are limited in scope, and place strong reliance on market and self-discipline, rather than regulatory discipline. In 2017, the International Monetary Fund (**IMF**) assessed our existing corporate governance policies as materially non-compliant with the Core Principles for Effective Banking Supervision (the **Basel Core Principles**) issued by the Basel Committee for Banking Supervision (**BCBS**).[6]

15. Our proposal seeks to address this through requirements in 3 areas:

    - **responsibilities of the boards** of locally-incorporated deposit takers and the New Zealand Chief Executive Officers (**CEOs**) of branches
    - **structural and compositional requirements** for the boards of locally-incorporated deposit takers
    - **fit and proper requirements** for the directors and senior managers of all deposit takers.

16. We propose that most of the requirements apply to all deposit takers (including branches). We consider that the requirements are crucial for all deposit takers but acknowledge that the implementation is likely to vary depending on the nature and complexity of the deposit taker's business. We propose to allow for some variations between the structural and compositional requirements for Group 1 and Group 2 and those for Group 3 following the Proportionality Framework. The principles-based requirements also allow for flexibility in how a deposit taker complies.

17. These proposals seek to strengthen the governance requirements that apply to deposit takers and address the recommendations from the IMF's assessment and the 2023 'Governance

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[4] Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Crisis Management Issues Paper. https://consultations.rbnz.govt.nz/dta-and-dcs/crisis-management-under-the-deposit-takers-act/user_uploads/crisis-management-issues-paper-august-2024.pdf

[5] The Proportionality Framework is a document made under section 77 of the DTA that sets out how we will take into account the proportionality principle under section 4(a)(i) of the DTA when making prudential standards. To make it easier for different groups of deposit takers to navigate the policy proposals in this document, we have arranged each chapter using the 3 Groups in the framework.

[6] *See* Table 1, page 67, Principle 14 and Table 2, page 71, Principle 14; https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/fsap/new-zealand-fsap-2016-fssa.pdf

Thematic Review' that we jointly conducted with the Financial Markets Authority (**FMA**).[7] We expect that most deposit takers are already substantively meeting these requirements as part of their own corporate governance practice.

The Lending Standard

18. Deposit takers are in the business of lending money to households and businesses. For deposit takers in New Zealand, a large proportion of their lending is to the residential property sector.

19. Macroprudential policy is one part of our financial stability toolkit and is designed to reduce systemic risks in the financial system. Currently, we use borrower-based macroprudential policy to reduce systemic risks to the stability of the financial system related to the residential property sector. Specifically, loan-to-value ratio (**LVR**) restrictions limit the size of the mortgage households can take out relative to the value of the property they are purchasing. Debt-to-income (**DTI**) ratio restrictions limit the amount of total debt households can take on, based on their income. These restrictions are intended to manage systemic risks in the financial system related to the residential property sector by limiting the amount households can borrow based on the size of their deposits or how much they earn.

20. The proposed Lending Standard imposes restrictions on high-LVR and high-DTI lending to the residential property sector.

21. The proposed Lending Standard includes the existing borrower-based macroprudential measures (LVR and DTI restrictions) for Group 1 and Group 2 based on the Proportionality Framework. We do not propose applying these restrictions to Group 3 deposit takers as they are small compared to the total market and do not pose systemic risk to the financial system. We do not propose to apply the standard to branches as they also do not pose systemic risk to our financial system.

22. Macroprudential settings need to be updated promptly in response to changing macroprudential conditions. Therefore, we propose including a set of LVR and DTI thresholds and speed limits in the Lending Standard (see Table I in the chapter 2: Lending Standard), which we would implement via a condition of licence. This will give us the ability to promptly amend macroprudential policy settings through licence conditions, rather than updating the overarching standard.

The Risk Management Standard

23. Effective risk management contributes to both the soundness of individual deposit takers and the stability of the financial system as a whole. Risk management is an important component of an organisation's internal controls.

24. Currently, we have limited risk management requirements for deposit takers. In 2017 the IMF raised several concerns regarding our approach to risk management.[8] While we require banks to have risk management policies and systems in place and directors to attest to the

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[7] Reserve Bank of New Zealand – Te Pūtea Matua. (2023). Cross-sector thematic review on governance. https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/thematic-reviews/cross-sector-thematic-review-on-governance

[8] *See* International Monetary Fund. (2016). New Zealand financial system stability assessment. Principle 15, p 68 Table 1, and p 71 Table 2. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/fsap/new-zealand-fsap-2016-fssa.pdf

adequacy of these systems, there is limited guidance and requirements as to what constitutes adequate risk management or how to assess the adequacy of these policies.

25. We propose that the Risk Management Standard includes the following requirements for deposit takers:

    - developing a risk management framework, strategy, policies and processes and a risk appetite statement
    - developing internal processes and information systems to monitor risk and undertaking forward looking stress-testing covering all material risks
    - adequately resourcing and providing authority and sufficient independence to risk management, audit and compliance functions.

26. We propose that these requirements would apply to both Group 1 and Group 2 deposit takers. Many of the requirements are principles- or outcomes-based in nature and allow deposit takers flexibility in how they comply with the requirements. Because of their principles-based nature the manner of compliance will be proportionate to the size and nature of the deposit taker. For this reason, we propose to apply largely the same requirements for Group 3 deposit takers, subject to some exceptions where there may be more fixed costs. These proposed exceptions are set out in chapter 3.

27. We also propose to apply these requirements to branches, with appropriate modifications to acknowledge their different legal form and the similar requirements imposed by their home regulator.

The Operational Resilience Standard

28. Operational risk is defined by the BCBS as the risk of loss resulting from inadequate or failed internal processes, systems and personnel management or from external events. This definition includes legal risk but excludes strategic and reputational risk.[9]

29. The growing complexity and interconnectedness of the financial services sector and the digitisation of financial services require a greater focus on operational resilience by both deposit takers and regulators.

30. Similarly to other standards, we propose an operational resilience standard that represents a formal strengthening of our requirements for deposit takers. However, we expect that most deposit takers will already be substantively meeting the requirements as part of their own operational risk management processes.

31. Our proposed standard is designed with a principles-based approach, where the requirements target outcomes and allow deposit takers flexibility in how they achieve these outcomes. This builds in proportionality as deposit takers can comply in a way that is proportionate to the complexity and scale of their business.

32. We propose the standard applies to all deposit takers (including branches) and covers 4 key areas.

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[9] *Refer to* Basel Committee on Banking Supervision. (2023). Calculation of RWA for operational risk: definitions and application. https://www.bis.org/basel_framework/chapter/OPE/10.htm?inforce=20230101&published=20230330

- **Operational Risk Management:** relates to frameworks in managing operational risk through identification and assessment of the deposit taker's operational risk profile, effective operational risk controls, and reporting relating to operational risk incidents.
- **Material Service Providers:** relates to management of risks arising from the use of external service providers to provide critical operations to the deposit taker's business (this area also relates to our proposed Outsourcing Standard – see chapter 7).
- **Information and Communication Technology:** relates to management of risks, including cyber risks, arising from the use of information and communications technology.
- **Business Continuity Planning:** relates to management of business disruptions and ensuring the operational resilience of critical operations.

The Related Party Exposures Standard

33. Related party exposures arise from a deposit taker's transactions and arrangements with the natural or legal persons who are closely related to the deposit taker or the governance or management of the deposit taker.

34. These exposures create risks to financial stability where deposit takers provide services to these related parties, through inherent conflicts of interest and large exposure risks. Regulators generally manage this risk by requiring deposit takers to enter transactions with related parties on the same terms they would anyone else and to abide by a maximum limit on the total exposure to the transactions.

35. Our current requirements are contained within the Connected Exposures Policy (**BS8**)[10] for registered banks and in the Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010 for NBDTs.[11]

36. Between 2021 and 2023, we reviewed, consulted on, and made changes to, BS8 which became effective from 1 October 2023.[12] We reviewed BS8 with reference to the DTA and consider the policy largely remains appropriate in the context of the DTA and is a good basis for developing the Related Party Exposures Standard.

37. We propose using the BS8 definitions of "connected person" and "connected exposures" as the definitions of "Related Party" and "Related Party Exposures" for all deposit takers. This will give clear and consistent definitions and is aligned with international standards.

38. For Group 1 and Group 2 deposit takers we propose to largely carry over the current BS8 requirements because they were recently reviewed and remain appropriate under the DTA legislative framework. This avoids unnecessary compliance costs through needless changes. For Group 3 deposit takers we propose applying the BS8 requirements, with revisions to account for those deposit takers that are exempt from obtaining a credit rating among other

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[10] Reserve Bank of New Zealand – Te Pūtea Matua. (2023). BS8 - Connected Exposures Policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs8-connected-exposures-policy-oct-2023-superseded.pdf

[11] Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010. https://www.legislation.govt.nz/regulation/public/2010/0167/latest/DLM3032713.html?src=qs

[12] Reserve Bank of New Zealand – Te Pūtea Matua. (2023, 29 September). Review of the Connected Exposures policy for banks. https://www.rbnz.govt.nz/have-your-say/2021/review-of-the-connected-exposures-policy-for-banks

relevant differences specific to Group 3 as discussed further in chapter 5. We do not propose to apply the standard to branches because of the nature of their business and legal structure.

The Open Bank Resolution (OBR) Pre-positioning Standard

39. In the event of a bank failure, we have a range of tools to limit the disruption to the economy. OBR is one of those existing tools. OBR pre-positioning is a mechanism for providing bank customers continued access to liquidity and banking services in a bank failure event. It aims to ensure a failing deposit taker can re-open the next business day after it is placed in statutory management, with customers able to access a portion of their account balances and other essential banking services.

40. This Consultation Paper contains our policy proposals for the OBR Pre-positioning Standard which incorporate the protection afforded by the DCS. We propose that OBR pre-positioning will need to provide customers with access to at least their DCS-protected balances by 9am on the day after the deposit taker's entry into OBR.

41. We also consider OBR in the context of the DTA's crisis management and resolution framework and are re-assessing the role of pre-positioning and how it fits in with the suite of resolution strategies that may be developed under the DTA. We propose to reframe OBR pre-positioning as an arrangement to support 'continuity of access to deposits' and note that it would form only part of a comprehensive end-to-end resolution process.

42. We propose to not carry over the current $1 billion retail deposit threshold ($1.3 billion based on 2023 prices) above which banks must comply with pre-positioning requirements. Instead, we propose to apply the OBR Pre-positioning Standard to all Group 1 and Group 2 deposit takers with scope to vary or waive the requirements if, in our resolution plan for a given deposit taker, we conclude that pre-positioning is not relevant to its resolution. We do not propose to apply the standard to Group 3 deposit takers or branches.

The Outsourcing Standard

43. Outsourcing occurs when a deposit taker uses another party to perform business functions that would normally be undertaken by the deposit taker itself. Outsourcing can reduce costs and allow a deposit taker to access specialist expertise that it cannot provide itself. However, there is a risk that outsourcing arrangements complicate the resolution of a deposit taker should it fail.

44. Our current Outsourcing Policy for banks (BS11)[13] aims to ensure that a bank can continue to provide a basic level of banking services to customers even if it has failed. We consider that current BS11 requirements support the purposes of the DTA. Taking into account the principles in the DTA and that the current version of BS11 was issued in 2017, we consider its requirements remain largely appropriate to carry over into the Outsourcing Standard.

45. We are taking the opportunity to propose minor changes to update terms and other similar technical matters. We propose that the standard apply to Group 1 deposit takers, along with Group 2 deposit takers that have either already been required to implement BS11 or who reach the $10 billion total liabilities (net amounts due to related parties) threshold, set out in

[13] Reserve Bank of New Zealand – Te Pūtea Matua. (2022). BS11 - Outsourcing Policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs11-sept-2022.pdf.

BS11, before implementation of the Outsourcing Standard. We do not propose that the standard apply to the rest of Group 2 or to Group 3 deposit takers.

The Restricted Activities Standard

46. Our proposed Restricted Activities Standard would contribute to financial stability by restricting deposit takers from undertaking activities that we assess as posing a risk to individual deposit takers and the financial system.

47. Currently, the elements that would be in scope for the proposed standards are set out in various banking prudential requirements, particularly our Statement of Principles: Bank Registration and Supervision (**BS1**).[14]

48. Our proposed standard would cover:

    - restrictions on deposit takers conducting insurance underwriting
    - restrictions on deposit takers conducting material non-financial activities
    - approval requirements for locally-incorporated banks setting up overseas
    - limitations on covered bond issuance.

49. We generally propose carrying over the current requirements for registered banks into the standard, except for the approval requirement to establish an overseas branch or subsidiary. For this requirement we propose changes to the process to better reflect the nature of the relationship between home and host supervisors.

50. Most Group 3 deposit takers are not currently subject to the existing restrictions. The restrictions will therefore be new. In general, most NBDTs will be unaffected by these changes as they do not undertake the activities subject to the restrictions. The most significant restriction for this Group is likely to be the restriction on conducting insurance business through the same legal entity.

51. We propose that the restrictions on conducting insurance business and material non-financial activities would continue to apply to branches, as these restrictions are equally applicable to these deposit takers.

The Branches of Overseas Deposit Takers (Branch) Standard

52. Overseas deposit takers operating in New Zealand can either be licensed as a locally-incorporated subsidiary or a branch of the overseas deposit taker (**branch**). In some cases, we grant licences to an overseas bank to operate both a subsidiary and a branch (dual operation). As a branch is part of a legal entity incorporated overseas, it is difficult to apply many of the requirements we impose on New Zealand-incorporated deposit takers.

53. Branches offer benefits to the New Zealand economy through the provision of products and services to large customers and support the diversity and resilience of the financial system. Our proposals seek to strike a balance between allowing branches to provide their benefits to

[14] Reserve Bank of New Zealand – Te Pūtea Matua. (2021). BS1 – Statement of Principles – Bank Registration and Supervision. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs1-statement-of-principles.pdf

the financial system and reducing our reliance on overseas supervisors to maintain financial stability in New Zealand.

54. We undertook a recent review of policy for the branches of overseas banks (the **Branch Review**) and propose that the policy decisions made through this review will be implemented by the Branch Standard.[15] The Branch Standard would apply only to branches. Our major proposals for the Branch Standard are that:

    - branches can only conduct business with wholesale customers
    - branches cannot exceed NZ$15 billion in total assets
    - dual-operating branches can only conduct business with large corporate and institutional customers.

The proposed consultation process

55. Following a similar process to consultation on the core standards, we are seeking feedback on all aspects of the proposed non-core standards in this Consultation Paper. Your feedback will help shape the final policy proposals, and this will be incorporated into Exposure Drafts of the 9 proposed non-core standards.

56. We intend to publish Exposure Drafts of the non-core standards in 2026 for further feedback to ensure the requirements are precise, easy to interpret, and feasible to comply with. From there, we intend to consider the feedback and finalise and issue the non-core standards in early-2027.

57. Figure 1 below shows our intended approach to the development of standards. Consulting separately on proposed core and non-core standards prioritises the development of the core standards, which as noted earlier, are needed for licensing existing banks and NBDTs under the DTA. We hope this phasing helps stakeholders to manage their input into our consultation process.

Figure 1: Process for developing standards

58. The shift to secondary legislation, and the need for standards to be precise and easy to interpret, means that the language of the existing largely administrative prudential requirements will change in places to conform with professional, best practice drafting norms.

[15] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2023, 7 November). Review of policy for branches of overseas banks website. https://www.rbnz.govt.nz/have-your-say/review-of-policy-for-branches-of-overseas-banks

Introduction

Why do we prudentially regulate deposit takers?

59. Deposit takers play a crucial role in the operation of the financial system and economy. In particular they:

    - provide individuals and businesses with access to essential day-to-day services (such as the ability to make payments using transactional accounts) and investment products
    - provide consumers and business with access to credit.

60. More broadly, by taking deposits and providing credit, they help to ensure the effective allocation of resources across the economy. The nature of deposit takers' business (that is, carrying on the business of borrowing and lending) also means that they have a high degree of interconnectedness with the rest of the financial system.

61. However, the essential functions carried out by deposit takers, their interconnectedness with the rest of the financial system, and the scale of some deposit takers, means that when a deposit taker fails it can have serious impacts on individuals, businesses and the economy as a whole.

62. The potential scale of these impacts is illustrated by events such as the finance company collapses of 2006–2011. The Commerce Select Committee noted in its 2011 Inquiry into Finance Company Failures:

    > *45 finance companies in New Zealand have failed, either being placed into receivership or entering into moratorium arrangements with debt holders. These failures have put at risk about $6 billion of investors' deposits, much of which will not be recovered. It is estimated that between 150,000 and 200,000 deposit holders have been affected, and the losses to date have been estimated at over $3 billion.*[16]

63. The effects of large deposit taker failures can also be even more severe, as illustrated internationally by the GFC.

64. Ultimately, a sound and well-functioning deposit taking sector and financial system provides an essential public benefit shared by society in much the same way that physical infrastructures – such as roads, water and power systems – provide benefits felt much more widely than by just individual users of these networks.

65. The DTA will replace the existing regulatory regimes for banks and NBDTs with a single modernised regulatory framework for all deposit takers. The DTA strengthens New Zealand's financial system through the introduction of the DCS, new prudential powers and a new suite of standards. These features are a complementary package, ensuring that the benefits of the DCS fund are matched by standards that ensure a minimum level of soundness for every individual deposit taker.

66. Under the DTA, prudential requirements for deposit takers are to be set via standards issued by us. These standards will replace our existing prudential requirements for banks and NBDTs

[16] Commerce Committee (New Zealand Parliament). (2011). Inquiry into finance company failures. http://umbraco.parliament.website/resource/mi-NZ/49DBSCH_SCR5335_1/0d9cfef1280ab5ba97f9569c8f965bfd7374305f

but, unlike most of our existing prudential requirements for registered banks that are made under the Banking (Prudential Supervision) Act 1989 (BPSA), these standards will be secondary legislation. They will be legislative rather than administrative instruments and be subject to certain processes common to secondary legislation.[17]

67. As part of our broader role as kaitiaki (guardian) of the financial system, the development of standards under the DTA gives us the opportunity to create a more coherent prudential framework for deposit takers that better promotes financial stability. We are seeking your feedback as we work to create this more coherent framework that supports the management of prudential risks.

68. This Consultation Paper seeks your input on a subset of the prudential standards, the non-core standards, which are all those standards that are not listed as a core standard in Part 1 of Schedule 1 of the DTA. We will use the 4 core standards for relicensing existing banks and NBDTs as licensed deposit takers under the DTA. The core standards are the Capital, Liquidity, DCS and Disclosure Standards. We concluded consultation on them on 16 August 2024.

69. Figure 2 below sets out how the non-core standards fit within the suite of standards under the DTA.

Figure 2: Deposit Taker Standards prudential framework

Development of the Deposit Takers Act 2023

70. In 2016, New Zealand's financial sector regulatory framework was reviewed as part of the IMF's Financial Sector Assessment Programme (FSAP). The IMF conducted this assessment using the principles and standards issued by international standard-setting bodies in, amongst other things, the banking, insurance and financial market infrastructure sectors. These principles and standards included the Basel Core Principles issued by the BCBS.

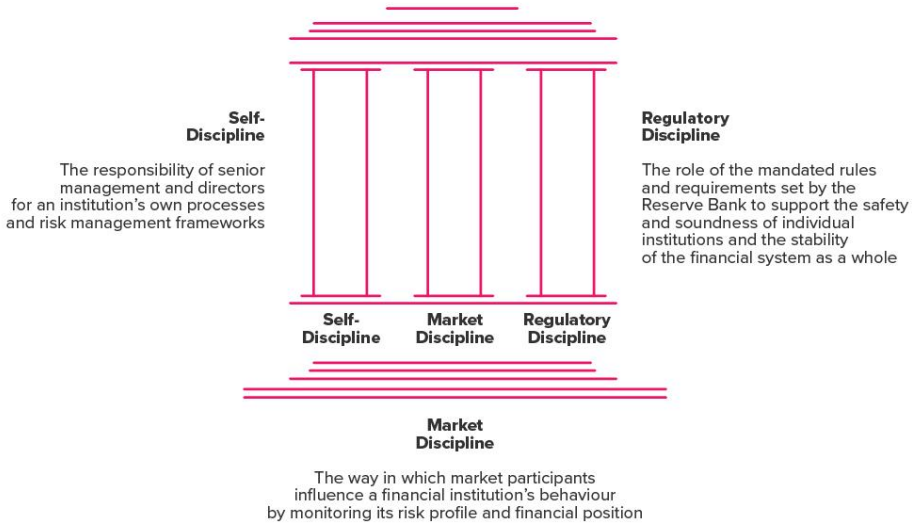
71. The IMF found that our rulebook (and approach to supervision) for banking was light-handed relative to international standards. It encouraged us to issue enforceable supervisory standards on key risks. It also recommended the establishment of deposit insurance.

[17] This includes being reviewed by Parliament's Regulations Review Committee, which acts on Parliament's behalf to ensure that the delegated law-making powers are being used appropriately. It examines all regulations, investigates complaints about regulations, and examines proposed regulation-making powers in bills for consistency with good legislative practice. The committee reports to the House and other committees on any issues it identifies, and the House can 'disallow' a regulation.

72. The IMF's FSAP report contributed to the development of the terms of reference for the later review of the Reserve Bank of New Zealand Act 1989 (which resulted in both the Reserve Bank of New Zealand Act 2021 and the DTA).

73. The DTA directly addresses most of the relevant recommendations from the IMF and represents a paradigm shift in New Zealand's regulation of deposit takers. This paradigm shift brings New Zealand's prudential framework for deposit takers closer to international norms. In particular, it aims to better balance the reliance on the 3 pillars of banking regulation by placing more weight on the regulatory discipline pillar than the market and self-discipline pillars we have historically relied upon (see Figure 3). This shift in regulatory approach reflects the wider costs to society following a deposit taker failure.

Figure 3: The 3 pillars approach



Purpose of setting standards

74. The main purpose of the DTA is to protect and promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system (section 3(1)). To that end, the DTA has the following additional purposes:

- Soundness – to promote the safety and soundness of each deposit taker (section 3(2)(a));
- Public confidence – to promote public confidence in the financial system (section 3(2)(b));
- Accessibility – to the extent not inconsistent with the main purpose or the other additional purposes, to support New Zealanders having reasonable access to financial products and services (section 3(2)(c));
- Avoidance or mitigation of risks – to avoid or mitigate the adverse effect of risks:
    - to the stability of the financial system; and
    - from the financial system that may damage the broader economy (section 3(2)(d)).

75. We may issue a standard when we are satisfied that it is necessary or desirable for one or more purposes of the DTA. The guiding purposes for the development of the non-core standards is to promote the safety and soundness of each deposit taker and to promote public confidence in the financial system, while promoting financial stability. The focus on soundness and safety of individual deposit takers is a marked change from the BPSA which sets out a system focus for prudential regulation. Some requirements also avoid or mitigate risks to the stability of the financial system, and the risks that the financial system poses to the broader economy.

76. The requirements of the non-core standards are not intended in themselves to support New Zealanders having reasonable access to financial products and services. The proposals in this Consultation Paper are empowered by the purposes in sections 3(2)(a), (b) and (d). We are not acting under the purpose in section 3(2)(c) in this document. We acknowledge however, that the proposals have an impact on diversity and we consider this through our analysis of the principle in section 4(a)(iii).

Principles to consider in setting standards

77. In issuing standards under the DTA, as well as identifying the purpose or purposes for which we are acting, we must take into account certain principles (where they are relevant to the performance or exercise of our powers under the DTA).[18] These principles are:

- the desirability of taking a proportionate approach to regulation and supervision (section 4(a)(i));
- the desirability of consistency in the treatment of similar institutions (section 4(a)(ii));
- the desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders (section 4(a)(iii));
- the need to maintain competition within the deposit-taking sector (section 4(b));
- the need to avoid unnecessary compliance costs (section 4(c));
- the desirability of maintaining awareness of, and responding to, the practices of overseas supervisors that perform functions in relation to any licensed deposit taker or any holding company of any licensed deposit taker; and guidance or standards of international organisations (section 4(d)(i) and (ii));
- the desirability of ensuring that the risks referred to in section 3(2)(d)[19] are managed (including long-term risks to the stability of the financial system) (section 4(e));
- the desirability of sound governance of deposit takers (section 4(f));
- the desirability of deposit takers effectively managing their capital, liquidity and risk (section 4(g)); and

[18] Deposit Takers Act 2023, section 4. https://www.legislation.govt.nz/act/public/2023/0035/latest/LMS469454.html
[19] Deposit Takers Act 2023, section 3. https://www.legislation.govt.nz/act/public/2023/0035/latest/LMS469453.html

- the desirability of depositors having access to timely, accurate, and understandable information to assist them to make decisions relating to debt securities[20] issued by deposit takers (section 4(h)).

78. The chapters in this Consultation Paper assess the costs and benefits of the proposed standards, taking into account each of the principles above (where those principles are relevant).

Q1	What do you think the cumulative impact of the proposed standards will be on the relevant principles?

Taking a proportionate approach to standards development

79. The DTA provides a single, coherent framework for regulating and supervising all deposit takers – both banks and NBDTs. However, given the diversity of deposit takers and the relative risks they pose there is a clear reason for adopting a proportionate approach to the calibration of requirements while also setting a baseline for soundness. The DTA recognises this in the proportionality principle (section 4(a)(i)) as well as by requiring us under section 77 to publish a Proportionality Framework that sets out how we will take account of the proportionality principle. When preparing our Proportionality Framework, section 77(3) requires us to have regard to the following:

    - the size and nature of the businesses of different deposit takers;
    - the extent to which a range of different requirements are necessary or desirable to promote the safety and soundness of each deposit taker; and
    - the relative importance of different deposit takers to the stability of the financial system.

80. We published our Proportionality Framework for Developing Standards under the Deposit Takers Act (the Proportionality Framework) on 14 March 2024.[21] It sets out how we propose to take into account the principle of proportionality when developing standards. The Proportionality Framework will help us balance the costs and benefits of proposed standards consistently and transparently in relation to different types of deposit takers. Taking a proportionate approach to developing standards also helps support a deposit taking sector that is safe, sound and stable, as well as diverse, competitive, innovative and inclusive.

81. In our Proportionality Framework we split out locally-incorporated deposit takers into 3 groups.

    - Group 1 – deposit takers with total assets of NZ$100 billion or more. This group is the domestic systemically important banks (D-SIBs)
    - Group 2 – deposit takers with total assets of NZ$2 billion or more, but less than NZ$100 billion

[20] Financial Markets Conduct Act 2013, section 8 (Definitions relating to kinds of financial products). https://legislation.govt.nz/act/public/2013/0069/latest/DLM4090911.html

[21] Reserve Bank of New Zealand – Te Pūtea Matua. (2024, 14 March) Proportionality Framework for Developing Standards Under the Deposit Takers Act. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf

- Group 3 – deposit takers with total assets less than NZ$2 billion.

82. We have used the Proportionality Framework's Groups to consider how best to tailor proportionate requirements when developing the standards. However, we acknowledge that this approach may not be appropriate in every circumstance and there may be circumstances that require a variation to requirements for a particular deposit taker or a particular type of deposit takers. The Proportionality Framework also sets out transition arrangements for when a deposit taker may change Groups.

83. In addition to the 3 Groups, we have also tailored requirements for branches. This is because we partially rely on the regulation of branches by their home regulator, and because of the different legal form of branches. We have also developed tailored requirements because, following our review of our branch policy concluded in December 2023, we have announced our intention to impose restrictions on branch size and nature of operation in New Zealand.[22] For these reasons, only the following non-core standards will apply to branches:

    - Governance
    - Risk Management
    - Operational Resilience
    - Branch.

84. Similarly, in our consultation on the core standards, we proposed that only subsets of the Disclosure and Liquidity Standards would apply to branches.

Q2	What do you think of the way we have taken into account the proportionality principle in developing the proposed standards?

Considering the need for minimum standards arising out of the DTA

85. When developing the proposals in this Consultation Paper, we considered the proposed standards as a whole and their interaction with the DTA, especially the creation of the DCS. The creation of the DCS stands to benefit deposit takers, by increasing trust of depositors in the sector and may lower funding costs for deposit takers, especially more risky depositors, by improving their ability to attract deposits. On the other hand, it socialises risk associated with individual deposit takers across the sector as a whole and across broader New Zealand society, as the DCS will be funded by levies paid by all deposit takers and some or all of the costs of these levies may be passed on to consumers.

86. Therefore, it is important that every deposit taker benefitting from the DCS meets minimum standards that would generally be expected of them. As outlined in the Proportionality Framework, we have reflected the need for minimum standards to support the safety and soundness of individual deposit takers when proposing requirements for each Group of deposit taker.[23] This approach supports public confidence in the financial system by

[22] Reserve Bank of New Zealand – Te Pūtea Matua. (2023, 5 December) Review of policy for branches of overseas banks. https://www.rbnz.govt.nz/have-your-say/review-of-policy-for-branches-of-overseas-banks

[23] When preparing the Proportionality Framework we were required to have regard to, amongst other things, "the extent to which a range of different requirements are necessary or desirable to promote the safety and soundness of each deposit taker" (Deposit Takers Act, section 77(3)(b)).

minimising the significant harm that could arise should there be failures of a number of deposit takers, similar to what happened during the finance company collapses and the GFC, as discussed above. The approach also supports the soundness of each individual deposit taker, another additional purpose of the DTA.

87. Taking into account the standards as a whole, the introduction of the DTA and the establishment of the DCS, we consider that we are proposing a robust, but proportionate, set of standards for deposit takers that will provide an overall net benefit to New Zealand. The net benefit includes costs and benefits to deposit takers and New Zealanders more generally. We will continue to refine our cost-benefit analysis of the core and non-core standards as we receive feedback from public consultation.

Considering diversity and access to financial products and services

88. Access to financial products and services offered by the deposit-taking sector supports individuals, communities and businesses to participate in, and contribute to, economic activity. Some deposit takers develop longstanding and deep connections with particular communities and customer groups and can provide services to underserved segments of the population who may otherwise struggle to access finance. This was a strong theme during the development of the DTA and has also been raised by stakeholders since the DTA was passed.

89. In September 2023 we released Our Approach to Financial Inclusion, which outlines how we are considering and contributing to an inclusive financial system in line with our role and remit.[24]

90. Financial inclusion is closely linked to the DTA principle on the desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders (section 4(a)(iii)).

91. This Consultation Paper includes our initial assessment of the likely impact of each of the proposed standards on both the diversity of institutions and access to financial products and services to a diverse range of New Zealanders. However, this assessment is based on limited information. We welcome views from stakeholders who may be able to provide more evidence of the impact of each of the proposed standards. We also analyse other related principles, such as avoiding unnecessary compliance costs, applying a proportionate approach to standards and maintaining competition in the sector as well as depositors having access to timely, accurate and understandable information. These principles can support New Zealanders' access to financial products and services. Therefore, the relevant principles will be addressed as we present our analysis for each non-core standard.

92. We also consider that access to financial products and services and financial stability can be interconnected. For example, a well-functioning financial system with low probability of deposit takers falling into financial difficulty increases the likelihood that people can access, and have trust in, the products and services they rely on, thereby increasing access to products and services.

[24] Reserve Bank of New Zealand – Te Pūtea Matua. (2023, 29 September). Our Approach to Financial Inclusion. https://www.rbnz.govt.nz/hub/publications/financial-inclusion-report/2023/our-approach-to-financial-inclusion

Q3	What do you think the implications of the proposed standards will be on the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services and on financial inclusion more generally? If possible, please provide specific feedback on how these requirements might impact the accessibility and affordability of financial services.

Implications for the Māori economy

93. In line with considering the desirability of the deposit taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders (section 4(a)(iii)), we are considering the impact of the standards on the Māori economy and the impact of the standards on deposit takers that are part of or interact with the Māori economy. The Māori economy includes Māori customers, iwi, individuals, and Māori businesses, trusts and entities. Support from the financial system ensures that Māori economic activity can contribute to a sustainable and productive economy. This will become increasingly crucial, with a young and growing Māori population that will make up the majority of the labour force growth in the coming years (currently 13% and projected to be 20% by 2040).[25]

94. In 2022, we undertook a consultation on Māori access to capital and the feedback from this consultation is informing our ongoing work in this area.[26] Our work to support Māori access to capital also reflects our commitment to identifying opportunities to give effect to Te Tiriti o Waitangi through our mahi and to show how we are delivering on those commitments. In addition, our work contributes to the government's work, led by Treasury, on improving Māori access to capital.

95. The safety and soundness of deposit takers and the stability of the financial system would support a sound basis through which Māori can access financial products and services.

96. This Consultation Paper is an opportunity to seek feedback on the impact the proposals may have on the Māori economy, especially in connection with the interaction of the Māori economy with the financial system and with deposit takers.

Q4	What do you think the impact of the proposed standards will be for the Māori economy, in particular on: a) the role of the financial system and deposit takers in supporting the Māori economy; and b) Māori customers, iwi and individuals and Māori businesses, trusts and entities?

[25] Reserve Bank of New Zealand – Te Pūtea Matua. (2021, 28 January). Te Ohanga Māori – The Māori Economy 2018. https://www.rbnz.govt.nz/hub/research/additional-research/te-ohanga-maori---the-maori-economy-2018

[26] Reserve Bank of New Zealand – Te Pūtea Matua. (2022, 9 August). Improving Māori Access to Capital. https://www.rbnz.govt.nz/have-your-say/improving-maori-access-to-capital

Considering our role and those of other agencies through the Council of Financial Regulators (CoFR)

97. New Zealand has a twin peaks model of financial regulation, where one regulator has responsibility for financial stability (us, the Reserve Bank) and another regulator has responsibility for the conduct of financial institutions (the FMA). The twin peaks model regulators each have their own clear and separate mandates and powers that are equally important to promoting the prosperity and well-being of New Zealanders. We have designed the proposed standards with this twin peaks model in mind which means our core standards should promote our financial stability mandate, while also allowing for the FMA to regulate conduct-based requirements.

98. For a twin peaks model to work well there must be effective coordination between the regulators. To coordinate well with the FMA and other agencies responsible for the regulation of the financial system in New Zealand we have the Council of Financial Regulators – Kaunihera Kaiwhakarite Ahumoni (**CoFR**). It is the body responsible for facilitating cooperation and coordination between CoFR members to support effective and responsive financial regulation.

99. We work collaboratively through CoFR to ensure that we keep other agencies informed of our work and to carry out work together where appropriate. For example, through thematic reviews where the topic covers both prudential and conduct matters we will work with the FMA, such as the previously mentioned 2023 Reserve Bank-FMA Governance Thematic Review. We acknowledge that our collaboration with the FMA is important for those non-core standards that are closely connected with some conduct-based requirements. This is particularly the case with the Governance, Risk Management and Operational Resilience Standards and some proposed requirements in other non-core standards.

100. Furthermore, the DTA requires us to consult with CoFR members before issuing a standard.[27] To that end, we have established a reference group comprised of the other CoFR members:

- the FMA
- the Commerce Commission
- the Treasury
- the Ministry of Business, Innovation and Employment (**MBIE**).

101. The input of these agencies is key to avoiding unnecessary costs from inadvertent regulatory overlap and ensuring the overall framework for the regulation of deposit takers is coherent and works well. Each agency also brings their specific expertise and perspective to support our analysis – for example, the Commerce Commission can support our competition analysis, the FMA and MBIE can facilitate alignment between our prudential regime and the Financial Markets Conduct Act 2013 (**FMCA**) and the broader conduct regime and the Treasury can make wider connections to the overall economy.

[27] Deposit Takers Act 2023, section 75. https://www.legislation.govt.nz/act/public/2023/0035/latest/LMS471895.html

Considering competition

102. Competition is an important consideration in our prudential decision making as it has a strong connection to efficiency. Moreover, as outlined above, the need to maintain competition within the deposit-taking sector is one of the principles we need to consider when developing standards under the DTA (section 4(b)). We consider that the need to maintain competition is always a relevant principle, given all prudential regulation tends to have some impact on competition, such as through altering compliance costs. Consideration of competition is also closely linked to some other principles, such as avoiding unnecessary compliance costs, proportionality and the desirability of the deposit-taking sector comprising a diversity of institutions. In some circumstances a prudential requirement may have a negative impact on competition, but this will be justified on a net benefit basis when considering the societal costs of deposit-taker failure, the risks to the DCS funds and in light of our financial stability objective.

103. We consider that the DTA and, by extension, the DTA standards will have both positive and negative impacts on competition in the deposit-taking market. Some positive effects include the benefits that smaller players receive by having their relative risk (as compared with larger deposit takers) reduced through the DCS and the greater chance of smaller and more vulnerable deposit takers surviving a banking crisis because of enhanced regulation putting them in a better prudential position. Another benefit to competition is the closer alignment to international standards, making it easier for new entrants from other jurisdictions to join the market. The proposed branch standard will also contribute to this by clarifying how an overseas entrant can be licensed as a branch rather than through a subsidiary. Further, the move away from regulating through conditions of registration to standards, a form of secondary legislation, will create more regulatory certainty and stability, making it easier for new entrants to join the market and for existing participants to compete in the market.

104. A further benefit to competition will come from reducing expansion costs from the single regime for all deposit takers under the DTA. For example, our principles-based approach to many of the non-core standards means our proposed requirements target outcomes and allow deposit takers flexibility in how they achieve these outcomes. This should, for example, reduce the costs for Group 3 deposit takers when transitioning into Group 2, compared to moving from entirely separate regimes.

105. However, there may be some negative effects (the magnitudes of which are uncertain). These include potentially higher DCS levies for smaller and riskier entities because of higher relative risk (albeit offset by the benefit of the DCS protection), regulatory transition costs for existing NBDTs which may adversely affect their ability to compete in the short term and higher costs of participating in the market in the long term, potentially deterring new entrants who could otherwise have more disruptive effects on competition in the deposit taking market.

106. Given these competing factors it is difficult to assess the overall impacts of the change in both the near term and in the long term, and we are interested in your views on the impact of the DTA standards on competition.

Q5	What do you think the cumulative impact of the proposed standards will be on competition? How do you think competition should be factored into our broader analysis of the principles?

Other procedural requirements

107. In addition to consulting with CoFR members, section 75 of the DTA requires us to notify the Minister of Finance about the prudential policy that we intend to implement through the proposed standards and consult with persons we consider will be substantially affected by the proposed standards. We consider that seeking formal submissions on this Consultation Paper, consulting on the exposure drafts of the standards in 2026 and conducting industry workshops and any bilateral meetings, constitutes consultation with substantially affected persons.

108. Under the Reserve Bank of New Zealand Act 2021, our Board is also required to have regard to the Financial Policy Remit at the point of issuing standards.[28] We are also required to assess the regulatory impact of policies that we intend to adopt under prudential legislation.[29]

Other design considerations for standards

109. In addition to the points discussed above, there are other considerations that we think should inform the development of the standards. These considerations may help illustrate why we have taken certain approaches in our proposed standards.

Minimising changes where appropriate

110. As part of the process of developing the standards, we have considered what areas of our existing regulatory regime could be carried over to the new regime. Wherever we have proposed to carry over existing requirements, we have conducted analysis to ensure that:

- the existing requirements are necessary or desirable for one or more of the DTA's purposes
- the DTA gives us the authority to make the requirements
- we have considered each of the relevant principles in section 4 of the DTA.

111. Based on this analysis, we are not intending to make new policy across all standards if we consider existing policy is fit for purpose. This approach minimises the transition costs to industry and makes the process of developing the proposed standards slightly less complex. However, we cannot simply 'copy and paste' over our existing requirements without first carrying out this analysis.

112. While the substance of some existing requirements may stay the same as long as the analysis supports this, we expect that drafting changes are likely as requirements are converted into secondary legislation and consistent definitions are adopted across all of the standards.

Aligning with international good practice

113. In developing the standards, we have considered the extent to which we should align with international standards (including the Basel Core Principles) and Australian prudential requirements.

114. Section 4 of the DTA requires us to have regard to:

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[28] Reserve Bank of New Zealand Act 2021, section 49. https://www.legislation.govt.nz/act/public/2021/0031/latest/LMS361391.html
[29] Reserve Bank of New Zealand Act 2021, section 255. https://www.legislation.govt.nz/act/public/2021/0031/latest/LMS287212.html

the desirability of maintaining awareness of, and responding to,—

i. the practices of overseas supervisors that perform functions in relation to any licensed deposit taker or any holding company of any licensed deposit taker; and

ii. guidance or standards of international organisations.

115. Additionally, our Statement of Prudential Policy states that we must have regard to international good practice when setting prudential requirements.[30] Alignment with the Australian prudential requirements also supports a consistent approach to the regulation and supervision of the different parts of trans-Tasman banking groups, thereby helping to ensure risks are managed in a consistent manner and reducing compliance costs. Trans-Tasman alignment also potentially reduces the risk of regulatory confusion or a lack of compliance because of potentially conflicting requirements, especially given that the 4 largest banks in New Zealand are owned by Australian banks.

116. Therefore, we have generally tried to align with international practice (including considering trans-Tasman alignment) when developing the standards except where:

- we have made a recent decision to adopt a different approach
- alignment would be in conflict with other principles under section 4 of the DTA, for example, where alignment would impose unnecessary compliance costs or not be proportionate to the risk the deposit taker poses to the financial system
- departure is justified by New Zealand specific circumstances
- New Zealand legislation requires an approach which differs from international practice.

117. For these reasons, we will likely follow international practice more closely when we are creating standards containing new requirements, rather than when we are basing the standards on our existing prudential requirements.

Developing an approach to regulating international banking groups under the DTA

118. In 2024, we became the home supervisor of an international banking group for the first time. An essential element of banking supervision is our oversight of the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide. We refer to this as 'group supervision'. The IMF's 2017 FSAP Report found that we did not effectively meet Basel Core Principle 12 – Consolidated Supervision and recommended that we develop a framework for group supervision.[31] We have developed a bespoke group supervision framework using conditions of registration to ensure effective supervision of the international banking group.

119. We are now actively considering how to embed a more comprehensive group supervision policy in our regulatory framework under the DTA that would apply to deposit takers that own overseas deposit-taking businesses. We expect to offer further clarity on the process for

[30] Reserve Bank of New Zealand – Te Pūtea Matua. (2022, 22 September). Statement of Prudential Policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/statements-of-approaches/sopp-2022.pdf

[31] International Monetary Fund. (2017). New Zealand Financial System Stability Assessment, Principle 12 Consolidated Supervision Table 1 and Table 2. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/fsap/new-zealand-fsap-2016-fssa.pdf

developing this policy in the coming months, ahead of consulting on Exposure Drafts of the proposed standards.

Making use of principles-based regulation where appropriate

120. We propose to make use of more principles-based requirements for qualitative requirements. This means obligations that require deposit takers to act in accordance with certain principles or achieve certain outcomes rather than comply with prescriptive rules. This approach promotes honouring the intent of regulation rather than the letter of the rules. A shift towards using more principles-based regulation has been common internationally. For example, the Prudential Regulation Authority of the Bank of England has explored and implemented (where appropriate) principles-based regulation since the late 2000s (beginning under its predecessor the Financial Services Authority).[32] Similarly, the Australian Prudential Regulation Authority (APRA) has said that it has adopted, and would continue to adopt, a principles-based and outcomes-based approach to its prudential framework.[33] In New Zealand, MBIE and the FMA's 'Conduct of Financial Institutions' regime, introduced in 2022, predominantly uses principles-based regulation.[34]

121. We consider that principles-based requirements have value in certain policy areas, especially where those areas are heavily influenced by a deposit taker's internal culture or where we are trying to lift industry practices over time and ensure that regulated entities take ownership of their approach to managing certain risks. A key advantage of principles-based regulation is its flexibility that allows for it to evolve to the changing needs of our increasingly fast-changing financial system and broader economy whereas prescriptive rules would need to be continually updated. Principles-based regulation also allows for more innovative practices to develop.

122. We propose to support more principles-based requirements with guidance on what best practice is. This acknowledges the fact that principles-based requirements can sometimes be less clear and that best practice guidance can lift industry practices while still leaving space for deposit takers to find the most efficient ways of achieving the required outcomes. We note that best practice guidance may also be especially helpful for smaller entities who may not be as sophisticated or well resourced. We also expect that the nature of our supervision of our prudential framework will change with the shift to more principles-based regulation, and we expect that there will be a need for an increased level of supervisory engagement.

123. We note that our new Enforcement Framework will be helpful for deposit takers to understand how principles-based requirements will be enforced (as well as the requirements more broadly).[35] Our Enforcement Framework provides guidance on how we act, or propose to act, in relation to our regulated entities, when using our enforcement discretion. The framework includes our enforcement principles, enforcement criteria, as well as our enforcement guidelines and investigation guidelines. Our 3 enforcement principles are:

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[32] Black, J., Hopper, M., and Band, C. (2007). Making a success of Principles-based regulation. *Law and Financial Markets Review, 1*(3), 191-206. https://www.lse.ac.uk/law/people/academic-staff/julia-black/Documents/black5.pdf.

[33] Australian Prudential Regulation Authority. (2014). Statement of Intent. https://treasury.gov.au/sites/default/files/2019-03/APRA_Statement_of_Intent.pdf

[34] Financial Markets Authority. (2024). Conduct of Financial Institutions (CoFI) legislation. https://www.fma.govt.nz/business/legislation/conduct-of-financial-institutions-cofi-legislation/

[35] Reserve Bank of New Zealand – Te Pūtea Matua. (2023, 26 January). Enforcement. https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/enforcement

- risk-based
- proportionate
- transparent.

124. The enforcement principles are a set of values that guide the direction of our investigation and enforcement strategy and inform our approach to applying our enforcement discretion. The enforcement criteria are specific considerations that will be worked through and weighed against the available evidence when deciding on the appropriate enforcement response to non-compliance. Our 4 enforcement criteria are:

    - seriousness of conduct
    - responsiveness
    - public trust and confidence
    - efficacy.

Setting board responsibilities at the appropriate level

125. We are trying to design requirements placed on deposit takers' boards so that directors can be focused on more strategic issues and oversight of management rather than the operational detail of complying with our regulations. This reflects directors' due diligence obligations under subpart 3 of Part 3 of the DTA, which imposes a duty on them to exercise due diligence to ensure that the deposit taker complies with its prudential obligations. We are trying to avoid imposing specific obligations on boards that could detract from focus on their primary roles of strategy and oversight.

Transition to the new prudential regime

126. Existing requirements carried over into the standards will generally need to come in effect when the BPSA and Non-bank Deposit Takers Act 2013 (NBDT Act) are repealed to avoid the existing requirements lapsing. These Acts are expected to be repealed upon the full commencement of the DTA, which is currently planned for July 2028.

127. For new requirements, there could sometimes be merit in delaying when they come into force (for example, by 12 to 24 months), to allow time for regulated entities to achieve compliance. However, this needs to be balanced against the risk that having a range of dates for requirements coming into effect could add complexity and make the prudential framework harder to administer.

128. We seek your feedback on what requirements may require bespoke transitional arrangements and our overall approach to transitional arrangements.

Q6	Do you think that this approach to developing standards is appropriate? Is there anything else we should take into account when developing the prudential framework?
Q7	What transitional arrangements would be appropriate? Are there any particular requirements that would take longer to comply with than others?

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 1

Deposit Takers Governance Standard

Deposit Takers Non-Core Standards Consultation

21 August 2024

CONSULTATION PAPER

Non-technical summary

Governance requirements for deposit takers seek to ensure that deposit takers are being governed consistently with sound corporate governance principles and support the stability of New Zealand's financial system more broadly.

Our proposed Governance Standard is set out in accordance with the Deposit Takers Act 2023 (DTA). We propose to set out requirements in the following areas:

- responsibilities of the board of directors (board) of locally-incorporated deposit takers and of the New Zealand Chief Executive Officer (the New Zealand CEO) of the branch of overseas licensed deposit takers (branches): to specify how these positions must exercise their governance responsibilities
- compositional and structural requirements for the board of locally-incorporated deposit takers: to support independent governance of deposit takers and help to ensure that sufficient governance attention is provided to the key concerns of the deposit taker
- fitness and propriety of directors and senior managers of all deposit takers: to ensure the suitability of people appointed to these important positions – that is, ensuring that they are of good character, appropriately qualified, capable and competent, among other criteria.

Our proposed requirements reflect minimum levels of good governance practice and are necessary for all deposit takers. For the most part we propose that the same requirements apply to all deposit takers. There are variations between requirements for Group 1 and Group 2 and the requirements for Group 3 for some of the compositional and structural requirements relating to boards to reflect the different size and nature of business among these Groups. Deposit takers are, nonetheless, expected to be able to comply in ways that are appropriate for their size and business operations.

Our proposed approach lifts our formal governance requirements for deposit takers and supports greater certainty in our supervisory approach for governance matters. In doing so, our proposals seek to address recommendations of the International Monetary Fund's (IMF's) 2017 New Zealand Financial Sector Assessment Program (FSAP) Report,[36] including those relating to the enforceability of our requirements, and the Reserve Bank's and Financial Markets Authority's (FMA's) 2023 Governance Thematic Review.[37]

Our proposed Governance Standard aims to support the safety and soundness of individual deposit takers and the overall stability of the New Zealand financial system while avoiding unnecessary compliance cost. Our proposed requirements are more explicit than the status quo. We expect that most deposit takers are already substantively meeting these requirements as part of their existing sound corporate governance practice.

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[36] International Monetary Fund. (2017). New Zealand: Financial Sector Assessment Program, Financial System Stability Assessment. Country Report No. 2017/110. https://www.imf.org/en/Publications/CR/Issues/2017/05/08/New-Zealand-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-44886

[37] Reserve Bank of New Zealand – Te Pūtea Matua and Financial Markets Authority – Te Mana Tātai Hokohoko (2023). Governance Thematic Review. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/thematic-reviews/rbnz-and-fma-governance-thematic-review-report.pdf

1 Introduction

129. This chapter sets out our proposed Governance Standard for deposit takers. Our proposals set out our requirements relating to the arrangements that deposit takers must put in place to support prudent governance. These include requirements on how a deposit taker must be managed and directed as well as how it will be held accountable for achieving its strategic and operational objectives, and how it governs the risks that it faces.

130. Sound governance by a deposit taker's board is essential for ensuring individual entity soundness and wider financial stability. The proposed governance standard sets out the board's fundamental responsibilities, including setting strategic direction, ensuring the financial safety and soundness of the deposit taker and providing appropriate levels of oversight of the management of the organisation.

1.1 Purpose of the Governance Standard

131. The proposed Governance Standard seeks to promote sound, effective and efficient corporate governance practice to support the safety and soundness of all deposit takers and, ultimately, the New Zealand financial system. Our proposed requirements seek to address the risks to financial stability arising from poor management and oversight of deposit takers; addressing these risks is critical to safeguarding public confidence in the financial system more broadly.

132. Our existing governance policies and requirements for registered banks and non-bank deposit takers (NBDTs) are limited in scope, as discussed below. They rely on the market and self-discipline pillars of our prudential framework significantly more than on the regulatory discipline pillar.[38] This leaves gaps in our requirements for governance of deposit takers.

133. In 2017, the IMF assessed our existing corporate governance policies as materially non-compliant with the international practice guidelines of the Basel Committee on Banking Supervision's (BCBS's) Core Principles for Effective Banking Supervision (Basel Core Principles).[39] Identified issues included the limited coverage of existing requirements and the lack of clear and enforceable requirements that also leads to a lack of clarity for supervision.

134. The proposed Governance Standard aims to remedy the gaps in our current policies by setting out clear and enforceable requirements for our regulated deposit takers in 3 key areas:

- responsibilities of the board and of the New Zealand CEO of branches[40]
- structural and compositional requirements for the boards of locally-incorporated deposit takers

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[38] *See* Fiennes, T. (2016, 1 September). New Zealand's evolving approach to prudential supervision. Reserve Bank of New Zealand. https://www.rbnz.govt.nz/hub/publications/speech/2016/speech2016-09-01

[39] International Monetary Fund. (2017). New Zealand: Financial Sector Assessment Program, Financial System Stability Assessment. Country Report No. 2017/110. https://www.imf.org/en/Publications/CR/Issues/2017/05/08/New-Zealand-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-44886 and International Monetary Fund. (2017). New Zealand: Financial Sector Assessment Program, Detailed Assessment of Observance of the Basel Core Principles for Effective Banking Supervision https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/fsap/fsap-review-assessment-of-observance-basel-principles-effective-bank-supervision.pdf

[40] Deposit Takers Act 2023, section 6, definitions of 'New Zealand Chief Executive Officer', 'senior manager/s' and 'overseas licensed deposit taker'. https://www.legislation.govt.nz/act/public/2023/0035/latest/LMS469462.html

- fit and proper requirements for the directors and senior managers of all deposit takers.

135. The DTA sets out the legislative framework for our proposed requirements. This includes:

    - standard-setting powers in the following areas:
        - the governance of a deposit taker (section 78(a))
        - the remuneration of directors and senior managers (section 78(b))
        - fit and proper persons (section 81).
    - parameters for our fit and proper persons policy
    - relevant definitions for the interpretation of our proposed requirements including, but not limited to, definitions of director, Fit and Proper Certificate, New Zealand CEO and senior manager
    - due diligence duties for the directors of licensed locally-incorporated deposit takers and New Zealand CEOs of branches – we will be preparing guidance on these due diligence duties and will be consulting separately on this guidance.

136. This Consultation Paper sets out our overall proposed policy approach for the Governance Standard. We also intend to prepare a guidance document to support the implementation of the Governance Standard. Following this consultation, we will consider how to balance our proposed policy between the standard and the accompanying guidance. We will be consulting on an exposure draft of the standard and the guidance.

1.2 The current approach

137. Existing governance requirements for deposit takers are set out in our Corporate Governance Policy (**BS14**), Suitability of Bank Directors and Senior Managers Policy (**BS10**) and the NBDT Act. Specifically:

    - BS14 refers to sources of guidance on good corporate governance practice and sets out limited explicit requirements on the responsibilities of the board and/or senior managers.[41,42] It is primarily focused on structural and compositional requirements for boards to support independent decision making. It aims to "ensure as far as possible that

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[41] BS14 cites:
Basel Committee on Banking Supervision. (2010). Principles for Enhancing Corporate Governance. https://www.bis.org/publ/bcbs176.pdf (superseded by the BCBS Corporate Governance Principles for Banks)
New Zealand Securities Commission. (2004). Corporate Governance in New Zealand, Principles and Guidelines, A Handbook for Directors, Executives and Advisers. https://www.fma.govt.nz/assets/Guidance/Corporate-governance-handbook-2004.pdf (previous version of the FMA handbook)
The 2018 FMA handbook (most recent edition), in turn, cites the NZX Corporate Governance Code (**NZX Code**) as reference for NZX-listed entities. *See* NZX. (2023). NZX Corporate Governance Code. https://www.nzx.com/regulation/nzx-rules-guidance/corporate-governance-code
See also
Basel Committee on Banking Supervision. (2015). Corporate Governance Principles for Banks. (**BCBS CGP**) https://www.bis.org/bcbs/publ/d328.pdf;
FMA. (2018). Corporate Governance Handbook. https://www.fma.govt.nz/library/directors-and-officers/corporate-governance-handbook/

[42] For full copies of prudential documents, *see* Reserve Bank of New Zealand – Te Pūtea Matua. (2022). Banking Prudential Requirements. https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/banking-prudential-requirements

the board collectively will, in practice, take decisions in the best interests of the bank, without undue influence from parties whose interests may diverge from the bank's"[43]

- BS10 sets out the requirements for the review of suitability of bank directors and senior managers
- bank disclosure requirements include disclosure relating to governance arrangements. These are set out in 2 Orders in Council, with supporting guidance in **BS7A** Registered Bank Disclosure Regime. This approach is supplemented by the director attestation regime for the disclosure requirements (contained in the Orders in Council), which require directors to attest that the bank has adequate systems in place to monitor and control the bank's material risks
- the NBDT Act governance requirements are limited to structural, independence and suitability requirements for directors (and senior officers for suitability)
- the NBDT (Debt Securities and Suitability Concerns) Regulations 2014 sets out suitability requirements for non-bank deposit takers.

1.3 Proposed policy development approach

138. In developing the proposed Governance Standard, we have taken into account existing guidelines and international practice. We have sought to align, where appropriate, with these precedents rather than creating bespoke requirements. We drew from our current requirements, particularly those stipulated in the disclosure Orders in Council, BS7A, BS10, BS14, NBDT Act and NBDT (Debt Securities and Suitability Concerns) Regulations 2014.

139. We have also taken into account requirements in the Companies Act 1993, the **FMA handbook** and the NZX Corporate Governance Code (**NZX Code**). Our proposed approach complements these requirements and guidance by setting out requirements on which we will supervise deposit takers. It is also consistent with the BCBS's guidelines Corporate Governance Principles for Banks (**BCBS CGP**) and the Basel Core Principles and has been informed by the guidelines of select BCBS jurisdictions.[44]

140. In framing our requirements, we have considered issues raised in related reviews. These include the 2023 Governance Thematic Review, 2018 Thematic Review of Bank Conduct and Culture, 2017 Review of Bank Directors' Attestation Regime, the 2017 IMF FSAP and independent reviews under section 95 of the Banking (Prudential Supervision) Act 1989 (formerly the Reserve Bank of New Zealand Act 1989).[45]

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[43] BS14, paragraph 13(1).

[44] BCBS. (2024). Core Principles for Effective Banking Supervision. https://www.bis.org/bcbs/publ/d573.pdf
BCBS. (2023).Consultative Document Core Principles for Effective Banking Supervision. https://www.bis.org/bcbs/publ/d551.pdf
BCBS. (2015). Guidelines Corporate Governance Principles for Banks. https://www.bis.org/bcbs/publ/d328.htm
NZX. (2023). NZX Corporate Governance Code. https://www.nzx.com/regulation/nzx-rules-guidance/corporate-governance-code
We likewise drew from the regulatory practices in Australia, Singapore, and the UK (where companies have a unitary board system like New Zealand's).

[45] Reserve Bank of New Zealand – Te Pūtea Matua and Financial Markets Authority – Te Mana Tātai Hokohoko. (2023). Governance Thematic Review. https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/thematic-reviews/cross-sector-thematic-review-on-governance
Reserve Bank of New Zealand – Te Pūtea Matua and Financial Markets Authority – Te Mana Tātai Hokohoko. (2018). Thematic Review of Bank Conduct and Culture. https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/thematic-

141. We have taken a hybrid principles-based approach in setting out many of our proposed requirements. In this approach, principles-based requirements are complemented with more specific requirements to support clarity in supervision. This means that, while the same requirements may apply for all deposit takers, we expect that the deposit takers will be able to comply with the requirements in a way that reflects their size and the nature of their business. This approach supports diversity amongst deposit takers in New Zealand and contributes to financial inclusion.

142. We expect that smaller deposit takers (or deposit takers with less complex business arrangements) will be able to implement aspects of the requirements in a manner that is less complex than that which would be reasonable for a larger or more complex deposit taker. We also set out the proposed requirements with the intent of avoiding unnecessary compliance costs and not undermining market competition.

143. A hybrid principles-based approach is appropriate for a qualitative standard, such as the Governance Standard, that seeks to achieve behavioural outcomes. This is in contrast to a more quantitative-based standard, such as the proposed Capital Standard,[46] in which specific rules are more easily set because the requirements are measurable. The hybrid principles-based approach enables us to communicate the outcomes that we seek to achieve and promote behaviour that supports these outcomes.

144. We will work with the FMA when it comes to supervising some of the requirements in the proposed Governance Standard. This is to be consistent with the approach proposed in the MBIE's recent consultation on fit for purpose financial services reform.[47] For example, this will relate to fit and proper assessments.

2 Proposed approach for Group 1 deposit takers

145. Our proposed requirements for Group 1 deposit takers cover the 3 policy areas that have been identified earlier (each is discussed below):

- responsibilities of the board
- structure and composition of the board

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reviews/thematic-review-of-bank-conduct-and-culture
Reserve Bank of New Zealand – Te Pūtea Matua and Deloitte (2017). Review of the Bank Directors' Attestation Regime. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/oias/2017/response-to-official-information-request-bank-directors-attestation-regime-2017.pdf
International Monetary Fund. (2017). New Zealand Financial Sector Assessment Programme, Financial System Stability Assessment. Country Report No. 2017/110. https://www.imf.org/en/Publications/CR/Issues/2017/05/08/New-Zealand-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-44886
Reserve Bank of New Zealand – Te Pūtea Matua. (2021). Risk Governance Review: Section 95 Review of Westpac New Zealand Limited. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/news/2021/section-95-risk-governance-review-of-westpac-new-zealand-limited.pdf?revision=01b8508a-1d83-47e9-b7cd-c35ce055c5de
Reserve Bank of New Zealand – Te Pūtea Matua and Deloitte. (2020), Section 95–Assessment of ANZ Bank New Zealand Limited's Compliance with the Reserve Bank's Capital adequacy requirements. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/news/2020/anz-nz-section-95-capital-report.pdf?revision=6aafb496-a837-41b3-aa45-759d5f7a466d

[46] Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Deposit Takers Core Standards Consultation Paper – Chapter 1: Capital Standard. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/deposit-takers-core-standards-consultation-paper-1.pdf

[47] Ministry of Business, Innovation and Employment. (2024). Fit for purpose financial services conduct regulation, Discussion Document, section 2D. https://www.mbie.govt.nz/dmsdocument/28373-fit-for-purpose-financial-services-conduct-regulation-discussion-document

- fitness and propriety of the directors and senior managers.

2.1 Responsibilities of the board

146. This section discusses our proposed requirements for the responsibilities of the board of Group 1 deposit takers. We have considered either to retain and adapt the current regulatory approach (that is the relevant provisions in BS14) or to make our requirements clearer and more explicit.

Preferred option

147. Our preferred option is to set out specific requirements for the responsibilities of the board. These requirements are intended to respond to issues identified in the 2017 IMF FSAP and recent reviews related to governance arrangements (in particular the 2023 Governance Thematic). In light of these reviews, we do not consider the alternative approach (adapting BS14 for the DTA framework) is credible as it would not provide clarity on our requirements for the responsibilities of the board.

148. Our proposed outcomes and associated requirements are set out in Table B. They cover 5 policy areas:

- oversight, prudent management and strategic direction
- risk culture and values
- skills and experience of the directors and senior managers
- internal governance
- remuneration.

149. Our proposed approach rebalances our reliance on the market and self-discipline pillars of our prudential framework and emphasises the regulatory discipline pillar more. It also intends to facilitate clearer supervision.

Table B: Proposed responsibilities of the board for Group 1 deposit takers

Proposed outcome/requirement
Outcome 1: Oversight, prudent management and strategic direction The deposit taker's board is ultimately responsible for prudently governing the deposit taker and for ensuring the safety and soundness of the deposit taker.[48]
Requirement 1: The board must set out and update its own charter. The charter must: • set out clearly the responsibilities and powers of the board as a collective and of the individual directors in governing the deposit taker and overseeing the management of the deposit taker

[48] Refer also BCBS CGP, Principle 1 and Basel Core Principles, Principle 14.

Proposed outcome/requirement

- set out the board leadership roles, size and its use of the risk, audit, remuneration and any other committees to effectively carry out its oversight function and other responsibilities, (where applicable – refer to proposed structure and composition requirements in section 2.2)
- define the scope and depth of the board's functions and the way they carry out their duties, including overseeing the delegated authorities
- set out clearly the board's responsibilities for the authorities/powers that it has delegated
- set out how the risks relating to conflicts of interests of directors are identified, reported and managed.

Requirement 2: The board must set the strategic direction of the deposit taker and oversee the management of the deposit taker in line with this direction.

Requirement 3: The board must ensure that deposit taker's risk management framework is consistent with the requirements of the risk management standard.

Requirement 4: The board must ensure the timeliness, quality and integrity of financial and non-financial reports, and the independence of the internal and external audit.[49]

Outcome 2: Risk culture and values

The deposit taker's board establishes a risk culture and values to support the safety and soundness of the deposit taker.[50,51]

Requirement 1: The board must set out the deposit taker's risk culture and values and ensure alignment with the deposit taker's risk management framework. The board must also ensure that:

- the risk culture and values are communicated throughout the deposit taker
- legitimate issues raised are addressed appropriately, and staff who raise concerns are protected from detrimental treatment or reprisals (refer to related requirements in the 'fit and proper' section below).

Requirement 2: The board must ensure that its actions as a collective and the actions of individual directors conform to the culture and values that it sets out, and that the deposit taker conducts its business lawfully and ethically.

[49] BS14 and the FMA handbook are explicit on this responsibility (*see*: BS14 Section 14(1) and the FMA handbook Principle 4). This is also part of the directors' attestation in their public disclosures.

[50] *See* also BCBS CGP, Principle 1 and Basel Core Principles, Principle 14; and responds to the findings of the 2017 IMF FSAP and 2023 Governance Thematic Review.

[51] Following the Basel Core Principles, risk culture refers to the "norms, attitudes and behaviours related to risk awareness, risk-taking and risk management, and controls that shape decisions on risks." It adds that "risk culture influences the decisions of management and employees during their day-to-day activities and has an impact on the risks they assume."

Proposed outcome/requirement

Outcome 3: Skills and experience of the directors and senior managers

The deposit taker's board and senior managers have the appropriate skills and experience, individually and collectively, to govern and manage the deposit taker prudently.[52]

Requirement 1: The board must ensure that the selection process for directors and senior managers is consistent with the board-approved fit and proper policy (see section 2.3 below).[53]

Requirement 2. The board must ensure that the skills and experience of directors and senior managers are appropriate for the deposit taker's size, complexity and risk profile.

Requirement 3: The board must ensure, on an ongoing basis, that the skills of the directors and senior managers remain appropriate to manage the deposit taker prudently.

Outcome 4: Internal governance

The deposit taker's board establishes internal governance systems that support prudent management of the deposit taker. Directors have a sound understanding of what is expected of them collectively and individually and how their performance will be assessed.[54]

Requirement 1: The board must set out and update its own structure, and the structure and purpose of any board committee. The board must also ensure that the:

- board committees support the board's collective obligations in governing the deposit taker
- board's accountabilities in delegating authorities to senior managers and/or board committees are clear
- information on what constitutes breaches of the delegated authority and how these breaches will be managed are clear
- directors have the capacity to perform their responsibilities and allocate sufficient time to discussing concerns that they assess to be materially relevant to the safety and soundness of the deposit taker.

Requirement 2: The board must ensure that the internal processes:

- set out the obligations of senior managers and the reporting lines between the board, board committees and senior managers
- are aligned with the deposit taker's strategic direction and risk culture and values
- set out the flow, type and structure of information between the board, board committees and senior managers.

[52] *See also* BCBS CGP, Principle 2, BS14 section 17 lines 1-3, the FMA handbook, Principle 2; the relevant guidelines of the BCBS jurisdictions that we scoped; and the findings of the 2023 Governance Thematic Review

[53] BCBS CGP provides some potentially useful pointers in assessing the collective suitability of the board in complying with this requirement.

[54] *See also* BCBS CGP, Principles 1, 2 and 3; Basel Core Principles, Principle 14; BS14, section 17, line 6; FMA handbook, Principle 3; and the findings of the 2023 Governance Thematic Review

Proposed outcome/requirement

Requirement 3: The board must set out and update board meeting procedures. The board must challenge the senior managers in managing the deposit taker. Directors must also challenge each other's views in governing the deposit taker. The challenge could be in the form of questioning, debating or asking for additional information or advice.[55]

Requirement 4: The board must conduct an annual internal assessment of its performance and periodically engage in an external review of its performance that is free from any conflicts of interest. Performance assessments must cover the performance of the board as a collective, board committees and individual directors. The frequency of external reviews must reflect the size of the deposit taker and the nature of the deposit taker's business.

Requirement 5: The board must establish a policy on board renewal, including how the board will renew itself to ensure it remains open to new ideas and independent thinking. The board must also ensure that the succession plans for the board, board committees and senior managers are formalised, clear and updated and executed appropriately.

Outcome 5: Remuneration

The deposit taker's board establishes a remuneration strategy that is consistent with the deposit taker's strategic direction and risk management framework and supports the safety and soundness of the deposit taker.[56]

Requirement 1: The board must ensure that the deposit taker's remuneration strategy is transparent and communicated clearly throughout the deposit taker. The remuneration policy must cover all forms of remuneration, notwithstanding its form (such as salary, incentives and other benefits).

Requirement 2: The board must 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.

Requirement 3: The board must ensure that recommendations relating to the remuneration strategy are free from conflicts of interest. Directors must not be involved in deciding their own remuneration package.

[Note that our proposed structural requirements include establishment of a board remuneration committee (see section 2.2 below)].

Requirement 4: The board must 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.

[55] *See* the 2023 Governance Thematic Review, p.26

[56] This is in line with BCBS CGP, Principles 3 and 11; Basel Core Principles, Principle 14; FMA handbook, Principle 5; and the findings of the 2023 Governance Thematic Review

Q8	Do you have comments on the proposed outcomes and requirements for the responsibilities of boards of Group 1 deposit takers?

2.2 Structure and composition of the board

150. This section discusses our proposed requirements for the structure and composition of the board.

151. As discussed in section 1.2, existing governance requirements for banks and NBDTs are focused on the structure and composition of the board. These requirements can be adapted, with some targeted enhancements, and remain largely fit for purpose in the DTA's new legislative framework. The purpose of these requirements is to ensure that the board is sufficiently independent to manage the deposit taker in the best interests of the deposit taker itself, and that it dedicates sufficient time to matters of importance in the overall prudent management of the deposit taker. This supports the overall soundness of individual deposit takers as well as contributing to the stability of the New Zealand financial system.

152. While we largely propose to adapt the existing requirements into the DTA's legislative framework, there are some inconsistencies between the existing bank and non-bank deposit taker regulatory frameworks. Where appropriate, we propose to harmonise the definitions to provide consistency of treatment across deposit takers.

153. We set out below our preferred option for the compositional and structural requirements for the board of Group 1 deposit takers.

Preferred option: compositional requirements for the board

154. We propose to substantially adopt the existing compositional requirements contained in BS14 for Group 1 deposit takers. Table C below outlines our proposed requirements. Our proposed definition of 'independent director' is outlined in the paragraphs following Table C.

Table C: Proposed Group 1 compositional requirements for the board

Proposed requirements
Requirement 1: The board must have at least 5 members.
Requirement 2: The majority of members must be non-executive.
Requirement 3: The chairperson must be independent.
Requirement 4: A majority of the members must be independent.
Requirement 5: At least half of the independent members must be ordinarily resident in New Zealand.[57]
Requirement 6: The deposit taker's constitution or rules must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what they believe is the best interests of the deposit taker.

[57] We propose to use the definition of ordinarily resident in New Zealand contained in schedule 2, clause 1(3) of the DTA.

155. As mentioned above, the proposed requirements are largely adaptations of BS14. The exception is Requirement 4, which is an enhancement to the BS14 requirement (that is, increasing from half to a majority of members being independent directors). The proposed requirements are intended to ensure that the board always act in the best interests of the deposit taker, benefit from diverse perspectives and exercise independent decision making. The proposed requirements also emphasise the importance of having a board chairperson who leads informed debate and challenge in decision making, manages the workloads of independent members on board committees and ensures that directors are present in New Zealand to facilitate the enforcement of rights, liabilities and other legislations.

156. For the independence requirements, we propose to adapt and enhance the definition of independence currently outlined in BS14. We propose that a director will be considered independent if that person:

    a) does not control or have significant influence over the deposit taker, and is not an officer of an entity that controls or has significant influence over the deposit taker

    b) is not employed, and has not previously been employed, in an executive capacity by the registered bank or another group member

    c) is not a director of any sister company of the deposit taker

    d) is not a current principal of a material professional adviser or a material consultant to the deposit taker or another group member and

    e) has not held a position as director of the deposit taker for more than 3 terms, totalling 9 years, unless approved by us.

157. We propose to adopt the existing exceptions contained in BS14:

    - a person must not have met conditions (a), (b) or (d) in paragraph 156 within the last 3 years, except for the exception to (a) in the circumstances outlined below
    - a person may fail condition (c) in paragraph 156 and still be considered independent if we have confirmed that none of the sister company directorships held by that person disqualify them from being an independent director of the registered bank
    - a person will not fail the independence test if they are a director of an intermediate holding company where that company's functions are limited to acting as a legal vehicle to hold investments in its subsidiaries and it does not undertake any direct revenue-generating activity
    - in a corporate restructuring in which a newly incorporated and licensed deposit taker may take over a substantial part of the business of a predecessor company that becomes the holding company of the deposit taker following the restructuring, a director of the predecessor company who transfers to the board of the new deposit taker will not fail the independence test.

158. We propose, as a starting point, to adopt the exception contained in BS14 to the independent chairperson requirement. This exception to (a) in paragraph 156 accommodates the case in which the chairperson of the bank's board also sits on the board of a holding company or parent bank. This exception is subject to approval by the Reserve Bank. The exception will be allowed if we are satisfied that:

- the only failure of the independence criteria is on account of the chairperson being a member of the parent bank or holding company board
- the chairperson's experience and background are such that they could be expected, when acting as a director of the holding company, to adequately contribute the subsidiary's perspective to the way that the group as a whole is run (within the constraint that their legal duty is to act in the best interests of the holding company itself)
- the chairperson has sufficient capacity to fulfil the obligation of their multiple directorship positions
- arrangements are put in place to manage any conflict of interest that may arise.

159. We are also considering whether this exception for the chairperson should be removed. The exception can promote consideration of the licensed New Zealand deposit taker's interests at the parent entity's board, to better inform the debate and decision-making process. However, even with suitable arrangements in place, this exception can lead to conflicts of interest for that person between serving the interests of the deposit taker and its parent. We seek your views on the impacts of removing this exception for the chairperson.

Preferred option: structural requirements for the board

160. Boards face significant demands on their time with the number of matters that demand their attention. There are also issues that require more time and in-depth discussion than others. Committees of the board enable attention to be devoted to such issues and also enhance the objectivity of the board's oversight of these important areas.

161. BS14 currently requires registered banks to have a separate Audit committee. We propose that this requirement is continued for the board of Group 1 deposit takers. The mandate of the audit committee must ensure the integrity of the deposit taker's financial controls, reporting systems and internal audit standards.

162. We propose that the board of Group 1 deposit takers must also maintain 2 additional committees:

- Risk committee: the mandate of which must include:
  - advising the board on the deposit taker's overall current and future risk appetite and risk management framework
  - overseeing the deposit taker's current and future risk position relative to its risk appetite and capital strength
  - overseeing senior managers' implementation of the risk management framework
  - reviewing the performance and setting the objectives of the deposit takers Chief Risk Officer (CRO)
  - overseeing the appointment and removal of the CRO.
- Remuneration committee: the mandate of which must include:
  - conducting regular reviews of the deposit taker's remuneration policy and making recommendations thereon to the board

- making annual recommendations to the board on the remuneration of the CEO, and senior managers, consistent with the remuneration policy
- making annual recommendations to the board on the remuneration of any other categories of persons covered by the remuneration policy.

163. The purpose of the requirements for these 3 committees is to ensure sufficient oversight by the board of issues that are important to the overall strategy and risk management of the deposit taker, and to the incentives for senior managers and the organisation influencing how that strategy is achieved and risk is managed.

164. For all the committees that we propose above, we propose the following compositional requirements:

- each committee must have at least 3 members
- every member of each committee must be a non-executive director of the deposit taker
- the majority of the members of each committee must be independent
- the chairperson of each committee must be independent and must not be the chairperson of the deposit taker.

165. These requirements are intended to support independent decision making within the board's committees, consistent with the overall compositional requirements. They contribute to the stability of the New Zealand financial system through enabling stronger governance of issues integral to the safety and soundness of individual deposit takers. The 2 additional committees we propose Group 1 deposit takers must maintain are consistent with international practice. These support strong governance of risk and remuneration for systemically important deposit takers. Current practice for Group 1 deposit takers suggests that our proposals are consistent with strong governance practice as they are already in place.

Alternative options

166. In addition to our preferred option above, we considered simply adapting the status quo with no additional requirements.

Q9	Do you have comments on the proposed board size and composition requirements for Group 1 deposit takers?
Q10	Do you have comments on the proposed criteria for independence of directors for Group 1 deposit takers?
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?
Q12	Do you have comments on the proposed requirements for board committees of Group 1 deposit takers?

2.3 Fitness and propriety of the directors and senior managers

167. This section discusses our proposed requirements to ensure that only a fit and proper person is appointed to, and continues to hold, a position as a director or senior manager of a deposit taker. The requirements fit within the overall governance requirements proposed in this chapter by ensuring the suitability of members of the deposit taker's board and senior managers.

168. The integrity and competence of directors and senior managers of deposit takers are critical to the sound and prudent governance and management of the deposit taker. Fitness tests aim to ensure that persons holding these positions are competent and capable of fulfilling their responsibilities. Propriety tests aim to ensure that directors and senior managers are of good character.

169. The fit and proper requirements aim to protect and promote the stability of the New Zealand financial system. The requirements will help ensure that directors and senior managers of the deposit taker possess an appropriate level of competency and capability to fulfil the responsibilities of their position as well as being suitable and of an appropriate character.

Legislative framework

170. Part 2, Subpart 4 of the DTA —Fit and proper requirements, sets out the general framework for our proposed fit and proper requirements. We summarise below the high-level requirements:

- section 26 establishes that a licensed deposit taker must obtain our approval before a new director or senior manager is appointed. It also requires that an approval request must be accompanied by a Fit and Proper Certificate
- approval may be given unconditionally or subject to conditions or may be refused; section 28 further details this process, including the timeframe for making a decision
- section 29 establishes that the Reserve Bank may suspend a director or senior manager if the approval is not obtained (that is, if the deposit taker fails to comply with section 26). Section 34 also establishes the Bank's power to remove directors and senior managers, and section 35 directs that a removed person may not then be reappointed.

171. Section 81 of the DTA sets out the provisions relating to setting a standard for ensuring fit and proper persons are appointed to, and continue to hold, director and management positions, including interim appointment of senior managers.

172. Our proposed fit and proper requirements for the boards of Group 1 deposit takers build on the legislative framework in 3 main areas:

- requirements for approving the deposit takers' directors and senior managers
- requirements relating to regular review to ensure ongoing suitability
- requirements for a deposit taker to set out a Fit and Proper Policy.

173. Under the DTA and our proposed requirements in this Governance Standard, when a Group 1 deposit taker seeks to appoint a director or senior manager, they will need to obtain the Reserve Bank's prior approval. In doing so they will need to have conducted their own assessment of the person, according to their own Fit and Proper Policy. They will then provide

a Fit and Proper Certificate to the Reserve Bank for that proposed appointee, attached to the approval request and also containing certain information and documentation. A decision will be made consistent with the legislative framework outlined above.

Preferred option: requirements for approving Group 1 deposit takers' directors and senior managers

174. Table D sets out our proposed requirements for the approval of directors and senior managers as fit and proper persons. This includes the matters that must be assessed in determining approval, requirements for a Fit and Proper Certificate, interim appointments and matters relating to protection of information.

Table D: Proposed outcome and requirements for approving a deposit taker's directors and senior managers for Group 1 deposit takers

Proposed requirement
Outcome: The primary responsibility for ensuring that current and proposed directors and senior managers meet the fitness and propriety tests rests with the deposit taker.
Requirement 1: A deposit taker must ensure that its current and proposed directors and senior managers meet the fitness and propriety criteria set out in this Governance Standard and their Fit and Proper Policy to perform their duties.
Matters assessed
Requirement 2: For the purposes of determining whether a person is fit and proper to hold a directorship or senior manager position, the criteria are, at a minimum, whether: a. the person possesses the competence, skills, experience, knowledge, capacity, diligence, judgement, character, honesty and integrity properly to perform the duties of the position b. the person is not disqualified under an applicable Act or regulation from holding the position c. the person does not raise any of the following suitability concerns: i. financial position ii. bankruptcy or related proceedings iii. influence over an at-risk, deteriorating, or dissolved entity iv. criminal record or prosecution v. professional or occupational malpractice; refusal of admission to, or expulsion from, a professional body vi. market participant regulatory non-compliance, sanctions applied by a regulator of another similar industry or previous questionable business practices vii. conflict of interest or potential conflict of interest viii. for directors, meeting independence criteria (refer to requirements in Tables B and E) d. The appointment reasonably contributes to:

Proposed requirement

i. the target balance of skills and experience that the board (or senior managers), taken as a whole, must have to manage the deposit taker effectively and prudently

ii. any other relevant requirements set in the Governance Standard.

Fit and Proper Certificates and information to be provided to the Reserve Bank

Requirement 3: When requesting the Reserve Bank's approval for an appointment, the deposit taker must provide a Fit and Proper Certificate containing:

a. the title of the person's position

b. the person's full name

c. the person's date of birth or ID (for identification purposes only)

d. the person's position and main responsibilities

e. a statement on the result of the assessment under the Fit and Proper Policy (referenced in Requirement 11).

Requirement 4a: When requesting the Reserve Bank's approval for an appointment, the deposit taker must provide the following documentation regarding the person:

i. CV

ii. criminal records (including any foreign records)

iii. financial checks

iv. foreign fit and proper assessments (if any)

v. conflict of interest disclosure. If there were any actual or potential conflict, the entity must inform whether the conflict is manageable, and explain how it will be managed

vi. any other documentation used to underpin the deposit taker's fit and proper assessment, including the matters referred to in Requirement 2

vii. a letter signed by the appointee, consenting to the Reserve Bank running the background checks necessary for the assessment

viii. any other information subsequently requested by the Reserve Bank

ix. the Fit and Proper Policy (upon request from the Reserve Bank).

Requirement 4b: The Reserve Bank may require further information to inform its decision on a request for approval. This could include interviewing the proposed appointee, or other directors, senior managers or employees of the deposit taker.

Requirement 5: The deposit taker must ensure that the certificate and information provided under Requirements 3 and 4 remain correct for all of its directors and senior managers. It must provide revised information to the Reserve Bank within 28 days of any change.

Requirement 6: The deposit taker must notify the Reserve Bank within 10 business days if it assesses that a responsible person is no longer fit and proper. If the person remains in the position, the notification must state the reason for this and the action that is being taken.

Proposed requirement
Requirement 7: The deposit taker must take reasonable steps to: a. obtain any information and documentation that the Reserve Bank asks of it b. provide that information to the Reserve Bank to assist the Reserve Bank in assessing the fitness and propriety of a person.
Requirement 8a: Interim appointments of senior managers (see section 26(3)(a) of the DTA) may be made without a full fit and proper assessment for a period of up to 90 days (or longer with the Reserve Bank's written agreement) including any previous period of interim appointment. Before making such an appointment, reasonable steps must be taken, as specified in the Fit and Proper Policy, to assess the fitness and propriety of the person. If the deposit taker proposes to appoint the same person on a permanent basis after the interim period, it must complete a full fit and proper assessment and follow the process for new appointments.
Requirement 8b: Before appointing a senior manager on an interim basis, the deposit taker must ensure it has, at a minimum, satisfactorily assessed the person's: i. CV ii. criminal records iii. conflict of interest disclosure.
Requirement 8c: When an interim appointment is made, the Reserve Bank must be notified on or before the date the interim appointment starts. The notice must include: i. the interim checks carried out ii. the period of the appointment iii. reasons for the interim appointment iv. the date by when the deposit taker expects to send a request for approval to appoint a person on a permanent basis.
Requirement 9: When a fit and proper assessment is conducted, the deposit taker must make all reasonable enquiries to obtain information that it believes may be relevant to an assessment of whether the person is fit and proper to hold the position. This may include collecting personal information as defined in the Privacy Act.
Requirement 10: If the deposit taker becomes aware of information that may affect a fit and proper assessment of an existing director or senior manager, the deposit taker must take all reasonable steps to assess whether that information affects the existing fit and proper assessment.

175. The proposed requirements in Table D, which are informed by international practice (of BCBS and APRA), establish the general framework for the fit and proper requirements. The aim is to clarify our requirements relating to minimum fit and proper criteria for a person to be a director or senior manager: propriety tests; impact assessment of appointments on the board's skill mix, capacity, and independence; and the contents of the Fit and Proper Certificate that deposit takers must provide to us. They also clarify our requirements on interim appointments of senior managers to support business continuity (discussed further

below) and on the collection and disclosure of information that is relevant to the fitness and propriety of directors and senior managers.

Preferred option: interim appointments

176. We propose that deposit takers can make interim appointments of senior managers for up to 90 days without a full fit and proper assessment. This is to avoid having vacancies in key positions because of unexpected events (for example, resignation) and enables regular business continuity when an unexpected vacancy occurs. Interim appointments must not be used in lieu of planned and normal succession.

177. Requirement 8b in Table D sets the minimum checks that must be conducted before an interim appointment is carried out. The deposit taker's Fit and Proper Policy could further expand on this list. The deposit taker must notify us of the interim appointment on or before the date when the appointee takes up the position. The notice must include the interim checks carried out beforehand, period of the appointment and reasons for the appointment. It must also include the date by which the deposit taker expects to send a request for approval to appoint a person on a permanent basis (see Requirement 8c(iv) in Table D).

178. Interim appointments are only permitted for senior manager positions, not directors.

Preferred option: ensuring ongoing suitability

179. We propose that the deposit taker's Fit and Proper Policy (see Table E) must require the deposit taker to undertake a fit and proper assessment at least every 3 years for each position of director and senior manager. The purpose of regular review is to ensure the ongoing suitability of directors and senior managers. A single-point-in-time assessment does not provide assurance of ongoing suitability.

180. This approach is consistent with the status quo for insurers but is less frequent than APRA's annual reassessment process. It is also aligned with the usual tenure period for directors. We consider that the 3-year period is also not unnecessarily long, considering that expertise is likely to remain current, and we must be notified of any changes or concerns arising at any point in time – such as in regard to capacity or integrity. Our proposed approach strikes a balance in ensuring ongoing suitability while providing a practicable process that is not unnecessarily burdensome.

Preferred option: deposit takers Fit and Proper Policy

181. We propose that deposit takers must have a board-approved Fit and Proper Policy for the purpose of ensuring that only fit and proper persons are appointed to, and continue to hold, positions as directors or senior managers. This help ensure that deposit takers have clearly identified and defined the skill, competency and propriety requirements for roles within the scope of the requirements. Table E sets out our proposed requirements for deposit takers in setting out and implementing a Fit and Proper Policy.

Table E: Proposed Fit and Proper Policy requirements

Proposed requirement
Framework for deposit takers' Fit and Proper Policies
Requirement 11: A deposit taker must have a board-approved Fit and Proper Policy for the purpose of ensuring that only fit and proper persons are appointed to, and continue to hold, positions as directors or senior managers.
Requirement 12: The Fit and Proper Policy must clearly define the competencies required from directors and senior managers.
Process for the fit and proper assessment
Requirement 13: The Fit and Proper Policy must include the processes to be undertaken in assessing whether a person is fit and proper for a specific position (fit and proper assessment). The processes must include details of: a. who will conduct fit and proper assessments on behalf of the deposit taker b. the information to be obtained and how it will be obtained c. the matters that will be considered before determining if a person is fit and proper for a specific position (consistent with the matters in requirement 2) d. the decision-making processes that will be followed.
Requirement 14: The Fit and Proper Policy must specify the actions to be taken when a person is assessed as: a. being not fit and proper b. raising 1 or more suitability concerns.
Requirement 15a: When a deposit taker has assessed, or it could reasonably form the opinion, that a person is not fit and proper, the deposit taker must take all steps it reasonably can to ensure that the person: a. is not appointed to the position b. if an existing director or senior manager, does not continue to hold the position.
Requirement 15b: When a deposit taker has assessed that a person raises 1 or more suitability concerns, the Fit and Proper Certificate must also: a. identify the relevant suitability concern or concerns b. describe how the relevant suitability concern has been addressed, mitigated or managed c. include any other information required by the Reserve Bank to be included in such certificates.
Requirement 16: The Fit and Proper Policy must provide that a copy of the Policy is to be given to: a. any candidate for election as a director as soon as possible after the candidate is nominated

Proposed requirement

b. any other person before an assessment of their fitness and propriety is conducted.

Requirement 17: The Fit and Proper Policy must require a fit and proper assessment at least every 3 years for each position of director and senior manager.

Provisions about collection and disclosure of information to the deposit taker or the Reserve Bank

Requirement 18: The Fit and Proper Policy must:

a. encourage any person to disclose information to the deposit taker or the Reserve Bank that may be relevant to a fit and proper assessment

b. enable the disclosure to the Reserve Bank of any information the deposit taker is required to provide under this Governance Standard

c. enable obtaining any consents required for the collection and use of any information by:

   i. the deposit taker, to comply with the Fit and Proper Policy (see Requirement 11) or Part 2, Subpart 4 of the DTA

   ii. the Reserve Bank, for the performance or exercise of its functions, powers, or duties in connection with the policy.

Requirement 19: The Fit and Proper Policy must include provisions:

a. to allow any person to disclose information if they have information that a person does not meet the deposit taker's fit and proper criteria

b. that the deposit taker consents to the person providing that information to either the person responsible for conducting fit and proper assessments or the Reserve Bank

c. to allow persons who have information that the deposit taker has not complied with this Governance Standard to provide that information to the Reserve Bank

d. that the deposit taker consent to any person who held a position of director or senior manager disclosing information or providing documents to the Reserve Bank relating to the reasons for their resignation, retirement or removal

e. a deposit taker must not constrain, impede, restrict or discourage, whether by confidentiality clauses, policies or other means, any person from disclosing information or providing documents to the Reserve Bank about matters above

f. that require all provisions of the Policy encouraging the disclosure of information, and the related procedures, are adequately explained to directors and employees of the deposit taker who are likely to have information relevant to fit and proper assessments

g. require all reasonable steps be taken to ensure that no person making disclosures under the requirements above in good faith is subject to, or threatened with, a detriment because of any notification in purported compliance with the requirements of the Fit and Proper Policy.

Documentation and review

Requirement 20: The Fit and Proper Policy must require that sufficient documentation for each fit and proper assessment is retained to demonstrate the fitness and propriety of the entity's current, and recently past, responsible persons. For past responsible persons, the Fit and Proper Policy must require

Proposed requirement
that the deposit taker retains the documentation for at least 6 years after ceasing to be a director or senior manager, or a candidate (if unsuccessful).
Requirement 21: The Fit and Proper Policy must be regularly reviewed and appropriately adjusted to reflect changing business strategy, needs and risk appetite, and to ensure it remains fit for purpose.

Q13 Do you have comments on the proposed fit and proper requirements for the boards and senior managers of Group 1 deposit takers?

182. The requirement for a Fit and Proper Policy is intended to ensure that the deposit taker has established policy and processes relating to the conduct of fit and proper assessments and disclosure of information that is relevant to the fitness and propriety of directors and senior managers. This includes ensuring that there is provision within the policy to allow any person to disclose relevant information and documentation to the entity and to the Reserve Bank and to prevent any barriers for a person disclosing information.

2.4 Analysis

183. Our status quo requirements do not provide sufficient clarity on our requirements for the prudent governance of Group 1 deposit takers under the new regulatory regime of the DTA. This creates uncertainties for deposit takers because of the lack of clear requirements. It also does not support credible supervision of governance practice and our articulated desire to be a more modern prudential regulator.[58]

184. Our proposed requirements aim to address this issue and to support clear supervision and enforceability of our governance requirements. The requirements should be understood as our minimum requirements for good governance practice. We outline below our analysis across the proposed requirements for Group 1 deposit takers. Where appropriate, we also identify relevant DTA principles (section 4) that we have considered in formulating our proposed requirements.

Rationale and approach

185. Our proposals lift our formal governance requirements for Group 1. The proposed board responsibility requirements seek to set out and clarify our requirements for the board's key governance accountability. The proposed requirements on structure and composition seek to ensure independent decision making in the governance of deposit takers and to ensure that sufficient time is devoted to key governance areas. The proposed fit and proper requirements seek to ensure that that the directors and senior managers are suitable and capable to perform their responsibilities.

186. Overall, we expect the Governance Standard to promote the safety and soundness of each deposit taker by promoting sound governance practice through independent decision making

[58] Hawkesby, C. and Prior, M. (2022). Our Transformation as a Prudential Regulator. A speech delivered to the Financial Services Council in Auckland on 22 September 2022 by Christian Hawkesby, Deputy Governor and General Manager Financial Stability, Reserve Bank of New Zealand. https://www.rbnz.govt.nz/hub/publications/speech/2022/speech2022-09-22

and ensuring the suitability of persons in decision-making and senior positions. This will promote public confidence in the financial system and the stability of the New Zealand financial system.

187. The proposed requirements will support deposit takers in effectively managing the risks to their business (section 4(g) of the DTA) through requiring strong governance practices. This is intended to improve the standing of deposit takers, enhance the trust of clients in deposit takers and promote stability of the New Zealand financial system (section 4(e) of the DTA).

188. The hybrid principles-based approach taken in setting out our proposed minimum requirements gives deposit takers the flexibility to comply with some of the proposed requirements in a manner that is suitable for the nature and size of their business. This supports our proportionate approach to this standard (section 4(a)(i) of the DTA) and consistency in our treatment of all similar institutions (section 4(a)(ii) of the DTA). The more prescriptive proposed requirements are set out to establish the necessary baseline requirements in certain areas of our policy.

189. The proposed requirements are designed to apply for any type of incorporated body that may be a deposit taker and support a deposit-taking sector with diverse institutions (section 4(a)(iii) of the DTA). Notably, not all deposit takers in New Zealand are companies (that is, they include building societies and credit unions), but all have, or will have, boards. They also support diversity by strengthening the positions of the existing deposit takers.

190. We have considered the principle of maintaining competition within the deposit-taking sector (section 4(b) of the DTA) in the context of avoiding unnecessary compliance cost (section 4(c) of the DTA). We balance our intent of fostering sound governance, lifting structural and compositional requirements and upgrading fit and proper requirements against the potential compliance costs.

191. We aim to set out requirements that are relevant, feasible and will not hinder the market entry of prospective Group 1 deposit takers. The proposed requirements support transparency in governance, structure and composition of the board, and fitness and propriety of directors and senior managers of Group 1 deposit takers, which should help inform depositors in their business decisions involving any Group 1 deposit taker (section 4(h) of the DTA).

192. Furthermore, the proposed requirements are informed by practices of overseas supervisors and standards of international organisations (sections 4(d)(i) and 4(d)(ii) of the DTA). We consider the Basel Core Principles and the BCBS CGP in formulating these requirements and draw from the regulatory guidelines in other BCBS jurisdictions.

Compliance

193. We have scoped information from publicly available sources (such as company reports and websites) and used recent reviews to assess the cost of the compliance with the proposed requirements. We expect that Group 1 deposit takers should already be broadly compliant with our proposed requirements across the Governance Standard:

- responsibilities of the board: our proposed requirements reflect common governance practice

- structure and composition of the board: our proposed requirements largely adapt existing requirements in BS14. Our proposed enhancements reflect common practice that we understand Group 1 deposit takers would already be compliant with
- fit and proper: our proposed requirements largely adapt existing requirements in BS10 or formalise good practice to support these requirements. The requirement to have a Fit and Proper Policy is a new element, but the substantive requirements align with existing practice and formalise internal practice of deposit takers.

194. While there may be some variation in existing practice, we anticipate the cost of compliance will likely be low overall. To the extent that there are additional compliance costs these are likely to relate to taking a more comprehensive approach to documenting policies and procedures.

195. There is a risk that clearer requirements could deter some candidates for the position of director. However, our proposals reflect common understanding of sound governance practice and reflect the important role that deposit takers play in the New Zealand financial system.

Q14	Do you have comments on our initial assessment of the impact of our proposals on Group 1 deposit takers?

3 Proposed approach for Group 2 deposit takers

196. This section outlines our proposed governance requirements for Group 2 deposit takers across the same 3 areas as for Group 1 deposit takers. That is:

- responsibilities of the board
- structure and composition of the board
- fitness and propriety of the directors and senior managers.

3.1 Responsibilities of the board

197. We propose that the requirements outlined for Group 1 in Table B are also required for Group 2 deposit takers.

Q15	Do you have comments on the proposed outcomes and requirements for the responsibilities of boards of Group 2 deposit takers?

3.2 Structure and composition of the board

198. We propose the requirements outlined for Group 1 in Table C are also required for Group 2 deposit takers.

Q16	Do you have comments on the proposed board size and composition requirements for Group 2 deposit takers?

Q17	Do you have comments on the proposed criteria for independence of directors for Group 2 deposit takers?

3.3 Fitness and propriety of the directors and senior managers

199. We propose the requirements outlined for Group 1 in section 2.3 and Tables C and D are also required for Group 2 deposit takers.

Q18	Do you have comments on the proposed fit and proper requirements for the boards and senior managers of Group 2 deposit takers?

3.4 Analysis

Rationale

200. Our analysis of the proposed requirements for Group 1 broadly applies to Group 2. The rationale for setting out these requirements for Group 2 deposit takers is the same as for Group 1 deposit takers. The same DTA principles were also considered.

201. Responsibilities of the board: we have proposed the same requirements for all groups as we consider that they are the minimum requirements for good governance practice for deposit takers. We expect that the manner of compliance between the groups will vary according to the size and nature of their business. We expect that Group 2 will be able to meet the requirements in a different way from that of Group 1. For example, the complexity of setting out a deposit taker's strategic direction will vary according to the sophistication and breadth of the deposit takers' operations. This approach reflects how we have taken a proportionate approach and ensured a consistent treatment of similar institutions.

202. Structure and composition: we have proposed the same requirements for Group 2 as for Group 1. For most requirements this is an adaptation of the status quo requirements under BS14. The most significant exception to this is our proposal that Group 2 entities must have separate committees covering audit, risk and remuneration. Currently only audit committees are required. are appropriate for Group 2. Our proposed approach will ensure that there is sufficient board oversight of issues that are important to the overall strategy and risk management of the deposit taker.

203. Fitness and propriety: we have proposed the same requirements for Group 2 as for Group 1. This reflects that there are minimum requirements to ensure fitness and propriety, and these apply equally for all deposit takers. To the extent that variation is necessary or desirable, the requirement for a deposit taker to prepare a Fit and Proper Policy enables these considerations to be taken into account beyond the minimum requirements we propose.

Compliance

204. Overall, similarly to Group 1, we expect that Group 2 deposit takers should already be broadly compliant with our proposed requirements across the Governance Standard:

- responsibilities of the board: our proposed requirements reflect common governance practice.

- structure and composition of the board: our proposed requirements largely adapt existing requirements in BS14. Our proposed requirements to have separate committees covering audit, risk and remuneration may have more impact for some Group 2 deposit takers. We understand that many Group 2 deposit takers would already comply with these proposals, but some may combine the subject matter of our proposed committees within a single committee. Maintaining separate committees ensures that sufficient time is dedicated in each subject matter and one area does not crowd out another
- fit and proper: our proposed requirements largely adapt existing requirements in BS10 or formalise good practice to support these requirements.

205. We acknowledge that there will be a baseline cost for meeting the proposed requirements for some deposit takers, depending on the existing level of practice. This could be higher for Group 2 deposit takers that are not currently meeting our proposed requirements. Overall, however, we assess that our proposals will unlikely impose significant additional compliance costs to Group 2.

206. While there may be some variation in existing practice, we anticipate the cost of compliance is likely to be low overall. To the extent that there are additional compliance costs, these are likely to relate to taking a more comprehensive approach to documenting policies and procedures.

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

4 Proposed approach for Group 3 deposit takers

207. This section outlines the proposed governance requirements for Group 3 deposit takers across the same 3 areas as for Group 1 and Group 2 deposit takers. That is:

- responsibilities of the board
- structure and composition of the board
- fitness and propriety of the directors and senior managers.

4.1 Responsibilities of the board

208. We propose the requirements outlined for Group 1 and Group 2 in Table C are also required for Group 3 deposit takers (see sections 2.1 and 3.1).

209. We considered either to adapt the current regulatory approach (that is, BS14 for Group 3 banks and NBDT Act for NBDTs) or to make our requirements clearer and more explicit. Our preferred approach is to make our requirements clearer and more explicit.

Q20	Do you have comments on the proposed outcomes and requirements for the responsibilities of boards of Group 3 deposit takers?

4.2 Structure and composition of the board

Preferred option: compositional requirements

210. We considered 2 options for the compositional requirements for Group 3 deposit takers:

- Option 1: retain and adapt existing NBDT requirements
- Option 2: adaptation of existing NBDT requirements into the same framework as that currently used by registered banks but adjusted for Group 3 deposit takers.

211. Our preferred approach is Option 2. The primary reason for this is that the DTA creates a single regulatory regime for deposit takers in the New Zealand financial system. We consider that board composition requirements should be on the same basis for all groups of deposit takers.

212. While we propose setting largely the same requirements for all Groups, we do propose that substantive requirements relating to the overall size of the board should remain smaller for Group 3, recognising the size and complexity of their business. Table F below sets out our proposed requirements and comments on the difference between our proposed option and the status quo requirements.

Table F: Proposed compositional requirements for Group 3

Proposed requirement	Comment
Requirement 1: The board must have at least 3 members.	A minimum size for the board of NBDTs is not currently set explicitly. Our proposed minimum size is based on the existing minimum number of independent directors. We consider this a minimum size to support strong governance and do not expect the requirement to result in any substantive change for Group 3 deposit takers.
Requirement 2: The majority of members must be non-executive.	There are no existing requirements relating to non-executive membership of the board of NBDTs. However, the existing minimum independence requirements would already enable compliance with this requirement.
Requirement 3: At least half of the independent members must be ordinarily resident in New Zealand.	This requirement is included for consistency with the Group 1 and Group 2 requirements. It is intended to support a New Zealand viewpoint and facilitates the enforcement of rights and liabilities and other legislation by ensuring directors are present in New Zealand. We anticipate that this requirement is unlikely to pose significant issues.
Requirement 4: The chairperson of the board must be independent.	This is an adaptation of an existing requirement.
Requirement 5: At least 2 of the board members must be independent.	This is an adaptation of an existing requirement. We also propose to maintain a numeric requirement, rather than a proportionate requirement (like Group 1 and Group 2) to

Proposed requirement	Comment
	allow for a diversity of types of business model. A proportionate requirement could pose issues for some types of business model where particular perspectives may need to be represented (for example, member representation on the board for a credit union).
Requirement 6: The deposit taker's constitution or rules must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what they believe is the best interests of the deposit taker.	This is an adaptation of an existing requirement in the NBDT Act. We propose to take a consistent approach as for Group 1 and Group 2.

213. We propose that the definition of independence proposed above for Group 1 and Group 2 deposit takers also apply to Group 3 deposit takers. This is a different definition from the definition currently used in the NBDT Act. Given the combining of the bank and NBDT regimes into a single regulatory regime under the DTA, we consider it appropriate that the same definition of independence should apply across the same regulatory regime for all deposit takers. This is an important concept for supporting independent decision making and strong governance practice. This definition does provide a greater level of detail than the definition currently applying to NBDTs; however, our assessment is that this is unlikely to result in a substantively different outcome.

Preferred option: board structure requirements

214. We considered two options for board structure requirements for Group 3 deposit takers:

- Option 1: a direct translation of existing NBDT requirements – that is, no structural requirements for Group 3 for board committees
- Option 2: requiring separate board committees for audit, risk and remuneration similar to Group 1 and Group 2.

215. Our preferred approach is Option 1. While we consider that separate board committees for audit, risk and remuneration can be beneficial for deposit takers of all sizes in focusing attention on these important areas, we recognise that the size and scale of some Group 3 deposit takers may not warrant the additional complexity and cost. Hence, we do not propose that such committees be required.

216. However, we consider that these issues remain of significant importance for Group 3 deposit takers and specific attention of the board should be focused on these matters. If a Group 3 deposit taker does not have specific committees for audit, risk or remuneration, we propose that these areas are required to be given specific scheduled time at board meetings to ensure that the board provides sufficient oversight of matters within these areas, consistent with the requirements proposed for these committees for Group 1 and Group 2 deposit takers.

Q21	Do you have comments on the proposed board size and composition requirements for Group 3 deposit takers?
Q22	Do you have comments on the proposed criteria for independence of directors for Group 3 deposit takers?

4.3 Fitness and propriety of the directors and senior managers

217. The options being considered for Group 3 deposit takers are the same as the options for Group 1 and Group 2 (see sections 2.3 and 3.3).

218. We propose that the same requirements we are proposing for Group 1 and Group 2 deposit takers (see sections 2.3 and 3.3 above) also apply to Group 3 deposit takers.

Q23	Do you have comments on the proposed fit and proper requirements for the directors and senior managers of Group 3 deposit takers?

4.4 Analysis

Rationale

219. Our analysis of the proposed requirements for Group 1 and Group 2 broadly applies to Group 3. The rationale for setting out these requirements for Group 3 is broadly the same as for the other groups. The same DTA principles were also considered.

220. Responsibilities of the board: we have proposed the same requirements for all groups as we consider that these are the minimum requirements for good governance practice for deposit takers. We expect that the manner of compliance between the groups will vary according to the size and nature of their business. We expect that Group 3 will be able to meet the requirements in a simpler manner than Group 1 and Group 2, for example, by using the flexibility to curate their documentation and processes in accordance with the size and complexity of their organisation. This approach reflects how we have taken a proportionate approach and consider the consistent treatment of similar institutions.

221. Structure and composition: we sought to balance our objective of ensuring the safety and soundness of individual deposit takers with the capability of Group 3 deposit takers to comply with the requirements. We have proposed to align the requirements for Group 3 with Group 1 and Group 2 in terms of the types of requirements put in place (there is currently variation in overall approach), but to vary the strength of come of the requirements. In particular we have proposed:

- a lower minimum board size to recognise that the size and scale of some Group 3 deposit takers may not warrant the additional complexity and cost
- a numerical rather than proportional approach to independent members to take into account the diversity of business models in Group 3

- not to require Group 3 to have separate board committees for audit, risk and remuneration, recognising that the size and scale of some Group 3 deposit takers may not warrant the additional complexity and cost.

222. Fitness and propriety: we have proposed the same requirements for Group 3 as for Group 1 and Group 2. This reflects that there are minimum requirements to ensure fitness and propriety, and these apply equally to all deposit takers. To the extent that variation is necessary or desirable, the requirement for a deposit taker to prepare a Fit and Proper Policy enables these considerations to be taken into account beyond the minimum requirements we propose.

Compliance

223. Overall, we expect that many Group 3 deposit takers will be broadly compliant with requirements in our proposed Governance Standard. However, we do expect greater variation in how formal some practices are, in particular relating to the documentation of some of the responsibilities of the board.

- Responsibilities of the board: our proposed requirements reflect common governance practice. We have less visibility of existing practice in this area but expect greater variation in the formality of the requirements we propose.
- Structure and composition of the board: our proposed requirements largely seek to achieve similar outcomes to existing requirements set out in the NBDT Act but adapted to the same framework as for the other Groups. We expect that Group 3 deposit takers will be complying with these requirements. If a board committee is not maintained, requirements relating to consideration of audit, risk and remuneration matters may require a more formal approach in dedicating time to these issues than currently occurs.
- Fit and proper: our proposed requirements differ from the existing 'suitability notice' in the NBDT Act, but the substantive requirements cover similar considerations. They also largely formalise good practice (such as developing a Fit and Proper Policy) to support these requirements.

224. We acknowledge that there will be a baseline cost for meeting the proposed requirements for some deposit takers, depending on the existing level of practice. We recognise that Group 3 deposit takers may have less developed or simpler governance frameworks than Group 1 and Group 2. They may also have less capability and resources to meet these requirements.

225. We anticipate that Group 3 deposit takers could incur higher initial cost to comply with some of the proposed requirements than Group 1 and Group 2 (relative to their size). However, we view the potential cost of compliance to be reasonable and commensurate to the benefits of ensuring the stability of Group 3 deposit takers.

Q24	Are there alternative options that we could consider to deliver the outcomes of the proposed Governance Standard for Group 3 deposit takers?
Q25	Do you have comments on our initial assessment of the impact of our proposals on Group 3 deposit takers?

5 Proposed approach for branches of overseas deposit takers

226. Our proposed requirements for branches cover:

- responsibilities of the New Zealand branch CEO
- fitness and propriety of the directors and senior managers of the branch (that is, the New Zealand CEO and CFO).

227. The requirements reflect the different legal structure and nature of operations of branches. As a result, we partially rely on a branch's compliance with regulation and supervision in its home jurisdiction.

5.1 Responsibilities of the New Zealand branch CEO

228. We considered 2 options in setting out our proposed requirements relating to the responsibilities of New Zealand branch CEOs.

- Option 1: to adopt the status quo (that is, continue to rely on home regulators' governance requirements)
- Option 2: to set out clearer and more extensive minimum requirements for New Zealand branch CEOs that support the desired outcomes.

229. We prefer Option 2, to address the limitations of the current governance regulatory framework in terms of adequacy, clarity and enforceability of our requirements.

230. Our proposed requirements for responsibilities are outlined in Table G. They cover requirements relating to:

- oversight and prudential management
- internal governance, risk culture and values.

Table G: Proposed responsibilities of New Zealand branch CEOs

Outcome/requirement
Outcome 1: Oversight, prudent management and strategic direction The New Zealand branch CEO is responsible for overseeing the branch and ensuring that it complies with its prudential obligations in New Zealand.
Requirement 1: The New Zealand branch CEO must ensure that senior managers' responsibilities are clear, updated and support the prudent management of the deposit taker.
Requirement 2: The New Zealand branch CEO must ensure that the deposit taker's strategic direction and risk management framework are clear and support prudent management of the branch; and any deficiencies are addressed sufficiently.
Requirement 3: The New Zealand branch CEO must ensure that the financial and non-financial reporting such as disclosures, assurances and attestations, among others, relating to the operations and stability of the branch are accurate and delivered within expected period.

Outcome/requirement
Requirement 4: The New Zealand branch CEO must ensure that the branch conducts all of its business lawfully and ethically.
Outcome 2: Internal governance, risk culture and values The New Zealand branch CEO is responsible for ensuring that the branch has a robust governance and risk management framework that provide clear lines of responsibility.
Requirement 1: The New Zealand branch CEO must ensure that the branch's governance arrangements, including information about the business relationship with the head office and the banking group, are clear, updated and support the prudent management of the deposit taker; and that the remedial measures that have been undertaken to address any deficiencies are sufficient.
Requirement 2: The New Zealand branch CEO must ensure that the responsibilities relating to the branch's risk management, and the reporting lines between the branch, head office and the group relating to risk management, are clear, updated and communicated throughout the deposit taker.
Requirement 3: The New Zealand branch CEO must ensure that the processes relating to selection, appointment, evaluation, retention and departure of employees are clear, support prudent management of the deposit taker and communicated throughout the deposit taker. (Note: Section 5.2 below discusses our proposed requirement relating to the branch's Fit and Proper Policy.)
Requirement 4: The New Zealand branch CEO must ensure that the arrangements relating to segregation of duties within the branch are clear and communicated throughout the deposit taker. The New Zealand CEO must also ensure that the performance of multiple functions by its employees does not and is not likely to prevent those employees from discharging any particular functions prudently.
Requirement 5: The New Zealand branch CEO must ensure that any conflict of interest is identified, reported and managed.
Requirement 6: The New Zealand branch CEO must ensure that the delegation of powers/authorities, accountabilities in delegating powers/authorities, information on what constitutes breaches of the delegated authority, and how these breaches will be managed, are transparent and clear.

Q26	Do you have comments on the proposed outcomes and requirements for the responsibilities of the New Zealand branch CEO?

5.2 Fitness and propriety of the directors and senior managers of branches

Options

231. The options being considered for branches are similar to the options for locally-incorporated deposit takers, where relevant. However, the DTA sets a different framework for branches, which is summarised below.

232. The main difference is that branches do not have to get our approval before appointing a new director or senior manager (that is, section 26 of the DTA does not apply to branches). Instead, branches are required to notify us after the appointment and provide a Fit and Proper Certificate. They must do so no later than 20 working days after the appointment (see section 30 of the DTA).

233. The fit and proper requirements for branches apply to directors (of the parent entity overseas) and senior managers (of the branch in New Zealand). As previously noted, senior managers for branches are defined in section 6 of the DTA, as the New Zealand CEO and New Zealand CFO.

234. We propose that both the Fit and Proper Certificate and accompanying documentation are the same as the ones proposed for Group 1 deposit takers (see section 2.3 above).

Preferred option

235. We propose that some of the same requirements we are proposing for Group 1 deposit takers (see section 2.3, and Tables E and F) also apply to branches, with some modifications arising from the different sections of the DTA that apply to branches, as discussed above. The proposed requirements are set below.

236. We propose that all the requirements proposed for Group 1 deposit takers (see Tables D and E) will apply, minus the following:

- 4 (b) – relating to providing further information
- 8 (a), (b) and (c) – relating to interim appointments
- Requirement 11 – relating to having a Fit and Proper Policy
- Requirement 17 – relating to reassessment of a fit and proper assessment.

237. Additionally, we propose that the following requirements also apply:

- the branch must provide us documentation on the residence of its senior managers
- a branch must have a New Zealand CEO-approved Fit and Proper Policy for the purpose of ensuring that only fit and proper persons are appointed to, and continue to hold, positions as directors or senior managers.

Q27	Do you have comments on the proposed fit and proper requirements for branch senior managers?

5.3 Analysis

Rationale

238. Responsibilities of the New Zealand branch CEO: our proposed requirements will support the safety and soundness of all branches. We propose requirements apply to the New Zealand CEO to reflect the legal structure of branches and the fact that they do not have a New Zealand board. Our proposed requirements recognise the nature of branch operations and the types of business they will be engaged in after the decisions in the Review of Policy

for Branches of Overseas Banks are implemented.[59] The rationale of the proposed requirements for branches is the same as the rationale explained in section 2.1 above for Group 1.

239. Fitness and propriety: our proposed requirements for branches, which are similar to the proposed requirements for locally-incorporated deposit takers, will support their safety and soundness and provide for the appointment of suitable people to these important roles. The additional documentary requirement relating to residency of the senior managers is in line with the DTA, which requires that the branch senior managers are ordinarily resident in New Zealand (or the Reserve Bank's approval for an alternative arrangement). The rationale of the proposed requirements for branches is the same as the rationale explained in section 2.3 above for Group 1.

240. In setting out our requirements, we considered the principles on proportionality (section 4(a)(i) of the DTA) and consistent treatment of similar institutions (section 4(a)(ii) of the DTA) in the case of branches. The proposed requirements for branches are relatively simpler than the proposed requirements for locally-incorporated deposit takers given the differences in the size and nature of business between them and locally-incorporated deposit takers.

241. The proposed requirements clarify the New Zealand CEOs' responsibilities in managing the branches and help ensure the fitness and propriety of senior managers and directors to support sound governance practices in branches (section 4(f) of the DTA). Sound governance requirements support the branches in their efforts to manage risks effectively (as part of section 4(g) of the DTA). They also support a deposit-taking sector with diverse institutions (section 4(a)(iii) of the DTA) and the overall stability of the New Zealand financial system (section 4(e) of the DTA).

242. We have considered the principle of maintaining competition within the deposit-taking sector (section 4(b) of the DTA) in the context of avoiding unnecessary compliance cost (section 4(c) of the DTA). We balance our intent of fostering sound governance of branches against the potential compliance costs and aim to set out requirements that are relevant, feasible and will not hinder the market entry of prospective branches. The proposed requirements also support transparency in governance practices of branches that should help inform depositors in their business decisions involving any branch (section 4(h) of the DTA).

243. Furthermore, as the proposed requirements draw from the requirements for locally-incorporated deposit takers, they are informed by practices of overseas supervisors and standards of international organisations (sections 4(d)(i) and 4(d)(ii) of the DTA).

Compliance

244. We assessed the proposed requirements to be reasonable for branches and we anticipate that these will impose a low compliance cost. Branches are likely to have well-defined governance policies that are tailored to the New Zealand jurisdiction and aligned with

[59] Reserve Bank of New Zealand – Te Pūtea Matua. (2023). Review of policy for branches of overseas banks. https://www.rbnz.govt.nz/have-your-say/review-of-policy-for-branches-of-overseas-banks

internationally accepted principles, given that they are all part of a parent entity that is domiciled in a BCBS jurisdiction.[60]

245. Furthermore, branches are already subject to fit and proper requirements in their home jurisdiction. As noted above, APRA has a similar residency requirement for foreign and other authorised deposit-taking institutions (ADIs). Documentation may have to be modified in some ways to be clear on certain details that we have identified, but it will not require significant resources.

Q28	Do you have comments on our initial assessment of the impact of our proposals on branches?

6 Conclusion

246. The proposed Governance Standard seeks to achieve the purposes of the DTA by promoting sound, effective and efficient corporate governance practice to support the safety and soundness of all deposit takers operating in the New Zealand financial system. Sound governance requirements are critical to addressing risks to financial stability arising from poor management and oversight of deposit takers and promote public confidence in the financial system more broadly.

247. Our proposed approach enhances our governance requirements for deposit takers, in accordance with the DTA, and supports greater certainty in our supervisory approach. Our proposals have been developed in accordance with the Proportionality Framework. We assess that they are reasonable requirements for sound governance practice of deposit takers in New Zealand. This consultation is intended to test the feasibility of our proposals and the soundness of our views.

Q29	Do you have 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?

[60] The 2023 Governance Thematic Review notes that for branches in New Zealand, "governance policies and processes were well outlined and designed to be effective globally while still tailored for the New Zealand jurisdiction". *See* Reserve Bank of New Zealand – Te Pūtea Matua and Financial Markets Authority – Te Mana Tātai Hokohoko (2023). Governance Thematic Review. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/thematic-reviews/rbnz-and-fma-governance-thematic-review-report.pdf

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 2

Deposit Takers Lending Standard

Deposit Takers Non-Core Standards Consultation

21 August 2024

CONSULTATION PAPER

Non-technical summary

Deposit takers lend money to households, businesses and other entities. New Zealand deposit takers make a large proportion of their loans to the residential property sector. Given this, we closely monitor lending in the residential property sector.

Macroprudential policy is designed to reduce systemic risks in the financial system (that is, risks to the system as a whole). Macroprudential policy works to complement microprudential policy tools. Microprudential policy focuses on addressing the risks that individual deposit takers face (which can differ across deposit takers), for example by increasing their capacity to withstand adverse events. Our microprudential policy tools are set out in our other proposed standards.

We use borrower-based macroprudential policy to reduce systemic risks to the stability of the financial system related to the residential property sector. Specifically, LVR restrictions limit the size of the mortgage borrowers can take out relative to the value of the property they are buying — essentially a minimum deposit is required. DTI restrictions limit the amount of debt borrowers can take on as a multiple of their income.

LVR restrictions reduce the risk to the financial system that borrowers will not be able to fully repay their loans if they default on their mortgages. DTI restrictions reduce the risk of borrowers defaulting on their mortgages or being forced to sell their houses. By restricting the share of high-LVR lending and high-DTI lending, we aim to limit the build-up of systemic financial stability risk (that is, risk to the system as a whole), particularly when house prices are rapidly increasing.

This supports financial stability by reducing the number of loans in default and, relatedly, the scale of losses faced by borrowers and deposit takers, particularly in the face of an adverse event. In turn, this also helps to reduce the risk of a house price correction and a downturn in the broader economy. For example, in such a situation, borrowers are likely to spend less, and banks are less willing to lend, which can exacerbate an economic downturn. Since introducing LVR restrictions in 2013, we have adjusted the settings multiple times in response to changing systemic financial stability risks. We published a DTI restrictions framework in 2023 and recently activated DTI restrictions.[61]

This chapter of the Deposit Taker Non-Core Standards Consultation Paper covers the key proposed components of the Lending Standard. For the most part, this takes existing borrower-based macroprudential policy requirements and proposes bringing them into the standard. We propose these requirements apply to Group 1 and Group 2 deposit takers. We do not propose applying borrower-based macroprudential policy to Group 3 deposit takers at this time as they are small compared to the total market and, in our view, do not currently pose a systemic risk to the financial system. However, we will monitor the housing market and if Group 3 deposit takers grow and start to pose a systemic risk to financial stability, we will re-evaluate our approach and could apply borrower-based macroprudential policy to Group 3 deposit takers in the future.

We propose these requirements for the purposes of protecting and promoting financial system stability and avoiding or mitigating the adverse effects of risks to, and from, the financial system. We have taken into account the relevant principles of the DTA.

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[61] Reserve Bank of New Zealand – Te Pūtea Matua. (2024, 28 May). Reserve Bank activates Debt-to-Income restrictions. https://www.rbnz.govt.nz/hub/news/2024/05/reserve-bank-activates-debt-to-income-restrictions

1 Introduction

248. This chapter of the Deposit Taker Non-Core Standards Consultation Paper focuses on the proposed Lending Standard, which will apply to residential property loans originated by deposit takers in New Zealand. The Lending Standard would impose restrictions on high-LVR and high-DTI residential property lending (including loans secured by owner-occupied residential property and loans secured by residential investment property).

249. Macroprudential policy is one part of our financial stability toolkit. Specifically, macroprudential policy is designed to reduce systemic risks in the financial system. The Lending Standard will provide the macroprudential policy tools relating to borrower-based measures, which limit how much a prospective borrower can borrow based on the size of their deposit or income. Other macroprudential policy tools are based on capital and liquidity metrics but will not form part of the Lending Standard.

250. Our macroprudential policy tools complement our microprudential policy tools, which are set out in our other proposed standards. Microprudential policy focuses on the risks to, and resilience of, individual deposit takers — for example, by requiring deposit takers to have processes in place to help them to respond to adverse events and regulatory capital to absorb potential losses. However, microprudential policy is not designed to address the build-up of systemic risks and the potential negative feedback loops that can emerge from interactions between entities across the financial system. Macroprudential policy can mitigate these potential negative feedback loops, for example by reducing extremes in credit cycles and therefore the risk that the financial system amplifies a severe downturn in the real economy.

251. Lending to the residential property sector makes up a large proportion of business for deposit takers. For example, just over half of all new lending in 2023 was to the residential property sector. Given its size, if there is a high proportion of high-LVR or high-DTI lending in the residential property sector, then this can lead to risks to the stability of the financial system, especially if an adverse event occurs. As a result, there may be a higher incidence of loans in default, and hence greater losses faced by borrowers and deposit takers.

252. Due to their size and importance to New Zealand's financial system, banks in New Zealand are required to limit their proportion of high-LVR or high-DTI lending in the residential property sector. This promotes the maintenance of a sound financial system by reducing the number of loans in default and, relatedly, losses faced by borrowers and deposit takers. Furthermore, borrower-based macroprudential policy is aimed at mitigating the adverse effects of risks to the financial system as a whole by limiting booms and busts in the residential property sector. This can also help to mitigate risks from the financial system that may damage the broader economy by limiting the negative feedback effects between falling house prices and the broader economy.

253. Since their activation in 2013, LVR restrictions have been the main borrower-based macroprudential policy tool used to address systemic financial stability risks related to the residential property sector. An LVR is a measure of how much a deposit taker lends against mortgaged property, compared to the value of that property. LVR restrictions limit the amount of lending that banks can do above an LVR threshold, known as a speed limit.

254. LVR restrictions have been effective in promoting financial stability by reducing the systemic risks associated with a build-up of highly leveraged housing loans in the financial system.[62] However, LVR restrictions relate mainly to one dimension of residential property loan risk — namely, the losses faced by banks and borrowers in case of a default, known as loss given default.

255. The other key component of risk relates to the borrower's capacity to service a loan, which in turn affects the probability of default. Debt Serviceability Restrictions (DSRs) are the main macroprudential instrument used internationally to address this second dimension of systemic risk related to the residential property sector. There are a range of DSRs; in New Zealand the DSR tool that we use are DTI restrictions.[63] DTI restrictions limit the portion of lending that banks can provide to residential borrowers with a DTI ratio above a certain threshold. A borrower's DTI ratio is calculated by dividing their total debt by their total income.

256. This chapter sets out our proposed approach to the Lending Standard for each Group of deposit takers. The Lending Standard will consist of borrower-based macroprudential policy measures (that is the LVR and DTI restrictions).

257. Note that this consultation is not about the specific calibration of borrower-based measures (such as the specific thresholds and speed limits for LVR and DTI restrictions). Instead, it focuses on the general design of borrower-based measures and which deposit takers these measures should apply to.

1.1 Purpose of the lending standard

258. Under the DTA, the proposed Lending Standard will impose restrictions on lending carried out by deposit takers, where the type of lending in scope will be determined by regulations as per section 83 of the DTA. However, as outlined in section 1.3 below, it is expected that the Lending Standard will only apply to residential property lending, consistent with existing borrower-based macroprudential policy.

259. By limiting both high-LVR and high-DTI residential property lending, the proposed Lending Standard aims to reduce systemic risks associated with a build-up of highly leveraged residential property loans in the financial system. This helps to mitigate the risk of contagion, where extremes in residential property sector cycles can lead to adverse events in the financial system, which may spill over and lead to a severe downturn in the broader economy.

260. This aligns with the main purpose of the DTA, to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system (section 3(1)).

261. Some aspects of the proposals also support the following additional purposes of the DTA:

- to avoid or mitigate the adverse effects of risks to the stability of the financial system (section 3(2)(d)(i))

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[62] *See* McDonald, C. & Markham, S. (2023). Reflections on a decade of using macroprudential policy. https://www.rbnz.govt.nz/hub/publications/bulletin/2023/rbb-2023-86-09

[63] Reserve Bank of New Zealand – Te Pūtea Matua. (2022). Feedback on debt servicing restrictions framework informs future policy direction. https://www.rbnz.govt.nz/hub/news/2022/04/feedback-on-debt-servicing-restrictions-framework-informs-future-policy-direction.

- to avoid or mitigate the adverse effects of risks from the financial system that may damage the broader economy (section 3(2)(d)(ii)).

1.2 Current approach

262. Under the current prudential frameworks for banks and NBDTs:

- lending restrictions (such as LVR and DTI restrictions) for banks are set out in Banking Supervision (BS) documents and imposed on each bank through their Conditions of Registration (CoR)
- no lending restrictions currently apply to NBDTs.

Current approach for banks

263. The Memorandum of Understanding (MoU) between the Minister of Finance and the Governor of the Reserve Bank sets out agreed operating guidelines for macroprudential policy. The MoU is not legally binding but requires us to consult the Minister of Finance and the Treasury when actively considering the use of macroprudential policy.[64]

264. The MoU was first established in May 2013. Following that, in June 2013, we consulted on the LVR framework document, BS19: Framework for Restrictions on High Loan-to Value Residential Mortgage Lending.[65] LVR restrictions were activated in October 2013. Since that time LVR restrictions have been the main tool used to address systemic financial stability risks related to the residential property market, and LVR settings have been adjusted multiple times as risks have evolved.

265. The other borrower-based measure that would form part of the Lending Standard are DTI restrictions. In April 2023, we published the DTI framework document, BS20: Framework for Restrictions on High Debt-to-Income Residential Mortgage Lending.[66] This did not activate DTI restrictions or set a specific calibration, instead it put rules in place so that banks could prepare to be operationally ready for DTI restrictions in the future. DTI restrictions were activated in July 2024. We summarise the key components of the current LVR and DTI policy in Table H below.

Table H: Overview of key components of current LVR and DTI policy

Component	Description
Qualifying new lending amounts	This refers to the value of residential property loans provided by a bank that are covered by the policy. Banks have separate qualifying new lending amounts for owner-occupiers and investors.

[64] Reserve Bank of New Zealand – Te Pūtea Matua. (2021). Memorandum of Understanding between the Minister of Finance and the Governor of the Reserve Bank of New Zealand. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/about/mou/reserve-bank-minister-of-finance-macroprudential-mou.pdf

[65] Reserve Bank of New Zealand – Te Pūtea Matua. (2021). BS19 – Framework for Restrictions on High Loan-to Value Residential Mortgage Lending policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs19-lvr-restrictions-framework.pdf

[66] Reserve Bank of New Zealand – Te Pūtea Matua. (2023). BS20 – Framework for Restrictions on High Debt-To-Income Residential Mortgage Lending. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/debt-serviceability-restrictions/dti-framework.pdf

Component	Description
Exemptions	Under BS19[67] and BS20,[68] there are several categories of residential property lending that are exempt from LVR or DTI restrictions, including: • Kāinga Ora First Home Loans • refinancing with another bank • loan portability • bridging finance • new construction loans • remediation loans • combined collateral[69] • loans granted in error.
Threshold	Thresholds refer to the specific level of LVR or DTI ratios that banks can lend up to without any restrictions. Thresholds are set out in a bank's CoR and are the same across all banks. Different thresholds can be applied to lending to owner-occupiers and investors.
Speed limit	A speed limit is the percentage of qualifying new lending amounts (in terms of value) that is permitted to exceed the LVR or DTI thresholds. Speed limits are set out in a bank's CoR and are the same across all banks. Different speed limits can be applied to lending to owner-occupiers and investors.
Measurement period	Banks must not breach the speed limit (lend more than the speed limit percentage of qualifying lending at DTIs or LVRs above the relevant thresholds) over the measurement period. LVR and DTI restrictions (or changes to settings) will normally apply from the first day of a month, and the relevant measurement period during which the restrictions would apply would be the three or six calendar months starting from that date. The subsequent measurement period would be the three or six calendar months starting one month later, and so on. Banks with new mortgage lending flows of more than $100 million per month are subject to a three-month rolling period. Banks with new mortgage lending flows of less than $100 million per month are subject to a six-month rolling period.

[67] *See* sections 12 and 13 of BS19 for more detail on LVR exemptions.
[68] *See* sections 14 and 15 of BS20 for more detail on DTI exemptions.
[69] The combined collateral exemption is not included in BS20, since collateral is not a relevant metric for the DTI ratio.

1.3 Proposed policy development approach

266. The policy proposals in this document have been split into those that apply to each of the 3 Groups of deposit takers in the Proportionality Framework.[70] The rest of this paper discusses the proposals for these Groups, posing a number of questions for feedback.

267. For Group 1 and Group 2, we have assessed the appropriateness of carrying over into the proposed standard our current borrower-based macroprudential policy requirements. This involved considering how borrower-based macroprudential policy aligns with the main and additional purposes of the DTA. It also involved taking into account the relevant principles set out in the DTA.

268. For Group 3, we assessed whether it would be appropriate to apply the existing borrower-based macroprudential policy requirements to these deposit takers but have concluded this is not necessary at this time.

269. Multiple possible LVR and DTI requirements (such as thresholds and speed limits) will be included in the Lending Standard, with the specific requirements applied to each deposit taker in their licence conditions. We think that this is appropriate because thresholds and speed limits for borrower-based macroprudential policy tend to be adjusted more frequently than requirements of other policies, as the appropriate settings can change through the housing cycle in response to changes in systemic risks to financial stability. In section 2.2, we discuss how this interacts with the Lending Standard and what an appropriate mechanism for adjusting settings might be given that the inclusion of regulatory requirements in a standard is the default approach under the DTA.

270. Furthermore, as noted above, the type of lending in scope of the Lending Standard will be determined by regulations. Regulations will not depend on the specific nature and size of deposit taker Groups as set out in the Proportionality Framework, so are outlined in this section.

Classes of lending prescribed by regulations

271. As per section 83 of the DTA, we expect to recommend to the Minister of Finance that a regulation be made that outlines the class or classes of lending that the Lending Standard may apply to (such as residential mortgage lending, commercial property and rural lending).

272. Lending to the residential property sector makes up a large proportion of business for deposit takers in New Zealand, far outweighing lending to other sectors. Hence, lending to the residential property sector is the main source of potential systemic risk to New Zealand's financial system.

273. We expect to recommend that the regulation made under section 83 of the DTA provides for the Lending Standard to only relate to residential mortgage lending, which aligns with our current macroprudential policy for borrower-based measures.

[70] Reserve Bank of New Zealand – Te Pūtea Matua. (2024, 14 March) Proportionality Framework for Developing Standards Under the Deposit Takers Act. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf.

Q31	Do you agree that the Lending Standard should only apply to residential mortgage lending (with a regulation made under the DTA to enable that)?

2 Proposed approach for Group 1 deposit takers

2.1 General approach

Preferred option

274. Group 1 deposit takers consist of the four large Australian-owned New Zealand-incorporated banks (also known as the D-SIBs). Given the size of these deposit takers and their systemic importance to New Zealand's financial system, they are the largest source of potential systemic financial stability risks. It is important that risks from the financial system are sufficiently contained so that they do not damage the broader economy.

275. Our proposed approach for Group 1 deposit takers is to carry over the existing borrower-based macroprudential policy requirements. This means carrying over the policy requirements for LVR and DTI restrictions as set out in BS19 and BS20, respectively (as outlined in Table H). Given the nature of systemic financial stability risks, our view is that it is important to continue to apply borrower-based macroprudential policy to residential property lending, particularly for the largest deposit takers.

276. Thresholds and speed limits for LVR and DTI restrictions tend to change over time as we respond to changes in systemic risk to financial stability. Therefore, it is the underlying framework and requirements that will be carried over from BS19 and BS20 to the Lending Standard – not the specific LVR and DTI settings. We discuss this further in section 2.2.

277. In April 2023, we published the DTI framework document (BS20), in which many definitions and requirements were based on the LVR framework document (BS19). As BS20 has only recently been published, we do not feel that major changes to borrower-based macroprudential policy requirements need to be made at this time. However, we will review the requirements over time and some minor or technical adjustments to the wording of these requirements are likely if they are converted into a Lending Standard.

278. Our proposal also includes that Group 1 deposit takers will be subject to lending restrictions on a three-month measurement period, which aligns with the current settings for the largest banks. A three-month measurement period means that Group 1 deposit takers must not breach the speed limit over that period. In other words, only a certain percentage of their loans (in terms of value) can exceed the threshold that we set for LVR or DTI over overlapping three-month periods starting on the first of each month.

Analysis

279. As discussed above we are proposing to carry across the current requirements for the D-SIBs to Group 1 deposit takers in the Lending Standard.

280. The DTA requires us to take into account a number of principles when developing standards. Our assessment is that the proposed approach to Group 1 deposit takers is consistent with the main purpose of the DTA (section 3(1)) as well as some of the additional purposes (section

3(2)(d)). We have also taken into account the relevant principles of the DTA in our conclusions regarding the proposed approach. We discuss this further below.

Proportionality and consistency across deposit takers

281. Existing borrower-based macroprudential policy is currently largely consistent across banks but adopts a proportionate approach in terms of varying measurement periods. As outlined in BS19 and BS20, larger banks currently have a shorter measurement period than smaller banks in terms of complying with speed limits – three-months vs six-months. This is because larger banks have lower volatility in their lending flows, which makes it easier for them to manage the flow of both high-LVR and high-DTI lending than it is for smaller banks. We discuss this in more detail in section 3.

282. We propose that Group 1 and Group 2 deposit takers are treated in a largely consistent manner but have tiered proportionality in terms of measurement periods. This means that Group 1 and Group 2 deposit takers will face the same system and data requirements, as well as the same LVR and DTI settings, with Group 2 deposit takers having a longer measurement period as discussed further in section 3.

283. This is the same as currently required (where the largest banks have shorter measurement periods). This means that Group 1 and Group 2 deposit takers would not face additional regulatory burden compared to the current policy. Note that we discuss Group 3 deposit takers further in section 4.

Compliance costs

284. Data requirements underpin current borrower-based macroprudential policy and are reasonably detailed. The data allows us to monitor the level of high-LVR and high-DTI lending in the residential property sector and compliance with speed limits.

285. The Lending Standard would require the reporting of data that Group 1 deposit takers already collect and report to us. Furthermore, we are proposing to carry over the same regulatory measurement periods as discussed previously in this section.

286. Our view is that, under the proposed Lending Standard, Group 1 deposit takers would avoid unnecessary compliance costs given the data required to monitor financial stability risks related to the residential property sector. Furthermore, this means that Group 1 deposit takers would not face additional compliance costs compared to the current borrower-based macroprudential policy.

Diversity and competition

287. Borrower-based macroprudential policy (that is, LVR and DTI restrictions) requires deposit takers to limit the amount of high-LVR and high-DTI lending that they do to the residential property sector. By limiting the amount of high-LVR and high-DTI lending, systemic financial stability risks can be reduced, which improves the resilience of deposit takers. This means that they are more likely to remain in business and continue to provide financial products and services, which is also vital for maintaining competition.

288. However, borrower-based macroprudential policy may have impacts on the accessibility of mortgage lending for some New Zealanders, where the impacts depend on the settings for LVR and DTI restrictions at the time (which can change in response to systemic risks to the

financial system). We assess these impacts each time we review the settings for LVR and DTI restrictions. It is also noted that the current policy includes speed limits[71] and exemptions,[72] which can mitigate the impacts on the accessibility of mortgage lending to some extent. Speed limits and exemptions will be carried over to the proposed Lending Standard, which will assist deposit takers in providing lending to a diverse range of New Zealanders.

Consistency with international practice

289. Macroprudential policy, in particular borrower-based measures, are reasonably common internationally. International regulators have increasingly embraced the role of borrower-based measures (such as LVR restrictions and DSRs) in containing systemic financial stability risks. LVR restrictions came to prominence earlier than DSRs, becoming more commonly used amongst regulators after 2009 as a key learning from the vulnerabilities exposed by the Global Financial Crisis.[73] DSRs became more widely used from 2015 onwards.

290. However, there are often differences in some of the underlying details of the policies across countries based on country-specific factors, which feeds into how they are calibrated.[74] For example, DTI restrictions are relatively rare and other countries tend to use other types of DSR tools, such as loan-to-income (LTI)[75] restrictions and test interest rate floors.[76] In previous consultations, we considered that DTI restrictions were likely to be more effective than other DSR tools in supporting financial stability because of the nature of New Zealand's housing market and the role that small scale investors play.[77]

291. Given the fact that differences in the details underlying borrower-based macroprudential policy can be wide-ranging because of country-specific factors and that it is still a relatively new policy area, there are not well-developed standards and guidance from international organisations that can be drawn upon. Nevertheless, we consider that we are broadly aligned with international practice as the Lending Standard will include LVR and DTI restrictions (which is a type of DSR). We note that LVR restrictions and DSRs are becoming increasingly common internationally,[78] but we consider factors specific to New Zealand when setting out the details for our borrower-based macroprudential policy.

Effective management of risk

292. Speed limits restrict the amount of lending that can be above high-LVR or high-DTI thresholds. In other words, thresholds for high-LVR or high-DTI lending are not hard limits and there is some flexibility. Speed limits can help to reduce efficiency costs and promote financial inclusion by allowing deposit takers to lend to otherwise creditworthy borrowers.

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[71] Speed limits allow deposit takers to still issue high-DTI or high-LVR loans up to the speed limit (that is, a percentage of lending).

[72] Certain categories of lending, such as Kāinga Ora First Home Loans, are not subject to DTI or LVR restrictions.

[73] Pisarska, A. & Wasilewska, N. (2020). The loan-to-value ratio as a macroprudential tool and assessment of real estate in the post-crisis period. Economic Annals-XXI, 185(9-10), pp 119-132. https://ea21journal.world/index.php/ea-v185-12/.

[74] For example, there can be differences in how central banks define collateral, debt and income because housing markets often have characteristics that are unique to a particular country.

[75] The LTI only accounts for a single mortgage loan and excludes other types of debt, whereas the DTI uses a prospective borrower's total debt.

[76] A floor on the interest rates used by banks in their debt serviceability tests, which assesses the ability of a borrower to continue repaying their loan if mortgage rates rise to a certain level.

[77] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2021). Debt serviceability restrictions consultation paper. rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/debt-serviceability-restrictions/debt-serviceability-consultation.pdf

[78] *See* Fiala, L. & Teplý, P. (2021). The Use of Borrower-based Measures within Macroprudential Policy: Evidence from the European Economic Area. European Financial & Accounting Journal, 16(1), Table 3. http://efaj.vse.cz/pdfs/efa/2021/01/04.pdf

Furthermore, deposit takers are able to allocate their speed limit as they see fit, depending on their own risk appetite.

293. However, by placing limits on both high-LVR and high-DTI lending in the residential property sector, this will help to manage long-term systemic risks to the stability of the financial system. Specifically, this works by reducing the risk that there will be a large number of loans in default and therefore reducing the losses faced by borrowers and deposit takers. In turn, this reduces the systemic risk associated with extremes in credit cycles related to the residential property sector.

Summary

294. We are proposing to carry over the existing borrower-based macroprudential policy requirements to Group 1 deposit takers when the Lending Standard comes into force (which includes a three-month measurement period). In conducting our analysis and reaching a preferred option, our focus has been on ensuring that the principles of the DTA have been taken into account.

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)?

2.2 Adjusting LVR and DTI settings

295. BS19 and BS20 do not set out the specific calibration of LVR and DTI restrictions (that is, the thresholds and speed limits). Currently, settings are set out in each bank's conditions of registration, which are altered for each bank every time the calibration is adjusted.

296. The inclusion of regulatory settings in a standard is the default approach under the DTA, especially if the settings are going to apply to all deposit takers or a Group of deposit takers with shared characteristics (as would be the case in the Lending Standard). This would mean that the Lending Standard would need to be amended each time that LVR and/or DTI settings were to be changed.

297. We have changed LVR settings multiple times since they were activated. They are generally changed more often than settings associated with other policies, as the appropriate settings can change through the housing cycle in response to changes in systemic risks to financial stability. At this stage, we expect DTI settings will be changed less frequently than LVR settings.

298. If we were to change LVR or DTI settings in the future, we would want to do so in as timely a manner as possible given that we would be responding to changes in systemic financial stability risks associated with the residential property sector. Hence, we need to consider the most appropriate and efficient way of adjusting LVR and DTI settings once the Lending Standard is in force, rather than amending the Lending Standard each time.

Preferred option

299. Our preferred option is to write a set of possible LVR and DTI threshold and speed limit requirements into the Lending Standard.

300. The specific LVR and DTI threshold and speed limit requirements that apply to a deposit taker at any specific point in time would then be set out in each deposit taker's licence conditions, where applicable. It is noted that we would give deposit takers at least 7 days' notice and a reasonable opportunity to make submissions on changes to their licence conditions as required under the DTA. This is the same as the current process under section 74 of the BPSA.

301. The set of LVR and DTI threshold and speed limit requirements that we propose (set out in Table I) are largely based on past calibrations and analysis but are also designed to future-proof the Lending Standard somewhat. It is noted that the set of LVR and DTI threshold and speed limit requirements set out in Table I are not mutually exclusive and there can be numerous combinations – for example, there could be an LVR threshold of 80% and a LVR speed limit of 20%, whereas the DTI threshold could be 6 with a DTI speed limit of 15%. There will also be separate requirements for owner-occupiers and investors.

Table I: Proposed set of LVRs, DTIs and speed limits

LVR threshold (%)	DTI threshold	Speed limit (%)
60	5	0
65	5.5	5
70	6	10
75	6.5	15
80	7	20
85	7.5	25
90	8	30

Analysis

302. There are significant lags in how quickly we can go from identifying a shift in systemic financial stability risks related to the residential property market to changing LVR and/or DTI settings. This is due to data lags, the time needed to consult and the time it takes for deposit takers to implement the settings. Writing a set of LVR, DTI and speed limit requirements into the Lending Standard (and then stating which applies in licence conditions) will allow us to respond to systemic financial stability risks in a more timely manner compared to having to amend the Lending Standard each time.

303. Historically, LVR thresholds have been set as low as 60% and as high as 80% and have typically been moved in increments of 5%. Therefore, we propose that there should be 5% increments from an LVR of 60% to 90%. This gives us a wider range of settings than we have used in the past, which will give us greater flexibility.

304. For DTI thresholds, we propose a range of 5 to 8. A DTI ratio of 5 is a starting threshold we have used to identify high-DTI lending in past consultations.[79] A DTI ratio of 8 is higher than we have suggested would be binding[80] through the cycle in our analysis in the recent consultation on the DTI calibration but gives us some flexibility if things change in the future.[81] At this stage, we only expect DTI settings to be set at whole numbers. However, we propose including increments of 0.5 to retain the possibility of setting the DTI threshold in between whole numbers (such as 5.5 and 6.5). This allows us to future-proof the standard as increments of 0.5 may add more nuance to the policy response to the systemic financial stability risks at the time.

305. Speed limits of up to 20%, in 5% increments, have been common since LVR restrictions were first activated. We expect this to be similar for LVR and DTI restrictions going forward however we include the option to extend to 30% to give flexibility.

306. The set of LVR, DTI and speed limit requirements will be applied to owner-occupiers and investors separately. For example, owner-occupiers may be subject to a LVR threshold of 80% with an LVR speed limit of 20% and a DTI threshold of 6 with an DTI speed limit of 15%, and investors may be subject to a LVR threshold of 70% with a LVR speed limit of 5% and a DTI threshold of 7 with a DTI speed limit of 20%.

Summary

307. We are proposing to include a set of LVR and DTI threshold and speed limit requirements in the Lending Standard. This will make the process of adjusting settings more efficient, instead of having to amend the Lending Standard each time settings need to be adjusted, which would lengthen the process (noting that adjustments to these settings are often time critical).

308. We note that we would still have the option to use LVR and DTI threshold and speed limit requirements not set out in the Lending Standard if market conditions warranted other settings. This would mean that the Lending Standard would need to be amended; hence lengthening the process when it comes to adjusting settings.

Q33	Do you agree with including the proposed set of LVR and DTI threshold and speed limit requirements in the Lending Standard?

2.3 Option to apply settings at an Auckland/non-Auckland level

309. The LVR framework (BS19) sets out separate definitions for Auckland and non-Auckland residential property. This gives the option to apply different LVR restrictions for Auckland and outside of Auckland.

[79] Reserve Bank of New Zealand – Te Pūtea Matua. (2017). Consultation Paper: Serviceability Restrictions as a Potential Macroprudential Tool in New Zealand. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/dti/consultation-paper-dtis-june-2017.pdf

[80] Binding' means constraining lending compared with the absence of the policy.

[81] Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Enhancing the efficiency of macroprudential policy: activating DTIs and loosening LVRs. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/dti-and-lvr-settings/enhancing-the-efficiency-of-macroprudential-policy-consultation-paper.pdf

310. Different Auckland and non-Auckland LVR restrictions were briefly in place from November 2015,[82] but LVR restrictions have been applied only at the national level since October 2016.

311. The recently published DTI framework (BS20) does not set out separate definitions for Auckland and non-Auckland residential property.

Preferred option

312. Our proposed approach is to exclude the option to apply the Lending Standard at an Auckland/non-Auckland level. This differs from the current LVR policy, which does not set out Auckland-specific LVR restrictions in the current settings but retains the option to do so as per BS19.

Analysis

313. Despite a brief slowdown in housing market activity and growth in house prices in the year or so following the activation of LVR restrictions, Auckland experienced rapid house price growth during 2015, which peaked at an annual rate of around 25 per cent. This was significantly higher than the rest of the country and was driven by record levels of net immigration into the region and constrained supply.

314. Auckland also accounted for around half of new lending flows in New Zealand at that time. This concentration of lending in a single geographic market meant that developments in the Auckland housing market were seen to be of systemic importance to the New Zealand financial system.

315. We felt that there was a case to target policy measures to Auckland – particularly as its property market was seen to be at risk of a substantial correction that had the potential to generate a significant period of macroeconomic weakness across the country. Therefore, in late 2015, we imposed tighter LVR restrictions in Auckland than the rest of the country.

316. Auckland house price growth had eased but house price inflation in the rest of the country had picked up throughout 2016, despite LVR restrictions remaining in place (albeit at looser settings than in Auckland). However, there was evidence that tighter LVR restrictions in Auckland were leading to a 'spillover' effect, with greater amounts of high-LVR lending moving to areas outside Auckland. For example, during this time, there was a significant increase in investor lending at high-LVR ratios outside Auckland, particularly in nearby regions. Accordingly, in October 2016, the Auckland/non-Auckland split was removed and LVR restrictions nationally were tightened further.[83]

317. The Auckland/non-Auckland split for LVR restrictions has not been used since because of the 'spillover' effects that it can create. Moreover, when implementing borrower-based macroprudential policy, we are targeting risks to the financial system as a whole.

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[82] Reserve Bank of New Zealand – Te Pūtea Matua. (2015). Consultation Paper: Adjustments to restrictions on high-LVR residential mortgage lending. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/macro-prudential/consultation-paper-investor-housing.pdf

[83] Reserve Bank of New Zealand – Te Pūtea Matua. (2016). Consultation Paper: Adjustments to restrictions on high-LVR residential mortgage lending https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/consultations/consultation-paper-july-2016-adjustments-restrictions-high-lvr-lending.pdf

Summary

318. In summary, we propose to exclude the option to apply the Lending Standard at an Auckland/non-Auckland level. Currently, it is unlikely that we would apply different borrower-based macroprudential policy settings at an Auckland/non-Auckland level in the future given the potential for spillovers of high-LVR or high-DTI lending to other regions with looser policy settings.

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

3 Proposed approach for Group 2 deposit takers

3.1 General approach

Preferred option

319. Group 2 deposit takers are less systemically important compared to the Group 1 deposit takers and generally do not have the same level of interconnectedness with other financial service providers. However, these deposit takers have the potential for sectoral or regional importance and/or service specific markets and can potentially pose systemic risks to financial stability if they engage in a high proportion of high-LVR or high-DTI lending in the residential property sector.

320. Our proposed approach is to adopt the same approach to Group 2 deposit takers that we are proposing to take for Group 1 deposit takers with the exception of a longer measurement period. Specifically, Group 2 deposit takers would be required to comply with speed limits based on a six-month measurement period, rather than a three-month measurement period.

Analysis

321. For the same broad reasons as discussed in relation to Group 1 deposit takers, we have concluded that our preferred option is the optimal way to design the Group 2 requirements as it takes into account systemic financial stability risks.

322. Currently, large banks and small banks are subject to the same requirements as outlined in BS19 and BS20, with the exception of different measurement periods. Specifically, the six largest banks are subject to three-month measurement periods and the rest are subject to six-month measurement periods, as the split is currently based on a threshold of new residential mortgage lending flows of $100 million per month.

323. We are now proposing to align with the Groups as set out in the Proportionality Framework, using the asset thresholds. Therefore, Group 1 deposit takers would be subject to a three-month measurement period and Group 2 would be subject to a six-month measurement period.

324. Our reasoning for different measurement periods largely follows the reasoning of the current policy and makes it consistent with the Proportionality Framework. Specifically, larger deposit takers generally have lower volatility in their lending flows and can more accurately forecast these based on seasonality and other factors. For deposit takers with lower lending flows (for example, Group 2 deposit takers), their lending flows tend to be more volatile, which makes it

more difficult to comply with speed limits over a shorter timeframe, hence the longer measurement period. We note that two banks, that are currently subject to a three-month measurement period, will be included in Group 2 based on the Proportionality Framework, and hence would be subject to a six-month measurement period. In our view, there would be very little regulatory burden in shifting from a three-month measurement period to a six-month measurement period as the definitions underpinning the data and systems would not change. The six-month measurement period also makes it easier to manage lending flows in terms of complying with speed limits.

325. In our view, it is simpler to align with the Proportionality Framework, and we do not see systemic risks to financial stability resulting from these two banks moving to a longer measurement period as they are relatively small compared to the four largest banks. However, if these two banks wished to remain on a three-month measurement period, then they would automatically comply with the six-month measurement period.

Summary

326. We are proposing to apply the existing borrower-based macroprudential policy requirements to Group 2 deposit takers when the Lending Standard comes into force (which includes a six-month measurement period). In conducting our analysis and reaching a preferred option, our focus has been on ensuring that the principles of the DTA have been taken into account.

Q35	Do you agree with our proposed approach to carry over the existing borrower-based macroprudential policy requirements to Group 2 deposit takers (which includes a six-month measurement period)?

3.2 Adjusting LVR and DTI settings

Preferred option

327. Our preferred approach for Group 2 deposit takers is to adopt the same set of LVRs, DTIs and speed limits as for Group 1 deposit takers laid out in section 2.2 above. These will be set out in the Lending Standard.

Analysis

328. Reasons for including a set of LVRs, DTIs and speed limits in the standard are given in section 2.2. This will give us a broad range of settings to choose from without having to amend the standard each time settings were changed.

329. Large banks and small banks have been subject to the same borrower-based settings over time, with the main difference being that small banks have had a longer measurement period. Borrower-based measures are designed to target systemic financial stability risks related to the residential property sector, so it makes sense to continue apply them at the same settings for Group 1 and Group 2 deposit takers (albeit with a longer measurement period for Group 2 deposit takers).

Summary

330. We propose the same treatment for Group 2 deposit takers as set out in the 'Summary' of section 2.2 for Group 1 deposit takers.

Q36	Do you agree that the proposal in section 2.2 should apply to Group 2 deposit takers?

3.3 Option to apply settings at an Auckland/non-Auckland level

Preferred option

331. Our preferred approach for Group 2 deposit takers is to adopt the same option as for Group 1 deposit takers laid out in section 2.3 above.

Analysis

332. We set out reasons for not including an option to apply borrower-based macroprudential policy settings at an Auckland/non-Auckland level in the Lending Standard in section 2.3. Applying borrower-based macroprudential policy settings at an Auckland/non-Auckland level can lead to 'spillovers' of high-LVR or high-DTI lending to other regions with looser policy settings.

Summary

333. We propose the same treatment for Group 2 deposit takers as set out in the 'Summary' of section 2.3 for Group 1 deposit takers.

Q37	Do you agree that the proposal in section 2.3 should apply to Group 2 deposit takers?

4 Proposed approach for Group 3 deposit takers

Preferred option

334. Our proposed approach is not to require Group 3 deposit takers to comply with borrower-based macroprudential policy measures as set out in the Lending Standard. This aligns with the current treatment of NBDTs and reflects the fact that Group 3 deposit takers are likely to have only a limited impact on systemic risk to New Zealand's financial system (as outlined in the Analysis section). However, we will keep monitoring Group 3 lending activity and assess emerging risks.

Analysis

335. Under the DTA the "desirability of taking a proportionate approach to regulation and supervision" is a principle we have to take into account when considering whether to issue a standard. This is a key consideration when thinking through requirements for Group 3 deposit takers. For example, the regulatory burden (that is the set-up and compliance costs) of imposing borrower-based macroprudential policy requirements on Group 3 deposit takers must be weighed against the financial stability benefits.

336. Borrower-based macroprudential policy is targeted at reducing systemic financial stability risks related to the residential property sector, that can spill over and damage the broader economy. The potential financial stability benefit of requiring Group 3 deposit takers to comply with borrower-based macroprudential policy measures is small, given that the deposit

takers that will form Group 3 are only a small percentage of the total market. For example, collectively, these deposit takers currently make up less than 1% of total residential mortgage assets in the market.

337. It is noted that borrower-based macroprudential policy works to complement our microprudential policy tools (which capture other types of risks). Microprudential policy supports financial stability by focusing on the risks to, and resilience of, individual deposit takers. The exact nature of these risks can differ across deposit takers and may result from inadequate or failed internal processes or systems, the actions or inactions of people or external drivers and events.

338. Our microprudential policies include those set out in the Capital Standard, the Risk Management Standard and the Operational Resilience Standard. These policies are designed to increase the capacity of individual deposit takers to withstand adverse events and the risks that they face. Specifically, this means that deposit takers will have processes in place to help them to be better prepared for adverse events and to absorb potential losses as a result.

339. However, microprudential policy is not sufficient to address the negative feedback loop that can emerge from interactions between entities across the financial system. Borrower-based macroprudential policy is aimed at increasing the resilience of the system, limiting booms and busts, and mitigating systemic risks resulting from an interconnectedness in the financial system. In our view, the Group 3 sector is small and not sufficiently interconnected to pose systemic risk to the financial system at this stage; however, our microprudential policy can address the risks that individual deposit takers face.

340. There would also likely be significant set-up and compliance costs if Group 3 deposit takers were to comply with borrower-based macroprudential policy. Some of the challenges may include:

- Group 3 deposit takers, mostly comprising current NBDTs, would be starting with minimal existing systems and a small resource base when setting up systems to collect and report on LVR and DTI data
- compliance can be an issue for smaller deposit takers, as their flows of lending are small and volatile. This means that it can be difficult to manage high-LVR and high-DTI lending flows and associated speed limits within the measurement periods.

341. Requiring Group 3 deposit takers to comply with borrower-based macroprudential policy measures would increase their regulatory burden. Specifically, data and system requirements are onerous and it is not realistic to simplify these requirements as definitions for LVR and DTI data are prescriptive. It is noted that data requirements are prescriptive to ensure there are clear rules for how to deal with a wide range of possible circumstances or borrowing arrangements. These data requirements may create unnecessary barriers given our view is that the Group 3 sector likely does not pose a systemic risk to financial stability.

342. We are aware that not applying borrower-based macroprudential policy to Group 3 deposit takers may lead to more high-LVR and high-DTI lending in the Group 3 sector (given that Group 1 and Group 2 deposit takers will be subject to the policy). We did not see this occur at a large scale with the introduction of LVR restrictions; research has shown that the scale of the movement to lenders not subject to LVR restrictions after they were first activated was too

small to significantly erode the effectiveness of LVR restrictions.[84] However, we will continue to monitor lending activity and potential increases in high-LVR and high-DTI lending in the Group 3 sector, particularly given the recent activation of DTI restrictions.

343. Based on our monitoring, in future, we may deem that Group 3 carries greater systemic financial stability risk than it has previously and as such we may re-evaluate our approach to Group 3 deposit takers. For example, there may be high growth across Group 3 that feeds into greater amounts of high-LVR and high-DTI lending in the residential property sector. A change in approach would involve requiring Group 3 deposit takers to comply with borrower-based macroprudential policy, which would be implemented via licence conditions.

344. As outlined previously, requiring Group 3 deposit takers to comply with borrower-based macroprudential policy would mean that these deposit takers would need to report more detailed LVR and DTI data. This data would require significant changes to their systems, so there would be a transition process. We will regularly monitor and engage on any potential changes, ensuring that there would be adequate time for deposit takers to transition to the requirements and get their systems ready.

345. If we chose to require Group 3 deposit takers to comply with borrower-based macroprudential policy, the process would be the same as that of Group 1 and Group 2 deposit takers (once Group 3 deposit takers had set up their systems). Specifically, LVR and DTI threshold and speed limit requirements that apply to a deposit taker at any specific point in time would be set out in each deposit takers licence conditions, where applicable. It is also noted that we would give deposit takers at least 7 days' notice and a reasonable opportunity to make submissions on changes to their licence conditions as required under the DTA.

Summary

346. We propose that Group 3 deposit takers are not required to comply with borrower-based macroprudential policy measures in the Lending Standard. This aligns with the current treatment of NBDTs. However, we will monitor Group 3 lending for any emerging risks, and in the future if we felt that Group 3 were starting to pose a systemic risk to financial system, we could consider requiring Group 3 deposit takers to comply with borrower-based macroprudential policy. If we decided to require Group 3 deposit takers to do so in the future, we would implement this via licence conditions, allowing for a sufficient transition period.

Q38	Do you agree with our proposed approach of not requiring Group 3 deposit takers to comply with borrower-based macroprudential policy requirements as set out in the Lending Standard?

5 Proposed approach for branches of overseas deposit takers

347. The Lending Standard will not apply to overseas deposit takers. The most relevant recommendations for the Lending Standard are those to limit branches to only conducting business with wholesale investors and to limit dual-registered branches to only conducting business with large wholesale investors. This means that overseas deposit takers would not have a retail business in New Zealand by the time standards come into force, which means

[84] *See* Lu, B. (2019). Review of the Reserve Bank's loan-to-value ratio policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2019/rbb2019-82-06.pdf

that they would not be involved in residential mortgage lending. We are also consulting on the Branch Standard, which is set out in chapter 9 of this Consultation Paper.

6 Conclusion

348. We use macroprudential policy to promote the stability of the financial system by mitigating systemic risks. Systemic risks to the stability of the financial system can arise from extremes in residential property sector credit cycles. In turn, systemic risks from the financial system can amplify a severe downturn and may damage the broader economy. Lending to the residential property sector represents a significant proportion of business for deposit takers (in aggregate), so is one of the major sources of potential systemic risk to the stability of the financial system.

349. We consider that the proposed Lending Standard will provide the necessary macroprudential policy tools to address the financial stability risks of residential property credit cycles. The Lending Standard uses borrower-based measures, which limit how much a prospective borrower can borrow based on the size of their deposit or how much they earn. The borrower-based measures are LVR and DTI restrictions, and the Lending Standard will set out the requirements for these.

350. In summary, we propose carrying over the current borrower-based macroprudential policy requirements to the Lending Standard. Specifically, we propose carrying over the existing borrower-based macroprudential policy requirements from BS19 and BS20 to the new Group 1 and Group 2 deposit takers, with Group 2 deposit takers having a longer measurement period than Group 1 deposit takers. Furthermore, we propose that Group 3 deposit takers are not required to comply with borrower-based macroprudential policy as set out by the Lending Standard, aligning with the current treatment of NBDTs. These deposit takers are small and likely do not pose a systemic risk to financial stability. However, we will monitor Group 3 and if, in the future, we felt that Group 3 was starting to pose a systemic risk to financial system, we could consider requiring Group 3 deposit takers to comply with borrower-based macroprudential policy.

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 3

Deposit Takers Risk Management Standard

Deposit Takers Non-Core Standards Consultation

21 August 2024

CONSULTATION PAPER

Non-technical summary

Effective and comprehensive risk management and controls help deposit takers better prepare for risk. Risk management is an important part of an organisation's internal controls, alongside corporate governance and policies like audit and compliance. By helping deposit takers better prepare for risk, risk management and controls contribute to the stability of the financial system, which helps promote the main purpose of the DTA.

The proposed Risk Management Standard is intended to capture essential foundational elements of effective risk management. We have designed the proposed requirements using a principles-based approach, where we set out requirements that target certain outcomes and give deposit takers the flexibility to choose the way in which they achieve these outcomes. This is aimed at increasing regulatory discipline, by setting out fundamental risk management requirements for every deposit taker, as well a deposit taker's self-discipline, supporting sound and prudent risk management which draws on international best practice.

This chapter sets out the key aspects of the proposed Risk Management Standard. Deposit takers in New Zealand would be required to have integrated risk management frameworks, policies and processes. It outlines our proposed requirements for risk management frameworks, including that they be strategic and forward-looking, taking a 'deposit-taker-wide' view to address all material risks. Risk management frameworks would be aligned with the board-approved risk management strategy and risk appetite statement.

We also propose requirements that capital and liquidity adequacy processes consider the nature and level of a deposit taker's risk, and that deposit takers undertake stress-testing programmes to better understand the financial impact of risk events and build resilience. Deposit takers would additionally be required to have management information systems and risk data aggregation and reporting capabilities, as well as risk management, compliance and internal assurance functions, to support informed decision making, reporting and compliance.

We propose to apply the same requirements for risk management to Group 1 and Group 2 deposit takers. Where appropriate, we propose similar requirements for Group 3 deposit takers and branches of overseas deposit takers. This includes requirements to have a risk management framework as well as requirements relating to board responsibilities; policies and processes; documentation and review; capital and liquidity adequacy processes; information and data management; and reporting and notification. We assess that these proposed requirements are crucial for all deposit takers as they reflect minimum levels of good risk management practice.

However, there are several requirements that we do not consider appropriate to apply to Group 3 deposit takers or branches reflecting their size, complexity and systemic importance, in line with the Proportionality Framework. We propose streamlined requirements relating to stress testing and risk management, compliance and internal assurance functions. Our proposed approach also reflects the different governance and structure of branches.

We propose to support the Risk Management Standard with additional guidance that provides examples of how to comply with each requirement for different Groups of deposit takers. This aims to promote best risk management practice and to make the proposed standard more user-friendly.

1 Introduction

351. This chapter outlines our proposed approach and requirements for a risk management standard for each Group of deposit takers, to be made under Part 3 of the DTA. Effective risk management contributes to the safety and soundness of deposit takers and the financial system.

352. The proposed Risk Management Standard would set out requirements for deposit takers in New Zealand to have integrated risk management frameworks, policies and processes. The standard is intended to provide deposit takers with good incentives for effective and comprehensive management of risk and controls. Risk is defined in ISO3100, an international standard on risk management, as "the effect of uncertainty on objectives".[85]

1.1 Purpose of the Risk Management Standard

Problem definition

353. The DTA proposes a single regulatory regime for all deposit takers and empowers us to make a prudential standard on risk management.[86]

354. Effective risk management contributes to promoting the safety and soundness of deposit takers and the stability of the financial system. Risk management is an important part of an organisation's internal controls, alongside corporate governance and policies like audit and compliance. It can also extend to contingency arrangements and stress testing. Despite the importance of risk management, we currently have limited requirements for deposit takers' risk management.

355. The IMF's 2017 New Zealand FSAP Report raised several concerns regarding our approach to risk management by banks (discussed further in section 1.2 below).[87] Currently, we require banks to have risk management systems and policies in place for initial registration and we also require directors to attest to the adequacy of these systems in annual disclosure statements.[88] The directors' attestation regime is designed to reinforce the responsibility of directors to run a bank prudently, relying on self-discipline and market discipline (see Figure 3) to incentivise banks to have appropriate risk management frameworks.

356. However, the IMF noted that we had limited guidance and requirements as to what constitutes adequate risk management or how to assess the adequacy of risk management systems and policies. The IMF also found that the lack of regulatory requirements raised concerns about the comparability of risk management practices across banks and the adequacy of the risk management to which directors attest.

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[85] International Organization for Standardization. (2018). ISO 31000:2018(en) Risk management — Guidelines. https://www.iso.org/obp/ui/#iso:std:iso:31000:ed-2:v1:en. *See also* the definition of risk management as "coordinated activities to direct and control an organisation with regard to risk.

[86] Deposit Takers Act 2023, section 85. *See also* section 79 and section 90(1)(d)

[87] International Monetary Fund. (2017). New Zealand, Financial Sector Assessment Program: Detailed assessment of observance – Basel core principles for effective banking supervision. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/fsap/fsap-review-assessment-of-observance-basel-principles-effective-bank-supervision.pdf

[88] *See* Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014, Schedule 17. For overseas-incorporated banks, the New Zealand Chief Executive Officer is responsible. *See* BS1 clause 122 and Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014, Schedule 3.

357. The IMF therefore recommended that we issue enforceable requirements on risk management and controls to make our expectations more transparent and support supervisory preventive action.

358. Similar conclusions were drawn in the August 2017 review of the bank directors' attestation regime,[89] which noted that the risk control environment in banks was less developed than the financial reporting control environment. It recommended that we set out our expectations of banks in relation to risk management, for example by requirements equivalent to APRA's Prudential Standard CPS 220 Risk Management (**CPS 220**).[90]

359. Since these reviews, we have made changes to our supervisory approach, including increased specialist support on specific risk areas and developing supervisory frameworks to support a more comprehensive assessment of regulated entities, allowing us to better examine trends over time and compare similar institutions.

360. These changes have contributed to more consistent supervisory assessments. However, we still lack clear requirements relating to comprehensive risk management. The proposed Risk Management Standard is intended to be the next step in this journey, consolidating and clearly setting out our proposed requirements for a deposit taker's integrated risk management framework, policies and processes.

361. As noted in the introduction to this Consultation Paper, there has been a philosophical shift under the DTA to increase reliance on the regulatory discipline pillar. While there would continue to be detailed requirements across the proposed standards that support market discipline and self-discipline, more explicit requirements on risk management are in line with this shift.

Purpose of the Risk Management Standard

362. Effective risk management is necessary to protect and promote the stability of the financial system, as articulated in the main purpose under section 3(1) of the DTA. The DTA provides us with a power to issue a standard on risk management, which presents an opportunity to consolidate and set out our expectations for risk management by deposit takers to give effect to this purpose. This also contributes to the objectives of other standards, such as the Governance Standard and specific types of risk management, including liquidity requirements or operational risk management.

363. Some aspects of the proposals also support the following additional purposes of the DTA:

- to promote the safety and soundness of each deposit taker (section 3(2)(a))
- to promote public confidence in the financial system (section 3(2)(b))
- to avoid or mitigate the adverse effectives of risks to the stability of the financial system (section 3(2)(d)(i)).

364. We see the primary objective of the Risk Management Standard as being to provide deposit takers with good incentives for effective and comprehensive risk management and control.

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[89] Deloitte, for Reserve Bank of New Zealand. (2017). Review of the bank directors' attestation regime. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/oias/2017/response-to-official-information-request-bank-directors-attestation-regime-2017

[90] *See* APRA. (2017). Prudential Standard CPS 220 Risk Management. https://www.apra.gov.au/sites/default/files/Prudential-Standard-CPS-220-Risk-Management-%28July-2017%29.pdf

The ultimate outcome of the standard would be for deposit takers to have effective risk management practices. This would help to promote the safety and soundness of each deposit taker.

365. Good culture is cited as a critical feature in best risk management practice and is important in ensuring that risk management processes are not seen as a compliance or 'tick box' exercise. The proposed standard would therefore focus on embedding effective risk management practices and culture, aligned with a deposit taker's risk strategy. As the board would be responsible for strategy, risk and performance, this would also include effective board and senior management oversight and engagement.

366. We have designed other policy outcomes to support the development of the Risk Management Standard as set out in Table J.

Table J: Key policy outcomes in developing the Risk Management Standard

	Key policy outcomes
1	To incentivise deposit takers to have dynamic and evolving risk management practices commensurate with their risk profile and systemic importance, and which are responsive to a risk environment increasingly characterised by constant and rapid change.
2	To ensure the high-level framework and principles of effective risk management within the proposed standard are longstanding and future-proof, while we expect to update guidance on expectations for deposit takers on a more regular basis.
3	To build in flexibility, so that requirements are commensurate with both the risks and circumstances of individual deposit takers and allowing deposit takers to take ownership of their own risk management, while setting minimum and enforceable thresholds.
4	To position deposit takers well to manage cross-cutting risks (such as climate-related), event risks (such as cyber or conduct) and secular risks (such as complacency or risk appetite creep), as well as to understand how various risks relate to, and interact with, each other (such as how climate risk impacts credit risk through a potential increase in defaults on loans by business and households affected by adverse climate events).
5	To ensure deposit takers have accurate, reliable, complete and timely risk data to support decision-making and reporting requirements in both normal operating conditions and stress conditions.
6	To support deposit takers to use findings from risk assessments to minimise the likelihood and impact of risks and be better prepared to respond to risk.
7	To support meaningful supervisory engagements on risk management to support better risk management practices across deposit takers.

1.2 Current approach

367. The current prudential framework derives from the BPSA for banks and the NBDT Act for NBDTs. Existing risk management requirements for deposit takers differ significantly between banks and NBDTs.

Current requirements for NBDTs

368. Section 27(1) of the NBDT Act requires every NBDT to have a risk management programme and to take all practicable steps to comply with that programme. Section 27(2) of the NBDT Act sets out the requirements for a risk management programme, and section 28 requires each NBDT's trustee to be satisfied that the risk management programme meets the requirements of the NBDT Act.

369. We have issued guidance on our expectations of compliance for NBDTs, while trustees are responsible for the direct supervision of NBDTs.[91]

Current requirements for banks

370. Our historic approach to regulation and supervision of risk management by banks is 'light touch' compared to overseas counterparts. There are some general requirements across the policy documents (BS1 to BS20) that make up the Banking Supervision Handbook and Banking Prudential Requirements (BPR). The main provisions are as follows:

- BS1 Statement of Principles, Bank Registration and Supervision – requires an applicant to have risk management systems and policies in place as a condition for initial registration as a bank. Our disclosure requirements require directors to attest to the adequacy of these systems in annual disclosure statements, as discussed in paragraph 355.
- We impose direct requirements on banks to have comprehensive risk management policies and processes for some categories of risks, such as capital adequacy via the Internal Capital Adequacy Assessment Process (ICAAP) requirements (see BPR100 Capital Adequacy) and liquidity risk management (see BS13 Liquidity Policy). Other examples include requirements for the largest banks to include risk mitigation provisions in their outsourcing arrangements (see BS11 Outsourcing Policy) and in open bank resolution planning (see BS17 OBR Pre-Positioning Requirements Policy).
- BS14 Corporate Governance sets out principles and practices for good governance, including that the board is properly represented in areas like risk management and corporate strategy.

371. We gain insight into how banks are meeting requirements, and into banks' strategies, policies and procedures, through report analysis and interviews with bank management.

1.3 Proposed policy development approach

372. This chapter sets out the proposed approach to risk management requirements for each Group of deposit takers under the Proportionality Framework. It discusses specific policy proposals for these Groups and seeks stakeholder feedback.

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[91] Reserve Bank of New Zealand – Te Pūtea Matua. (2009). Risk Management Programme Guidelines for NBDTs. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/non-bank-deposit-takers/3697899.pdf

373. We have used a variety of approaches to help develop the requirements to be included in a Risk Management Standard. In particular, we have looked at international practices, such as APRA's CPS 220 and the Basel Core Principles issued by the BCBS, and issues raised in related reviews (discussed in section 1.1) and assessed these against the main purpose of the DTA. Our analysis also involved taking into account the principles set out in the DTA, wherever relevant.

374. The Basel Core Principles define 29 principles designed for a banking supervisory system to be effective. These relate to the powers, responsibilities and functions of supervisors, as well as prudential regulations and requirements for banks.

375. We are proposing to develop a Risk Management Standard that sets out clear requirements for effective risk management, based on Basel Core Principle 15 Risk Management Process (Basel CP15). Following Basel CP15, the proposed requirements for risk management are based on the Three Lines Model,[92] which sets out that roles relating to risk management be differentiated as shown in Table K.

Table K: High-level summary of the Three Lines Model of risk management

Line	Function
First line	Risk owners, whereby business management is responsible for the implementation, ongoing maintenance and enhancement of the risk management framework, including internal control frameworks.
Second line	Review and challenge, whereby risk management and compliance function(s) provide independent oversight of the risk profile and risk management framework through risk management.
Third line	Independent audit, whereby an internal audit function or third party assurance provider (such as an external audit) provides regular assurance that the risk management framework has been complied with, is operating effectively and is adequate.

376. We propose a balance of principles-based requirements and specific rules within the Risk Management Standard to capture essential foundational elements of effective risk management and provide entities with the flexibility to tailor their risk management practices to their circumstances. This means that, while the same requirements may apply for all deposit takers, we expect that they will be able to be complied with in a way that reflects the size and nature of a deposit taker's business. The proposed Risk Management Standard therefore seeks to increase regulatory discipline, by setting out fundamental risk management requirements for every deposit taker, as well as a deposit taker's self-discipline, supporting sound and prudent risk management.

377. We believe that a principles-based approach is appropriate for the proposed Risk Management Standard because it is a qualitative-based standard that seeks to achieve

[92] The Institute of Internal Auditor's Three Lines Model is a useful tool in facilitating good governance and risk management through identifying the structures and processes around an organisation's governing body, management and internal audit functions. *For an overview, see* Institute of Internal Auditors. (2020). The IIA's Three Lines Model - an update of the Three Lines of Defense. https://www.theiia.org/globalassets/site/about-us/advocacy/three-lines-model-updated.pdf

behavioural outcomes for effective risk management. Given that risk management is closely linked to good culture, some regulators have found it challenging to foster good outcomes through prescriptive rules. As with good corporate governance, we consider that there is no single best practice for risk management. We believe that effective risk management relies on sound corporate governance and an open culture that encourages challenge. A principles-based approach can have the benefit of communicating the outcomes we seek to achieve and promoting behaviour that supports those outcomes, rather than simply complying with prescriptive rules.

378. Given many of the proposed requirements would be new to a New Zealand prudential regime and will be mostly principles-based in nature, we intend to develop guidance to support the Risk Management Standard. Guidance can provide examples of how to comply with each requirement for different types of deposit takers, including branches. This can help promote best practice, make the standard more user-friendly, further articulate our approach to proportionality and support compliance. The intention of this chapter is to consult on our policy intent and the exact form (that is, whether the policy is implemented via standards or guidance) will be consulted on as part of the exposure draft consultation.

379. We have developed the proposed Risk Management Standard to be a comprehensive and intersecting standard that sets out key principles on risk management that sit across all material risks, providing a framework or architecture for effective risk management. This aligns with international approaches and can reduce the duplication that exists across risk categories in the current prudential regulatory requirements.

380. Risk-specific qualitative and quantitative requirements would be supported by the relevant proposed standard, for example, the Liquidity, Capital and Operational Resilience standards. Our proposed requirements are also closely aligned with those in the proposed Governance Standard (in this Consultation Paper) and the proposed Disclosure Standard (in the Deposit Takers Core Standards Consultation Paper).

Discounted options

381. Throughout our analysis, we have considered other options to develop the risk management regulatory and supervisory regime:

- Retention of the status quo: we consider that this option is not appropriate given the IMF's finding that a lack of clear risk management requirements did not align with the Basel Core Principles and impeded market discipline and self-discipline of deposit-takers, as discussed in section 1.1 above. A lack of clear requirements on risk management could mean that some deposit takers do not have adequate risk management practices and we do not have a good understanding of which deposit takers may not be meeting best practice. This means that this option is not in line with the main purpose of the DTA, to protect and promote the stability of the financial system. Further, this option does not align with international practice nor enable us to take a consistent supervisory approach across deposit takers.
- Publication of non-enforceable guidelines on general risk management: we consider that this option is not appropriate as there is no legislative requirement in the DTA that deposit takers have a risk management framework and therefore would not resolve the problems with the status quo. Additionally, while guidelines would help to clarify good

practices in risk management by deposit takers and support supervisory engagements with deposit takers, there would be issues with enforcement.

- Issuing standards on risk management only for specific categories of risk: a Risk Management Standard would set out principles on comprehensive risk management that sit across all material risks. Without this, there is a risk of continued variation in risk management practices across deposit takers. Deposit takers may be less well positioned to deal with cross-cutting risks or risk categories for which we have not issued a prudential standard, which means that this option is not in line with the main purpose of the DTA. There may also be duplication of prudential requirements across risk categories, which can increase compliance costs.
- Issuing a prescriptive standard: as discussed above, we are concerned that a more prescriptive Risk Management Standard could encourage a 'tick box' approach to compliance, rather than greater ownership of risk management practices by regulated entities with a focus on good risk management culture. This option would also require a more fundamental change in our supervisory approach and carry unnecessary compliance and transition costs for deposit takers that may already have good risk management practices that do not meet a more prescriptive approach.

Proportionality

382. We consider that it is appropriate and prudent to apply the majority of the proposed requirements to every deposit taker. We have balanced the costs and benefits of the proposed requirements in relation to different Groups of deposit takers and have assessed that these proposed requirements are crucial for all deposit takers; they reflect minimum levels of good risk management practice and are therefore essential for the safety and soundness of each deposit taker. We expect that smaller deposit takers or deposit takers with less complex business arrangements would be able to implement the requirements in a manner that is less complex than that which would be reasonable for a larger or more complex deposit taker. We will provide examples of best practice across different Groups of deposit takers to support this approach, most likely in guidance.

383. However, while we consider that most requirements are appropriate to apply to all deposit takers (albeit with different ways of complying depending on the size and nature of the entity), we consider some requirements should only apply to Group 1 and Group 2 deposit takers to reflect their size, complexity and systemic importance. This is especially the case for requirements that are more restrictive in nature or could involve high fixed costs. We believe that this is the best way to achieve the purposes of the DTA, including to promote the safety and soundness of each deposit taker and avoid or mitigate the adverse effects of risks to the stability of the financial system.

384. Application of the Proportionality Framework to each proposed requirement for different Groups of deposit takers is discussed further below at section 2 (Group 1 deposit takers), section 3 (Group 2 deposit takers), section 4 (Group 3 deposit takers) and section 5 (branches).

Compliance costs and other impacts

385. All deposit takers in New Zealand already have some degree of risk management frameworks, processes and policies and we do not expect our proposed requirements to place

unnecessary compliance costs on deposit takers that already have good risk management practices. The proposed requirements are designed to be sufficiently flexible so that entities can tailor their risk management practices to their circumstances and still comply with the proposed standard, and do not need to substantially change practices that are already working well. However, we recognise that there is variance in current practice and some deposit takers will need to make changes to reach the proposed requirements.

386. We seek feedback on the expected compliance costs of the Risk Management Standard as a whole and whether there are elements of the proposed requirements that can be modified to avoid unnecessary compliance costs while still achieving our policy intent.

387. In addition to the proportionality analysis above, we have also assessed our proposed approach against other principles set out in the DTA:

- Diversity of institutions in the deposit-taking sector: we expect that allowing deposit takers flexibility to comply with requirements in a manner that is commensurate to the size and nature of their business will support a diversity of institutions that can provide services to a diverse range of New Zealanders.
- Maintaining competition: it is unlikely that compliance with the proposed requirements would considerably affect the competition within the deposit-taking market, given the proposed requirements are not expected to be significant for existing deposit takers. There may be a marginal effect on competition through a slight increase in barriers to entry for new entrants.
- Aligning with international practice: we have considered international practices, such as APRA's CPS 220 Risk Management and the Basel Core Principles. Our proposed standard is based on Basel's Core Principle 15 Risk Management Process and aligns with international good practice, such as the Three Lines Model of risk management.
- Sound governance: sound and prudent management of a deposit taker's business operations rests with its governing body. The proposed Risk Management Standard sets out clear expectations for risk management, including board and senior management responsibilities, and links to the due diligence obligations under sections 93–94 of the DTA. This will contribute to improved risk governance.
- Effective management of capital, liquidity and risk: capital adequacy and liquidity risk management are fundamental to ensuring a deposit taker's sustainability and so must be considered in the context of risk management. The proposed Risk Management Standard would ensure that deposit takers have processes in place to take an integrated approach to capital adequacy, liquidity risk and other risk management. This will contribute to the main purpose of the DTA, as deposit takers would be better prepared to absorb losses. This reduces the likelihood of failure and risks to the stability of the financial system.

388. We welcome your feedback on compliance costs, including whether there are certain requirements for which transitional or phasing in provisions would be useful.

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

Q40	What do you think the compliance costs associated with the requirements in the proposed standard are likely to be? Is there another way that we can achieve our policy intent with lower compliance costs?
Q41	Are there certain requirements for which transitional provisions would be useful?

2 Proposed approach for Group 1 deposit takers

389. In the following sections, we discuss the proposed requirements for risk management for Group 1 deposit takers which would be implemented through the proposed Risk Management Standard. We propose that these requirements replace the existing prudential approach to risk management by banks, as set out in section 1.2 above.

2.1 The risk management framework

390. Risk management frameworks can be understood as the totality of systems, structures, policies, processes and people within an institution that identify, measure, evaluate, monitor, report on and control or mitigate all internal and external sources of material risk.[93]

Preferred option

Requirement to have a risk management framework

391. We propose to require deposit takers to have a risk management framework to identify, measure, evaluate, monitor, report on and control or mitigate all material risks.[94] For the purposes of the standard, we propose that a risk management framework would include:

- the board-approved risk management strategy
- the board-approved risk appetite statement
- clearly defined and documented roles, responsibilities and reporting structures
- procedures for monitoring and reporting risk exposures, risk issues and breach or non-compliance issues
- policies and processes related to the validation, approval and use of any models to measure components of risk
- policies and processes related to the early identification and management of problem assets, including the classification and valuation of these assets
- policies and processes related to establishing and maintaining appropriate contingency arrangements to address risks that may materialise and actions to be taken in stress conditions

[93] This definition is from CPS 220, paragraph 20. *See also* ISO 31000.
[94] *See* Basel CP15, Essential Criteria 2. *See also* CPS 220 paragraph 9 and paragraphs 19–20.

- policies and processes related to identifying, monitoring and managing potential and actual conflicts of interest
- procedures for review
- appropriate internal processes for assessing their overall capital adequacy and liquidity risk management
- forward-looking stress testing, including how the results of stress-testing programmes are integrated into decision making, risk management processes and the assessment of their capital and liquidity levels
- information management systems and risk data aggregation and reporting capabilities
- risk management (including the Chief Risk Officer (CRO)), compliance and internal assurance functions
- internal control frameworks.

392. Each of these aspects of the framework is discussed in more detail throughout this chapter.

393. We also propose to require that the risk management framework:

- be commensurate with the size and business of the deposit taker and the complexity of its operations. This requirement would help ensure that the required content of a risk management framework is proportionate and tailored to the different circumstances of individual deposit takers
- recognise uncertainties, limitations and assumptions attached to the measurement of each material risk. The deposit taker would be required to ensure that the board and senior management regularly review and consider the implications and limitations (including the risk measurement uncertainties) of the risk management information received
- be strategic and forward-looking and consider risks across different time horizons and from internal and external sources. This includes forward-looking factors, such as changes in the deposit taker's business strategy and risk profile and risks arising from the macroeconomic environment.[95] This requirement relates to how decision makers think about, assess, view and create future opportunities and predict business conditions. We seek to support more effective risk management by ensuring decision makers are considering both present and future threats, risks and opportunities
- consider risk across the individual deposit taker by providing a comprehensive, deposit-taker-wide view of risk across all material risk types, including risk exposure.[96] This means that a deposit taker's risk management framework would be required to consider the deposit taker's functions and operations as a whole (rather than each function or operation in isolation)
- be appropriately documented.[97]

[95] *See* Basel CP15, Essential criteria 2, and CPS 220, paragraph 23I. *See also* CPS 220 paragraphs 31–34.
[96] *See* Basel CP15, Essential criteria 2, and CPS 220, paragraph 19.
[97] *See* Basel CP15, Essential criteria 3.

Risk management at the group level

394. If a deposit taker is part of a group, we expect that risk will be managed through a whole-of-group approach (noting that overseas regulators would impose requirements at the global group level), at a New Zealand group level and also at the individual deposit taker level. Accordingly, we propose:

- to require the deposit taker to consider risks from related parties within the group in its risk management framework (for example, from its parent, any subsidiaries or sister companies it may have or any branches operated by group members). 'Related parties' is a concept used in the proposed Related Party Exposures Standard
- that, if a deposit taker is part of an overseas deposit taker, the deposit taker may use group risk management frameworks, policies and procedures so long as New Zealand-specific prudential requirements are met and the board of that deposit taker is satisfied that the requirements are met in respect of that deposit taker. This would enable a deposit taker to use a group-level risk management framework, should one exist, as we consider it desirable for risk management to be consistent across the group.

Analysis

395. The proposed approach requires deposit takers to have a risk management framework that is proportionate and risk based. An effective risk management framework aims to support deposit takers to effectively monitor, minimise and mitigate the impact of material risks. This supports sound governance as well as more effective management of capital and liquidity risks and other risks (in a manner that is appropriate for a deposit taker's risk appetite and risk profile).

396. Establishing enforceable requirements relating to comprehensive risk management by deposit takers is crucial to pursuing our mandate as the prudential regulator and to responding to the matters raised with the status quo approach by the IMF and in other subsequent reviews. It ensures that supervisors can better review arrangements by deposit takers in relation to sound management and coverage of risks and that any deficiencies be remedied. This would also contribute to the objectives of other standards, such as sound governance and effective management of other risks (for example, operational or liquidity risks).

397. As noted earlier, our proposed approach also seeks to ensure deposit takers consider the material risks holistically (rather than in a siloed manner or within business units). Deposit takers operate in complex ecosystems with interdependencies between various processes, business units and stakeholders. A holistic approach considers these interdependencies, contributing to the sound governance of deposit takers and more effective risk management practices. This also helps ensure that deposit takers make well-informed decisions with regard to their levels of capital, liquidity risk management and management of other risks (consistent with their risk appetite and risk profile).

398. We have taken into account guidance from international organisations when developing these requirements. In particular, our proposed approach is based on key elements of Basel CP15, refined for a New Zealand context. We consider that the proposed risk management framework requirement would help ensure that deposit takers better identify and manage material risks, thereby contributing to the safety and soundness of that deposit taker as well as the stability of the financial system in the short, medium and long term.

399. An alternative option would be to simplify the requirements to just having a risk management framework, a board-approved risk management strategy and a board-approved risk appetite statement. This would be a simpler and less detailed approach, that may also impose lower compliance costs. However, we do not consider that this option would address the issues identified by the IMF, would not align with international good practice nor provide sufficient clarity to deposit takers. We consider our proposed approach would best align with the main purpose of the DTA and the outcomes that we are seeking for effective risk management.

400. We have also considered the practices of overseas supervisors, in particular, APRA's requirements in CPS 220, to the extent that they are consistent with our proposed policy development approach. Our preferred approach is to mirror some aspects of CPS 220. We consider that this approach is appropriate for the New Zealand context and will ensure consistency and alignment with international policies and approaches, particularly APRA, reflecting the fact that Group 1 deposit takers have parent banks that are APRA-regulated.

401. We expect that all deposit takers in New Zealand already have some degree of risk management frameworks, processes and policies and therefore we do not expect the proposed requirements to be burdensome on deposit takers who already have good risk management practices. In particular, we expect limited compliance costs under these proposed requirements for Group 1 deposit takers, which are already subject to similar but more prescriptive requirements in CPS 220.

402. Sufficient documentation and record keeping enhance transparency, compliance and informed decision making. The proposed requirements are based on Basel CP15 and contribute to improved risk management, sound governance and hence the safety and soundness of deposit takers. This proposed requirement also supports the duty on deposit takers in section 115 of the DTA to ensure that there are in place effective methods in place for monitoring the licensed deposit taker's compliance with the prudential obligations.

Summary

403. We are proposing to place a new requirement on deposit takers to have a risk management framework to identify, measure, evaluate, monitor, report on and control or mitigate all material risks.

404. We also propose that the risk management framework:

- be commensurate with the size and business of the deposit taker, and the complexity of its operations
- recognise uncertainties, limitations and assumptions attached to the measurement of each material risk
- be strategic and forward-looking and consider risks across different time horizons and from internal and external sources
- consider risk across the individual deposit taker by providing a comprehensive, deposit-taker-wide view of risk across all material risks, including risk exposure
- be appropriately documented.

405. If a deposit taker is part of a group, we propose:

- to require the deposit taker to consider risks from other members of the group
- that, if a deposit taker is a part of an overseas deposit taker, allow the deposit taker to use group risk management frameworks, policies and procedures so long as New Zealand-specific prudential requirements are met and the board of that deposit taker is satisfied that the requirements are met in respect of that deposit taker.

Q42	Do you agree with our proposed approach in relation to the requirement for deposit takers to have a risk management framework?
Q43	Do you agree with our proposed requirements relating to risk management at the deposit taker and group levels?

2.2 Material risks

406. As described in section 2.1, we propose to require that risk management frameworks be concerned with only material risks.

Preferred option

407. We propose that the risk management framework must address all material risks.[98]

408. Deposit takers would be required to identify risks, and then assess them to determine whether they are material. This links to the proposed requirement to have a risk management framework to identify, measure, evaluate, monitor, report on, and control or mitigate all material risks on a timely basis, set out in section 2.1 above.

409. We propose to set out a list of the categories of risk that deposit takers must consider, at a minimum, including:

- operational risk, including cybersecurity risk and risks arising from the business strategy[99]
- credit risk, including concentration risk and large exposure risk
- liquidity risk
- interest rate risk
- market risk
- model risk (for example, the risk that a model for calculating capital would not perform adequately)
- other cross-cutting risks that relate to risks listed above (such as climate-related risks) that, singularly or in combination with different risks, may have a material impact on the deposit taker.

[98] *See* Basel CP15, Essential criteria 2 and 11, and Additional criterion 1, and CPS 220, paragraph 26.

[99] *See* Basel CP15, Essential criteria 8 and CPS230, paragraph 25. Risks arising from the business strategy include reputational and strategic risks; risks inherent in new products or material modifications to existing products; risks inherent major management initiatives such as changes in systems, processes, business models and major acquisition.

410. These risk categories are interrelated and overlapping and should be considered holistically. This approach aligns with our current supervisory approach.

411. For each material risk listed, we intend to cross-reference the relevant standard and/or any guidance that defines the risk category and specifies qualitative and quantitative requirements relating to how that risk must be addressed: for example, the proposed Operational Resilience Standard and Governance Standards in this consultation paper, the proposed Capital Standard and Liquidity Standard in the Core Standards Consultation Paper, and climate-related risk management guidance.[100]

Analysis

412. We believe that our proposed approach strikes a balance between providing a sufficient level of detail without encouraging a 'tick-box' approach to risk management. A materiality threshold is an aspect of the current prudential regime for banks and is important to support deposit takers to prioritise significant risks, avoiding unnecessary compliance costs. It also provides deposit takers with flexibility to comply in a manner that is proportionate to the size and nature of their business, while contributing to their safety and soundness and the stability of the financial system.

413. Banks are already required to identify and measure all material risks as part of the ICAAP process.[101] We seek your feedback on whether to include a definition of material risk in the proposed Risk Management Standard and what definition would be appropriate. We have considered how overseas regulators approach this. APRA define material risks as "those that could have a material impact, both financial and non-financial, on the institution or on the interests of depositors and/or policyholders".[102] The European Central Bank define a material risk as "a risk that would have an impact on the prudential elements of the institution if it materialised".[103]

414. We consider the management of the proposed list of risks to be fundamental risk management for any prudent deposit taker. However, we consider this list to be a starting point. There are choices about which risk categories to include. We seek your feedback on the proposed risk categories.

415. By creating a minimum list of risk categories that we expect to be considered in the risk management framework, we intend to create a minimum benchmark across all deposit takers and ensure they do not leave out a significant risk, while also ensuring that deposit takers do their own analysis to identify risks that are material to their banking business (which may sit outside the proposed list of risks). Setting out minimum requirements would contribute to an even playing field and lower legal uncertainty, while supporting each deposit taker to consider which risks it faces and whether these risks are material.

416. We note the possibility that listing risk categories in the standard is seen as a tick-box exercise by deposit takers. The objective of the proposed Risk Management Standard is to encourage

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[100] Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Managing climate-related risks. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/climate/guidance-managing-climate-related-risks.pdf

[101] BPR100 section D1.1 and section D3.3.

[102] CPS220, paragraph 20.

[103] European Central Bank. (2023). Supervisory Methodology, section 3.2. https://www.bankingsupervision.europa.eu/banking/srep/2023/html/ssm.srep202302_supervisorymethodology2023.en.html#:~:text=A%20%E2%80%9Cmaterial%20risk%E2%80%9D%20is%20defined,the%20institution%20if%20it%20materialised.

entities to consider what their material risks are. However, as the list is non-exhaustive, we consider that this maintains the onus on the deposit taker to consider all material risks relevant to its business. This will support better risk management by deposit takers.

Summary

417. We propose that the risk management framework must, at a minimum, address all material risks, including:

- operational risk, including cybersecurity risk and risks arising from the business strategy
- credit risk, including large exposure risk
- liquidity risk
- interest rate risk
- concentration risk
- market risk
- model risk
- other cross-cutting risks that relate to risks listed above, (such as climate-related risks) that, singularly or in combination with different risks, may have a material effect on the deposit taker.

418. We seek your feedback on whether a definition of 'material risk' would be helpful in the Risk Management Standard and options for a proposed definition.

Q44	Do you agree with our proposed approach that the risk management framework addresses all material risks?
Q45	Do you agree with our proposal to set out a non-exhaustive list of material risk categories? If so, do you agree with our proposed non-exhaustive list of material risk categories?
Q46	Do you consider that we should define 'material risk' and what do you think would be an appropriate definition?

2.3 Responsibilities of the board

419. Under section 72 of the DTA, we are empowered to make standards for deposit takers and deposit takers have a corresponding obligation to comply (section 73 of the DTA). Directors of deposit takers are required to ensure the deposit taker complies with the deposit takers' prudential obligations (section 93 of the DTA).

420. We intend to impose obligations on boards by imposing requirements on deposit takers. This will be reflected in the exposure drafts but, for the purposes of this chapter, we seek your feedback on the policy intent, which is to ensure that the board of a deposit taker takes responsibility for risk management.

Preferred option

421. Our preferred option is to set out requirements for the responsibilities of the governance arrangements of deposit takers in relation to risk management. These requirements are intended to respond to issues identified in the IMF's 2017 New Zealand FSAP and in recent reviews related to governance arrangements (in particular, the 2023 Governance Thematic Review).[104]

422. We propose to require deposit takers to have a board-approved risk management strategy[105] and a board-approved risk appetite statement[106]. Table L below sets out more detail on these proposed requirements.

423. As with other aspects of the risk management framework, the board-approved risk management strategy and risk appetite statement must be commensurate with the size and business of the deposit taker, and the complexity of its operations, as with other parts of the risk management framework (see section 2.1). The board-approved risk management strategy and risk appetite statement will also be subject to regular review requirements (see section 2.5).

Table L: Proposed requirements for risk management relating to the board of a deposit taker

Proposed requirement	Description	Supplementary requirements
To have a board-approved risk management strategy	A risk management strategy determines how the deposit taker will treat risks, following their risk identification and assessment. It describes the strategy for managing risk and the key elements of the risk management framework that give effect to this strategy (including policies and processes).	Risk management strategies must describe each identified material risk and the approach to managing these risks. Risk management strategies must specify the policies and processes dealing with risk management matters and describe roles and responsibilities (including the risk management function and governance arrangements). Risk management strategies must outline an approach for building awareness of the risk management strategy.
To have a board-approved risk appetite statement	A risk appetite statement defines the level of risk the deposit taker is willing to assume or tolerate. This statement specifies risk boundaries that enable communication of risk tolerance for	The risk appetite statement must specify risk tolerances that must be set to support the translation of the risk appetite by management into operational limits for the day-to-

[104] Reserve Bank of New Zealand – Te Pūtea Matua and Financial Markets Authority – Te Mana Tātai Hokohoko. (2023). Governance Thematic Review. https://www.fma.govt.nz/library/reports-and-papers/governance-thematic-review/

[105] *See* Basel CP15, Essential criteria 1 and CPS 220, paragraph 9(a). *See also* Basel CP14, Essential criteria 5 and CPS 220, paragraphs 29–30.

[106] *See* Basel CP15, Essential criteria 1 and CPS 220 paragraph 9(a). *See also* Basel CP14, Essential criteria 5and CPS 220, paragraphs 27–28.

Proposed requirement	Description	Supplementary requirements
	specific risks and monitoring of how the deposit taker is operating against its stated appetite for a particular risk. It informs the policies and processes developed for risk-taking, measurement and monitoring.	day management of material risks. It may not be possible to set quantitative tolerances or limits for all risks.

424. Further, we propose to require the board to establish a sound risk management culture throughout the deposit taker to promote the development and execution of its strategy.[107] This includes:

- ensuring that the risk management framework is understood by, and regularly communicated to, relevant staff
- implementing clearly defined and documented roles, responsibilities and formal reporting structures for the management of material risks throughout the deposit taker
- establishing procedures for monitoring and reporting risk issues, such as breaches of risk limits and significant deviations from established policies. This includes escalation procedures for the reporting of material events to the appropriate level of management and (where necessary) the board.[108]

425. We propose to set out some more concrete steps relating to how a board can promote a good culture in the standard, for example, by ensuring that:

- there is an approach to ensuring all persons within the institution have an awareness of the risk management framework and developing an appropriate risk culture across the deposit taker[109]
- there are defined roles, responsibilities and lines of authority for risk management procedures[110]
- the board and senior management are routinely provided with information on their material risk exposures. Reporting must be clear and easily understandable. This would allow the board and senior management to obtain sufficient information to understand the nature and level of risk being taken by the deposit taker and how this risk relates to adequate levels of capital and liquidity[111]
- that appropriate actions are taken in a timely manner for any breach or non-compliance issue. Procedures would be standardised, relevant and consistent with the deposit taker's activities.[112]

[107] Refer Basel CP15 at EC1 and APRA CPS 220 at 9(b). *See* also Basel CP14 at EC5. 'Risk management culture' refers to the norms of behaviour for individuals and groups within a deposit taker that determine the collective ability to identify, understand, openly discuss, and act on the organisation's current and future risk.
[108] 'Material events' refers to significant breaches of, or material deviations from, the risk management framework.
[109] *See* Basel CP14, Essential criteria 5 and CPS 220, paragraph 30(e).
[110] *See* CPS 220, paragraph 23(d).
[111] *See* Basel CP15, Essential criteria 4 and CPS 220, paragraph 30.
[112] *See* Basel CP15, Essential criteria 3 and CPS 220, paragraph 37(g).

426. Collectively, these requirements would place a responsibility on the board to clearly define the deposit taker's risk strategy, appetite and culture, including the risk boundaries and acceptable behavioural norms, as part of effective risk management and establishing a strong control environment.

427. We plan to provide guidance on the role of the board vis-à-vis senior management and that we do not expect the board to be involved in the day-to-day management of risks. Responsibility for the operation of a deposit taker's risk management framework would be with senior management, including monitoring and managing all material risks consistent with the policies and processes approved by the board.[113] This provides a first line of defence and ensures that the deposit taker does not assume risks beyond its risk appetite.

Analysis

428. We consider that the board of a deposit taker should be ultimately responsible for the deposit taker's risk management.[114] Responsibility for the sound and prudent management of a deposit taker's business operations should rest with its board, and this includes the entity's risk management framework. Our proposed requirements align with the approach proposed in the Governance Standard, that the board approves and oversees the implementation of the deposit taker's business strategies, including risk management.

429. We seek to ensure that boards take ownership and responsibility for risk management by deposit takers, but that requirements are set so that senior management is responsible for the day-to-day management of a deposit taker and boards focus on strategy and governance. This contributes to the sound governance of deposit takers and more effective management of risk.

430. Our proposed approach also responds to the IMF's recommendation that we set out clear expectations for risk management, including board and senior management responsibilities, and to recent reviews related to governance arrangements. It also builds on from the responsibilities imposed on directors by the due diligence obligations under sections 93-94 of the DTA.

431. We have considered international guidance and practices. In particular, the proposed requirements are based on Basel CP15 and align with CPS 220. Our proposed approach also aligns with the Three Lines Model of risk management.

432. A sound risk culture is a core element of an effective risk management framework and is strongly influenced by the tone at the top. A board-approved risk management strategy and risk appetite statement will ensure that the board can clearly communicate its approach to risk management as well as its expectations of how much risk the deposit taker is willing to accept. This is a critical part of effective risk management and establishing a strong control environment.

433. Additionally, the board must form a view of the risk culture that allows it to ensure the deposit taker operates within its risk appetite. A sound risk culture encourages awareness of risks and responsibility for managing those risks, to ensure that appropriate actions are taken in a timely

[113] *See* Basel CP15, Essential criteria 1 and CPS 220, paragraph 9(c).
[114] *See* Basel CP15, Essential criteria 1 and CPS 220, paragraph 9. *See also* Basel CP14, Essential criteria 5.

manner in response to issues and risks identified that are outside of set thresholds, tolerances and limits.

434. We plan to issue guidance on the soundness and adequacy of risk management cultures. We intend to identify best practices (for example, encouraging and educating others in risk and risk management to promote the effectiveness of internal controls and risk reporting, and demonstrating a positive attitude towards risk management by raising risk as part of every decision and praising staff who identify risk issues early) as well as identifying behaviours/culture that are not conducive to effective risk management. We seek your feedback on this approach.

435. We consider that clear, enforceable requirements relating to board roles and responsibilities would contribute to improved risk culture and sound governance.

436. We have balanced the costs and benefits of the proposed requirements and assessed that the proposed requirements reflect minimum levels of good risk management practice and are essential to promoting a good risk management culture. The proposed requirements will also lead to better risk management and compliance by deposit takers and support our supervisory and enforcement action, contributing to the safety and soundness of deposit takers.

437. We expect that Group 1 deposit takers will already be complying with the proposed requirements, as the requirements are aligned with APRA requirements. The proposed requirements are designed to be sufficiently flexible so that entities can tailor their risk management practices to their circumstances and still comply with the Risk Management Standard. This flexibility will also help to support a diversity of institutions that can provide services to a diverse range of New Zealanders and maintain the competitiveness of the deposit-taking market.

Summary

438. We propose that deposit takers must have a board-approved risk management strategy and a board-approved risk appetite statement.

439. We also propose that the board must establish a sound risk management culture throughout the deposit taker, to promote the development and execution of its strategy, as outlined above.

Q47	Do you agree with our proposed approach relating to the responsibilities of the board?
Q48	Do you agree with our proposal that deposit takers must have a board-approved risk management strategy?
Q49	Do you agree with our proposal that deposit takers must have a board-approved risk appetite statement?
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

the soundness and adequacy of risk management cultures? Do you think there is an alternative way we could achieve the desired policy outcomes?

2.4 Policies and processes

440. Policies and practices facilitate a consistent approach to the identification, assessment and management of risks and help ensure that responsibility is taken for risk management.

Preferred option

441. We propose that Group 1 deposit takers would be required to have risk management policies and processes. These policies and processes must be aligned with the risk management strategy and risk appetite statement.[115] This includes policies and processes relating to:

- The validation, approval and use of any models to measure components of risk:[116] deposit takers would have policies and processes aimed at identifying the limitations and assumptions relating to any models used to measure components of risk that could materially affect their decision making. The proposed Risk Management Standard would cross-reference model requirements in other standards, such as in the proposed Capital Standard and Liquidity Standard in the Deposit Takers Core Standards Consultation Paper, and therefore contribute to better management of model risk related to capital and liquidity risk. This requirement would not be relevant to deposit takers that do not use models to measure components of risk.
- Early identification and management of problem assets, including the classification and valuation of these assets:[117] deposit takers would have prudent and well-documented policies and processes for the early identification and management of problem exposures (including non-performing and restructured exposures and other transactions) and the maintenance of adequate provisions. Early identification of a deterioration in loan quality or increasing problem exposures can improve options for remediating the exposure and managing the risk. The proposed Risk Management Standard would cross-reference problem asset requirements in other proposed standards, such as the proposed Capital Standard.
- Establishing and maintaining appropriate contingency arrangements to address risks that may materialise and actions to be taken in stress conditions:[118] contingency arrangements, such as continuity and recovery planning, are designed to address unexpected stress events or risks and involve defining action steps to be taken if an identified risk event should occur, including addressing potential risks and their impact. These are important responses to risk and should be considered as part of the overall risk management framework. Requirements for continuity planning are proposed in the Operational Resilience Standard and for recovery planning in the Issues Paper on the crisis management framework under the DTA (as referenced in the OBR Pre-positioning Standard and the Outsourcing Standard). There are also linkages to the stress-testing

[115] *See* Basel CP15, Essential criteria 1 and Essential criteria 3, and CPS 220, paragraphs 9(e) and 23(d). *See also* CPS 220, paragraphs 35–36.
[116] The empowering provision is section 85(1)(vii) of the DTA. *See also* Basel CP15 Essential criteria 6 and CPS 220, paragraph 35(b).
[117] The empowering provision is section 85(b)(ii) of the DTA. *See also* CPS 220, paragraph 32.
[118] The empowering provisions are sections 85(a)(i), 85(b)(i) and 89(1) of the DTA. *See* Basel CP15, Essential criteria 12 and CPS 220 paragraph 35(h).

requirements proposed as part of this Risk Management Standard, set out in section 2.7 below.

- Identifying, monitoring and managing potential and actual conflicts of interest:[119] policies and procedures on conflicts of interest support deposit takers to articulate what a conflict of interest is and, when an actual or potential conflict of interest arises, ensures that the deposit taker has a process in place to identify, monitor and manage it. The Risk Management Standard would cross-reference the fit and proper requirements proposed in the Governance Standard.

442. For entities with both a subsidiary and a branch operating in New Zealand (that is, entities operating two related licensed deposit takers), we propose to require that the conflicts of interest policies specifically address situations where the New Zealand CEO of the branch is also an employee of the subsidiary, as well as potential conflicts of interest between related parties (both as part of ongoing risk management requirements and in a stress situation).

443. As with other aspects of the risk management framework, risk management policies and processes must be commensurate with the size and business of the deposit taker and the complexity of its operations (see section 2.1). Risk management policies and processes would also be subject to regular review requirements, as discussed in section 2.5.

Analysis

444. Policies and practices facilitate a consistent approach to the identification, assessment and management of risks by deposit takers. This ensures the deposit taker is being prudently managed, having regard to the size, business and complexity of its operations. The proposed requirements, taken collectively, can improve decision making and sound governance of deposit takers.

445. We have taken into account international practice when developing the proposed requirements. Our proposed approach is based on Basel CP15 and aligns with existing requirements under APRA's CPS 220, which Group 1 deposit takers are already subject to. We consider that the proposed requirements are the bare minimum for Group 1 deposit takers.

446. Requiring policies and processes to be aligned with the board-approved risk management strategy and risk appetite statement (see section 2.3) ensures that these documents are integrated into planning and decision making. This contributes to improved risk governance and supports the prudent management of deposit takers and the effective management of risk.

447. Where there are compliance costs, we consider that the proposed requirements would contribute to the safety and soundness of deposit takers and, by extension, stability of the financial system by ensuring that entities are better prepared for risk incidents and events. However, the proposed requirements are designed to be sufficiently flexible so that entities can tailor their risk management practices to their circumstances, avoiding unnecessary compliance costs. This flexibility will also help to support a diversity of institutions that can provide services to a diverse range of New Zealanders and supports the competitiveness of the deposit-taking market by reducing potential barriers to entry into the market and allowing deposit takers to compete in different ways.

[119] The empowering provision is section 90(1)(d) of the DTA. *See* Basel CP14, Essential criteria 5 and CPS 220, paragraph 35(e).

Summary

448. We propose to require Group 1 deposit takers to have risk management policies and processes that are aligned with the risk management strategy and risk appetite statement. This includes policies and processes relating to:

- the validation, approval and use of any models to measure components of risk
- early identification and management of problem assets, including the classification and valuation of these assets
- establishing and maintaining appropriate contingency arrangements to address risks that may materialise and actions to be taken in stress conditions
- identifying, monitoring and managing potential and actual conflicts of interest.

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

2.5 Review

Preferred option

449. We propose to require that the risk management framework be regularly reviewed and appropriately adjusted to reflect changing risk appetite, risk profiles and market and macroeconomic conditions.[120]

450. Reviews would be event-based (for example, following a breach of risk limits, a significant deviation from policies or following a 'material event') and periodic (such as, at least annually or every three years, as discussed further below). The review could be undertaken by internal audit staff or a third party assurance provider (including an external auditor).

451. The results of reviews must be reported to the deposit taker's board Risk Committee.

Analysis

452. Regular review of the risk management framework, including its policies and procedures, would systematically identify deficiencies in the effectiveness of the programmes. This provides a third line of defence and ensures the risk management framework is effective in identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating material risks. This contributes to more effective risk management by deposit takers and supports the safety and soundness of deposit takers.

453. We seek feedback on the breadth and frequency of the reviews. We recognise that, depending on the scope of the review, annual reviews may be too frequent (for example, it could lead to the framework being constantly reviewed, leaving limited time for implementation).

454. We propose that, at a minimum, the risk management strategy and risk appetite statement would be reviewed annually. This ensures that these documents are updated to reflect any changes in the business environment, industry trends and regulatory requirements. An annual

120 *See* Basel CP15, Essential criteria 3, and CPS 220, paragraph 23(h). *See also* CPS 220, paragraphs 44–48.

review also ensures that there is regular engagement with the board on the deposit taker's risk management, business strategy and appetite for risk. This is considered to be good practice internationally and important to ensure that the risk management strategy and risk appetite statement remain fit for purpose, relevant and effective in guiding the risk management practices of a deposit taker. It also contributes to the safety and soundness of individual deposit takers and, by extension, the stability of the financial system.

455. We note the risk that an annual review requirement leads to rolling reviews or crowd-out time for implementation of the risk management strategy and risk appetite statement. We have limited the scope of the proposed annual review requirement to the primary board-approved documents within the broader risk management framework to help mitigate this risk.

456. Other parts of the risk management framework could be reviewed more comprehensively on an annual rolling basis. Reviews should be undertaken at least once every three years, which aligns with the proposed approach across other DTA standards. This would also align with CPS 220, which requires that elements of the risk management framework are reviewed in depth and on a rotational basis.[121]

457. We do not expect the proposed requirements to carry high compliance costs above current practices. Prudent deposit takers should already have sufficient review arrangements. Where there are compliance costs, the proposed requirements are designed to be sufficiently flexible so that entities can tailor their risk management practices to their circumstances. In this way, we consider that the proposed requirements avoid unnecessary compliance costs.

458. Additionally, we note that CPS 220 requires APRA-regulated institutions to audit their risk management framework annually as well as to undertake a more comprehensive review at least every three years.[122] All Group 1 deposit takers are currently subject to these through their parent companies. We consider that APRA's approach is more prescriptive than we are proposing in our Risk Management Standard.

Summary

459. We propose to require that the risk management framework be regularly reviewed and appropriately adjusted to reflect changing risk appetite, risk profiles and market and macroeconomic conditions. We seek your feedback on the breadth and frequency of the reviews.

460. The results of reviews must be reported to the deposit taker's board Risk Committee.

Q52	Do you agree with our proposal that the risk management framework be regularly reviewed and adjusted?
Q53	What do you consider to be appropriate for the breadth and frequency of the review requirement?

[121] Refer CPG 220 at 83.
[122] Refer APRA CPS 220 at 44-45.

2.6 Processes for capital adequacy and liquidity risk management

461. Capital adequacy and liquidity risk management are important for ensuring a deposit taker's sustainability. Capital adequacy is about loss events: deposit takers should consider what level of capital is adequate to support the nature and level of a deposit taker's risk. Considering capital adequacy in the context of risk management supports improved capital planning as well as the setting of internal capital targets and the development of strategies to achieve those targets. Qualitative and quantitative capital requirements proposed for Group 1 deposit takers are set out in the proposed Capital Standard in the Deposit Taker Core Standards Consultation Paper.

462. Similarly, liquidity risk management is about the ability to meet financial commitments as they fall due (that is, identifying funding gaps, managing sources of regular funding and maintaining sources of emergency backup liquidity). Qualitative and quantitative liquidity requirements proposed for Group 1 deposit takers are set out in the Deposit Takers Core Standards Consultation Paper, Liquidity Standard Chapter.

Preferred option

463. We propose to require deposit takers to have internal processes for assessing their overall capital adequacy and liquidity in relation to their risk management strategy and risk appetite statement.[123]

464. These requirements would cross-reference the relevant requirements in the proposed Capital Standard and Liquidity Standard relating to capital adequacy and liquidity risk management. In particular, 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.[124]

Analysis

465. Levels of capital and liquidity risk management should be sufficient to support the nature and level of a deposit taker's risk, and so must be considered in relation to risk management. The proposed requirements would ensure that deposit takers have processes in place to take an integrated approach to capital and liquidity risk management (that is, to ensure that the levels of capital and liquidity held are considered in the context of the risk management strategy and risk appetite of that deposit taker). This would contribute to the safety and soundness of deposit takers, as deposit takers would be better prepared to absorb losses. This reduces the likelihood of failure and risks to the stability of the financial system.

466. We do not consider that these requirements would impose high compliance costs. We expect that most deposit takers already have appropriate processes for capital and liquidity risk management that consider the relationship with other risk management and the deposit taker's risk appetite. Group 1 deposit takers are already subject to qualitative and quantitative capital and liquidity adequacy requirements in the existing prudential regime (for example, ICAAP), which we propose to carry through into the Capital and Liquidity Standards described in the Deposit Takers Core Standards Consultation Paper. Where there are compliance costs,

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[123] The empowering provisions are sections 85(a)(ii) and 79(a) of the DTA (related to capital adequacy) and sections 85(a)(iii) and 79(b) of the DTA (related to liquidity adequacy). *See also* Basel CP15, Essential criteria 5 and CPS 220, paragraph 23(f).

[124] Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Deposit Taker Core Standards Consultation Paper, chapter 1 Capital Standard. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/

the proposed requirements are designed to be sufficiently flexible for deposit takers to be able to tailor their internal processes to their circumstances and still comply with the standard. In this way, we consider that the proposed requirements avoid unnecessary compliance costs.

467. We have taken into account international practice when developing the proposed requirements. We have based our approach on Basel CP15, which recommends that supervisors determine whether banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile.

468. Our proposed approach also aligns with CPS 220, which requires an APRA-regulated institution to have an ICAAP as part of its risk management framework.[125] APRA also imposes quantitative and qualitative liquidity requirements through its Prudential Standard APS 210 Liquidity.

Summary

469. We propose to require deposit takers to have appropriate internal processes for assessing their overall capital adequacy in relation to their risk management strategy and risk appetite statement.

470. We similarly propose to require deposit takers to have appropriate internal processes for assessing their overall liquidity risk management in relation to their risk management strategy and risk appetite statement.

Q54	Do you agree with our proposal to require deposit takers to have appropriate internal processes for assessing their overall capital adequacy?
Q55	Do you agree with our proposal to require deposit takers to have appropriate internal processes for assessing their overall liquidity risk management?

2.7 Stress testing

471. Stress testing assesses the resilience of deposit takers to severe or extreme but plausible risks (for example, severe economic downturns). It is a useful prudential tool to build resilience and for identifying anticipated financial impacts of material risks (that is, it determines whether a deposit taker has enough capital or financial resilience to withstand adverse scenarios).

Preferred option

472. We propose to require that Group 1 deposit takers have forward-looking stress testing covering all material risks, commensurate with the size and business of the deposit taker and the complexity of its operations.[126]

473. Stress testing would include scenario analysis and sensitivity analysis with reference to specific risks, commensurate with the size and nature of deposit takers. We envisage that stress testing would leverage our existing guidance on requirements for entity-led stress testing.[127] As a

[125] *See* CPS 220, paragraph 23(f)
[126] *See* Basel CP15, Essential criteria 13 and CPS 220, paragraph 24
[127] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (20XX). Discussion Document: Stress-testing methodology for New Zealand incorporated banks. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/stress-testing/stress-testing-discussion-document.pdf

starting point, we would envisage that deposit takers would make use of multiple models (especially for larger deposit takers, including Group 1 deposit takers) and that approaches to modelling are informed by expert judgement. Our current guidance also sets out 18 principles for stress testing, which we consider would be a useful starting point for future guidance on stress testing.

474. We propose that the results of stress testing (along with context explaining how the results should be interpreted) must be reported to the board and to us, and that deposit takers would consider how to integrate the results of stress testing programmes into decision making, risk management processes and the assessment of their capital and liquidity levels.[128]

Analysis

475. Stress testing by deposit takers is important because the financial system is volatile, subject to disruptions and interconnected. Stress testing gauges the potential impact on a portfolio or entity of hypothetical events and movements in a set of financial variables. It supports proactive risk identification, improved understanding of risks to the business and possible ways to mitigate those risks, contributing to more resilient and safe deposit takers.

476. These requirements would relate to deposit takers' internal stress testing processes and are proposed in addition to our programme of industry stress tests.[129] Like APRA, we currently use stress testing as a supervisory tool and conduct annual capital and liquidity stress tests for Group 1 deposit takers.

477. We note that the proposed requirements relating to stress testing would overlap with stress testing requirements in other standards, such as for ICAAP purposes in the proposed Capital Standard. The proposed requirements relating to stress testing for the Risk Management Standard are intended to be for broader risk management purposes and would link to and align with stress testing requirements in other standards. Deposit takers would not be required to undertake stress testing multiple times under the different proposed standards but would be required to use their stress testing for multiple purposes.

478. The results of internal stress tests can be used by deposit takers for risk management, capital and liquidity buffer setting, and strategy and investment decisions. Additionally, the results of entity-led stress testing are also helpful for our role in monitoring financial stability, allowing us to assess risks to individual deposit takers. This would complement our programme of industry stress testing.

479. We have considered international guidance when developing the proposed requirements, particularly the Basel Core Principles, which sees stress testing as an integral part of risk management frameworks.[130] Our proposed approach also aligns with CPS 220, which requires APRA-regulated institutions to include stress testing programmes within its risk management programme.[131]

480. We do not consider that these requirements would impose significant additional compliance costs as we currently expect Group 1 deposit takers to invest in stress-testing models and

[128] *See* Basel CP15, Essential criteria 13 and CPG 220, paragraph 36.
[129] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (20XX). Stress testing regulated entities. https://www.rbnz.govt.nz/financial-stability/stress-testing-regulated-entities
[130] *See* Basel CP15, Essential criteria 13.
[131] *See* CPS 220, paragraph 24.

infrastructure, as well as to carry out internal stress testing for all material risks as part of ICAAP.[132] We also note that the parent banks of Group 1 deposit takers are already subject to parallel requirements in APRA's CPS 220. The proposed requirements will be further supported by guidance.

Summary

481. We propose to require deposit takers to have forward-looking stress testing covering all material risks, commensurate with the size and business of the deposit taker and the complexity of its operations.

482. We also propose to require deposit takers to consider how to integrate the results of stress-testing programmes into decision making, risk management processes and the assessment of their capital and liquidity levels.

Q56	Do you agree with our proposal relating to stress testing?
Q57	What stress testing would be appropriate for the different material risks that Group 1 deposit takers assess? Do you think our existing guidance is an appropriate starting point?

2.8 Information and data management

Preferred option

483. We propose to require deposit takers to have management information systems adequate for measuring, assessing and reporting on a deposit-taker-wide basis across all risk types, products and counterparties.[133]

484. The proposed Risk Management Standard would set out our requirements for management information systems, such as what features we would expect these to include. The adequacy of a deposit taker's management information system would relate to its ability to provide appropriate information at each level of management and decision making within the deposit taker, both under normal operating systems and in times of stress.

485. We also propose to require deposit takers to develop and maintain appropriate risk data aggregation and reporting capabilities.[134] The Risk Management Standard would also set out requirements relating to these capabilities and capacities, including that they are adequate in normal times and stress conditions.

486. We note that these systems and capabilities can also be a source of risk. These requirements would cross-reference the relevant information and communication technology (ICT) components of the proposed Operational Resilience Standard.

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[132] *See* BPR100 at D3.5.

[133] *See* Basel CP15, Essential criteria 7 and CPS 220, paragraph 23(g).

[134] This was proposed as an amendment to Basel CP15 in its public consultation on revisions to the core principles on 6 July 2023. *See* Basel Committee on Banking Supervision. (2023) Consultative Document: Core principles for effective banking supervision. https://www.bis.org/bcbs/publ/d551.pdf

487. We also propose to require that the reports generated are provided on a timely basis to the deposit taker's board and senior management.

Analysis

488. Effective management information systems provide appropriate information for decision making and support business reporting (for example, production of risk and compliance data and reports). These are a central tool to help mitigate and manage risk and ensure the institution has regular, accurate and timely information regarding its risk profile.

489. Similarly, risk data aggregation capabilities and risk reporting practices support the board and senior management in making appropriate risk-based decisions in normal times and in periods of stress.

490. Collectively, these requirements seek to ensure that deposit takers have the capability and capacity to take a holistic, deposit-taker-wide view of the risks posed. Both proposed requirements are based on Basel CP15. Effective information and data management supports improved risk management and sound governance of deposit takers, contributing to the safety and soundness of deposit takers and, by extension, the stability of the financial system.

491. We do not expect either proposed requirement to carry additional compliance costs. Prudent deposit takers should already have sufficient information systems, data risk aggregation capabilities and risk reporting systems.

492. Our proposed approach also aligns with CPS 220, to which the parent banks of Group 1 deposit takers are already subject. CPS 220 requires APRA-regulated institutions to have a management information system supported by a robust data framework that enables the aggregation of exposures and risk measures across business lines.[135]

493. For these reasons we consider our proposals avoid unnecessary compliance costs.

Summary

494. We propose to require deposit takers to have management information systems adequate for measuring, assessing and reporting on the size, composition and quality of exposures on a deposit-taker-wide basis across all risk types, products and counterparties.

495. We also propose to require deposit takers to develop and maintain appropriate risk data aggregation and reporting capabilities.

Q58	Do you agree with our proposed approach to information and data management?

2.9 Risk management function

496. A risk management function is an independent function responsible for identifying, managing and overseeing business risks (including the cross-functional impacts of those risks) across the enterprise.

[135] CPS 220, paragraphs 23(g) and 25.

Preferred option

Requirement to have a Risk Management Function

497. We propose to require deposit takers to have adequate risk management functions covering all material risks with sufficient resources, independence, authority and access to the board to perform their duties effectively.[136]

498. The proposed Risk Management Standard would set out that risk management functions must be:

- responsible for assisting the deposit taker's board (including the board Risk Committee) and senior management to maintain the risk management framework
- commensurate with the size, business and complexity of the deposit taker
- adequately resourced with personnel that have clearly defined roles/responsibilities and experience/qualifications
- adequately resourced with ICT systems
- separate from the risk-taking functions (that is, have sufficient operational independence)
- involved in, and have the authority to provide effective challenge to, activities and decisions that may materially affect the deposit taker's risk profile
- able to report on risk exposures directly to the deposit taker's board Risk Committee and senior management, as relevant
- required to notify the board of any significant breach of, or material deviation from, the risk management framework
- required to inform the internal assurance function of material changes to the deposit taker's risk management strategy, policies or process (see section 2.10).

499. We propose 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.

500. We would allow the risk management function to be combined with the compliance function (see section 2.10), so long as the roles and responsibilities of each function are sufficiently allocated. However, we consider that this would be more appropriate for smaller deposit takers.

501. A deposit taker would be able to engage the services of an external service provider to perform part of the risk management function if it can demonstrate to us that the risk management function meets the expectations set out in the Risk Management Standard, as well as the proposed Outsourcing Standard.

502. We also propose to require that the risk management function be subject to regular review by the internal assurance function (discussed further in section 2.10).[137] The frequency of the

[136] Refer Basel CP15 at EC9 and APRA CPS 220 at 23(e) and 37.
[137] *See* Basel CP15, Essential criteria 9 and CPS 220, paragraphs 44–45. *See also* CPS 510, paragraph 91.

review would be event-based and periodic (such as at least once every three years). The results of the review must be reported to the deposit taker's board Risk Committee.

Requirement to have a CRO

503. Additionally, we propose to require that Group 1 deposit takers have a dedicated risk management unit[138] overseen by a Chief Risk Officer (CRO) or equivalent function with sufficient independence, authority and access.[139]

504. CROs lead the second line of defence, providing corporate oversight and ongoing monitoring to ensure risk exposures are within prudent risk limits. CROs also support the board in its engagement with, and oversight of the development of, the risk management strategy and risk appetite statement, which ensures that these documents are implemented through the deposit taker.

505. Our expectations for CROs would be linked to the fit and proper requirements proposed in the Governance Standard. In particular, we propose that the CRO must:

- be operationally independent from revenue-generating responsibilities and the finance function. We propose to require that the CRO not be the CEO, Chief Financial Officer (CFO) or Head of Audit. The CRO would be able to have other roles and responsibilities so long as there is no conflict of interest
- be involved in, and have the authority to provide effective challenge to, activities and decisions that may materially affect the deposit taker's risk profile
- have a reporting line to the CEO and regular and unfettered access to the board Risk Committee.

506. If the CRO (or equivalent function) of a deposit taker is removed from their position for any reason, we propose that this must be done with the prior approval of the deposit taker's board Risk Committee and be disclosed publicly.[140] This aligns with the approach proposed in the Governance Standard.

Analysis

507. A risk management function provides a second line of defence and is responsible for assisting the board, relevant board committees and senior management of a deposit taker to maintain the risk management framework. The proposed requirements are important for the effective functioning of the risk management function.

508. While it is common for risk managers to work closely with business units, the risk management function should be sufficiently independent and have sufficient access and authority to appropriately challenge business operations. Restricting the linking of a deposit taker's financial performance to any discretionary benefits that might apply to members of the risk management function will also help to ensure that the risk management function is an

[138] 'Risk management unit' refers to a business unit or team that monitors risk against limits and is responsible for risk analysis and support. This will be expected to meet the requirements of the risk management function at requirement 19.1. The designated head of the risk management unit does not have to be called a CRO.
[139] *See* Basel CP15, Essential criteria 10 and CPS 220, paragraphs 38–42.
[140] *See* Basel CP15, Essential criteria 10.

appropriate check and balance to risk-taking functions, supporting sound governance and prudent risk-taking by deposit takers.

509. For Group 1 deposit takers, we propose that the risk management function be a separate organisational unit and resourced adequately. This reflects the complexity of Group 1 deposit takers and their operations, supporting a cross-functional approach to risk identification and management across the enterprise.

510. As discussed in sections 1.1 and 2.3, a good culture is critical for effective risk management. It is important that risk management is a discipline embedded throughout the organisation and that all staff within a deposit taker can support risk management functions.

511. Furthermore, it is important that the risk management function is regularly reviewed by the internal assurance function. This would bring objective, additional expertise and resources to the process of identifying, managing and controlling risks. It would also ensure that appropriate controls are in place and that the function is keeping pace with the deposit taker's business needs, contributing to the safety and soundness of deposit takers. Regular reviews can also guide future assurance and audit planning, discussed further in section 2.10.

512. Lastly, we expect that Group 1 deposit takers should have a CRO or equivalent function with overall responsibility for the deposit taker's risk management function. The CRO role supports the sound governance of deposit takers and the effective management of risk, which ultimately contributes to the safety and soundness of deposit takers and therefore financial stability.

513. We also propose that the dismissal of the CRO position should be approved by the board Risk Committee and disclosed publicly. This gives the CRO some independence from the CEO and other senior managers while reflecting the nature of the role of the CRO as a senior manager who provides challenge within a deposit taker.[141]

514. Our proposed requirements align with international practice. In particular, Basel CP15 states that supervisors should determine that deposit takers have risk management functions covering all material risks with sufficient resources, independence, authority and access to their boards to perform their duties effectively.[142] Furthermore, Basel CP15 recommends that larger and more complex deposit takers have a dedicated risk management unit overseen by a CRO.[143]

515. We do not consider that the proposed requirements would have significant additional compliance costs. Group 1 deposit takers are currently required to disclose an explanation of the structure and organisation of the relevant risk management function.[144] All Group 1 deposit takers already have CROs and risk management functions.

516. Similarly, APRA requires its regulated institutions to have a risk management function and to designate a CRO (or equivalent role) to be responsible for the risk management function.[145]

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[141] We note that the Governance Standard proposes that the deposit taker's board Remuneration Committee makes annual recommendations to the board on the remuneration of the CRO and other senior management.
[142] *See* Basel CP15, Essential criteria 9.
[143] *See* Basel CP15, Essential criteria 10.
[144] Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2024, Schedule 17, clause 2(2)(b).
[145] *See* CPS 220, paragraphs 37–40.

We note that all Group 1 deposit takers are already subject to these requirements through their parent.

Summary

517. We propose to require deposit takers to have adequate risk management functions covering all material risks with sufficient resources, independence, authority and access to the board to perform their duties effectively (as outlined above).

518. We propose 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.

519. We also propose to require that the risk management function be subject to regular review by the internal assurance function.

520. We propose to require that Group 1 deposit takers must have a dedicated risk management unit overseen by a CRO or equivalent function with sufficient independence, authority and access.

Q59	Do you agree with our proposal to require deposit takers to have adequate risk management functions?
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?
Q61	Do you agree with our proposal that the risk management function be subject to regular review by the internal assurance function?
Q62	Do you agree with our proposal to require Group 1 deposit takers to have a dedicated risk management unit overseen by a CRO or equivalent function?

2.10 Internal controls and assurance

Preferred option

Internal control frameworks

521. We propose to require deposit takers to have adequate internal control frameworks to establish and maintain an effectively controlled and tested operating environment, considering the risk profile of the deposit taker and taking a forward-looking view.[146]

522. The Risk Management Standard would set out our requirements for internal control frameworks and their adequacy (that is, they are commensurate with the size, business and complexity of the deposit taker and they are sufficiently resourced). We propose to require

[146] *See* Basel CP26 Essential criteria 1–2 and CPS230, paragraphs15(c) and 28.

deposit takers to undertake regular reviews to assure the effectiveness of the internal controls (as part of an audit plan).

Requirement to have a compliance function

523. We propose to require deposit takers to have an independent and adequately resourced compliance function.[147] A compliance function would be responsible for identifying, reviewing and monitoring a deposit taker's compliance risks (such as compliance with prudential requirements).[148]

524. We propose to require that the compliance function would have a reporting line independent from business lines and have sufficient resources. We also propose to require that the compliance function would have staff that are suitably trained, have relevant experience and have sufficient authority within the deposit taker to perform their role effectively.

525. The compliance function would not have to be an organisational unit.

526. The compliance function can be combined with the risk management function (see section 2.9), so long as the roles and responsibilities of each function are sufficiently allocated.

527. We do not propose to allow the compliance function to be outsourced. This reflects our existing expectations that deposit takers have in-house compliance functions. There are risks and opportunities to outsourcing this function. We seek your feedback on this approach.

Requirement to have an internal assurance function

528. We propose to require deposit takers to have an independent and adequately resourced internal assurance function.[149] An internal assurance function would be responsible for providing assurances, audits and advice to management. It does not manage risk.[150]

529. We propose to require that internal assurance functions be responsible for assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the size and business of the deposit taker and complexity of its operations.

530. We propose to require that internal assurance functions must:

- have appropriate independence with reporting lines to the deposit taker's board Audit Committee[151]
- have sufficient resources and staff that are suitably trained, have relevant experience and have sufficient authority within the deposit taker to perform their role effectively
- be effective (that is, have sufficient status within the deposit taker to ensure that senior management reacts to and acts upon its recommendations, and have access to and communication with staff as well as records, files and data)

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[147] *See* Basel CP26, Essential criteria 3 and CPS 220, paragraph 43.

[148] For further detail, *see* Basel Committee on Banking Supervision. (2005, April). Compliance and the compliance function in banks. https://www.bis.org/publ/bcbs113.pdf

[149] *See* Basel CP26, Essential criteria4 and CPS 510 paragraphs 90–91

[150] For further detail, *see* Basel Committee on Banking Supervision (2012, June). The internal audit function in banks. https://www.bis.org/publ/bcbs223.pdf

[151] *See also* the proposed Governance Standard.

- have the authority to audit any outsourced functions.[152]

531. We expect that, to ensure that a deposit taker complies with policies and processes, the internal assurance function would prepare an assurance or audit plan. This would give effect to the review requirements proposed in section 2.5 above.

532. The internal assurance function would not have to be an organisational unit.

533. We do not propose to allow the internal assurance function to be outsourced. This reflects our existing expectations that Group 1 deposit takers have in-house internal audit/assurance functions. There are risks and opportunities to outsourcing this function. We seek your feedback on this approach.

Analysis

534. A strong internal control framework, including independent and effective compliance and audit functions, is part of sound corporate governance and risk management. As discussed in section 1.3; in developing the proposed Risk Management Standard we have based the proposed requirements for risk management on the Three Lines Model:

    - internal controls serve as the first line of defence, providing checks and balances. Internal controls complement risk management frameworks and support compliance with prudential requirements. They help the board and management to safeguard a deposit taker's resources, produce reliable financial reports and comply with laws and regulations
    - the compliance function provides a second line of defence and assists senior management in effectively managing compliance risks. This supports sound and prudent governance. The compliance function is complementary to the risk management function described in section 2.9
    - the internal assurance function is a third line of defence, providing the board and senior management with assurance that the business is managing risk successfully. In doing so, the function helps to reduce the risk of loss or damage to the deposit taker.

535. We do not consider that the proposed requirements would have unnecessary compliance costs as we expect well-run deposit takers to have internal controls frameworks, compliance functions and internal assurance functions, and we already review control frameworks through our supervisory framework as well as having disclosure requirements relating to internal controls.

536. We propose to formalise these expectations within the Risk Management Standard, as this would align with the policy intent of the standard to provide an overarching framework for risk management and control with more detailed, risk-specific requirements set out in other standards.

537. We have developed the proposed requirements relating to internal control, compliance functions and internal audit functions in line with Basel Core Principle 26 Internal controls and audit.[153] Our proposed requirements also align with CPS 220, which specifically requires that APRA-regulated institutions have an adequately staffed and appropriately trained compliance

[152] *See also* the proposed Outsourcing Standard.
[153] *See* Basel Core Principle 26 Internal control and audit, in BCBS. (2024). Core Principles for effective banking supervision. https://www.bis.org/bcbs/publ/d573.pdf

function, with a reporting line independent from business lines,[154] as well as CPS 510 Governance, which requires that APRA-regulated institutions have an independent and adequately resourced internal audit function.[155]

Summary

538. We propose to require Group 1 deposit takers to have adequate internal control frameworks to establish and maintain an effectively controlled and tested operating environment, considering the risk profile of the deposit taker and taking a forward-looking view.

539. We also propose to require deposit takers to have independent and adequately resourced compliance and internal assurance functions.

Q63	Do you agree with our proposal to require deposit takers to have adequate internal control frameworks?
Q64	Do you agree with our proposal to require deposit takers to have a compliance function?
Q65	Do you agree with our proposed approach to require deposit takers to have an internal assurance function?

2.11 Reporting and notification

Preferred option

540. We propose to require deposit takers to provide us with a copy of the deposit taker's risk management strategy and risk appetite statement, both on adoption and following any material revisions. This would be provided as soon as practicable, and no more than 10 business days, after approval by the board. We also propose to require other core risk reporting to be provided to us, such as CRO reports and exposure reporting.

541. We also propose to require deposit takers to notify us of material changes made to the risk management framework, as well as after certain events such as significant breaches or material deviations from the risk management framework.

Analysis

542. Reporting and notification practice occurs already through supervisory engagement, information gathering powers and breach reporting obligations. Banks are currently required to notify us of material breaches of prudential requirements, including requirements imposed by a condition of registration, a requirement to have a credit rating, or requirements in an Order in Council. Banks are also required to provide six-monthly reports on all matters they consider to be non-material breaches. We therefore do not expect the proposed requirements to have high compliance costs above current practices.

[154] *See* CPS 220, paragraph 43.
[155] *See* CPS 510 Governance, paragraphs 90–91.

543. We consider there is value in formalising reporting and notification obligations. Imposing the proposed requirements through the Risk Management Standard makes the obligations more transparent and supports compliance. This enables us to take a more consistent supervisory approach across deposit takers.

544. We expect that a deposit taker would continue to be in regular dialogue with their supervisors about potential material changes to the organisation or the risk management framework. The requirements would allow us to take action if we had prudential concerns following significant breaches or material deviations from the risk management framework, and to therefore promote the purposes of the DTA.

545. We have also considered international practice in developing the proposed requirements. Our proposed approach aligns with CPS 220, whereby APRA-regulated institutions must on adoption, and following any material revisions, submit a copy of the institution's risk appetite statement, business plan and risk management strategy to APRA. CPS 220 also specifies a range of notification requirements, including that institutions notify APRA of a significant breach of, or material deviation from, the risk management framework of the institution,[156] or when a risk event occurs and the risk management framework of the institution does not adequately address a material risk.[157]

Summary

546. We propose to require deposit takers to provide us with, on adoption and following any material revisions, a copy of the deposit taker's risk management strategy and risk appetite statement, as well as CRO reports and exposure reporting.

547. We also propose to require deposit takers to notify us of material changes made to the risk management framework as well as after certain events, such as significant breaches or material deviations from the risk management framework.

Q66	Do you agree with our proposal relating to reporting and notification requirements?

3 Proposed approach for Group 2 deposit takers

Preferred option

548. We propose that Group 2 deposit takers are subject to the same risk management requirements as Group 1 deposit takers.

Analysis

549. As outlined in section 1.3, we consider it appropriate to apply the same requirements for risk management to Group 2 deposit takers as we would for Group 1. We have balanced the costs and benefits of the proposed requirements in relation to Group 2 deposit takers and have assessed them to be essential for Group 2 deposit takers as they reflect minimum levels of good risk management practice for a prudent deposit taker. This aligns with international practice.

[156] *See* CPS 220, paragraph 52.
[157] *See* CPS 220, paragraph 53.

550. We consider that these minimum levels of risk management practices are necessary to promote the safety and soundness of each deposit taker, and to support the effective management of risk. Therefore, we believe that the proposed approach best contributes to the purposes of the DTA and supports the principles set out in the DTA. Applying the majority of requirements across all deposit takers will also promote consistency.

551. We expect that smaller deposit takers or deposit takers with less complex business arrangements would be able to implement the requirements in a manner that is less complex than would be reasonable for a larger or more complex deposit taker. We will issue guidance to support this approach. Additionally, the proposed requirements are designed to be sufficiently flexible for deposit takers to be able to tailor their risk management practices to their circumstances when complying with the proposed requirements (see section 2.1). Therefore, we expect absolute compliance costs for Group 2 deposit takers to be lower than for Group 1, proportionate to their size and the risk they pose to the financial system. For these reasons we consider that the requirements avoid unnecessary compliance costs.

552. We expect that there may be some necessary compliance costs but anticipate these costs to be manageable overall. Compliance costs are likely to vary across deposit takers depending on existing practices and the changes needed to reach the proposed minimum level of risk management practices (for example, uplift in capability and resourcing). We seek your feedback on what the compliance costs associated with the requirements in the proposed Risk Management Standard are likely to be and whether there is another way that we can achieve our policy intent with lower compliance costs.

Summary

553. We propose that Group 2 deposit takers be subject to the same requirements as Group 1 deposit takers.

Q67	Do you agree with our proposal to take the same approach to risk management requirements for Group 2 deposit takers as we propose for Group 1?
Q68	What do you think the compliance costs associated with our proposed approach to Group 2 deposit takers are likely to be? Is there another way that we can achieve our policy intent with lower compliance costs for Group 2 deposit takers?

4 Proposed approach for Group 3 deposit takers

554. In the following sections, we discuss the proposed requirements for risk management for Group 3 deposit takers. For the Group 3 entities that are NBDTs, this would replace the existing prudential approach to risk management by NBDTs (see section 1.2).

Preferred option

555. We propose to take the same approach to Group 3 deposit takers as for Group 1 and Group 2, except for the requirements described below. We consider that these particular

requirements have compliance costs that are not easily scalable, meaning that it would not be proportionate to apply them to Group 3 deposit takers.

- Stress testing (see section 2.7): we propose to simplify the coverage of stress testing by requiring Group 3 deposit takers to only undertake stress testing covering material risks that are capital, liquidity and operational risks. For all other requirements relating to stress testing, we propose to take the same approach as for Group 1 and Group 2 (see section 2.7), noting that the sophistication and extent of stress testing required would be proportionate to the size and nature of the Group 3 deposit taker.
- Risk management function (see section 2.9): we do not propose to require Group 3 deposit takers to have a risk management function overseen by a CRO or equivalent function. Instead, we propose to require that Group 3 deposit takers that do not have a CRO have an executive responsible for risk management. Where a requirement relates to the deposit taker's board Risk Committee, if a Group 3 deposit taker does not have a specific board committee on risk, the requirement would relate to the board as a whole. For all other requirements relating to the risk management function, we propose to take the same approach as for Group 1 and Group 2 (see section 2.9), noting that the size and resources allocated to the risk management function would be proportionate to the size and nature of the deposit taker.
- Internal controls and assurance (see section 2.10): we propose to allow outsourcing of compliance and internal assurance functions. If a requirement relates to the deposit taker's board Audit Committee, and a Group 3 deposit taker does not have a specific board committee on audit, the requirement would relate to the board as a whole. For all other requirements relating to internal controls and audit, we propose to take the same approach as for Group 1 and Group 2 (see section 2.10), noting that controls and assurance would be proportionate to the size and nature of the deposit taker.

556. Table M summarises where we propose to apply the same requirements to Group 3 deposit takers as to Group 1 and Group 2 and where we propose a differentiated approach.

Table M: Summary of the proposed requirements for Group 3 deposit takers

Proposed requirements for Group 1 and Group 2 deposit takers	Proposed approach for Group 3 deposit takers
The risk management framework (see section 2.1)	Same approach as for Group 1 and Group 2.
Material risks (see section 2.2)	Same approach as for Group 1 and Group 2.
Responsibilities of the board (see section 2.3)	Same approach as for Group 1 and Group 2.
Policies and processes (see section 2.4).	Same approach as for Group 1 and Group 2.
Review (see section 2.5)	Same approach as for Group 1 and Group 2.

Proposed requirements for Group 1 and Group 2 deposit takers	Proposed approach for Group 3 deposit takers
Processes for capital adequacy and liquidity risk management (see section 2.6).	Same approach as for Group 1 and Group 2.
Stress testing (see section 2.7)	Differentiated: we propose to simplify the coverage of stress testing by requiring Group 3 deposit takers to only undertake stress testing covering material risks that are capital, liquidity and operational risks. For all other requirements relating to stress testing, we propose to take the approach set out in section 2.7.
Information and data management (see section 2.8)	Same approach as for Group 1 and Group 2.
Risk management function (see section 2.9)	Differentiated: we do not propose to require Group 3 deposit takers to have a risk management function overseen by a CRO or equivalent function. Instead, we propose to require that Group 3 deposit takers who do not have a CRO have an executive responsible for risk management. If a requirement relates to the deposit taker's board Risk Committee, and a Group 3 deposit taker does not have a specific board committee on risk, the requirement would relate to the board as a whole. For all other requirements relating to the risk management function, we propose to take the approach set out in section 2.9.
Internal controls and assurance (see section 2.10)	Differentiated: we propose to allow outsourcing of compliance and internal assurance functions. If a requirement relates to the deposit taker's board Audit Committee, and a Group 3 deposit taker does not have a specific board committee on audit, the requirement would relate to the board as a whole. For all other requirements relating to internal controls and assurance we propose to take the approach set out in section 2.10.
Reporting and notification (see section 2.11).	Same approach as for Group 1 and Group 2.

557. If proposed requirements relate to the board Risk Committee or the board Audit Committee, and a Group 3 deposit taker does not have a specific board committee on risk or audit, we propose that the board set aside dedicated time to consider risk and audit matters. This reflects the proportionate approach to board committee structure taken in the proposed Governance Standard.

Analysis

558. We propose to take the same approach to Group 3 deposit takers as for Group 1 and Group 2 for the majority of the proposed requirements, as set out in Table M. As outlined in section 1.3, we consider it proportional and desirable to apply similar requirements for risk management across all groups of deposit takers.

559. Taken collectively, we consider that our proposed approach would support better risk management practices across Group 3 deposit takers. We seek to incentivise responsive and flexible risk management practices commensurate with the size and business of the deposit taker and the complexity of its operations. Our proposed approach would also position Group 3 deposit takers well to manage material risks, as well as to understand how various risks relate to, and interact with, each other. This would improve preparedness for risk and resilience, including through improved governance and management of capital and liquidity risk. We believe that this is the best way to achieve the purposes of the DTA, including to promote the safety and soundness of each deposit taker and avoid or mitigate the adverse effects of risks to the stability of the financial system.

560. Where we propose to take a consistent approach across all groups of deposit takers, we believe that this approach is appropriate as the proposed requirements constitute the minimum levels of risk management practices for a prudent deposit taker. This approach aligns with international good practice. We consider that the analysis in section 2 in relation to the proposed requirements also largely applies to Group 3 deposit takers. However, we acknowledge that the principles-based nature of the requirements will be more important to Group 3 deposit takers, as they allow deposit takers flexibility to comply in a manner that is proportionate to the size and nature of their business, while contributing to their individual safety and soundness and the stability of the financial system. We consider that this will also support a diversity of institutions that can provide services to a diverse range of New Zealanders. We plan to support principles-based requirements with examples to demonstrate how deposit takers can comply in a manner proportionate to their size. We will issue guidance to support this approach. This principles- or outcomes-based approach can help to promote best practices and make the standard more user-friendly for Group 3 deposit takers, further articulate our approach to proportionality and support compliance. For these reasons, we consider the approach outlined in Table M would avoid unnecessary compliance costs.

561. However, there are a number of requirements that we do not consider appropriate to apply to Group 3 deposit takers, reflecting their size, complexity and systemic importance, as we consider these requirements have fixed cost elements (and cannot be as easily scaled to the size and nature of the deposit taker). This approach is in line with the principle relating to the desirability of taking a proportionate approach to regulation and supervision and the Proportionality Framework. Taking a proportionate approach will avoid unnecessary compliance costs and support a diversity of institutions that can provide services to a diverse range of New Zealanders, and the competitiveness of the deposit taking market.

562. We seek your feedback on what compliance costs associated with the proposed requirements for Group 3 deposit takers are likely to be and whether there is another way that we can achieve our policy intent with lower compliance costs. We note that many of the proposed requirements are a feature of the current NBDT regime, which discussions with trustees have suggested well-run NBDTs are already following. However, compliance costs are

likely to vary across Group 3 deposit takers, including Group 3 entities that are banks, depending on existing practices.

563. We have considered the impact of the proposed requirements for Group 3 deposit takers to ensure that our approach would be relevant and appropriate:

- Risk management framework (see section 2.1): we consider that it is appropriate to apply the proposed requirements to Group 3 deposit takers given the important role that an effective risk management framework plays in supporting deposit takers to effectively monitor, minimise and mitigate the impact of material risks and therefore is important to an individual entities' soundness. For the Group 3 entities that are banks, we expect these deposit takers would have risk management frameworks, processes and policies in order to meet their current director attestation requirements. Similarly, for the Group 3 entities that are NBDTs, they are currently required under section 27 of the NBDT Act to have a risk management programme that is appropriate for the operations of the NBDT (see section 1.2). However, we recognise that there is variance in current practice and some Group 3 deposit takers would need to make more changes to meet the proposed requirements.
- Material risks (see section 2.2): we consider that it is appropriate to apply the proposed requirements to Group 3 deposit takers as identification and management of all material risks are a minimum for a prudent deposit taker. We note that compliance costs may be higher for Group 3 deposit takers who are currently not adequately considering all material risks within their risk management programme.
- Responsibilities of the board (see section 2.3): we consider that the proposed requirements are appropriate to apply to Group 3 deposit takers as the overall responsibility for the sound and prudent management of a deposit taker should rest with its board. As the current NBDT requirements are more granular than we are proposing in the Risk Management Standard we consider it likely that the governing bodies of Group 3 entities that are NBDTs are already performing these functions.[158] Additionally, the current NBDT guidance includes obligations on deposit takers relating to culture[159] and it may be easier for a board to maintain culture in a smaller organisation where there may be less hierarchy.
- Policies and processes (see section 2.4): we consider that the proposed requirements are appropriate to apply to Group 3 deposit takers, as policies and practices facilitate a consistent approach to the identification, assessment and management of risks by deposit takers. We recognise that there may be compliance costs for Group 3 deposit takers that are banks, as the proposed requirements are not current features of our prudential regime. While we currently expect NBDTs to have contingency plans[160] and conflicts of interest policies,[161] we currently do not have specific requirements for NBDTs relating to model risk and problem assets. However, we consider that these kinds of policies and processes are important for the soundness of individual deposit takers as well as for financial stability purposes.

[158] NBDT Risk Management Guidance, clause 10.
[159] NBDT Risk Management Guidance, clauses 10-11.
[160] NBDT Risk Management Guidance, clause 8.
[161] NBDT Risk Management Guidance, clause 10(1)(f).

- Review (see section 2.5): we consider our proposals align with existing expectations on banks and NBDTs, as well as international practice. We do not expect the proposed requirements to carry high compliance costs above current practices. For the Group 3 entities that are NBDTs, we note that NBDTs are already required to have sufficient review arrangements.[162]
- Processes for capital adequacy and liquidity risk management (see section 2.6): we consider that the proposed requirements are appropriate to apply to Group 3 deposit takers as it is important for adequate risk management, and management of capital and liquidity levels, that Group 3 deposit takers consider capital adequacy and liquidity risk management in the context of other risk management and the deposit taker's risk appetite. We do not consider that these requirements would carry high compliance costs above current practices: banks are already subject to qualitative and quantitative capital and liquidity requirements, while NBDTs are currently required to link their risk management programmes to their capital adequacy policy[163] as well as to consider key elements of liquidity risk in their risk management programmes.[164]
- Stress testing (see section 2.7): we consider it appropriate to require Group 3 deposit takers to undertake stress testing. Stress testing is important, as the financial system is volatile, subject to disruptions and interconnected. However, we recognise that undertaking internal stress testing can be resource intensive. We therefore propose to streamline the requirements for Group 3 deposit takers related to stress testing, in line with the Proportionality Framework. We consider that requiring stress testing for material risks that are capital, liquidity and operational risks is important for improved risk management, as it would support deposit takers to utilise findings from risk assessments to minimise the likelihood and impact of risks and be better prepared to respond to risk. We propose that the guidance accompanying the proposed Risk Management Standard would note the support that we provide deposit takers on stress testing, which enables a proportionate approach (for example, the guidance could provide smaller deposit takers with set assumptions or sensitivities to aid Group 3 deposit takers in their stress testing).
- Information and data management (see section 2.8): we consider that the proposed requirements are appropriate to apply to Group 3 deposit takers, as effective management information systems, risk data aggregation capabilities and risk reporting practices support prudent decision making by deposit takers and their boards. We expect that there may be compliance costs associated with these proposed requirements, as these are not features of the current bank or NBDT prudential regimes and we invite your feedback on this. We are interested in understanding current practices with regards to information and data management.
- Risk management function (see section 2.9): we consider it appropriate to require Group 3 deposit takers to have a risk management function that meets the requirements set out above. As discussed in section 1.1, a good risk culture is critical for effective risk management. It is important that risk management is a discipline embedded throughout the organisation and that all staff members within a deposit taker manage risk and consider risk management in their day-to-day work. This requirement reflects existing

[162] Non-Bank Deposit Takers Act 2013, section 27(2)(d). *See* also NBDT Risk Management Guidance, clause 9.
[163] NBDT Risk Management Guidance, clause 5(2)(j).
[164] NBDT Risk Management Guidance, clause 15.

expectations of NBDTs, as set out in the NBDT Risk Management Guidance. A proportionate approach would be taken when considering the resourcing, independence, authority and access requirements of the risk management function for Group 3 deposit takers. This would ensure that the risk management function is fit for purpose and help to mitigate the compliance costs, while ensuring that the risk management function is an appropriate check and balance to risk-taking functions, supporting sound governance and prudent risk-taking by deposit takers.

564. We do not consider that it is appropriate or proportional to require Group 3 deposit takers to have a dedicated risk management unit overseen by a CRO or equivalent function with sufficient independence, authority and access. We propose to recommend this as good practice for larger Group 3 deposit takers in the guidance accompanying the Risk Management Standard. Instead, we propose to require that Group 3 deposit takers that do not have a CRO have an executive responsible for risk management. We do not expect this to have unnecessary compliance costs, as the senior management of NBDTs are currently tasked with many of the responsibilities we would expect to sit with a CRO. We consider it is good practice for accountability to have an individual responsible for risk management operations.

- Internal controls and assurance (see section 2.10): we consider it appropriate to require Group 3 deposit takers to have adequate internal control frameworks, independent and adequately resourced compliance functions and independent and adequately resourced internal assurance functions. We anticipate that there may be compliance costs for some Group 3 deposit takers that do not currently have compliance or internal assurance requirements. We invite your feedback on this. To help avoid unnecessary compliance costs, we propose to take a proportionate approach when considering the resourcing and independence requirements for both the compliance function and internal assurance function for Group 3 deposit takers (that is, that these functions are commensurate with the size and business of the deposit taker, and the complexity of its operations). We also propose to allow Group 3 deposit takers to outsource these functions to reduce compliance costs. However, Group 3 deposit takers would also be free to retain these functions in-house if this suited their business interests.

- Reporting and notification (see section 2.11): we consider that the proposed requirements are appropriate to apply to Group 3 deposit takers as reporting and notification practice occurs already through engagement between us and banks, as well as between trustees and NBDTs. We do not consider that the proposed requirements would carry high compliance costs above current practices, as they would only impose an obligation on deposit takers to share key documents with us and notify us of material changes to those documents. Our proposed approach aligns with international good practice and current expectations of banks. For Group 3 deposit takers that are NBDTs, we consider our proposed approach to be less onerous than existing requirements on NBDTs. We currently require NBDTs to submit risk management programmes for trustee approval to ensure that its trustee is satisfied that the risk management programme meets the requirements of the NBDT Act,[165] as well as to seek approval from its trustee to any

[165] Non-Bank Deposit Takers Act 2013, section 28.

amendments to its risk management programme.[166] Therefore, we consider that the requirements avoid unnecessary compliance costs.

565. Taking these collectively, we consider that our proposed approach would support better risk management practices across Group 3 deposit takers. We seek to incentivise responsive and flexible risk management practices commensurate with the size and business of the deposit taker and the complexity of its operations. Our proposed approach would also position Group 3 deposit takers well to manage material risks, well as to understand how various risks relate to, and interact with, each other. This would improve preparedness for risk and resilience, including through improved governance and management of capital and liquidity and other risk. We believe that this is the best way to achieve the purposes of the DTA, including to promote the safety and soundness of each deposit taker and avoid or mitigate the adverse effects of risks to the stability of the financial system.

566. We do not propose to include 'safe harbour' provisions in the Risk Management Standard. While safe harbour provisions can support compliance while minimising compliance costs, we do not want to include these as this may incentivise deposit takers to treat risk management as a 'tick box' exercise and this does not align with the proposed policy objectives outlined in section 1.1. Rather, we intend to support compliance through proportionality and by providing detail in the guidance on what these required documents should include to support best practices and minimise compliance costs.

Summary

567. We propose to take the same approach to risk management requirements for Group 3 deposit takers as we propose for Group 1 and Group 2 deposit takers, except for:

- Stress testing: we propose to require Group 3 deposit takers to have forward-looking stress testing covering material risks that are capital, liquidity and operational risks, commensurate with the size and business of the deposit taker and the complexity of its operations.
- Risk management function: we do not propose to require Group 3 deposit takers to have a dedicated risk management unit overseen by a CRO or equivalent function. We propose to recommend this as good practice for larger Group 3 deposit takers in the guidance accompanying the Risk Management Standard. We propose to require that Group 3 deposit takers who do not have a CRO have an executive responsible for risk management.
- Internal controls and assurance: we propose to allow Group 3 deposit takers to outsource their compliance and internal assurance functions.

Q69	Do you agree with our proposal to take the same approach to risk management requirements for Group 3 deposit takers as we propose for Group 1 and Group 2 deposit takers, except for the requirements identified?
Q70	What do you think the compliance costs associated with our proposed approach to Group 3 deposit takers are likely to be? Is there another way that

[166] Non-Bank Deposit Takers Act 2013, section 27(2)(d)(ii).

	we can achieve our policy intent with lower compliance costs for Group 3 deposit takers?
Q71	Do you agree with our proposal to require Group 3 deposit takers to undertake stress testing covering material risks that are capital, liquidity and operational risks?
Q72	Do you agree with our proposal to not require Group 3 deposit takers to have a dedicated risk management unit overseen by a CRO or equivalent function, but to require that Group 3 deposit takers who do not have a CRO to have an executive responsible for risk management?
Q73	Do you agree with our proposal to require Group 3 deposit takers to have a compliance function, but allow this to be outsourced?
Q74	Do you agree with our proposed approach to require Group 3 deposit takers to have an internal assurance function, but allow this to be outsourced?

5 Proposed approach for branches of overseas deposit takers

568. In the following sections, we discuss the proposed requirements for risk management for branches of overseas deposit takers (branches), which would be implemented through the proposed Risk Management Standard. Our proposed approach reflects the different legal structures and nature of the operations of branches. As a result, we partially rely on a branch's compliance with regulation and supervision in its home jurisdiction. This is discussed further in the proposed Branch Standard.

Preferred option

569. We propose to take the same approach to branches as for Group 1 and Group 2 deposit takers, except for the requirements related to:

- Risk management framework (see section 2.1): we propose to require branches to have a risk management framework, as proposed for Group 1, Group 2 and Group 3 deposit takers, but note that this would be limited to the deposit taker's business in New Zealand. Additionally, as a branch is part of an overseas group, we expect that risk will be managed through a whole-of-group approach (noting that home regulators would impose requirements at the global group level), at a New Zealand group level (that is, where an overseas deposit taker has both a branch and a locally-incorporated subsidiary operating in New Zealand) and also at the branch level. Accordingly, we propose to require that branches:
    - must consider risks from related parties within the group in its risk management framework (for example, from the overseas deposit taker, any subsidiaries or sister companies it may have, or any branches operated by group members)

- may use group risk management frameworks, policies and procedures so long as New Zealand-specific prudential requirements are met and the New Zealand CEO is satisfied that the requirements are met in respect of its New Zealand operations.

- Responsibilities of the board (see section 2.3): the proposed board responsibilities would sit with the New Zealand CEO of the branch, in line with the due diligence obligations in section 94 of the DTA, rather than the board of the deposit taker. Risk appetite statements would be required to be appropriate for the branch and a New Zealand context, as well as consistent with the overall legal entity incorporated overseas.
- Stress testing (see section 2.7): we do not propose to require branches to undertake stress testing.
- Risk management function (see section 2.9): we do not propose to require branches to have a risk management function overseen by a CRO or equivalent function. For all other requirements relating to the risk management function, we propose to take the same approach as for Group 1, Group 2 and Group 3 as set out in section 2.9.
- Internal controls and assurance (see section 2.10): we propose to allow outsourcing of compliance and internal assurance functions. For all other requirements relating to internal controls and audit, we propose to take the same approach as for Group 1, Group 2 and Group 3 as set out at section 2.10.

570. We consider that it would not be proportionate or practical to apply these particular requirements to branches.

571. Table N below summarises where we propose to apply the same requirements for branches as for Group 1 and Group 2 deposit takers and where we propose a differentiated approach.

Table N: High-level summary of the proposed requirements for branches

Proposed requirement for Group 1 and Group 2 deposit takers	Proposed approach for branches
The risk management framework (see section 2.1)	Requirement to have a risk management framework: We propose to apply this requirement to branches and note that this would be limited to the deposit taker's business in New Zealand Risk management at the group level: Differentiated: as a branch is part of an overseas group, we expect that risk will be managed through a whole-of-group approach (noting that home regulators would impose requirements at the global group level), at a New Zealand group level (that is, where an overseas deposit taker has both a branch and locally-incorporated subsidiary operating in New Zealand) and also at the branch level.
Material risks (see section 2.2)	Same approach as for Group 1, Group 2 and Group 3. Branches would be required to consider, at a minimum, the same list of categories of risk, but we recognise that the monitoring, minimising and mitigating of risk will be quite different for a

Proposed requirement for Group 1 and Group 2 deposit takers	Proposed approach for branches
	branch to Group 1, Group 2 and Group 3 deposit takers. We will issue guidance to support this.
Responsibilities of the board (see section 2.3)	Differentiated: the proposed board responsibilities would sit with the New Zealand CEO of the branch, in line with the due diligence obligations in section 94 of the DTA rather than the board of the deposit taker. Risk appetite statements would be required to be appropriate for the branch and a New Zealand context, as well as consistent with the overall legal entity incorporated overseas.
Policies and processes (see section 2.4)	Same approach as for Group 1, Group 2 and Group 3.
Review (see section 2.5)	Same approach as for Group 1, Group 2 and Group 3.
Processes for capital adequacy and liquidity risk management (see section 2.6)	Same approach as for Group 1, Group 2 and Group 3.
Stress testing (see section 2.7)	Differentiated: we do not propose to require branches to undertake stress testing.
Information and data management (see section 2.8)	Same approach as for Group 1, Group 2 and Group 3.
Risk management function (see section 2.9).	Differentiated: we do not propose to require branches to have a risk management function overseen by a CRO or equivalent function. Where a requirement relates to the board Risk Committee of a deposit taker, for branches we propose that these obligations sit with the New Zealand CEO, as per section 94 of the DTA. For all other aspects of the requirement, as set out in section 2.1, we propose to take the same approach as for Group 1 and Group 2.
Internal controls and assurance (see section 2.10)	Differentiated: we propose to allow outsourcing of compliance and internal assurance functions. Where a requirement relates to the board Audit Committee of a deposit taker, for branches we propose that these obligations sit with the New Zealand CEO, as per section 94 of the DTA. For all other aspects of the requirement, as set out in section 2.1, we propose to take the same approach as for Group 1 and Group 2.

Proposed requirement for Group 1 and Group 2 deposit takers	Proposed approach for branches
Reporting and notification (see section 2.11)	Same approach as for Group 1, Group 2 and Group 3.

572. Where proposed requirements relate to the board or board committee of a deposit taker, for branches we propose that these obligations sit with the New Zealand CEO, as per section 94 of the DTA. This reflects the approach taken in the proposed Governance Standard.

Analysis

573. We propose to take the same approach to branches as for Group 1 and Group 2 for the majority of the proposed requirements, as set out in Table N. As outlined in section 1.3, we consider it proportionate and desirable to apply similar requirements for risk management across all groups of deposit takers We consider that taking a consistent approach across all groups of deposit takers is appropriate given the requirements are high-level and principles-based and constitute the minimum levels of risk management practices for a prudent deposit taker. This approach aligns with international practice, in particular APRA's approach. This approach also supports the additional purpose of promoting the safety and soundness of each deposit taker.

574. As outlined in section 1.3, we have designed the requirements to be high-level and principles-based, which helps to avoid unnecessary compliance costs by providing branches with flexibility to comply in a manner that is proportionate to the size and nature of their business, while contributing to their individual safety and soundness and the stability of the financial system. The requirements are designed to be applied flexibly so that branches can comply in a way that aligns with home regulator requirements, but still meet our minimum requirements. We will issue guidance to support this approach. This principles- or outcomes-based approach can help to promote best practices and to make the standard more user-friendly for branches, further articulate our approach to proportionality and support compliance. For these reasons, we consider the approach would avoid unnecessary compliance costs.

575. However, there are a number of requirements that we do not consider appropriate to apply to branches, reflecting the different legal structure and nature of operations of branches, as well as their size, complexity and systemic importance. This approach is in line with the DTA Section 4(a)(i) principle relating to the desirability of taking a proportionate approach to regulation and supervision, and the Proportionality Framework. Taking this approach will avoid unnecessary compliance costs and support a diversity of institutions that can provide services to a diverse range of New Zealanders and the competitiveness of the deposit taking market.

576. We seek your feedback on what compliance costs associated with the proposed requirements for branches are likely to be and whether there is another way that we can achieve our policy intent with lower compliance costs. We note that many of the proposed requirements are a feature of international prudential regimes and many overseas banks with branches in New Zealand are likely to be subject to similar requirements. In particular, all the branches currently operating in New Zealand are part of overseas deposit takers that are domiciled in a

Basel-compliant jurisdiction and have to adhere to Basel Core Principles, including those on risk management. However, compliance costs are likely to vary across branches depending on existing practices.

577. To ensure that our approach would be relevant and appropriate, we have considered the impact of the proposed requirements for branches in more detail below:

- Risk management framework (see section 2.1): we consider that our proposed requirements relating to risk management frameworks would help ensure that branches better identify and manage material risks, thereby contributing to the safety and soundness of that deposit taker as well as the stability of the financial system. Requiring a risk management framework aligns with international good practice. However, as branches are not separate legal entities from the overseas bank, we do not propose to require branches to consider risk across the individual deposit taker by providing a comprehensive, deposit-taker-wide view of risk across all material risk types. Instead, we propose to require that a branch's risk management framework be comprehensive and align with all the branch's business activities.

  We consider that our proposed approach would enable branches to consider the totality of risks to their business in New Zealand. This will also help to mitigate the risk that branches present to the New Zealand financial system. We do not consider that the proposed requirements would impose high compliance costs as we expect the home regulator to have equivalent requirements on the overseas deposit taker. We note that the proposed Branch Standard would include a requirement that branches comply with home regulatory requirements, which we expect will include a requirement of this nature.

- Material risks (see section 2.2): we consider that it is appropriate to apply the proposed requirements to branches as identification and management of all material risks are the bare minimum for a prudent deposit taker. We recognise that the monitoring, minimising and mitigating of the proposed list of risks will be quite different for a branch from those of Group 1, Group 2 and Group 3 deposit takers. We will issue guidance to support this. We note that compliance costs may be higher for branches who are currently not adequately considering all material risks within their risk management programme. However, we consider that the materiality threshold would provide branches with flexibility to comply in a manner that is proportionate to the size and nature of their business, while contributing to their safety and soundness and the stability of the financial system.

- Responsibilities of the New Zealand CEO (see section 2.3 Responsibilities of the board): we consider that the proposed requirements relating to board responsibilities are appropriate to apply to the New Zealand CEO of a branch. The DTA, section 94, confirms that the New Zealand CEO of a branch must exercise due diligence to ensure that the deposit taker complies with its prudential obligations. We therefore expect that, as the responsibility for the sound and prudent management of a branch's business operations rests with the New Zealand CEO, the New Zealand CEO would be responsible for the branch's risk management. This aligns with the approach proposed in the Governance Standard as well as international practice. Our proposed approach would also contribute to sound governance and risk management by branches. We do not consider that the proposed requirements would carry significant compliance costs as we consider it likely

that the New Zealand CEOs of branches are already performing these functions. We also expect the home regulator to have equivalent requirements on the overseas deposit taker.

- Policies and processes (see section 2.4): we consider that the proposed requirements are appropriate to apply to branches as policies and practices facilitate a consistent approach to the identification, assessment and management of risks by deposit takers. This ensures the deposit taker is being prudently managed, having regard to the size, business and complexity of its operations. As noted in section 2.4, for dual-registered deposit takers, we propose to require that the conflicts of interest policies would specifically address situations where the CEO of the branch is also an employee of the subsidiary, as well as potential conflicts of interest between related parties (both as part of ongoing risk management requirements and in a stress situation). We do not consider that the proposed requirements relating to policies and processes would carry unnecessary compliance costs as the requirements are based on international practice and are principles-based, and we expect home regulators would have equivalent requirements.
- Review (see section 2.5): we do not expect the proposed requirements to carry high compliance costs above existing practices as we expect home regulators to have equivalent requirements requiring overseas deposit takers to have sufficient review arrangements.
- Processes for capital adequacy and liquidity risk management (see section 2.6): as set out in the proposed Capital Standard and Liquidity Standard, we are not proposing to impose quantitative capital adequacy or liquidity requirements on branches (although we are proposing qualitative liquidity requirements). Nevertheless, we consider that it is appropriate to apply high-level risk management requirements on branches to have appropriate internal processes for assessing their overall capital and liquidity adequacy. We consider that it is important for adequate risk management, and management of capital and liquidity levels, that capital adequacy and liquidity risk are considered in the context of other risk management and the branch's risk appetite. We do not expect the proposed requirements to carry high compliance costs above current practices as we expect home regulators to have equivalent requirements requiring overseas deposit takers to have appropriate processes for capital and liquidity adequacy in the context of risk management.
- Stress testing (see section 2.7): we do not consider that it is justified to require branches to undertake stress testing. We currently do not impose stress testing requirements on branches and do not consider that there is a compelling reason to apply the requirements to branches. We expect that branches would be subject to similar requirements in their home jurisdiction via the overseas deposit taker business and do not consider that the benefits of imposing additional New Zealand-specific requirements for financial stability purposes would be proportionate or outweigh the compliance costs, given the small size of branch-operated businesses operating in New Zealand. We consider it may be more appropriate for a branch to be subject to stress testing at a group level, in which case the stress testing requirements would be put in place by the home regulator. Therefore, our current position is that the additional compliance costs associated with applying stress testing to branches is unnecessary, but we are interested in your feedback on this assessment.

- Information and data management (see section 2.8): we consider that the proposed requirements are appropriate to apply to branches as effective management information systems, risk data aggregation capabilities and risk reporting practices support prudent decision making by branches and their senior management. This would ensure deposit takers have accurate, reliable, complete and timely risk data to support decision making and reporting requirements in both normal operating conditions and stress conditions. We do not expect the proposed requirements to carry high additional compliance costs as we expect home regulators to have equivalent requirements on overseas deposit takers.
- Risk management function (see section 2.9): we consider it appropriate to require branches to have a risk management function that meets the proposed requirements. A proportionate approach would be taken when considering the resourcing, independence, authority and access requirements of the risk management function for branches of overseas deposit takers. This would ensure that the risk management function is fit for purpose and help to mitigate the compliance costs. Consideration would also need to be given to the independence requirement in the context of a banking group operating both a subsidiary and a branch in New Zealand, that may combine aspects of the risk management function across the branch and the locally-incorporated deposit taker. We would allow the risk management function to be resourced by the home entity, so long as adequate resources were devoted to the risk associated with the New Zealand business. Similar to our proposed approach to Group 3 deposit takers (see section 4), we do not consider that it is appropriate or proportionate to require branches to have a dedicated risk management unit overseen by a CRO.
- Internal controls and assurance (see section 2.10): we consider it appropriate to require branches to have adequate internal control frameworks, independent and adequately resourced compliance functions and independent and adequately resourced internal assurance functions. Collectively, we consider that the proposed requirements would support the New Zealand CEO and senior management to more prudently manage risk and support the sound operation of the deposit taker in New Zealand. We do not consider that the proposed requirements would carry significant additional compliance costs as we expect the home regulator to have equivalent requirements. We also propose to allow options for combining or outsourcing some functions; however, branches would also be free to retain these functions in-house if this suited their business interests. We would allow the functions to be resourced by the home entity, so long as adequate resources were devoted to the risk associated with the New Zealand business. Consideration would also need to be given to the independence requirement in the context of entities operating both a subsidiary and a branch in New Zealand, who may combine aspects of the compliance and internal audit functions across the branch and the locally-incorporated deposit taker.
- Reporting and notification (see section 2.11): we consider that the proposed requirements are appropriate to apply to branches as some reporting already occurs through regular supervisory engagements. We seek to formalise existing expectations within the Risk Management Standard, providing transparency and supporting compliance. We do not consider that the proposed requirements would impose unnecessary compliance costs, as they would only impose an obligation on deposit takers to share key documents with us and notify us of material changes to those documents.

578. Taking these collectively, we consider that our proposed approach would support better risk management practices across branches. We seek to incentivise responsive and flexible risk management practices commensurate with the size and business of deposit takers, and the complexity of their operations. Our proposed approach would also position branches well to manage material risks, as well as to understand how various risks relate to, and interact with, each other. This would improve preparedness for risk and resilience, including through improved governance and management of capital and liquidity risk. We believe that this is the best way to achieve the purposes of the DTA, including promoting the safety and soundness of each deposit taker.

Summary

579. We propose to take the same approach to risk management requirements for branches as we propose for Group 1 and Group 2 deposit takers, except for:

- Risk management framework: we propose to require branches to have a risk management framework to identify, measure, evaluate, monitor, report on and control or mitigate all material risks to its business in New Zealand. As a branch is part of a group, we propose to require that branches:
    - must consider risks from related parties within the group in its risk management framework (for example, from the overseas deposit taker, any subsidiaries or sister companies within the deposit taking group, or any branches operated by group members)
    - may use group risk management frameworks, policies and procedures so long as New Zealand-specific prudential requirements are met and the New Zealand CEO is satisfied that the requirements are met in respect of that deposit taker.
- Responsibilities of the New Zealand CEO: we propose to apply the proposed requirements relating to the responsibilities of boards of Group 1, Group 2 and Group 3 deposit takers (set out in section 2.3) to the New Zealand CEO of branches of overseas deposit takers.
- Stress testing: we do not propose to impose requirements on branches relating to stress testing.
- Risk management function: we do not propose to require branches to have a dedicated risk management unit overseen by a CRO or equivalent function. We propose to recommend this as good practice for larger branches in the guidance accompanying the Risk Management Standard. We propose to require that branches who do not have a CRO have an executive responsible for risk management.
- Internal controls and assurance: we propose that branches be able to outsource their compliance and internal assurance functions.

Q75	Do you agree with our proposal to take the same approach to risk management requirements for branches as we propose for Group 1 and Group 2 deposit takers, except for the requirements identified?

Q76	What do you think the compliance costs associated with our proposed approach to branches are likely to be? Is there another way that we can achieve our policy intent with lower compliance costs for branches?
Q77	Do you agree with our proposed approach to the requirement for branches to have a risk management framework?
Q78	Do you agree with our proposed requirements for risk management at the branch and group levels?
Q79	Do you agree with our proposal to apply the proposed requirements for responsibilities of New Zealand CEOs of branches of overseas deposit takers?
Q80	Do you agree with our proposal to not impose requirements for stress testing on branches?
Q81	Do you agree with our proposal to not require branches to have a dedicated risk management unit overseen by a CRO or equivalent function?
Q82	Do you agree with our proposal to require branches to have a compliance function, but allow this to be outsourced or resourced by the home entity?
Q83	Do you agree with our proposed approach to require branches to have an internal assurance function, but allow this to be outsourced or resourced by the home entity?

6 Conclusion

580. In conclusion, we consider that the proposed Risk Management Standard is necessary to protect and promote the stability of the financial system, by contributing to the safety and soundness of deposit takers, as articulated in the main purpose under the DTA, section 3(1). The proposed Risk Management Standard would consolidate and set out our expectations for risk management by deposit takers to give effect to this purpose. This would also contribute to the objectives of other standards proposed under the DTA, such as governance and specific types of risk management, such as liquidity requirements or operational risk management.

581. We see the primary objective of the proposed Risk Management Standard as being to provide deposit takers with good incentives for effective and comprehensive risk management and control. Good culture is cited as a critical feature in best risk management practice and the proposed Risk Management Standard would therefore focus on embedding effective risk management practices and culture, aligned with a deposit taker's risk strategy. This would be supported by effective board and senior management oversight and engagement.

582. We propose to apply the proposed requirements of the Risk Management Standard to every deposit taker. We believe that this is appropriate as the requirements are high-level and principles-based and constitute the bare minimum for a prudent deposit taker. However, noting the Proportionality Framework, the preferred approaches for Group 3 deposit takers and branches are a streamlined version of the proposed requirements for Group 1 and Group 2. We consider that this will provide consistency in treatment, improve comparability across deposit takers and align with international best practice.

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 4

Deposit Takers Operational Resilience Standard

Deposit Takers Non-Core Standards Consultation

21 August 2024

CONSULTATION PAPER

Non-technical summary

The digitisation of financial services and the growing complexity and interconnectedness of the financial services sector has led to a greater focus on operational resilience by deposit takers and regulators. In 2024 both the BCBS and APRA concluded significant reviews of their regulatory frameworks for the management of operational risk to address the growing and evolving risks in this area.

The proposed Operational Resilience Standard focuses on enabling all deposit takers operating in New Zealand to achieve operational resilience. It sets out requirements that will help ensure that deposit takers adequately manage their operational risk practices and remain resilient through operational disruptions. Our objective for the standard is to promote sound, effective and efficient operational risk practices in deposit takers that enhance the operational resilience of each deposit taker.

To achieve this objective, we propose the standard includes requirements in 4 key areas.

- Operational Risk Management: requirements to manage operational risk through identification and assessment of the deposit taker's operational risk profile, effective operational risk controls and reporting relating to operational risk incidents.
- Material Service Providers: requirements to manage risks arising from the use of external service providers to provide critical operations to the deposit taker's business. This area also relates to our proposed Outsourcing Standard. We will aim to avoid any unnecessary change for deposit takers that are also required to comply with the Outsourcing Standard.
- Information and Communication Technology: requirements to manage risks arising from the use of information and communications technology, including cyber risks.
- Business Continuity Planning: requirements to support the operational resilience of critical functions through business disruptions.

We propose applying the Operational Resilience Standard to all Groups of deposit takers. We propose requirements we view as the minimum necessary to support the operational resilience, and in turn the safety and soundness of deposit takers operating in New Zealand. The requirements will support promoting the stability of the New Zealand financial system.

Our proposed standard is designed using a hybrid principles-based approach, in which requirements target outcomes and give deposit takers the flexibility to choose the way in which they achieve these outcomes, thus supporting our intent of setting out requirements proportionately.

Our proposed approach lifts the formal operational resilience requirements compared to the existing bank and NBDT regimes. This reflects the purposes of the DTA and our intent to strengthen regulatory discipline and support clarity in supervision. While our proposed requirements are more explicit, we expect that most deposit takers should already be substantively meeting the requirements as a part of their existing operational risk management practices. However, we recognise that practices may vary across deposit takers.

1 Introduction

583. Internationally, the focus on operational risk and resilience has grown in recent years. Operational risks have become more complex – particularly because of the increasing digitalisation of financial services. Greater reliance on technology by deposit takers means that the impact of an operational failure can be greater than in the past and could undermine the stability of the financial system.

584. Supporting operational resilience is important in ensuring that New Zealand deposit takers avoid or minimise operational disruptions. It is also critical in reinforcing public trust in deposit takers and maintaining the stability of New Zealand's financial system. This emphasises the importance of having clear requirements to support operational resilience.

585. The BCBS defines operational resilience as "the ability of a bank to deliver critical operations through disruption" and notes that "operational resilience is an outcome that benefits from the effective management of operational risk."[167] Separately, the BCBS also defines operational risk as "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external event," and this definition "includes legal risk but excludes strategic and reputational risk."[168]

586. To support operational resilience, the BCBS has outlined principles relating to governance, operational risk management, business continuity planning (**BCP**) and testing, mapping of interconnections and interdependencies of critical operations, third-party dependency management, incident management, and resilient information and communication technology (**ICT**), including cyber security.[169]

1.1 Purpose of the Operational Resilience Standard

587. The primary purpose of the Operational Resilience Standard is to set out clearer regulatory requirements to support effective supervision of operational risks facing New Zealand-incorporated deposit takers and their operational resilience.

588. The current absence of clear requirements constrains our ability to supervise our deposit takers' operational resilience practices. This creates a significant gap in our prudential framework and has implications for both the resilience of individual deposit takers and the financial system. It also limits our ability to support a resilient and diverse range of deposit takers to provide access to a range of financial products and services.

1.2 Current approach

589. Our current approach to foster operational resilience amongst deposit takers relies largely on self- and market discipline to ensure that banks and NBDTs are adequately managing their operational risks.

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[167] Basel Committee on Banking Supervision. (2021). Principles for Operational Resilience. https://www.bis.org/bcbs/publ/d516.pdf

[168] *See* Basel Committee on Banking Supervision. (2022). OPE – Calculation of RWA for operational risk, OPE10 – Definitions and application. https://www.bis.org/basel_framework/chapter/OPE/10.htm?inforce=20191215&published=20191215&tldate=20221228

[169] Basel Committee on Banking Supervision. (2021). Principles for Operational Resilience. https://www.bis.org/bcbs/publ/d516.pdf

590. We do not currently have a stand-alone operational risk policy for banks or NBDTs. However, aspects of our existing prudential requirements or guidelines cover areas of operational risk. In particular:

- our Statement of Principles Bank Registration and Supervision (**BS1**) outlines that applicants to be a **registered bank** will be required to satisfy us that they "have, or will have, risk management systems and policies that are appropriate for a registered bank and for the type of business to be conducted." Such policies should include managing operational risks[170]
- our disclosure regime for banks mandates that directors are required to attest in disclosure statements that "the registered bank had systems in place to monitor and control adequately the material risks of the registered bank's banking group including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks, and that those systems were being properly applied" [171]
- our Advanced Measurement Approach Operational Risk (**BPR151**) sets out qualitative requirements for managing operational risk for those banks accredited to use the advanced measurement approach (**AMA**) [172]
- our Outsourcing Policy (**BS11**) details the aspects of the outsourcing policy that include the management of operational risks relating to the outsourcing of critical services (although much of this policy has a resolution focus)[173]
- our Cyber Resilience Guidance outlines our expectations for all our regulated entities on a principles-based approach. [174] We have set out guidelines for a deposit taker's **board** and senior managers to support cyber resilience. The cyber resilience guidance expands our oversight in this area, and we have set out cyber data reporting requirements that draw from this guidance. [175] We consider building on these regulatory initiatives to have formal, enforceable, requirements for critical sectors moving forward
- section 27 of the NBDT Act requires **licensed NBDTs** to have a risk management programme (and to take all practicable steps to comply with that programme) including

[170] Reserve Bank of New Zealand – Te Pūtea Matua. (2021). Statement of Principles, Bank Registration and Supervision (BS1). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs1-statement-of-principles.pdf

[171] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2022). Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended), Schedule 2, clause 17(2)(c). https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/disclosure-requirements

[172] Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Advanced Measurement Approach Operational Risk (BPR151). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bpr151-ama-operational-risk-1-july-2024pdf.pdf

[173] Reserve Bank of New Zealand – Te Pūtea Matua. (2022). Outsourcing Policy (BS11). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs11-sept-2022.pdf

[174] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2021). Guidance on Cyber Resilience. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/cyber-resilience/guidance-on-cyber-resilience.pdf

[175] Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Cyber Resilience Data Collection. https://www.rbnz.govt.nz/have-your-say/2023/cyber-resilience-data-collection

managing operational risk.[176] Limited high-level guidance on this requirement is provided in our Risk Management Programme Guidelines for NBDTs[177]

- our Managing Climate-related Risks Guidance for Prudentially Regulated Entities notes that "better practice extends to measuring the impacts of climate-related risks on outsourcing arrangements, service providers, full value chains and business continuity planning" and that "an entity should ensure its own operational continuity if a severe weather event occurs." [178]

1.3 Proposed policy development approach

591. Our objective for the Operational Resilience Standard is to promote sound, effective and efficient operational practices that enhance the operational resilience of each deposit taker, consistent with the framework of the Risk Management Standard.

592. We have designed our proposed requirements following a hybrid principles-based approach in which we propose requirements to achieve certain outcomes. This approach is intended to give deposit takers the flexibility to comply with requirements in a manner that is proportionate to the size and nature of their business. This approach will also support a diversity of institutions that provide services to a diverse group of New Zealanders and contribute to financial inclusion.

593. We have sought to align our proposals with any existing requirements and international practice where possible. This will help avoid the potential costs associated with unnecessary changes to current practice. We also consider it unlikely that the proposed requirements will have any material impact on the level of competition among deposit takers.

594. We will work with the Financial Markets Authority in supervising some of the requirements in this standard, consistent with the approach proposed in section 2D of the Ministry of Business, Innovation and Employment recent consultation on fit for purpose financial services reform. [179] [180]

595. Operational resilience is an area of evolving risk, particularly because of technological change. This chapter sets out our proposals to establish minimum standards in this context. In the

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[176] Non-Bank Deposit Takers Act 2013. https://www.legislation.govt.nz/act/public/2013/0104/latest/DLM3918915.html

[177] Reserve Bank of New Zealand – Te Pūtea Matua. (2009). Risk Management Programme Guidelines. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/non-bank-deposit-takers/3697899.pdf

[178] Reserve Bank of New Zealand – Te Pūtea Matua. (2009). Risk Management Programme Guidelines. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/non-bank-deposit-takers/3697899.pdf

[179] Ministry of Business, Innovation and Employment. (2024, May). Fit for purpose financial services conduct regulation. Discussion document, section 2D. https://www.mbie.govt.nz/dmsdocument/28373-fit-for-purpose-financial-services-conduct-regulation-discussion-document

[180] The RBNZ works closely with the FMA for streamlined, effective and responsive regulation in this policy area, in line with the 'twin peaks' model. The Conduct of Financial Institutions (**CoFI**) regime, which will commence on 31 March 2025, is a relevant regulation that has benefited from RBNZ-FMA cooperation (FMA, 2024, https://www.fma.govt.nz/business/legislation/conduct-of-financial-institutions-cofi-legislation/). Pursuant to the CoFI regime, the FMA sets out licensing requirements for financial institutions (that include deposit takers) relating to outsourcing (condition 4), business continuity and technology systems (condition 5) and operational resilience (condition 6), noting the increasing relevance of ensuring that "financial institutions have suitable arrangements in place to be able to manage disruptions to their business" (*see* FMA, 2022a, https://www.fma.govt.nz/assets/Compliance/Standard-conditions-for-financial-institutions.pdf; FMA, 2022b, https://www.fma.govt.nz/assets/Consultations/Proposed-standard-conditions-for-financial-institution-licences-consultation-paper.pdf). The RBNZ and FMA also collaborated on the Cyber resilience data collection (RBNZ, 2024, https://www.rbnz.govt.nz/have-your-say/2023/cyber-resilience-data-collection)

future we expect that the standard and guidance will need to evolve over time in response to emerging risks.

1.4 Definition of 'critical operations'

596. Throughout our Operational Resilience Standard, we use the concept of 'critical operations', which we propose to define below.

> *Critical operations are 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.*
>
> *Critical operations include but are not limited to transactional, savings and deposit accounts, credit services, payment clearing and settlement services.*

597. Our definition allows the deposit taker to identify which of its activities, functions and services are critical to its business. A minimum requirement of which operations constitute critical operations is outlined in the second limb of the definition above. For clarity, this is not intended to be an exhaustive list.

598. This definition will have interactions with other standards. For example, the proposed Outsourcing Standard (which translates the existing BS11) uses the concept of 'critical service providers' as part of its definition of 'time critical obligations'. This definition is used in a recovery and resolution context to understand what key vendors must be paid in order to continue the provision of their services after the day of failure. Our proposed definition of 'critical operations' is intended to enable a deposit taker's approach more broadly. It should capture operations that are performed by deposit takers in-house and those that are outsourced. The 2 approaches are related but used for different purposes.

599. Where appropriate, we intend for this definition of 'critical operations' to be used across all relevant DTA standards.

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

2 Proposed approach for Group 1 deposit takers

600. We propose requirements for Group 1 deposit takers that cover the following 4 key areas:

- operational risk management
- material service providers (MSP)
- ICT
- BCP.

2.1 Operational risk management

601. Appropriate identification, assessment and management of operational risks is essential to a deposit taker's operational resilience. Clear regulatory requirements for operational risk management are an important part of enabling clear supervision of operational risk practice.

We have considered 2 options in this regard: Option 1 is to maintain the status quo by translating the existing qualitative requirements for operational risk for AMA banks under BPR151. Option 2 is to set out clearer minimum requirements for the frameworks that Group 1 deposit takers should put in place to manage their operational risk.

Preferred option

602. Our preferred option is to set out clearer minimum operational risk management requirements (Option 2). Our proposed requirements, outlined in Table O, seek to address the limitations of the current operational risk regulatory framework in terms of adequacy, clarity and enforceability of our requirements. The proposed requirements also aim to strike a better balance in the use of regulatory discipline in our prudential framework to support both certainty for deposit takers and clearer supervision.

603. Our proposed requirements focus on the responsibilities of the deposit taker's board, establishing an operational risk profile and assessment, implementing operational risk controls and reporting operational risk incidents. The intent is to ensure effective operational risk management, facilitate a deposit taker staying within its risk appetite and promote its overall operational resilience. The requirements place the onus on the deposit takers to identify and protect themselves from operational threats and potential failures and to respond, adapt and recover from disruptive events in a timely manner while minimising the impact on delivery of critical operations.

Table O: Proposed operational risk management requirements for Group 1 deposit takers

#	Proposed outcome and requirement
	Outcome 1: Prudent operational risk management The deposit taker's board has a clear understanding of the operational risks that the deposit taker faces on an ongoing basis and must establish processes to detect, mitigate and respond to these risks.
1.1	The deposit taker's board must approve the deposit taker's operational risk management framework consistent with the requirements of this section.
1.2	The deposit taker must maintain a comprehensive assessment of its operational risk profile. To do so it must also: • maintain appropriate information systems to monitor operational risk • compile and analyse operational risk data • identify and document the processes and resources needed to deliver critical operations (including people, technology, information, facilities and service providers, the interdependencies across them, and the associated risks, obligations, key data and controls) • assess the impact of its business and strategic decisions on its operational risk profile and operational resilience, as part of its business and strategic planning processes, including in the implementation of new products and services.
1.3	The deposit taker must design internal controls that provide assurance to its customers and us that it is efficiently and effectively mitigating its operational risks to align with its risk appetite and comply with all prudential obligations.

#	Proposed outcome and requirement
1.4	The 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.
1.5	The 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.
1.6	A report on the results of testing the control environment must be provided to the deposit taker's senior managers. The issues identified during testing must be addressed in a timely manner
1.7	The deposit taker must notify us as soon as possible and, in any case, no later than 72 hours, after becoming aware of an operational risk incident that it determines to be likely to have a material financial impact on the deposit taker or a material impact on the ability of the deposit taker to maintain its critical operations. Materiality for operational incidents should be interpreted consistent with tolerance thresholds for critical operations.

Rationale

604. Our proposed operational risk management requirements seek to set out our minimum requirements for a deposit taker to document and assess its operational risk profile. They seek to ensure the baseline components of an operational risk management framework, including access to systems and data, identification of upstream and downstream dependencies, controls and regular review.

Q85	Do you have comments on our proposed operational risk management requirements for Group 1 deposit takers?

2.2 Material Service Providers (MSP)

605. The increasing use of third parties in the New Zealand financial sector, especially for the provision of critical operations, necessitates a greater regulatory focus. In the context of fostering operational resilience, it is important for us to understand how financial service providers identify, manage and mitigate the associated operational risk.

606. For the purposes of our proposed standard, we define MSPs as those "third-party service providers that provide critical operations to a deposit taker while MSP arrangements are the binding contractual agreements between the MSPs and the deposit taker." The term 'critical operations' is defined in section 1.4 above.

607. There is a separate proposed Outsourcing Standard being developed (based on BS11)[181] that aims to support recovery and resolution. Meanwhile, our proposed requirements relating to MSPs focus on supporting the operational resilience of deposit takers when utilising third-party service providers.

[181] Reserve Bank of New Zealand – Te Pūtea Matua. (2022). Outsourcing Policy (BS11). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs11-sept-2022.pdf

Preferred option

608. Our preferred option is to set out minimum requirements for the management of MSPs from an operational resilience perspective. Our proposed requirements for how Group 1 deposit takers manage their relationships with MSPs, which are outlined in Table P, reflect the increasing complexity and diversity of the arrangements deposit takers enter with suppliers.

609. The scope of our proposed requirements includes managing all stages of the service provider arrangement lifecycle (from initiation through to exit), which provides confidence of any arrangement's resilience to operational disruption. Our proposed requirements cover identification, assessment and ongoing management of service provider arrangements. They take a holistic approach to incentivise the development of the kinds of contingency arrangements required for deposit takers to be resilient to disruptions.

Table P: Proposed MSP requirements for Group 1 deposit takers

#	Proposed outcome and requirement
	Outcome 2: Comprehensive material service provider management The deposit taker has appropriate measures in place to oversee and manage the risks arising from the use of material service providers.
2.1	The deposit taker must maintain a board-approved service provider management policy that includes: • the identification and risk management of its MSPs • managing its MSP arrangements (for example, entry, monitoring and exit) • responsibilities for managing its MSP arrangements.
2.2	The deposit taker must maintain a register of its MSPs.
2.3	For each MSP arrangement, the deposit taker must: • conduct due diligence and regular risk assessment • ensure the associated BCP arrangements are practicable • ensure that orderly exit from the arrangement is practicable.
2.4	The deposit taker must notify us of new or material changes to existing MSP arrangements.
2.5	The deposit taker must conduct a risk assessment before providing a critical operation (and therefore a material service) to another party.
2.6	The deposit taker's internal audit must review any proposed MSP arrangement that involves the outsourcing of a critical operation.
2.7	The deposit taker's internal audit must provide reporting to the deposit taker's board (or board 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.

Rationale

610. Our proposed material service provider requirements seek to ensure that deposit takers are proactively considering and managing the lifecycle of arrangements with MSPs. This supports effective operational risk management by increasing the visibility of risk and promoting the establishment and documentation of appropriate mitigants.

611. Our proposed requirements seek to strike a better balance in the use of regulatory discipline in our prudential framework to support both certainty for deposit takers and clearer supervision. As it stands, we do not have clear requirements on how deposit takers must manage their service provider arrangements from a business-as-usual operational continuity perspective. This gap creates uncertainty for deposit takers and does not support credible supervision.

612. Our proposed MSP requirements do not duplicate the proposed Outsourcing Standard requirements that we are also developing. While the proposed Outsourcing Standard looks at outsourcing arrangements from a resolution perspective, our proposed MSP requirements seek to ensure that these types of arrangements are managed in a way that ensures operational continuity. Our proposed MSP requirements also include monitoring and managing the risks of service provider arrangements that do not fall under the definition of the term 'outsourcing' in the proposed Outsourcing Standard (such as services which the deposit taker cannot undertake itself). When it comes to preparing the standard, we will try to avoid any unnecessary change for deposit takers that are also required to comply with the Outsourcing Standard.

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?

2.3 Information and Communications Technology (ICT)

613. Risks relating to ICT systems from both non-malicious internal system failures and malicious external threats to these systems continue to grow. We have considered 2 options to address these risks. Option 1 is to rely on our existing Guidance on Cyber Resilience[182] and our cyber incident reporting requirements.[183] Option 2 is to set out minimum requirements relating to ICT risk management in this standard.

Preferred option

614. Our preferred option is to set out minimum requirements relating to ICT risk management to uplift the scope and provide enforceable requirements beyond our existing guidance (Option 2). We propose requirements relating to ICT systems in 6 areas:

- governance
- capacity building
- assurance and assurance audit
- information sharing
- third-party management
- notification obligations.

[182] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2021). Guidance on Cyber Resilience. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/cyber-resilience/guidance-on-cyber-resilience.pdf

[183] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Cyber Resilience Data Collection. https://www.rbnz.govt.nz/have-your-say/2023/cyber-resilience-data-collection

615. This approach builds off our existing Guidance on Cyber Resilience. Our proposed requirements (see Table Q) seek to align a Group 1 deposit taker's ICT strategy and framework with risk management processes (contained in the Risk Management Standard) while considering the risk profile of the entity.

616. We also propose to clearly set out the role of the board in providing oversight and approval of the deposit taker's ICT strategy and framework. Our overarching objective is to ensure that the framework clearly outlines the deposit taker's internal controls, covering at the minimum: user access management, patch and change management, backup management and incident management.

617. The proposals include explicit requirements on incident notification (similar to APRA's CPS 234)[184] and clarify our requirement to be informed if a material incident happens or a material information security control weakness is detected (similar to the existing material cyber incident reporting). We also propose requirements relating to system assurances on the effectiveness of controls and auditing of these assurances. The intent is to ensure that the deposit takers' board is reassured that the desired level of ICT system security is maintained.

618. We detail in Table R our proposed definitions of the terms 'information and communication technology' or 'ICT', 'material incident' and 'security' for the purposes of informing on the intended scope of the proposed requirements and guiding policy development.

619. We intend to continue to use our existing Guidance on Cyber Resilience to supplement our proposed ICT requirements and inform the drafting of this part of the standard.[185]

Table Q: Proposed ICT requirements for Group 1 deposit takers

#	Proposed outcome and requirement
	Outcome 3: Responsive ICT strategy The deposit taker has a board-approved ICT strategy that protects against risks to its ICT systems and ensures the security of its critical operations and information.
3.1	Governance The deposit taker must have an updated board-approved ICT strategy and framework. Directors and senior managers must have a sound understanding of the risks to the deposit taker's ICT systems, and the experience and resources to perform their required tasks required by the ICT strategy and framework effectively. The board-approved ICT strategy and framework must include information on the: • deposit taker's objectives for the ICT strategy and framework • responsibilities of the board and senior managers in managing the deposit taker's ICT risk • risk tolerance thresholds approved by the board, consistent with the board-approved risk appetite statement (see the Risk Management Standard)

[184] Australian Prudential Regulation Authority. (2019). Prudential Standard CPS 234 Information Security. https://www.apra.gov.au/sites/default/files/cps_234_july_2019_for_public_release.pdf

[185] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Cyber Resilience Data Collection. https://www.rbnz.govt.nz/have-your-say/2023/cyber-resilience-data-collection

#	Proposed outcome and requirement
	• deposit taker's ICT resilience targets and implementation plan • defining the ICT threats and the vulnerabilities information that must be reported to the board • responsibilities of all personnel in ensuring security of its ICT systems • level of awareness and skills required from all personnel to keep the deposit taker's ICT systems secure.
3.2	ICT systems and tolerance thresholds The deposit taker must set out its tolerance thresholds and the classification of all the elements in the deposit taker's ICT systems based on criticality. The processes to detect, monitor, respond to and recover from material incidents affecting the deposit taker's ICT systems must also be clear, adequately communicated throughout the deposit taker and appropriately enforced. These include processes relating to: • system accounts, access privileges, linkages across functions/elements and roster of key personnel that support the ICT system • security controls and monitoring • ICT system vulnerabilities assessments, including security controls effectiveness tests and assurances • detection of anomalous activities, reporting of these activities and analysis of the information collected.
3.3	Information security assurance and assurance audit The deposit taker must set out: • the processes that ensure that the information security control assurance is provided by personnel appropriately skilled in providing such assurance • the processes in assessing the information security control assurance provided by a related party or third party. The deposit taker must set out the qualifications of the personnel providing the assurance and the parameters considered in assessing the information security control assurance.
3.4	Information sharing The deposit taker must set out the channels, processes and protocols relating to information sharing and exchange. The information sharing processes cover all types of information and information transmission mechanisms that are available to all the personnel, communicated throughout the deposit taker and appropriately enforced.
3.5	Third-party service providers The deposit taker must set out its processes in vetting third-party service providers that will perform ICT functions for the deposit taker. The types of functions/activities that are outsourced and the information/data that the third-party service provider collects, stores and/or can access must be documented (see the Outsourcing Standard for the outsourcing functions/activities that are covered). The deposit taker must be comfortable with the potential risk associated with the prevailing practices including those related to data storage, processing and transmission as well as

#	Proposed outcome and requirement
	the potential jurisdictional and legal risk, compliance issues and oversight limitations associated with outsourcing.
3.6	Notification obligation The deposit taker must notify us as soon as possible and, in any case, no later than 72 hours, after becoming aware of a material ICT incident, and no later than 10 business days after it becomes aware of a material information security control weakness that the deposit taker expects it will not be able to remediate in a timely manner. We may request additional information from the deposit taker regarding the incident reported as a part of ongoing supervisory engagement relating to the incident.

Table R: Proposed definitions for ICT requirements

Term	Definition	Reference
Information and Communication Technology (or ICT)	Underlying physical and logical design of information technology and communication systems, the individual hardware and software components, data and the operating environments	BCBS (2021)[186]
Material ICT incident	An ICT event that materially affected, or had the potential to materially affect, financially or non-financially, the deposit taker or the interests of depositors, policyholders, beneficiaries or other customers	Material cyber incident reporting template/APRA CPS 234 (slightly modified to cover all ICT events)
Security	Freedom from those conditions that can cause loss of assets with unacceptable consequences	Financial Stability Board Cyber Lexicon 2023

Rationale

ICT requirements

620. Our proposed ICT requirements outlined in Table R above aim to promote the safety and soundness of Group 1 deposit takers by supporting the prudent management of ICT risks. Our proposals should be understood as minimum requirements and that they relate to the resilience of a deposit taker's ICT systems as a whole. The intent is to ensure that deposit takers have the appropriate practices in place to mitigate ICT risks and that the governance and accountabilities for those practices are clear to support the deposit taker's operational resilience.

621. We do not currently have specific regulatory requirements regarding the broader protection of ICT systems, including internal systems used in processing, exchanging and storing

[186] Basel Committee on Banking Supervision. (2021). Revisions to the Principles for the Sound Management of Operational Risk. https://www.bis.org/bcbs/publ/d515.pdf

information that are not linked to the cyber space. Our existing policy relevant to ICT systems focuses on cyber resilience, which can be perceived as only applying to risks that arise from malicious activities targeting ICT systems in the cyber domain (although our existing guidance is clear that the policy is not limited to malicious activities).

622. While we do not consider that there is a substantive difference in terms of how these risks will be managed from the expectations in our Guidance on Cyber Resilience, we consider that it is important to clarify the nature of the risks that the requirements will seek to mitigate. It is for this reason that we frame these requirements as ICT requirements rather than cyber requirements.

623. We further note that our Guidance on Cyber Resilience is not enforceable. It was put in place as a step in our evolving requirements in this space. However, we do not consider it to be credible to solely rely on guidance to manage the fast-evolving ICT risks. It is also not in line with international practice of having enforceable requirements to manage the ICT risks.

Definitions

624. Following Table R above, we propose to adopt the ICT definition used by the BCBS, since the intent of this standard is to support the security of a deposit taker's ICT system and the information that is stored, processed and transferred through that system. The BCBS's definition of ICT is consistent with our intent to cover data, information, technology and operating environment.[187]

625. In BCBS (2021),[188] the term 'ICT' is meant to include 'cyber' which our Guidance on Cyber Resilience defines as "relating to, within or through the medium of the interconnected information infrastructure of interactions among persons, processes, data and information systems," consistent with the definition in the Financial Stability Board's Cyber Lexicon.

626. For the definition of 'material ICT incident', we consider that adopting the definition of 'material cyber incident' in our cyber reporting requirements supports consistency in our regulatory approach.[189]

627. Finally, for the definition of 'security', we consider that the Financial Stability Board's definition is appropriate for the purposes of this standard, considering its broad applicability to any domain (see Table R).

Q87	Do you have comments on our proposed ICT risk management requirements for Group 1 deposit takers?
Q88	Do you have comments on our proposed definitions?

[187] This definition of ICT is in line with the Financial Stability Board's definition of 'Information System' as a "set of applications, services, information technology assets or other information-handling components, which includes the operating environment and networks." *See* Financial Stability Board. (2023). Cyber Lexicon. https://www.fsb.org/wp-content/uploads/P130423-3.pdf

[188] Basel Committee on Banking Supervision. (2021). Revisions to the Principles for the Sound Management of Operational Risk. https://www.bis.org/bcbs/publ/d515.pdf

[189] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Cyber Resilience Data Collection. https://www.rbnz.govt.nz/have-your-say/2023/cyber-resilience-data-collection

2.4 Business Continuity Planning (BCP)

628. Business continuity is vital in promoting operational resilience. The inability of deposit takers to manage their critical operations through business disruption events (for example, natural catastrophes, pandemics or disease outbreaks and cyber-attacks) can undermine the deposit taker's soundness. Depending on the nature of the event and the relative systemic importance of the individual deposit taker, these disruptions can also undermine the stability of the New Zealand financial system.

629. With this in view, we considered whether the current regulatory approach (that is, no explicit formal requirements) remains fit for purpose or to set out more concrete requirements relating to BCP.

Preferred option

630. Our preferred option is to set out clearer requirements relating to BCP to address the limitations of the current operational risk regulatory framework from an operational resilience perspective (see Table S). We propose to set out requirements relating to 5 areas:

- critical operations
- business continuity plan
- monitoring and reporting
- testing and review
- audit and assurance.

Table S: Proposed BCP requirements for Group 1 deposit takers

#	Proposed outcome and requirement
	Outcome 4: Robust BCP The deposit taker has a board-approved business continuity plan that enables it to maintain its critical operations through defined tolerance levels in the event of an operational disruption.[190]
4.1	The deposit taker must develop and maintain a board-approved business continuity plan, which sets out how the deposit taker would identify, manage and respond to a disruption outside tolerance thresholds. This plan must be regularly tested with severe but plausible scenarios.
4.2	The deposit taker's business continuity plan must include: • the register of critical operations and associated tolerance thresholds • triggers to identify a disruption to critical operations and prompt activation of the plan and arrangements to direct resources in the event of activation • actions it would take to maintain its critical operations within tolerance thresholds through disruptions • an assessment of the execution risks, required resources and preparatory measures, including key internal and external dependencies needed to support the effective implementation of the business continuity plan actions • a communications strategy to support the execution of the plan.

[190] The term 'critical operations' is defined in section 1.4.

#	Proposed outcome and requirement
4.3	The deposit taker must identify, and maintain, a register of its critical operations. Critical operations include but are not limited to transactional, savings and deposit accounts, credit services, payment clearing and settlement services.
4.4	For each critical operation, the deposit taker must establish board-approved tolerance thresholds, consistent with the deposit taker's risk appetite statement (required under the Risk Management Standard), for the: • maximum period of time the deposit taker would tolerate a disruption to the operation • maximum extent of data loss the deposit taker would accept as a result of disruption • minimum service levels the deposit taker would maintain while operating under alternative arrangements during a disruption.
4.5	The deposit taker must maintain the capabilities required to execute the business continuity plan, including access to people, resources and technology.
4.6	The deposit taker must monitor compliance with its tolerance thresholds and report any failure to meet tolerance thresholds, together with a remediation plan, to its board.
4.7	The deposit taker must have a systematic programme for testing its business continuity plan that covers all critical operations and includes an annual business continuity exercise. The testing must be tailored to the material risks facing the deposit taker and must test the effectiveness of the deposit taker's business continuity plan in a range of severe but plausible scenarios.
4.8	The deposit taker must review and update its business continuity plan on, at the minimum, an annual basis to reflect any changes in legal or organisational structure, business mix, strategy or risk profile. The plan must be updated for any shortcomings identified as a result of the review and testing of the business continuity plan.
4.9	The deposit taker's internal audit must review the business continuity plan no less frequently than every 3 years.
4.10	The internal audit function must provide periodic assurance to the deposit taker's board that the business continuity plan sets out a credible plan for how the deposit taker would maintain its critical operations within tolerance thresholds through disruptions, and that testing procedures have been conducted and are adequate.
4.11	The deposit taker must notify us as soon as possible and, in any case, no later than 72 hours, after activating its business continuity plan. The notification must describe the critical operations affected, the nature of the disruption, the action being taken, the likely impact on business operations and the expected timeframe to return to normal operations.

Rationale

631. Our proposed requirements for BCP outlined in Table S would contribute to the safety and soundness of each deposit taker by ensuring that they plan and have adequate policies and processes for business continuity in the event of a disruption. This contributes to the resilience and stability of the financial system by reducing the frequency and impact of operational disruptions that can impact other financial market participants.

Q89 Do you have comments on our proposed business continuity planning and management requirements for Group 1 deposit takers?

2.5 Analysis

632. Our status quo requirements do not provide sufficient clarity on our requirements for the prudent operational risk management to ensure the operational resilience of Group 1 deposit takers under the new regulatory regime of the DTA. This creates uncertainties for deposit takers because of the lack of clear requirements. It also does not support credible supervision of operational risk practice and our articulated desire to be a more modern prudential regulator.[191]

633. Our proposed requirements aim to address this issue and to support clear supervision and enforceability of our operational resilience requirements. We outline below our analysis across the proposed requirements for Group 1 deposit takers. Where appropriate, we also identify relevant DTA principles that we have considered in formulating our proposed requirements.

Approach

634. Our proposed requirements outlined in Tables O–S will promote the safety and soundness of Group 1 deposit takers through requiring practices to support their operational resilience. The proposed requirements, which should be understood as minimum requirements of good BCP management, aim to support the operational resilience and continuity of deposit takers. Compared to the status quo, they seek to strike a better balance in the use of regulatory discipline in our prudential framework to support both certainty for deposit takers and enable clearer supervision.

635. Our existing approach is not a credible alternative option. It does not set out clear requirements for deposit takers of how we expect them to undertake BCP from an operational continuity perspective. This creates uncertainty for deposit takers and does not support credible supervision.

636. Our approach balances the objective of fostering sound operational risk management practices while seeking to avoid unnecessary compliance cost in meeting the proposed requirements. We have done this through our hybrid principles-based approach to setting requirements, which enables flexibility for deposit takers to comply with the requirements in a manner that is suitable for the size and nature of their businesses in line with our Proportionality Framework.

637. APRA's CPS 230[192] and CPS 234 and revisions in the Basel Core Principles relating to operational resilience have also substantively informed our proposals. Our intent is to avoid inconsistency with international standards, where possible, while still ensuring the individual operational resilience of New Zealand deposit takers as well as the stability of the New Zealand financial system. Taking into account APRA's CPS 230 and CPS 234 supports consistency in our approach for deposit takers that are part of groups operating in both New Zealand and Australia, thereby minimising compliance costs.

638. We also framed the requirements with the intent of supporting enforcement with due consideration to their applicability to different types of deposit takers. We consider that these

[191] Hawkesby, C. and Prior, M. (2022). Our Transformation as a Prudential Regulator. A speech delivered to the Financial Services Council in Auckland on 22 September 2022 by Christian Hawkesby, Deputy Governor and General Manager Financial Stability, Reserve Bank of New Zealand. https://www.rbnz.govt.nz/hub/publications/speech/2022/speech2022-09-22

[192] Australian Prudential Regulation Authority. (2022). Prudential Standard CPS 230 Operational Risk Management. https://www.apra.gov.au/sites/default/files/2022-07/Draft%20Prudential%20Standard%20CPS%20230%20Operational%20Risk%20Management.pdf

requirements are detailed enough to facilitate effective enforcement but provide sufficient flexibility for deposit takers to comply with them in a manner that is suitable for the size and nature of their businesses.

Compliance

639. We have scoped information from publicly available sources (for example, company reports and websites) and utilised recent reviews to assess the cost of the compliance of the proposed requirements. We expect that Group 1 deposit takers should already be broadly compliant with our proposed requirements across the governance standard:

- Operational risk management: there is substantive alignment between BPR151's current requirements and our proposals. We assess our proposed requirements as being a clearer articulation of these requirements. We also consider it unlikely that the proposed standard would entail significant compliance costs and materially impact the level of competition amongst deposit takers.

  All the current Group 1 deposit takers are also subsidiaries of Australian-incorporated deposit takers that will be subject to APRA's CPS 230 when it enters into force, which sets out requirements that are consistent with our proposals. Thus, all Group 1 deposit takers will already be required to put in place policies and processes to meet requirements that are similar to our proposals.

- Material service providers: our initial assessment is that Group 1 deposit takers will already have some degree of MSP management policies and processes in place. This is based on existing requirements imposed by BS11, such as the requirement to assess all new outsourcing arrangements to determine whether they meet BS11 outcomes (a)–(d).[193]

  Furthermore, deposit takers that constitute part of an Australian banking group and are subject to APRA's CPS 231[194] will already have in place policies and processes to assess the materiality of outsourcing arrangements as part of their obligation to comply with CPS 231 on a group basis (to be replaced by CPS 230). Hence, we assess the additional compliance costs associated with the proposed MSP requirements to be low and consider it unlikely that they will have any material impact on the level of competition among deposit takers.

- Information and communication technology risk: we expect that Group 1 should already be substantively compliant with our proposed ICT requirements, in line with our Guidance on Cyber Resilience. The Australian banking groups of all the Group 1 deposit takers in New Zealand are also subject to APRA's CPS 234.

- Business continuity planning: Group 1 deposit takers should already have some degree of BCP policies and processes in place. Deposit takers that constitute part of an Australian banking group and have been subject to APRA's CPS 232 should already have in place

[193] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2022). Outsourcing Policy (BS11). https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs11-sept-2022.pdf

[194] *See* Australian Prudential Regulation Authority. (2017). Prudential Standard CPS 231 Outsourcing. https://www.apra.gov.au/sites/default/files/Prudential-Standard-CPS-231-Outsourcing-%28July-2017%29.pdf

policies and process to ensure robust BCP as a part of their obligation to comply with CPS 232 on a group basis (to be replaced by CPS 230).

640. While there may be some variation in existing practice, we anticipate the cost of compliance is likely to be low overall. To the extent that there are additional compliance costs, these are likely to relate to taking a more comprehensive approach to documenting policies and procedures.

Q90 Do you have comments on our analysis and cost of compliance assessment?

3 Proposed approach for Group 2 deposit takers

641. Our proposed requirements for Group 2 deposit takers cover the same 4 key areas outlined for Group 1 deposit takers in section 2: that is, operational risk management, MSPs, ICT and BCP.

Preferred option

642. We propose that our requirements for Group 1 deposit takers across all 4 key areas (as outlined in section 2, Tables O–S) apply to Group 2 deposit takers.

Analysis

643. Our proposed requirements for Group 2 reflect our view that the rationale explained above for setting out these requirements for Group 1 also applies to Group 2. The same DTA principles were also taken into account.

644. The hybrid principles-based approach that we took in setting out the requirements gives the deposit takers the flexibility to choose the way in which they achieve the outcomes. Thus, while we propose the same requirements for Group 1 and Group 2 deposit takers, we anticipate that the manner in which they will comply with the requirements will differ depending on their size and nature of their business, supporting diversity amongst deposit takers.

645. Compliance may require more resources relative to the size of Group 2 deposit takers than Group 1, but we anticipate that the cost for Group 2 will not be substantial. Group 2 deposit takers have notably fewer formal existing operational resilience requirements compared to Group 1. For example, among others:

- Group 2 deposit takers do not currently use the AMA approach for calculating operational risk and so are not required to comply with the qualitative requirements in BPR151 for operational risk
- most Group 2 deposit takers are not currently required to comply with any formal requirements relating to MSPs
- Group 2 deposit takers do not have existing formal BCP requirements.

646. However, despite limited formal existing requirements, the directors of all current Group 2 deposit takers are required to attest to having systems in place to monitor and control adequately the deposit taker's operational risk. All Group 2 deposit takers are also within the

scope of our Guidance on Cyber Resilience, which has heavily informed our proposed ICT requirements.

Q91	Do you have comments on our proposal to apply the same requirements for Group 1 deposit takers to Group 2?
Q92	Do you have comments on our analysis and cost compliance assessment for Group 2?

4 Proposed approach for Group 3 deposit takers

647. Our proposed approach so far maintains uniform operational resilience requirements for Group 1 and Group 2 deposit takers across the 4 key areas (operational risk management, MSPs, ICT and BCP, as outlined in section 2).

Preferred option

648. We propose that our requirements for Group 1 deposit takers across all 4 key areas (as outlined in section 2, Tables O–S) apply to Group 3 deposit takers.

Analysis

649. We proposed the same requirement for Group 3 deposit takers because we view that they face the same operational resilience risks as Group 1 and Group 2. We consider that the rationale in setting out the proposed requirements for Group 1 explained above applies to Group 3, taking into account the same DTA principles. Like Group 2, the hybrid principles-based approach taken allows Group 3 deposit takers to tailor their compliance to the same requirements in a manner that is suitable to their business, supporting a diversity amongst deposit takers.

650. We view that our cost of compliance assessment for Group 2 is applicable to Group 3. Ultimately, this depends on the state of the current practice. We note that Group 3 deposit takers have fewer formal, and less specific, existing operational resilience requirements. For example, among others:

- most current Group 3 deposit takers have high-level requirements relating to risk management, including operational risk, through requirements set out in the NBDT Act and the associated risk management and contingency planning guidelines for NBDTs[195]
- most current Group 3 deposit takers do not currently have formal requirements relating to material service providers.

651. However, like Group 2, the directors of the 2 banks captured within Group 3 are required to attest to having systems in place to monitor and adequately control the deposit taker's operational risk. All Group 3 deposit takers are also within the scope of our Guidance on Cyber Resilience, which has heavily informed our proposed ICT requirements.

[195] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2009). Risk Management Programme Guidelines for NBDTs. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/non-bank-deposit-takers/3697899.pdf

Q93	Do you have comments on our proposal to apply the same requirements for Group 1 deposit takers to Group 3?
Q94	Are there alternative options that we could consider to deliver the outcomes of the proposed Operational Resilience Standard?
Q95	Do you have comments on our analysis and cost compliance assessment for Group 3?

5 Proposed approach for branches of overseas deposit takers

Preferred option

652. We propose that our requirements for Group 1 deposit takers across all 4 key areas (operational risk management, MSPs, ICT and BCP, as outlined in section 2, Tables O–S) apply to branches.

Analysis

653. We set out our proposed requirements for branches with the view that the operational risks that branches face are not significantly different from those faced by locally-incorporated deposit takers. The discussion on the rationale of the proposed requirements, DTA principles and our hybrid principles-based approach in setting out the requirements above accordingly applies to branches.

654. We do not expect our proposed requirements to impose significant cost for branches even if their governance structure is different from locally-incorporated deposit takers. We note that references to a board-approved requirements must be read as requiring approval by the New Zealand Chief Executive Officer (NZ CEO) for branches.

655. Currently, branches have fewer formal existing operational resilience requirements than locally-incorporated deposit takers. For example, among others:

- branches do not currently use the AMA approach for calculating operational risk and so are not required to comply with the qualitative requirements in BPR151 for operational risk. However, they will also utilise the operational risk frameworks of their parent which, generally speaking, may be subject to more comprehensive requirements than we have currently applied
- most branches do not currently have formal requirements relating to MSPs in New Zealand
- branches do not have existing BCP requirements.

656. However, like locally-incorporated deposit takers, the directors of the parent entity of the branch and the NZ CEO of a branch are required to attest to having systems in place to monitor and adequately control the deposit taker's operational risk. All branches are within the scope of our Guidance on Cyber Resilience, which has heavily informed our proposed ICT requirements. The parents of all the branches in New Zealand are also domiciled in BCBS

jurisdictions, and we expect them to already have internationally accepted operational resilience practices in place for their groups.

Q96	Do you have comments on our proposed operational resilience requirements for branches?
Q97	Do you have comments on our analysis and cost compliance assessment for branches?

6 Conclusion

657. Our proposed Operational Resilience Standard seeks to achieve the purposes of the DTA by promoting the safety and soundness of all deposit takers in order to promote the stability of the New Zealand financial system.

658. Our proposed approach broadens our formal requirements for deposit takers' operational resilience (consistent with the purpose and principles of the DTA) and supports greater certainty in our supervisory approach. We assess that our proposals, which are framed in accordance with our Proportionality Framework, are reasonable requirements for sound operational risk management. This consultation is intended to test the feasibility of our proposals and the soundness of our views.

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 5

Deposit Takers Related Party Exposures Standard

Deposit Takers Non-Core Standards Consultation

21 August 2024

CONSULTATION PAPER

Non-technical summary

Regulating related party exposures helps address the risks to financial stability posed by a deposit taker providing services to individuals, businesses, or other entities who are related to the deposit taker. Such parties may be considered a 'related party' (examples include a director, a senior manager, or a close family member). Exposures to related parties can take a variety of forms, such as, loans, leases, deposits and other financial transactions.

Our proposed Related Party Exposures Standard covers how we intend to regulate these matters. In general, it will require deposit takers to enter transactions with related parties on the same terms as they would any other party and to comply with a maximum limit on the total exposures they have to related parties. The standard will replace both the existing requirements for registered banks under the Connected Exposures Policy (**BS8**)[196] and the requirements for NBDTs in the Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010 (the **NBDT regulations**).[197]

We reviewed BS8 between 2021 and 2023, and an updated version of BS8 came into force on 1 October 2023.[198] Although BS8 was not developed under the DTA, we reviewed and updated it with reference to the then Deposit Takers Bill (in anticipation of the DTA being passed) and to minimise implementation costs.[199] We consider that its purpose aligns with the DTA's main purpose and is a good starting point from which to proportionally develop the standard for each Group of deposit takers. Therefore, we have focused on 2 policy issues:

- what definition of "related party" the standard should use and whether we should use different definitions for each Group of deposit takers
- what requirements should apply to each Group of deposit takers.

We propose adopting BS8's definition of 'connected person' (and 'connected exposures') as the meaning of related party (and exposure) in the standard for all three Groups of deposit taker.

For Group 1 and Group 2 deposit takers, we propose adapting the current BS8 requirements because we reviewed them recently and consider that they are still appropriate in the context of the DTA.

For Group 3 deposit takers, we also propose applying the BS8 requirements and updating them to account for those deposit takers that would be exempt from having to have a credit rating as proposed in the Capital Standard (by treating them as if they had a credit rating of BBB+/Baa1 or below). We propose that the standard aligns with final policy decisions regarding the Capital Standard's position on whether to allow Group 3 deposit takers to net their exposure.

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[196] Reserve Bank of New Zealand – Te Pūtea Matua. (2023, October). BS8 Connected Exposures Policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs8-connected-exposures-policy-oct-2023.pdf

[197] Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) regulations 2010. https://www.legislation.govt.nz/regulation/public/2010/0167/latest/DLM3032713.html?src=qs

[198] Reserve Bank of New Zealand – Te Pūtea Matua. (2023, September). Review of the Connected Exposures policy for banks. https://www.rbnz.govt.nz/have-your-say/2021/review-of-the-connected-exposures-policy-for-banks

[199] Reserve Bank of New Zealand – Te Pūtea Matua. (2023, October). Review of Connected Exposures Policy Response to Submissions. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/consultations/connected-exposures-summary-of-submissions.pdf

1 Introduction

659. Related party exposures are a deposit taker's exposures to natural or legal persons who are related to the deposit taker, its directors or its management. Examples include a deposit taker's owners, other entities over which a deposit taker's owners may have significant influence, or the close relative of a deposit taker's CEO.

660. These exposures can arise out of a variety of different arrangements, such as loans, leases, deposits, investments (which include investments in equities and bonds issued by related parties), undrawn lines of credit, bank guarantees of a related party's obligations to third parties and financial contracts (such as derivatives) with related parties. In principle, any transactions and arrangements that deposit takers enter into with related parties are considered related party exposures.

661. The proposed standard will require deposit takers to measure their exposures to related parties and limit the size of their total related party exposures in relation to their capital. We are satisfied the proposed requirements set out in this chapter are necessary or desirable:

- to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system
- to promote the safety and soundness of each deposit taker
- to promote public confidence in the financial system.

1.1 Purpose of the Related Party Exposures Standard

662. The proposed standard aims to address the potential conflict of interest and large exposure risks inherent in a deposit taker entering into any transaction or arrangement with a related party. Regulatory intervention can achieve this by stipulating that exposures to related parties must not be on more favourable terms than corresponding exposures to non-related parties and limiting deposit takers' total exposures to related parties.

663. A deposit taker's related parties might take advantage of their position to access credit that could endanger the deposit taker's capital, its overall soundness, and even the stability of the financial system. Such risks could crystallise if, for example, a related party faces financial difficulty themselves and this consequently exposes the deposit taker to potential losses. The proposed standard also aims to address the risk that a deposit taker might be unduly influenced by a related party, which could compromise the deposit taker's ability to assess the costs and benefits of transacting with that related party in an objective and independent manner.

664. Principle 20 of the Basel Core Principles recommends regulatory measures to address the risk of conflicts of interest to prevent abuses arising in transactions with related persons. Specifically, it states:

> *To prevent abuses arising in transactions with related parties and to address the risk of conflicts of interest, the supervisor requires banks to: enter into any transactions with related parties on an arm's length basis; monitor these transactions; take appropriate steps*

to control or mitigate the risks; and write off exposures to related parties in accordance with standard policies and processes.[200]

665. By regulating exposures to related parties, the standard will promote safety and soundness of each deposit taker This will promote the stability of the financial system and public confidence in it, specifically through preventing erosion of capital that might otherwise occur via improper or too large exposures to related parties, and by supporting the good governance of the deposit taker.

1.2 Current approach

666. Our proposals use the term related party even when some concepts are drawn from the current "connected person" definition for banks or the current "related party" definition for NBDTs.

Current requirements for banks

667. The equivalent related party exposures requirements for banks are currently outlined in the Connected Exposures Policy (BS8).[201] BS8 applies to locally-incorporated registered banks through their Conditions of Registration, and sets out:

- the definition of a connected person
- requirements to monitor transactions with connected persons
- requirements on conduct and systems and controls – particularly in relation to unusually favourable contract terms with connected persons
- requirements on how to calculate a banking group's exposure to connected persons
- limits on the permitted size of the aggregate connected exposures relative to the banking group's Tier 1 capital and credit rating.

668. In this context 'banking group' is intended to capture the deposit taker and any subsidiaries (including any entity that might be classified as a subsidiary for financial reporting purposes).

669. BS8 sets requirements for credit risk mitigation and netting arrangements for calculating net exposures (consistent with the treatment of netting in our current capital adequacy requirements).[202] The exposure limit is on a net basis across aggregate exposures of the banking group to all connected persons[203] and is calculated as a percentage of Tier 1 capital.

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[200] Basel Committee on Banking Supervision. (2023). Consultative document Core principles for effective banking supervision, p 54. https://www.bis.org/bcbs/publ/d551.pdf

[201] Reserve Bank of New Zealand – Te Pūtea Matua. (2023, October). BS8 Connected Exposures Policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs8-connected-exposures-policy-oct-2023.pdf

[202] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2024). BPR131 Standardised Credit Risk RWAs. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr131-standardised-credit-risk-rwas-apr-24.pdf
and Reserve Bank of New Zealand – Te Pūtea Matua. (2023). BPR132 Credit Risk Mitigation. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr132-credit-risk-mitigation-oct-23.pdf

[203] This includes both bank and non-bank connected person exposures.

670. Connected persons are intended to include a person 'A' if:

- A is a director or senior manager of the registered bank or of any person who has control of the registered bank
- A is a close family member of a director or senior manager of the registered bank or of any person who has control of the registered bank
- A is a subsidiary of the registered bank
- A has control of the registered bank
- A has significant influence over the registered bank
- the registered bank has control of A
- the registered bank has significant influence over A
- a director of the registered bank has control of A
- any other person who has control of the registered bank has either control of or significant influence over A or
- any other person who has significant influence over the registered bank and has control of A.

671. Although it is a net limit, banks may choose to use gross exposure in calculations as a conservative alternative; that is, they have the option not to apply netting calculations. The applicable aggregate limit is then contingent on a bank's credit rating as per Table T below. For example, an A+ rated bank would be compliant if it lent amounts equivalent to 60% of its group Tier 1 capital to all connected persons, but no more.

672. The limits in Table T have been in place since 2003. They were set based on:

- the principle that limits should be a function of a bank's financial strength, as proxied by its credit rating
- a consideration of the profile of the implied entity default rates (based on each rating level within the table)
- a desire to keep the limit framework simple.

673. This resulted in a steadily reducing maximum exposure limit as we move down the table to lower credit ratings. When we reviewed BS8 in 2021–2023, we assessed the appropriateness of the net exposure limits based on banks' estimates provided during the consultation process and compared the estimates against banks' survey returns data. Banks' estimates indicated that the October 2023 changes were unlikely to make significant changes to the banks' net exposure amounts. Hence, we decided to maintain the limits set out in Table T.

674. In addition to the aggregate limit, the total of all exposures to "non-bank connected persons" must not exceed 15% of the banking group's Tier 1 capital. Therefore, in addition to meeting the 60% limit, an A+ rated bank would be compliant if it lent amounts equivalent to 15% of its group Tier 1 Capital to connected persons that are not banks, but no more. We will publish a list of approved credit rating agencies under the DTA on our website. The credit rating

requirements for the Related Party Exposures Standard will be aligned with the Capital Standard.

Table T: BS8 aggregate credit exposures limits[204]

Credit rating[205]	Connected exposure limit (% of the Banking Group's Tier 1 capital)[206]
AA/Aa2 and above	75
AA-/Aa3	70
A+/A1	60
A/A2	40
A-/A3	30
BBB+/Baa1 and below	15

Current requirements for NBDTs

675. The equivalent related party exposures requirements for NBDTs are currently outlined in the NBDT regulations.[207]

676. The NBDT Act defines "related party" and this definition is used in the NBDT regulations. This definition differs from BS8's definition of "connected person". These differences are discussed in section 2.1 below.

677. Part 4 of the NBDT regulations requires every NBDT and trustee to ensure that the NBDT's trust deed sets a limit on aggregate gross exposures to related parties.[208] The limit must be expressed as a ratio of related party exposures to capital, and it cannot exceed 15%, although the limit can be set lower by the trustee supervisor. NBDTs are required to obtain a credit rating (unless exempted) but the 15% maximum limit is not rating-contingent – in contrast to existing bank requirements. Details on determining capital and calculating the ratio are set out in the NBDT regulations.

678. Our guidance on risk management requirements for NBDTs are set out in our Risk Management Programme Guidelines.[209] These guidelines cover managing transactions with related parties and conflicts of interest.

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[204] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2023, October). BS8 Connected Exposures Policy, p. 6. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs8-connected-exposures-policy-oct-2023.pdf

[205] The rating scales in this column are presented as "Standard & Poor's scale/Moody's Investor Services scale", noting that Fitch Ratings' scale is identical to Standard & Poor's.

[206] The aggregate credit exposures of the banking group to all connected persons must not exceed the rating-contingent limit outlined in the matrix at the end of each working day.

[207] Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010. https://www.legislation.govt.nz/regulation/public/2010/0167/latest/DLM3032713.html?src=qs

[208] Non-bank Deposit Takers Act 2013, part 1, section 6 Related party defined. https://www.legislation.govt.nz/act/public/2013/0104/latest/DLM3918991.html

[209] *See* sections 10(1)(f) and (g) https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/non-bank-deposit-takers/3697899.pdf

1.3 Proposed policy development approach

679. We reviewed BS8 between 2021 and 2023, and an updated version of BS8 come into force on 1 October 2023.[210] Although BS8 was not developed under the DTA, we reviewed and updated it with reference to the then Deposit Takers Bill (in anticipation of the DTA being passed).[211] We consider that BS8 achieves the DTA's purpose of protecting and promoting the stability of the financial system as it effectively addresses the conflict of interest risk inherent in a deposit taker transacting with its related parties. BS8 provides a strong foundation to promote the safety and soundness of each deposit taker and promote public confidence in the financial system.

680. We propose that Group 1 and Group 2 deposit takers be subject to the same requirements while Group 3 deposit takers have a proportionally adjusted version of those requirements. We consider this is desirable to have consistent treatment of similar institutions (that is, Group 1 and Group 2 deposit takers) and to avoid unnecessary compliance costs.

681. BS8 also aligns with Principle 20 of the Basel Core Principles; alignment with the Basel Core Principles was one of the recommendations made in the IMF 2017 FSAP review of New Zealand. We also consider it desirable to take account of international standards in general. Therefore, with this FSAP review in mind, we consider that BS8 is a good basis for the proposed standard (with further tailoring for Group 3 deposit takers).

682. We consider it desirable to have a single, clear and consistent definition of related party across all Groups of deposit takers because it:

- supports consistency of treatment of similar institutions
- avoids unnecessary compliance costs for Group 1 and Group 2 deposit takers (by not changing a definition that has only recently been amended)
- supports comparability across deposit takers which:
    - assists depositors to understand the comparative risk of different deposit takers
    - maintains competition within the deposit-taking sector.

683. This means we have focused on two main policy issues:

- what definition of "related party" should the standard use, considering the different definitions currently applying under the bank and NBDT regimes
- how should we account for proportionality when carrying over BS8 into the standard?

[210] Reserve Bank of New Zealand – Te Pūtea Matua. (2021). Review of the Connected Exposures policy for banks. https://www.rbnz.govt.nz/have-your-say/2021/review-of-the-connected-exposures-policy-for-banks

[211] Reserve Bank of New Zealand – Te Pūtea Matua. (2023). Review of Connected Exposures Policy, Response to Submissions. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/consultations/connected-exposures-summary-of-submissions.pdf

2 Proposed approach for Group 1 deposit takers

2.1 Definition of a Related Party

684. As noted earlier, BS8 uses "connected person" and "connected exposures" while the NBDT regulations use "related party" and "related party exposures". We will use the term related party in the standard and in this analysis, even when some concepts are drawn from BS8.

Preferred option

685. We propose that the definition of a related party for Group 1 deposit takers is as adapted from the current connected person definition in BS8, (see paragraph 11 above).

Analysis

Proportionality Framework

686. When applying the Proportionality Framework to the BS8 definition of connected person we conclude that it is both 'strong' and 'comprehensive'. We think a strong and comprehensive approach is appropriate for the largest entities and that continuing to apply the current BS8 definition is a proportionate approach for Group 1.

Costs and benefits

687. We also considered whether the BS8 connected person definition could be improved by taking into account aspects of the NBDT regulations' definition of related party. For a full analysis of the differences see the Group 3 deposit takers' analysis section later in this chapter. In summary, BS8 and the NBDT regulations' definitions differ in four main ways:

- BS8 captures a narrower set of family members of directors and senior managers than the NBDT regulations
- BS8 captures entities controlled by a director whereas the NBDT regulations do not
- the NBDT regulations capture entities where there is a 40% overlap in membership of their boards whereas BS8 does not
- the NBDT regulations have a lower threshold for what constitutes a 'substantial interest' compared to BS8's threshold for 'significant influence' and 'control':
    - BS8 defines 'significant influence' broadly as exercising 25% of voting rights (or power to appoint 50% or more of the board of directors). 'Control' is based on 50% of voting rights (or power to appoint 50% of more of the board of directors).
    - For NBDTs the threshold for having a 'substantial interest' in an entity is broadly controlling (directly or indirectly) 10% of voting rights (or otherwise controlling 25% or more of the composition of the governing body).

688. Although the BS8 definition is wider than the NBDT regulations in some respects, such as capturing entities controlled by a director, it is narrower in others – such as the higher threshold for significant influence versus substantial interest. BS8 is also narrower in terms of family members of directors and senior managers captured (provided that the directors or

senior managers are themselves captured), and in not containing a clause related to 40% overlap of governance bodies.

689. Consultation on BS8 revealed that a wide definition of family member would result in the capture of too broad a group of people, particularly for large banking groups, making it effectively unworkable because of excessive compliance costs (relative to the benefits). In the BS8 consultation we concluded that a narrower definition of family member was sufficient to meet the policy objectives of avoiding concentrated exposures and managing potentially abusive contracts.[212]

690. Following the review of BS8, the BS8 definition includes those entities controlled by a director of the registered bank as connected persons (see paragraph 682 above). This inclusion was made deliberately to respond to one of the recommendations made in the IMF's 2017 FSAP report[213] and to align with Principle 20 of the Basel Core Principles.[214] We consider it desirable to respond to international standards.

691. The NBDT regulations' requirement to include related parties with 40% of overlapping governance bodies would, in theory at least, increase the number of entities captured relative to BS8. However, this would only happen if the relevant entities had overlapping governance bodies but no other connections, such as an ownership relationship, which would bring the party within the definition of related in any case. We view this criterion as conceptually similar to widening the definition of family member and consider that the feedback on that proposal received in the BS8 consultation could be equally applicable to including an overlapping governance criterion.

692. Entities where control of voting rights is in the specific range 10% to 24% of total votes would be captured in the NBDT regime (substantial interest) but excluded from BS8 (significant influence). We do not view the inclusion of this lower range as essential to achieving the policy intent of BS8 or the purposes of the DTA for Group 1.

693. We propose to carry over the current BS8 connected person definition adapted into the standard as the meaning for related party for Group 1 deposit takers. This means we will:

- keep the narrower BS8 definition of family member for the standard
- keep BS8's inclusion of entities controlled by a director
- not include the NBDT regulations' 40% overlap criterion
- keep the BS8 concept of significant influence.

694. An additional advantage of this approach is to avoid unnecessary compliance costs by adapting the current BS8 connected person definition to suit the DTA rather than changing the definition so soon after the comprehensive review and implementation of BS8. We note that the definition of 'significant influence' being adapted from BS8 is different from

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[212] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2023). BS8 Review of Connected Exposures Policy Summary of Submissions and Final Decisions, section 4. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/consultations/connected-exposures-exposure-draft-response-to-submissions.pdf

[213] *See* International Monetary Fund. (2017). New Zealand Financial System Stability Assessment, p 72, Table 2. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/fsap/new-zealand-fsap-2016-fssa.pdf

[214] Basel Committee on Banking Supervision. (2023). Consultative document Core principles for effective banking supervision, p 54. https://www.bis.org/bcbs/publ/d551.pdf

'significant influence' at section 39 of the DTA[215] (in particular, BS8 does not use 'specified person' in relation to influence exercised jointly). This was a deliberate choice in the 2023 formulation of BS8 to reduce the compliance burden.

Summary

695. Our preferred option for Group 1 deposit takers is to base the related party definition on the BS8 connected person definition. We consider this remains proportional to the risks Group 1 deposit takers pose to financial stability. Additionally, the current BS8 definition aligns with international standards.

2.2 Exposure limits and risk management

Preferred option

696. We propose carrying over the BS8 requirements for Group 1 deposit takers, including:

- quantitative limits on net exposure (as in Table T)
- netting in exposure calculations and associated technical requirements
- preventing abuses in transactions with related parties: that is, contracts and transactions must not be on more favourable terms than for non-related parties.

Analysis

Proportionality Framework

697. When applying the Proportionality Framework to the current BS8 requirements we conclude that it is both Strong and Comprehensive, as we did for the BS8 definition of connected person earlier. We think a 'strong and comprehensive' approach is appropriate for the largest entities. Therefore, we consider carrying over the BS8 requirements to a Related Party Exposures Standard is adequate for Group 1 deposit takers.

Costs and benefits

698. As part of the BS8 review we made a number of changes, for example, around the requirements on netting and the removal of the gross limit. We considered whether any of the changes could lead to greater risks to financial stability and concluded that the remaining risks are sufficiently addressed by the netting requirements in our capital adequacy requirements. This in turn gave us confidence that the gross limit was no longer required. The net limit on connected exposures instead acts as a safeguard to reduce the risks associated with connected exposures. Therefore, we consider that BS8 still meets the purposes of the DTA by protecting and promoting financial stability.

699. In addition, BS8 clarifies a bank's responsibility to have effective systems and controls in place to manage conflicts of interest, and to ensure that credit exposures to connected persons are neither contrary to the interests of the banking group nor on more favourable terms than corresponding exposures to non-connected persons (not 'abusive'). These requirements also contribute to deposit takers' sound governance.

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[215] Deposit Takers Act 2023, section 39. https://legislation.govt.nz/act/public/2023/0035/latest/LMS469449.html

700. During consultation on BS8, we gave weight to submitters' concerns on the compliance burden. Avoiding change so soon after implementing an updated policy also avoids unnecessary compliance costs. Therefore, the compliance costs of maintaining the policy substance of BS8 in a DTA standard remain acceptable for Group 1 deposit takers.

701. The review of BS8 responds to Principle 20 of the Basel Core Principles and one of the recommendations made in the IMF's 2017 FSAP review. This remains the case if we keep the substance of BS8 in the proposed Related Party Exposures Standard and we consider it desirable to respond to international standards on this matter.[216] Risks to the stability of the financial system and broader economy are in part managed by our proposal's requirements for deposit takers to manage their exposures prudently with regard to related parties for each entity. This included managing the aggregate exposure to related parties, and ensuring the terms of contracts with related parties are not unduly favourable to those related parties and therefore detrimental to the regulated entity. It helps each deposit taker to improve individual soundness and in aggregate the stability of the financial system.

Summary

702. By managing exposures to related parties, the standard will promote the main purpose of the DTA through preventing erosion of deposit takers' capital that might overwise occur through exposure to related parties, as well as supporting the overall good governance of deposit takers.

703. In reaching this conclusion, our central focus has been to ensure that the existing set of BS8 policy settings will deliver the main purpose of the DTA. We are confident that this is the case.

Q98	Do you agree with the proposed approach for Group 1 deposit takers?
Q99	Are there any developments or changes since our BS8 review that we should be aware of?

3 Proposed approach for Group 2 deposit takers

Preferred option

704. Our preferred option for Group 2 deposit takers is to apply the same requirements as proposed for Group 1 deposit takers. That is to use the same definition of related party based on BS8's connected person definition and to carry over the current requirements of BS8.

Analysis

705. Group 2 deposit takers are less systemically important than Group 1 deposit takers and do not have the same interconnectedness with other financial service providers. However, Group 2 deposit takers do have the potential for sectoral or regional importance and service specific markets. For the smaller deposit takers in Group 2, systemic importance is likely to be relevant primarily in terms of potential concentration in the relevant sector, region or market served.

[216] For a proposed standard applying to New Zealand-incorporated deposit takers, DTA principle 4(d)(i) relates to overseas supervisors (including of holding companies) in Australia, China, India, and The Netherlands. These countries are all committee members of the Basel Committee on Banking Supervision (BCBS), which indicates their regulatory regimes will also have regard to the full range of Basel Core Principles.

However, even smaller deposit takers can pose contagion risks for the wider financial sector during a crisis. Therefore, we consider Group 2 deposit takers to pose risks to financial stability and that the same requirements we propose for Group 1 deposit takers are likely appropriate.

706. When applying the Proportionality Framework to BS8 we conclude that it is both strong and comprehensive. In the context of related parties, we think a strong and comprehensive approach is appropriate for Group 2 entities. Therefore, we consider it proportional and desirable to continue to apply the BS8 requirements to Group 2 deposit takers. This means we will apply the same requirements as we propose for Group 1 deposit takers; refer to our analysis for Group 1 deposit takers in section 2 which we consider is also applicable to Group 2 deposit takers. To the extent that Group 2 entities have fewer connected persons in total and may not use certain calculations such as netting of eligible credit mitigations, compliance costs for Group 2 may be somewhat lower than for Group 1.

707. By applying the same Group 1 requirements to Group 2 deposit takers, the BS8 approach ensures consistent treatment across institutions and allows for a level playing field for competition.

Summary

708. In summary, our preferred option implies no change in the compliance costs imposed on Group 2 deposit takers while ultimately maintaining meaningful benefits to financial stability, as well as being proportional to the risks posed by them. This is supported by the analysis and rationale provided for Group 1 deposit takers to use the same definition of related party based on BS8's connected person definition (see section 2.1) and to carry over the requirements of BS8 (see section 2.2).

Q100	Do you agree with the proposed approach for Group 2 deposit takers?

4 Proposed approach for Group 3 deposit takers

709. In this section we propose our approach for Group deposit takers. Firstly, we propose using the same definition of related party for Group 3 deposit takers as is proposed for Group 1 and Group 2 deposit takers. Secondly, we propose carrying the BS8 exposure limits and risk management requirements to Group 3 deposit takers. Thirdly, we seek feedback on whether Group 3 deposit takers would benefit from the ability to use net rather than gross exposures, compared to being required to use the gross exposure measurement.

4.1 Definition of a Related Party

710. We consider the definition of a related party for Group 3 deposit takers to be a choice between two options:

- Option A – the BS8 "connected person" definition (currently applicable to banks and our preferred option for Group 1 and Group 2 deposit takers)
- Option B – a hybrid definition of the BS8 "connected person" definition and the NBDT regulations' "related party" definition (as currently applicable to NBDTs). This hybrid definition would allow some parts of the NBDT regulations' definition to be incorporated into the BS8 definition.

Preferred option

711. As discussed under section 1.31.3 Proposed policy development approach, our preference is for all deposit taker Groups to have a single, clear and consistent related party definition in the standard. This means our preferred option is Option A, to apply the BS8 connected person definition to Group 3 deposit takers under the standard.

Analysis

712. The key differences in definitions between BS8's connected person and the NBDT regulations' related party definitions are outlined in Table U below. Option B would involve merging these differences with the BS8 definition to form a hybrid definition. The four main differences are:

- BS8 captures a narrower set of family members of directors and senior managers than the NBDT regulations
- BS8 captures entities controlled by a director whereas the NBDT regulations do not
- the NBDT regulations capture entities where there is a 40% overlap in membership of their governance bodies whereas BS8 does not
- the NBDT regulations have a lower threshold for what constitutes a "substantial interest" compared to BS8's threshold for "significant influence" and "control" (see paragraph 687 for more detail).

Proportionality Framework

713. Group 3 deposit takers are relatively less systemically important compared to Group 1 and Group 2 deposit takers and do not have the same level of interconnectedness with other financial service providers. However, Group 3 deposit takers do have the potential for sectoral or regional importance and service specific markets. For Group 3 deposit takers, systemic importance is likely to be relevant primarily in terms of potential concentration in the relevant sector, region or market served. However, even smaller deposit takers can pose contagion risks for the wider financial sector during a crisis.

714. We consider that the four main differences between the current BS8 and NBDT regulations' definitions when taken in aggregate do not represent a significant difference in the Strength or Comprehensiveness dimensions. We conclude that both Option A and Option B are both Strong and Comprehensive. We believe that either Option A or Option B could be proportionate to apply to Group 3.

Table U: Comparison of BS8's connected person versus the NBDT regulations' related party

Are the following included in the definitions?	BS8's connected person	The NBDT regulations' related party
An owner (defined via "significant influence" or "substantial interest")	✓ ("significant influence")	✓ ("substantial interest")
An owner (defined via control or substantial interest)	✓	✓

Are the following included in the definitions?	BS8's connected person	The NBDT regulations' related party
Indirect owners	✓	✓
Entities in which an owner has a substantial interest, or significant influence	✓	✓
Respectively: Directors of the registered bank; or of the NBDT or an NBDT's guaranteeing subsidiaries	✓	✓
Respectively: Senior managers of the registered bank or of the NBDT	✓	✓
Entities (not otherwise connected) controlled by a director of the registered bank or NBDT	✓	X
A spouse or child under the age of 20 of director or senior manager of the registered bank, NBDT, or its owners	✓	✓ But restricted to relatives of the NBDT's (or guaranteeing subsidiaries') director or senior manager
Director or senior manager of an entity that controls the regulated entity	✓	✓
Director or senior manager of an entity that is an associated person	✘ But controlling entity directors, senior managers are captured	✘
Sibling, parent, stepparent of a relevant director or senior manager or of their spouse	✘	✓
Entity which shares 40% of individuals on the governing body with the registered bank or NBDT	✘	✓

Costs and benefits

715. The first main difference between the BS8 and NBDT regulations definitions is BS8's narrower definition of 'family member'. The role of, and exposure to, individual natural persons may be relatively greater for Group 3 deposit takers than for Group 1 and Group 2 deposit takers

because of their smaller size and more local customer base. However, on balance we consider that the proposed BS8-based definition adequately manages the risks to financial stability posed by Group 3 deposit takers, reduces compliance costs for them and has the advantage of consistent treatment for all Groups.

716. The second main difference is that the requirements in BS8 around additional entities controlled by a director of the NBDT could increase the number of entities captured and aggregate exposure relative to the NBDT regulations. However, we do not consider this to be overly onerous for Group 3 deposit takers to administer. Our analysis of data provided to us by NBDTs suggests that their current related party exposures have been substantially below 15% in recent years. This means there is scope for exposures to increase while remaining below the 15% maximum limit. In addition, the three other proposed changes will reduce calculated exposures, which will have an offsetting effect. The communication with directors and gathering of information on entities they control appears feasible for all Groups of deposit takers.

717. The third main difference, the removal of related parties with overlapping governance bodies, has the effect that, in theory at least, the number of entities captured decreases. This would only apply if the relevant entities had overlapping governance bodies but no other connections such as an ownership relationship (resulting in control or significant influence).

718. The fourth difference relates to whether an owner is defined via a substantial interest versus significant influence. Entities where control of voting rights is in the specific range 10% to 24% of total votes are currently captured in the NBDT regime (substantial interest) but excluded from BS8 (significant influence). We do not view the inclusion of this lower range as essential to achieving the policy intent of the standard for Group 3.

Summary

719. Overall, we consider that the impact of these four main differences do not indicate any significant difference in the benefits to financial stability between Options A or B. Moving to either option would require one-off costs as Group 3 deposit takers adopt the new definition. We expect the overall long-run compliance costs would be lower under Option A than Option B. Applying our Proportionality Framework does not suggest that one option should be preferred strongly over another. Therefore, we consider that the consistent treatment of similar institutions and avoiding the unnecessary compliance costs associated with having different definitions support our preference for Option A.

Q101	Do you agree with the preference for Option A, that is, adopting the BS8 definition?
Q102	Do you agree that not continuing to include governance bodies 'overlapping by 40%' as part of the definition of related party is reasonable in light of the risks the standard seeks to manage?
Q103	Do you consider the inclusion of entities controlled by a director of the NBDT will result in aggregate exposures that remain within the 15% limit?

Q104	Do you agree the definition of family member, and adjusted thresholds for 'significant influence' and control are reasonable in light of the risks the standard seeks to manage?

4.2 Exposure limits, netting exposures and risk management

720. Aside from the definition of a related party, the remaining considerations are the appropriate exposure limits, whether or not to allow netting of exposures and the appropriate risk management approach for Group 3. Broadly, we propose aligning requirements with BS8, as we have proposed for Group 1 and Group 2. However, we have considered two options in relation to how the netting of exposures to connected parties is handled:

- Option C – aligning with BS8, including allowing the option to use net exposures
- Option D –aligning with BS8, but not allowing the option to use net exposures.

Preferred Option

721. On the use of netting, our preferred approach is to align the Related Party Exposures Standard with the Capital Standard. In the recent Core Standards consultation, we sought feedback on how credit risk mitigation for Group 3 deposit takers should be treated in the Capital Standard. One idea included in the Capital Standard consultation was to consider removing credit risk mitigation for the purposes of simplification and we noted that this may affect the use of netting of exposures. Based on the feedback we receive; we will reach a decision for the approach to credit risk mitigation and the implications for netting for the Capital Standard and then propose applying that approach to the Related Party Exposures Standard. We think it is important that the issue of netting for Group 3 deposit takers is aligned with the overarching proposal under the Capital Standard and feedback during the BS8 review supported this (albeit the review was oriented to Group 1 and Group 2). Our conclusion was that BS8 should use the same netting requirements as the applicable capital adequacy policy and that it is appropriate to apply the same for Group 3 deposit takers regarding the Related Party Exposures Standard.

Analysis

722. In our analysis we compare the options with the NBDT regulations as assessed against the DTA. Our analysis focuses on the three main differences (excluding the definition of a related party) between the NBDT regulations and Options C and D. In summary they are:

- quantitative limits on net exposure
- netting in exposure calculations and associated technical requirements
- preventing abuses in transactions with related parties.

Proportionality Framework

723. We compare Option C and Option D and the NBDT capital regulations against the Proportionality Framework's dimensions of strength and comprehensiveness. Note Option C is effectively an adaptation of BS8 which we conclude is both strong and comprehensive.

724. We consider both options and the NBDT regulations as strong. The NBDT regulations are strong because they apply a strict maximum exposure limit of 15%. Option C and D allow higher maximum exposure limits for deposit takers rated above BBB+/Baa1. However, no current members of Group 3 hold a credit rating above BBB+/Baa1 – so Options C and D and the NBDT regulations would lead to the same exposure limit. Option C and Option D additionally explicitly exclude transactions on unusually favourable terms.

725. We consider the NBDT regulations and Option D to be simpler than Option C because they only allow for gross exposure with no option to apply complex net exposure methods ('simple' on the comprehensiveness dimension). This makes their requirements marginally simpler by removing what otherwise might be extraneous detailed requirements for Group 3 deposit takers; however, the change is marginal as all entities have the option not to use netting under Option C.

Costs and benefits

Quantitative limits on net exposure

726. Options C and D would apply the maximum exposure limits in BS8 to Group 3 deposit takers. We find that this would result in effectively little change compared to the current NBDT maximum exposure limit of 15%. Currently no NBDT has a credit rating above BBB+/Baa1 and so under either Option C or Option D the maximum exposure limit would remain at 15% as shown in Table V. Note that some NBDTs are exempt from the requirement to obtain a credit rating, and the Capital Standard consultation discusses continuing to provide for exemptions, so we propose the BBB+/Baa1 and below threshold is adjusted to include those exempted deposit takers.

Table V: Related Party Exposures Standard proposed aggregate credit exposures limits[217]

Credit rating[218]	Proposed limit (percentage of the Deposit Taker group's Tier 1 capital)[219]
AA/Aa2 and above	75
AA-/Aa3	70
A+/A1	60
A/A2	40
A-/A3	30

[217] Based on a similar table found in Reserve Bank of New Zealand – Te Pūtea Matua. (2023). BS8 Connected Exposures Policy, p 6. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs8-connected-exposures-policy-oct-2023.pdf

[218] The rating scales in this column are presented as "Standard & Poor's scale/Moody's Investor Services scale", noting that Fitch Ratings' scale is identical to Standard & Poor's.

[219] The aggregate credit exposures of the banking group to all connected persons must not exceed the rating-contingent limit outlined in the matrix at the end of each working day.

Credit rating[218]	Proposed limit (percentage of the Deposit Taker group's Tier 1 capital)[219]
BBB+/Baa1 and below or exempted from obtaining a credit rating	15

727. A difference between the NBDT regulations and the options proposed for this standard comes from the ability of current trustee supervisors to require a lower maximum exposure limit of an NBDT, whereas BS8 sets a one-size-fits-all approach for all entities with a credit rating BBB+/Baa1 and below. The application of lower limits is not widespread. We do not expect this change to have a significant impact on financial stability.

728. Another difference in calculating aggregate exposures is that banks under BS8 are allowed to net off certain exposures to counterparties (such as some transactions with collateral) whereas NBDTs currently must use gross exposures. It would be most consistent to allow all deposit takers – regardless of their Group or credit rating – to choose to use either gross or net limits. Group 3 deposit takers tend to have less complexity in their connections to parent companies or in the use of instruments such as derivatives than Group 1 or Group 2 entities, so in practice may not benefit from an option to use net exposure.

729. Overall, we think the main driver of whether the standard should allow netting in Group 3 deposit takers' connected exposure limits should be in alignment with the overarching position on the role of credit risk mitigation and the recognition of netting in their capital ratio calculations under the proposed Capital Standard. Feedback during the BS8 review was clear that any related party exposures policy should use the same netting requirements as the applicable capital adequacy policy.

Preventing abuses in transactions with related parties

730. Currently the NBDT regulations have no explicit requirements to manage conflicts of interest in contracts with related parties for NBDTs. Instead, we set out guidance on risk management requirements for NBDTs in our Risk Management Programme Guidelines. These guidelines cover managing transactions with related parties and conflicts of interest.

731. Both Option C and Option D would introduce explicit requirements to manage conflicts of interest in contracts with related parties. This will in part contribute to the one-off costs of switching from the current NBDT regulations to a new standard, but we do not think the long-term compliance costs of either Option C or Option D would be excessive as the requirements would not differ significantly from the guidelines.

732. Including new explicit requirements to address conflicts of interest and abusive contracts is desirable, as this will contribute to the sound governance of deposit takers and at the same time will take account of international standards as per Principle 20 of the Basel Core Principles.[220] We consider it desirable for Group 3 deposit takers to have the same baseline governance requirements regarding conflicts of interest as Group 1 and Group 2 deposit takers and support treating all Groups consistently.

[220] BCBS. (2023). Consultative document Core principles for effective banking supervision, p 54. https://www.bis.org/bcbs/publ/d551.pdf

Summary

733. We propose that Group 3 deposit takers move to the definition of related party as in BS8. This will slightly change who is captured as a related party relative to the NBDT regulations – with some changes broadening and other changes narrowing the scope. We also propose moving to the same exposure limits as BS8 – which in most cases will mean Group 3 deposit takers will continue to be subject to a 15% exposure limit. We also intend to explicitly include a restriction on terms of transactions with related parties. These proposals for Group 3 would align with the proposals for Group 1 and Group 2 deposit takers.

734. In addition, we are proposing that the decision about whether Group 3 deposit takers should be allowed to net off their exposures to related parties when calculating regulatory limits will depend on whether netting is allowed under the new Capital Standard. A decision on that will be made following feedback on the Core Standards consultation.

Q105	Do you agree with the proposed approach for Group 3 deposit takers?
Q106	Do you agree that the calculation of aggregate net exposures in the Related Party Exposure Standard remains aligned with the Capital Standard for Group 3 deposit takers?
Q107	Is our evaluation of the impact of requiring Group 3 deposit takers to prevent abuses in transactions with related parties accurate?

5 Conclusion

735. The early work on the Related Party Exposures Standard was undertaken following a review of the 'Connected Exposures' policy for banks (BS8). We consider that the content of BS8 aligns with the purposes of the DTA for depositors in Group 1 and Group 2. We also considered the current NBDT regulations, and their similarities to and differences from BS8.

736. After considering how to draw all three groups into the new standard and noting the desirability of consistent treatment of entities as well as having regard to proportionality, we propose that Group 1 and Group 2 deposit takers have the policy requirements largely carried over from BS8, while Group 3 deposit takers have a version of those same requirements which will vary somewhat from previous obligations under the NBDT regulations. We have developed these proposals taking into account the principles of the DTA and we are satisfied they are necessary or desirable for the purposes set out in section 3(1) and (2)(a) and (b) of the DTA.

737. Proposals for the largest deposit takers Group 1 and Group 2 are closely related to the BS8 policy as issued after the review ending October 2023. The proposals in this paper carry over these requirements into the Related Party Exposures Standard. For Group 3 deposit takers we propose moving the requirements in the standard to a similar level and content as for Groups 1 and 2, while also considering minor variations as outlined in section 4.2.

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 6

Deposit Takers Open Bank Resolution (OBR) Pre-positioning Standard

Deposit Takers Non-Core Standards Consultation

21 August 2024

CONSULTATION PAPER

Non-technical summary

Our current framework for regulating and supervising financial institutions aims to reduce the risk of banking failure. However, bank failures can still occur, and we have introduced measures such as the Outsourcing Policy (**BS11**) to limit the disruption of bank failures on the financial system and broader economy.

Open bank resolution (**OBR**) is a functionality pre-positioned in banks' systems and processes that enables us to manage a bank that has failed by giving customers access to their funds, reducing disruptions to the financial system and economy that could arise from putting the failing bank into liquidation. In the ordinary course of liquidation, households and businesses may find themselves unable to access their funds, make payments or draw on their credit lines, which disrupts economic activity.

We introduced our current Open Bank Resolution (OBR) Pre-positioning Requirements Policy (**BS17**)[221] after the 2007/2008 global financial crisis (**GFC**) to facilitate ongoing access to financial services and payment systems in the event of a bank failure, and to avoid reliance on taxpayer-funded bailouts.

We propose to carry over the majority of the existing BS17 requirements into a new OBR Pre-positioning Standard. We also propose to update the standard to reflect the protection afforded by the Depositor Compensation Scheme (**DCS**). In short, it is our view that the standard will need to provide customers continued access to at least their DCS-protected balances by 9am on the day after their deposit taker's entry into OBR. We are interested in identifying any issues and impediments to our proposed approach to integrating OBR and the DCS.

Our proposed standard aims to enhance our ability to deal with failed Group 1 and Group 2 deposit takers, particularly those that are already pre-positioned for OBR under BS17. We propose to remove the current $1 billion retail deposit threshold ($1.3 billion based on 2023 prices). We would instead apply the standard to all Group 1 and Group 2 deposit takers, with scope to vary or waive the requirements if we do not expect OBR pre-positioning to be relevant to our resolution plan for a given deposit taker.[222] We do not propose to apply the standard to Group 3 deposit takers.

Our proposed OBR Pre-positioning Standard will form part of the resolution framework under Part 7 of the DTA. We are reassessing the role of OBR pre-positioning and how it fits in with the possible suite of resolution tools that are available under the DTA. In this regard, we see OBR pre-positioning as an arrangement to support 'continuity of access to deposits' in resolution generally (rather than a measure solely designed to support the OBR process). We note that OBR pre-positioning would form only part of a comprehensive end-to-end resolution process.

We have published an Issues Paper on the DTA crisis management framework alongside this Consultation Paper.[223] Among other things, the Issues Paper includes further discussion of the role of OBR pre-positioning within our future crisis management framework.

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[221] Reserve Bank of New Zealand – Te Pūtea Matua. (2013). BS17 Open Bank Resolution (OBR) Pre-Positioning Requirements Policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs17-obr-policy.pdf?sc_lang=en

[222] Section 260 of the DTA will require us to develop an orderly resolution plan for each deposit taker.

[223] Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Crisis Management Issues Paper. https://consultations.rbnz.govt.nz/dta-and-dcs/crisis-management-under-the-deposit-takers-act/user_uploads/crisis-management-issues-paper-august-2024.pdf

1 Introduction

738. Resolution is an integral part of our prudential framework. In line with section 68(b) of the BPSA, we currently use our statutory resolution powers to ensure that resolution of a registered bank avoids significant damage to the financial system. Under the DTA, our statutory resolution powers will apply to all licensed deposit takers and will seek to achieve a broader range of purposes (see paragraph 747 below).

739. There are a range of potential resolution tools we can use to manage a deposit taker that has failed.[224] These tools involve using specific combinations of statutory powers to deliver a resolution. For banks that are part of an overseas-based banking group, we also look to coordinate with relevant overseas regulators on group-level resolution strategies that suitably protect New Zealand's financial stability.

740. OBR is a resolution tool currently available to the Reserve Bank. It allows the failed bank to reopen the next day under statutory management and avoids the adverse consequences of disruption to the bank's critical functions. The basic idea is to provide customers access to their accounts as swiftly as possible so they can carry on making and receiving payments. When OBR is applied, it allows customers to gain full or partial access to their accounts and other bank services while an appropriate long-term solution to the bank's failure is worked out.

741. Our existing OBR pre-positioning requirements are set out in BS17 and apply to some registered banks (corresponding to all of Group 1 and some Group 2 deposit takers under our Proportionality Framework).[225] BS17 supports our ability to give effect to OBR in practice. In brief, it requires in-scope banks to have processes and systems to enable a statutory manager to freeze liabilities upon the bank's entry into statutory management, then unfreeze a given proportion of customer deposits by 9am the following business day. The freeze is legally possible through the application of a moratorium. The unfreezing is legally possible because the statutory manager can choose who may access their frozen funds (that is, the statutory manager can choose to lift the moratorium on a case-by-case basis, at amounts of its choosing).

742. The DTA introduces significant new resolution responsibilities for us. For example, it broadens the purposes for which we may exercise resolution powers (section 259 of the DTA) and requires us to produce orderly resolution plans for each deposit taker (section 260 of the DTA) and publish a statement of approach to resolution (section 261 of the DTA). Subpart 9 of Part 7 of the DTA also introduces a 'No creditor or stakeholder worse off' safeguard to compensate creditors if they end up in a worse position than they would have been in from a liquidation because of actions taken during resolution.

743. The DTA carries over existing powers and provisions that underpin the OBR process, allocating powers to either the Reserve Bank or a 'resolution manager'.[226] This includes the power to suspend payment of money owing (section 330 of the DTA), and to dispose of

[224] By failure, we mean that one or more of the statutory grounds in section 265(2) of the DTA for entry into resolution have been met.

[225] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Proportionality Framework. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf

[226] A resolution manager is appointed by the Reserve Bank and is responsible for carrying out certain functions during the resolution process. (These functions largely relate to the day-to-day operation of the deposit taker in resolution.) The Reserve Bank may appoint either a third party or itself as a resolution manager.

assets and liabilities (section 320 of the DTA). The DTA also includes updated moratorium provisions (section 284 of the DTA) and a new 'restriction on resolution trigger' (section 287 of the DTA) that prevents creditors and other counterparties taking certain actions that could otherwise undermine the resolution process.

744. Section 89(2) of the DTA enables us to issue standards to ensure that deposit takers can be resolved in accordance with the additional purposes for exercising resolution powers. We intend initially to use this power to issue the proposed OBR Pre-positioning Standard. At a later stage, we may issue other standards to help facilitate the resolution process.

745. This chapter sets out our views on the key design aspects of our proposed OBR Pre-positioning Standard and how it supports the purposes of the DTA, including the additional purposes of Part 7 of the DTA (which deals with crisis management and resolution). We are proposing that the standard will carry over the majority of existing requirements in BS17 but will be updated to better achieve the purposes of the DTA.

746. We have also published a Crisis Management Issues Paper alongside this Consultation Paper, setting out our initial thinking on how we could update the broader framework in light of the DTA.[227] This paper covers topics such as potential updates to our resolution toolkit, the potential role of statutory bail-in and the potential for a broader 'crisis preparedness' standard. That standard could include additional planning requirements for recovery, exit and resolution that would build upon the proposed OBR Pre-positioning Standard and Outsourcing Standard. We see both the OBR Pre-positioning Standard and the Outsourcing Standard as important ongoing elements of our crisis management framework to enable us to meet the DTA purposes when resolving an in-scope deposit taker.

1.1 Purpose of the OBR Pre-positioning Standard

747. The proposed OBR Pre-positioning Standard pursues the overall purpose of the DTA (section 3), as well as the additional purposes of the crisis management regime (section 259 of the DTA). These additional purposes can be summarised as follows:

a) to avoid significant damage to the financial system from a deposit taker in distress – including by maintaining the continuity of systemically important activities and mitigating any loss of confidence in the financial system

b) to support the purposes of the DCS – including by protecting depositors to the extent they are covered by the DCS

c) to enable deposit takers in resolution to be dealt with in an orderly manner

d) to minimises costs and losses in connection with a distressed deposit taker – including by preserving creditor interests, maintaining the creditor hierarchy, and dealing with distress as quickly as reasonably practicable

e) to avoid or otherwise manage the need to rely on public money.

(Note that the purposes in (d) and (e) only apply to the extent they are not inconsistent with the purposes in (a)–(c).)

[227] Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Crisis Management Issues Paper. https://consultations.rbnz.govt.nz/dta-and-dcs/crisis-management-under-the-deposit-takers-act/user_uploads/crisis-management-issues-paper-august-2024.pdf

748. The proposed OBR Pre-positioning Standard requires a deposit taker to have mechanisms in place ahead of its potential failure for the purpose of ensuring customers quickly regain access to liquidity and banking services. These mechanisms entail customers being able to access all or part of their transactional accounts, including all balances identified as being covered by the DCS, shortly after a deposit taker enters resolution. Remaining balances would be frozen, so that customers would be unable to access these funds unless the statutory manager subsequently releases part of the frozen portion.

749. Liquidation and DCS payout would be highly disruptive for deposit takers with substantial amounts (at least $1 billion) of retail deposits so would be unlikely to achieve the purposes in section 259 of the DTA. If a deposit taker is closed, access to banking services abruptly stops and a large number of customers would need to establish new banking relationships elsewhere. Uninsured creditors would generally be paid from the proceeds of assets in liquidation, which may take some time and lead to further losses. Such an outcome would likely lead to loss of public confidence, financial instability and spillovers to the real economy such as through liquidity or credit impacts on customers.

750. By limiting disruption to account access and banking services, OBR pre-positioning addresses the purposes in section 259 of the DTA to maintain the continuity of systemically important activities undertaken by licensed deposit takers in New Zealand and to mitigate any loss of confidence resulting from a deposit taker being in financial distress. It also helps enable the deposit taker in resolution to be dealt with in an orderly manner.

751. Integrating DCS protection within the OBR functionality supports the purposes of the DCS. Under Part 6 of the DTA, the DCS Fund[228] may be used to contribute to a resolution measure (including activating the OBR functionality) provided that, as a result of the resolution measure, eligible insured depositors are likely to receive no less favourable treatment than would have been the case had they been paid compensation under a direct insured-deposit payout. This implies a need to provide depositors with access to insured balances in OBR at least as fast as under a DCS payout.

752. We propose that the OBR Pre-positioning Standard include some changes to the BS17 requirements to help ensure that OBR pre-positioning also supports other resolution tools that we might use to meet the section 259 purposes. We provide further detail on these tools in the accompanying Crisis Management Issues Paper.

753. In light of updates to the underlying payments systems, we also propose that OBR pre-positioning should allow a deposit taker to reopen the following calendar day. This promotes confidence in the DCS by providing depositors of a deposit taker in resolution with next-day access to insured balances on all days of the week. (The current BS17 policy only requires access on the next 'business' day.) This may also enhance our ability to meet the section 259 purposes by accelerating depositors' access to their funds if resolution is undertaken over a weekend or public holiday. Considering the above, we see OBR as enabling 'continuity of access to deposits'.

[228] The DCS will be funded through levies on deposit takers. For further detail *see* The Treasury. (2024). Statement of Funding Approach Funding Strategy for the Depositor Compensation Scheme, Second Stage Consultation Paper. https://www.treasury.govt.nz/sites/default/files/2024-05/consultation-second-stage-sofa-strategy-depositor-compensation-scheme.pdf

1.2 Current approach

754. We introduced BS17 after the GFC to facilitate ongoing access to financial services and payment systems in the event of a bank failure, and to avoid reliance on taxpayer-funded bailouts.

755. BS17 was developed to apply to systemically important banks in order to comply with the purpose under section 68(b) of the BPSA, of avoiding significant damage to the financial system. The policy was extended to other deposit takers (with over $1 billion in retail deposits) given the absence of alternative resolution tools for those entities. Deposit takers are also allowed to opt in if they want to.

756. Ten banks are currently pre-positioned for OBR under BS17, including all Group 1 deposit takers and some Group 2 deposit takers. The outcomes those 10 banks are required to achieve through OBR pre-positioning, and the corresponding functionalities required to deliver those outcomes, are summarised in Part B2 of BS17.

757. In summary, BS17 requires the functionality for a bank in statutory management to give effect to the following actions by the statutory manager:

- temporarily closing the failing bank
- applying a freeze on a proportion of unsecured liabilities (to cover estimated losses) with claims of shareholders and other capital providers frozen in full
- reopening the bank the next business day.

758. The freeze seeks to ensure that it is shareholders and potentially creditors that bear the losses of the failed deposit taker rather than taxpayers. The failed bank is unlikely to have enough assets to cover its liabilities. Suspending the payment of a portion of the bank's liabilities therefore enables the bank to continue operating, avoiding the need for a taxpayer-funded bailout to cover the shortfall in assets.

759. BS17 requires banks to pre-position certain liabilities to enable customers to have access to their unfrozen balances. This includes pre-positioning to apply a 'de minimis' amount (for example $500–$1,000 per transaction account) that is unfrozen in full. These pre-positioned liability accounts refer to bank products, like current accounts, that are critical for customers, such that interrupting access may carry high economic costs for both individual customers and the economy. Term deposit accounts, whilst not transactional in nature, are also pre-positioned so they become available (in part or in full as applicable) at their pre-agreed maturity. Pre-positioning is also required for credit cards, revolving credit facilities and overdrafts with positive balances.

760. As well as the pre-positioning required by BS17, the ability for the bank to continue providing critical banking functions in OBR is made possible through:

- the statutory manager carrying on all or any part of the business of the bank in resolution (and having all of the powers, rights and authorities that are necessary or desirable to carry on that business)

- a government guarantee for any new and unfrozen liabilities of the deposit taker undergoing OBR when it reopens for business the next day.[229]

761. To help ensure the OBR process works effectively, banks subject to BS17 are also currently required to maintain an OBR Implementation Plan, including a compendium of pre-positioned liabilities, and to test their OBR functionality on an annual basis.

1.3 Proposed policy development approach

762. Part 6 and Part 7 of the DTA establish the DCS and a new crisis management regime for deposit takers. In developing the proposed standard, we have considered what updates to OBR pre-positioning are needed to support our implementation of this new regime. This includes looking at the role of OBR pre-positioning, how we apply proportionality and other general updates.

The role of OBR pre-positioning

763. In our future resolution framework, we see OBR pre-positioning as providing the capability to support continuity of access to deposits in resolution. However, OBR pre-positioning would form only part of a comprehensive end-to-end resolution process; it would be one aspect of a range of potential 'open bank' resolution strategies that may be adopted under the DTA.

764. We also see OBR pre-positioning as a functionality to assist with protecting depositors covered by the DCS. In addition to protecting eligible depositors directly, the DTA also allows DCS funds to be used to support the resolution of a licensed deposit taker.

765. In light of these updates, we are considering whether the OBR functionality should be renamed to better reflect its intended role, to support continuity of access to deposits in resolution.

Applying proportionality

766. In developing the proposals below, we have considered our Proportionality Framework for developing standards under the DTA (noting that the Proportionality Framework does not directly apply to our exercise of powers under Part 7 of the DTA).[230]

767. We expect that the resolution of Group 1 and Group 2 deposit takers would generally be more complex, in part because of the need to provide continuity of access to deposits (through OBR or otherwise) to preserve systemically important activities and limit contagion.

768. However, we are still considering whether continuity of access to deposits is necessary for all Group 2 deposit takers, notably for those that are not currently in scope of BS17. We expect that this will become clearer as we work towards developing resolution plans for these entities, as required by the DTA.

769. We do not propose to impose the new standard on Group 3 deposit takers. We consider that Group 3 deposit takers do not individually pose material risks to financial stability. From this perspective there is less need to provide continuity of access to deposits in resolution. For

[229] This includes a default guarantee and/or other risk assurance documents to enable the failed deposit taker's continued participation in certain payment systems.

[230] The DTA does not expect the Proportionality Framework to set out how the Reserve Bank takes a proportionate approach to carrying out other functions/duties, such as supervision (DTA, Part 4), enforcement (DTA, Part 5) and resolution (DTA, Part 7). The Proportionality Framework sets out how the Reserve Bank takes into account the proportionality principle in developing standards.

these entities, there are also other ways to enable depositors' access to financial services without keeping the entity itself open for business (for example, as part of our approach to DCS payouts). We also need to have regard to the desirability of taking a proportionate approach to regulation, noting that the costs of implementing the standard could be material for Group 3 deposit takers.

General updates

770. Finally, given that BS17 has been in place for over 10 years, we need to consider what other policy updates may be warranted to reflect changes in deposit takers' systems and operating environment (for example, industry's transition to a 365-day payment system).

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

2 Proposed approach for Group 1 deposit takers

2.1 Retention of OBR pre-positioning requirements

Preferred option

771. For Group 1 deposit takers, we propose largely to carry over the pre-positioning requirements of BS17 Part B3, Part B4, and Part C into the proposed standard, with some updates to the OBR functionality set out in section 2.2 below. These requirements provide the ability to freeze the claims of shareholders and creditors in resolution, with the deposit taker quickly reopening for business and providing access to (a portion of) its customer deposits.

Analysis

772. Should one of the current Group 1 deposit takers (that is, the four Australian-owned banks) experience a severe stress, we would engage closely with our Australian counterparts on a group-level solution. This solution could enable the New Zealand deposit taker to obtain parental support before it reached the point of non-viability. Nonetheless, it is equally important that we maintain a credible local resolution strategy to separate the New Zealand subsidiary from the Australian parent if necessary to protect domestic financial stability.

773. Our ability to manage a potential failure in line with the applicable statutory purpose depends on what arrangements deposit takers have in place to manage these failures. This is particularly important for a Group 1 deposit taker whose failure would pose significant risks to the stability of the financial system and the continuity of systemically important activities.

774. A 'closed bank' resolution of a Group 1 deposit taker can cause significant disruption both through direct impact on individuals and businesses, and indirectly through contagion to the wider financial system and economy. The majority of retail and business customers have their transactional or everyday accounts held in Group 1 deposit takers. Entry into liquidation and DCS payout for a Group 1 deposit taker would be highly disruptive, so is unlikely to achieve the purposes in section 259 of the DTA.

775. OBR helps to manage a bank that has failed in an orderly manner by protecting continuity of systemically important activities such as core banking services. This is designed to ensure that liquidity is maintained in the system, minimising the costs to the wider economy and to

taxpayers and ultimately supporting the purposes of the DTA resolution framework. For example, it also aims to help mitigate any loss of confidence in the financial system resulting from a deposit taker being in financial distress.

776. Therefore, we consider that there is a need for resolution tools that ensure Group 1 deposit takers continue to operate and provide continuity of access to customer deposits whilst undergoing resolution. To this end, Group 1 deposit takers should continue to be subject to requirements for OBR pre-positioning.

777. Having regard to the principles in section 4 of the DTA, we note that:

- Group 1 deposit takers have higher operational capability to absorb the compliance costs of pre-positioning. As such we consider applying standards that are proportionate to the risks set out above.
- Policies such as OBR can also support competition and sound risk management in the financial system by providing alternatives to taxpayer funded bailouts. The prospects of such bailouts can otherwise give undue advantage to systemic institutions and exacerbate moral hazard.
- Having regard to maintaining awareness of the practices of overseas authorities, we note that overseas deposit insurers and resolution authorities such as the US's Federal Deposit Insurance Corporation and the Canada Deposit Insurance Corporation have regulations requiring insured institutions to execute 'holds' on liability accounts. These hold mechanisms are like our OBR freeze and unfreeze functionality, with the objective of providing depositors timely access to their funds.

778. Apart from the current OBR tool, there are other tools available to resolve a Group 1 deposit taker. We are still considering other options and provide more detail on this matter as part of our Issues Paper. Even if we did use alternative tools for Group 1 deposit takers, we still see a potential role for OBR pre-positioning in supporting depositors' ability to access their insured balances.

Summary

779. We therefore propose that the OBR Pre-positioning Standard apply to all Group 1 deposit takers in the same way as BS17. This retains our ability to resolve these deposit takers in a way that maintains continuity of access to deposits, thereby protecting insured deposits and broader financial stability.

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?

2.2 Proposed changes to OBR functionality: OBR–DCS integration

780. The default use of deposit insurance funds is to reimburse insured depositors directly following the entry of a deposit taker into liquidation or resolution under Part 7 of the DTA, or the appointment of a receiver. The funds may also be used for resolution measures other than payout that preserve depositors' access to their deposits. In line with international

guidance[231] and practice,[232] the DTA recognises that depositor protection is not limited to depositor reimbursement but includes the use of resolution tools designed to preserve critical bank functions. In this regard, DCS funds may be tapped to support preserving continuity of access to deposits in resolution.[233]

781. The DCS is a key driver for updating our OBR policy. We need to be able to resolve deposit takers in ways that protect both financial system stability and insured depositors. This requires an 'OBR–DCS integrated solution'. There may be other potential ways to integrate OBR and DCS. Our preferred option is set out below.

Preferred option

782. Under our proposed 'OBR–DCS integrated solution', in the event of failure a deposit taker should be able to identify the estimated protected/insured balances as well as uninsured balances and reopen by 9am the next day, providing depositors with access to their DCS-protected funds and a portion of uninsured funds.

783. The de minimis amount in BS17 is no longer required. Instead, the DCS coverage limit of $100,000 per depositor per deposit taker will be protected against losses. DCS-protected products will be incorporated into the OBR pre-positioned accounts.[234] This proposed alignment demonstrates the complementarity between the DCS as a financial safety net and OBR as a resolution tool.

784. The OBR–DCS integration proposal supports the primary purposes of resolution (Part 7 of the DTA) of avoiding significant damage to the financial system from a deposit taker in distress by maintaining continuity of systemically important activities, mitigating loss of public confidence and supporting the DCS's purpose by protecting depositors and allowing the DCS Fund to contribute to a resolution measure.

785. For example, if a depositor held a total of $200k of deposits in a pre-positioned deposit taker, they could expect the following outcomes in OBR:

- in this example, the bank reopens with a 10% freeze applied on uninsured pre-positioned liabilities
- the depositor would be able to access $190k of their deposits ($100k that is 'insured' plus 90% of the remaining 'uninsured' $100k) under their usual terms
- the remaining $10k would remain frozen.

786. Under this model, the DCS would fund the additional unfreezing of insured balances (such as beyond the partial unfreezing applicable to balances not covered by the DCS) so that these balances would be available in full to depositors the next day. To achieve this, the DCS could make a contribution to the deposit taker undergoing resolution in line with the aggregate expected loss that would have been attributable to insured balances. This contribution would be a lump-sum payment from the DCS to the failed deposit taker, rather than a series of

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[231] The International Association of Deposit Insurers. (2014). Core Principles for Effective Deposit Insurance Systems. https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf

[232] Around 80% of deposit insurers globally allow the broader use of their deposit insurance fund. This approach appears to be advancing globally (*see* Financial Stability Institute. (2022). Counting the cost of payout: constraints for deposit insurers in funding bank failure management. FSI Insights No 45. https://www.bis.org/fsi/publ/insights45.htm)

[233] *See* the Deposit Takers Act 2023, section 230.

[234] Although OBR-pre-positioned accounts may include products not covered by the DCS, for example, foreign currency accounts.

payments into the accounts of eligible depositors. In the example above, the DCS would pay $10k as part of its contribution to the deposit taker, reflecting the additional 10% unfreezing to the depositor's $100k of insured balances.

787. Further payments to or from the DCS Fund may take place after the initial contribution, for example if the aggregate loss is lower than initially expected and further frozen funds are released. See Appendix 1 for a diagram of this model.

788. To ensure that deposit takers can give effect to our preferred OBR–DCS integrated solution, we propose that the standard require the capabilities to:

- identify insured/uninsured balances
- unfreeze insured balances
- subsequently release funds at customer account level
- report on amounts depositors were given access to.

Capability to identify insured/uninsured balances

789. We propose adding to the requirements in Part C3 of BS17 to include the determination of insured direct balances, uninsured direct balances, and look-through accounts, as set out below. To deliver next-day access to insured balances, deposit takers will need the capability to identify these balances more rapidly than may be required under the proposed DCS standard. We are open to your views on how deposit takers can use their Single Depositor View (SDV)[235] capabilities together with their existing OBR pre-positioning and any other processes and operating systems to help meet these outcomes.

790. We propose that the OBR Pre-positioning Standard will not by itself deal with the determination of account ownership or eligibility, product eligibility, rules on aggregation of balances for multiple eligible accounts and hierarchy of accounts.[236] Instead, deposit takers need to estimate DCS entitlements based on the applicable DCS rules and policy.[237]

Insured direct balances[238]

791. Deposit takers should be able to identify protected deposits of eligible depositors and calculate their 'notional' DCS entitlements[239] as at entry into resolution, by aggregating balances across all accounts held directly by an eligible depositor. The notional DCS entitlement will form the basis for making account balances available to customers by 9am the

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[235] Single Depositor View (SDV) files refer to data generated by the deposit takers' systems that enable the Reserve Bank to determine the entitlement to compensation of an eligible depositor.

[236] The hierarchy of account refers generally to how DCS protection is apportioned to multiple eligible accounts, for example, in cases in which a depositor's total of deposits is over the DCS protection limit. An example would be giving transactional accounts priority in terms of DCS protection, as these are commonly used for day-to-day transactions by households and businesses; this would be consistent with the objective of ensuring 'continuity of access to critical functions'.

[237] A webinar was conducted in September 2023 to update OBR banks on how the DCS protection could be incorporated into OBR. We stressed that banks need systems in place to deliver DCS-consistent outcomes. This consultation follows through from that presentation.

[238] Insured direct balance refers to protected deposits held by eligible depositors in their own right (that it, not jointly with other persons or via complex arrangements).

[239] In resolution, we would generally not trigger a DCS payout (by issuing a specified event notice). As such, no entitlement to receive DCS compensation technically exists.

following day. We may subsequently use the SDV file to confirm that insured balances have been accurately identified.

792. In order to calculate protected deposit balance amounts, transactions requiring interbank settlement, or settlement through Visa or Mastercard networks, would only be taken into account if the interbank settlement is completed or all elements of the transaction have been settled respectively. This should take into account any regulations dictating how DCS entitlements should account for **in-flight** payments.[240]

Uninsured direct balances

793. Deposit takers should be able to identify account balances that are not subject to DCS protection. This includes the portion of deposits above the coverage limit and deposits held by ineligible depositors or in ineligible products.

Look-through accounts[241]

794. Deposit takers should be able to identify any insured balances in accounts that will be subject to **look-through** treatment (as per any requirements in our proposed DCS Standard). Given that deposit takers do not routinely collect data on who the funds in these accounts ultimately belong to, we do not propose providing full access to insured balances in look-through accounts the next day. Instead, we intend to treat these accounts as fully uninsured and subject balances to a percentage freeze until we have confirmed whether any of these funds are in fact insured and therefore need to be released. The process for making this confirmation is still under development.

Capability to unfreeze insured balances

795. We propose to substantively amend the requirements in Part C5 of BS17 to focus on what balances should be made available (that is, unfrozen) through the OBR process. We envisage that deposit takers should be able to leverage existing OBR functionality and processes to meet the desired outcomes, such as preparations for robust access-channel closure, processing of pending payments for customer liability accounts and next day re-entry into the payment system.

796. As a result of these changes, we do not propose carrying over the requirements in C4 of BS17 regarding the de minimis in the proposed standard. Instead, banks will need to exempt balances from the OBR freeze at the customer account level where they have identified these balances to be 'insured' under the DCS.

Accessible balance

797. A deposit taker (under the control of a resolution manager) should have the capability to make each depositor's 'accessible balance' available to the depositor by 9am the day following the deposit taker's entry into resolution. This 'accessible balance' is comprised of:

- 100% of insured direct balances

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[240] Payments that have been initiated but not fully processed as at the time the deposit taker enters resolution.

[241] Look-through treatment applies to certain deposits where funds are being held on behalf of an eligible depositor(s). The bank itself will not know which balances belong to each depositor. We will therefore need a separate process to identify any insured balances in look-through accounts and to release further funds accordingly.

- a percentage of any uninsured direct balances and balances held in look-through accounts (to the extent available, for example, bank-sponsored 'PIE' deposits). As resolution authority, we will specify the applicable percentage when a deposit taker is in resolution.

798. Customers' accessible balances should be available in the same accounts where they were located immediately before entry into resolution. The definition of 'insured balance' above should mean that deposit takers can attribute a depositor's insured balances first to current accounts, then other on-call accounts, before savings accounts and term accounts (or as per any alternative waterfall of accounts that may be established for DCS purposes).

799. Other balances not accessible by the depositor could be made visible to the depositor as a 'frozen' amount. As per Part C5 of BS17, the partial freezing of uninsured balances would reflect an initial assessment of the losses of the failed deposit taker and aims to ensure the total value of unfrozen liabilities does not exceed the assessed value of the deposit taker's assets (including any DCS support provided).

Resumption of access to deposits/accounts and payment channels

800. We propose to carry over existing requirements in BS17, Part C6. As such, deposit takers should have the capability to ensure that depositors can continue to make payments to and from their existing accounts using current payment instruments and facilities, including via some or all of the deposit taker's various payment channels. This includes ongoing processing and settling of incoming and outgoing payments, such as direct deposits (salaries, superannuation and benefits, among others), automatic payments, card payments and ATM withdrawals.

801. Payment channels that may be reopened include branches, ATMs, phone banking, internet banking and point of sale networks. Pre-defined daily limits on ATM and other bank card transactions may continue as per normal. After payment channels have been reopened, automatic payments and direct debits will only be processed to the extent they do not reduce the balance in the account below the frozen balance.

Capability to subsequently release funds at customer account level

802. With respect to release of funds, we propose adding to the existing requirements in BS17, Part C7. Deposit takers should have the capability to subsequently release a specific amount of frozen funds in a specified customer account when required to do so by us or the resolution manager. Deposit takers should be able to do so on a timely basis, including for multiple cases that need to be processed at the same time. There are several reasons why this might be needed, including but not limited to:

- protecting insured balances held indirectly through look-through accounts, as may be determined in the days and weeks following entry into resolution
- accounting for cases in which the overnight OBR process has not provided a given depositor full access to their insured balances. This is to ensure that the depositor can access through existing accounts at least what their DCS entitlement would have been if

we had triggered a DCS payout as at the time when the bank was placed into resolution.[242]

803. As per part C7 of BS17, deposit takers should also have the capability to apply a percentage unfreeze to frozen balances, if instructed to in the weeks or months following entry into resolution. For example, we may subsequently assess that the initial freeze was too conservative. This functionality could be used to reduce frozen funds in line with the updated assessment of the deposit taker's losses.

Capability to report on amounts depositors given access to

804. We propose a new reporting requirement be included in the standard beyond that required by BS17. Within the same timeframe as required for submitting an SDV file, deposit takers should be able to provide us with customer-level reporting on the amounts depositors were given access to in resolution. This includes a reconciliation (that is, a comparison of depositor-level outcomes) against estimated DCS entitlements in its SDV file.

805. This reporting should include the deposit taker's estimate of the initial DCS contribution required to fund the protection of insured depositors, as well as sufficient supporting information for these estimates to be validated. Deposit takers should be able to update these estimates if frozen funds are subsequently released either at the customer level (see paragraphs 803 and 804 above) or aggregate level (see paragraph 786 above) to inform any further payments to or from the DCS Fund.

806. The finalised OBR Pre-positioning Standard or guidance may provide a template for these purposes.

Revised OBR Implementation Plan

807. Deposit takers will need to update their OBR Implementation Plan to reflect the steps taken to deliver the outcomes described above. In this regard, deposit takers should provide a process diagram and an explanation of the steps involved.

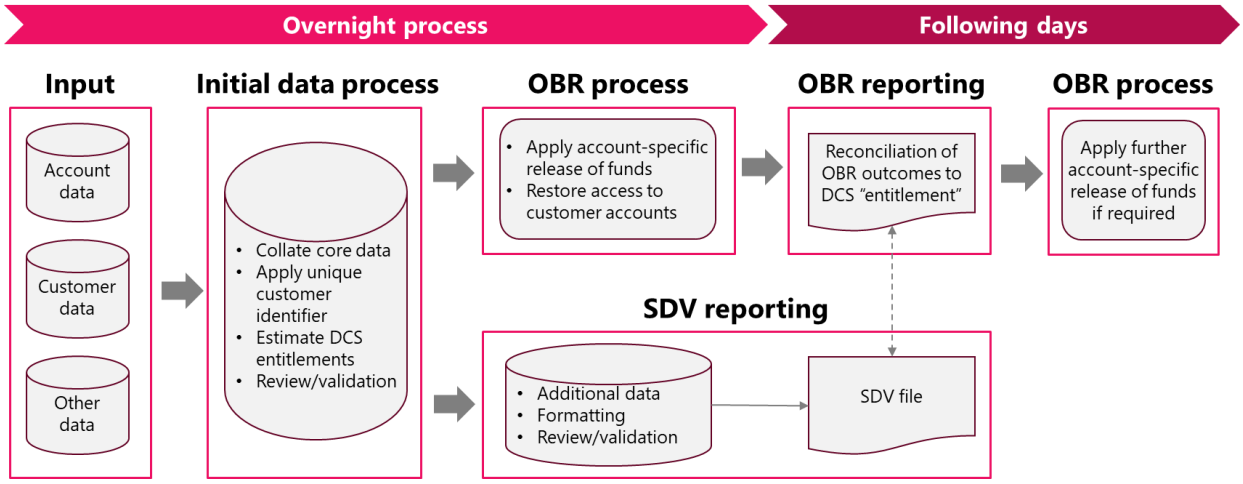
808. The processes should ensure that insured direct deposits are correctly identified in line with the relevant DCS rules and regulations. This includes that balances are correctly aggregated across different systems and that the balances incorporate the impact of in-flight payments and accrued interest up to a reference date and time to be specified by us or the resolution manager.

809. Deposit takers should have process controls in place to ensure data accuracy and completeness and to identify key risks and how these risks could be mitigated. As well, there should be a process for reconciling deposit data with the SDV and against the latest financial records of the deposit taker (for example, the General Ledger accounts for deposits).

810. Figure 4 shows a simplified diagram of a potential OBR–DCS integration model that illustrates how the outcomes above might be delivered in practice.

[242] An entitlement to DCS compensation is triggered when a 'specified event notice' is issued by the Reserve Bank with respect to a deposit taker and which states the date and quantification time for the calculation of protected deposits.

Figure 4: Illustrative OBR–DCS systems process



Compendium of liabilities

811. BS17 and DCS requirements are not aligned in terms of scope of accounts for OBR purposes and product eligibility for DCS compensation purposes. For example, BS17 requires pre-positioning of foreign currency accounts, but these are not eligible for DCS compensation.

812. Under the OBR Pre-positioning Standard, we propose that DCS eligibility rules will be used to define the 'insured balances' that will be protected through the updated pre-positioning. However, we propose that the scope of pre-positioned liabilities will remain as in BS17, potentially including some products ineligible for DCS compensation (for example, foreign currency accounts).

813. Under the proposed OBR Pre-positioning Standard, deposit takers should indicate in the compendium of liabilities included in their OBR Implementation Plan whether or not a pre-positioned liability is eligible for DCS compensation.

Analysis

Costs and benefits of preferred option

814. The main benefits of our proposed OBR–DCS integrated solution come from enhancing our ability to meet section 259 of the DTA purposes, notably to protect depositors to the extent they are covered by the DCS, and to mitigate any loss of confidence in the financial system. The proposal also has the benefit of promoting confidence in the DCS during business-as-usual situations, which in turn supports the overarching DTA purpose to promote confidence in the financial system.

815. 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. For the purposes of this Consultation Paper, we are keen to understand the key drivers of costs beyond what would have been incurred for the DCS and beyond the capabilities that are already pre-positioned.

816. We welcome estimates on the costs that may be incurred to meet the outcomes under the proposed OBR Pre-positioning Standard. We note that alternative options would not be

costless. For example, deposit takers may need capabilities to facilitate DCS top-up payments or to apply a bulk release of funds at the customer account level.

Alternative option (not preferred)

817. An alternative option would be to continue with the account-based view and application of a de minimis amount as currently available under BS17. Should a Group 1 deposit taker fail, some depositors would initially face a freeze of some of their insured balance. A separate process would then provide depositors access to the remainder of their DCS-protected balance as soon as practicable, for example by subsequent release of funds by the failed deposit taker, or top-up payments from the DCS.

818. This option however is likely to carry high operational and execution risk and could delay the ability of large numbers of depositors to access insured balances in full. Depending on the nature of the workaround, depositor outcomes could vary as they would be contingent on the de minimis amount, the number of accounts held by the depositor and the balance available per account. In some cases, this could compromise our ability to meet the section 259 purposes around orderly resolution and mitigating loss of confidence in the financial system.

819. Another concern with this alternative is that it would be difficult to communicate customer outcomes both in resolution and in business as usual. This could make it harder to promote public confidence in the OBR process and the protection afforded by the DCS. By not unfreezing all insured direct balances the following day, this alternative could also reduce the total amount of funds made available to depositors in OBR.

820. The proposed implementation date of the OBR Pre-positioning Standard is 2028, but the DCS is expected to start in mid-2025. This means that we may need to temporarily rely on an interim solution like that described in Box A below should we need to apply OBR during this period.

Box A: Potential OBR–DCS interim solutions

In the unlikely event that we needed to apply OBR before the OBR Pre-positioning Standard is implemented, the OBR–DCS integrated solution above may not be available to protect insured depositors. Instead, we could take a general approach based around:

- the application of an initial per-account *de minimis* and partial unfreeze using a bank's existing OBR pre-positioning functionality
- a separate process to then determine and unfreeze additional balances, so that eligible depositors are able to access an amount at least equal to their DCS-protected balances.

The deposit taker in OBR could use its existing OBR functionality to apply a per-account *de minimis* on those accounts for which the *de minimis* has been pre-positioned (for example, transactional and savings accounts). We would specify the *de minimis* once OBR was initiated. We may set the *de minimis* below the DCS limit of $100,000 per depositor to limit the cost of over-protecting eligible depositors with multiple protected deposits. We may request data from a distressed deposit taker during the lead-up to resolution to inform the level of the *de minimis*. Once the deposit taker is in OBR, it could use its customer data to compile an '*ad-hoc*' SDV (potentially over days or weeks). We may subsequently direct the release of further frozen funds as needed to ensure that eligible depositors can access their insured balances in full.

Summary

821. We propose that Group 1 deposit takers be required to develop the capabilities set out above in paragraphs 789-813. This is to promote confidence that depositors will have access to insured balances in full the day after the deposit taker's entry into resolution (with only limited exceptions). This outcome will help enable us to resolve Group 1 deposit takers in a way that meets the applicable purposes of the DTA.

Q110	Do you support the integration of DCS with OBR and the proposed solution?
Q111	Are there any other solutions that would achieve the same outcomes (or better) for depositors?
Q112	Do you agree that the compendium of liabilities will need to be updated to reflect DCS-eligible products?
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.

2.3 Settlement Before Interchange 365 (SBI365)

Preferred option

822. We propose that the OBR Pre-positioning Standard requires Group 1 deposit takers to be able to reopen on the next 'calendar day', rather than on the next 'business day' as currently required in BS17.

Analysis

823. On 26 May 2023, the Settlement Before Interchange 365 (**SBI365**) project was completed. SBI365 allowed for the interchange of retail electronic payments amongst Exchange Settlement Account System (**ESAS**)[243] participants to be extended to 7 days a week, 365 days a year. One benefit of SBI365 is the reduced pipeline for retail payments because of more frequent settlement. This helps limit the number of payments that may be disrupted because of a deposit taker's entry into resolution.

824. SBI365 potentially means that the deposit taker undergoing OBR could reopen the next calendar day following its entry into resolution. In contrast, BS17 uses the business day convention and currently provides that the deposit taker must have the capability to reopen access channels no later than 9am on the next business day (as defined in section A3(1) of BS17).

825. We propose to use 'calendar day' (or simply 'day') in the OBR Pre-positioning Standard rather than carry over BS17's 'business day' convention. Overseas examples show that resolution is often initiated on a Friday night. Being able to reopen the bank on Saturday morning instead of what would typically be a Monday morning could materially reduce disruption for retail depositors and help us better meet the purposes in section 259 of the DTA (for example, by mitigating any loss of confidence in the financial system).

826. Moreover, this change would address potential unintended consequences of deposit takers operating on an SBI365 7-day model versus BS17's current business-day model. This supports the section 259 of the DTA, purpose of enabling deposit takers in resolution to be dealt with in an orderly manner.

827. This change means that a deposit taker in OBR would be expected to have the capability to reopen the next calendar day. Testing and walk-through exercises would have to incorporate scenarios involving failures and reopening during weekends or holidays.

Summary

828. We propose that the OBR Pre-positioning Standard requires Group 1 deposit takers to be able to reopen the next calendar day. This will help provide depositors with quicker access to their funds in resolutions that take place over a weekend.

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?

[243] ESAS it is a settlement account service for financial institutions. An ESAS account holder can conduct settlements with other account holders using central bank funds. Financial institutions such as smaller banks and non-banks have agency arrangements with ESAS account holders (that is, direct participants) that facilitate the settlement of transactions on their behalf. With SBI365, deposit takers offering ESAS agency facilities to other deposit takers may submit files on a 7-days-a-week basis and offer that service to their clients.

2.4 Treatment of non-deposit liabilities

829. OBR, and a number of potential alternative resolution tools, envisage the transfer of assets and liabilities to a healthy deposit taker or bridge institution (such as an acquirer). In these cases, the acquirer may temporarily rely on the systems and staff of the failed bank to provide continued access to customer accounts and to meet other payment obligations.

830. There is a risk that non-payment of a transferred liability could undermine the transition of liabilities to the acquirer or in some cases destabilise the acquirer itself. We may therefore need the following pre-positioning to ensure that transferred liabilities are paid appropriately. This is mainly relevant for non-deposit liabilities (for example, wholesale debt or operational liabilities), which are not otherwise pre-positioned for OBR.

Preferred option

831. We propose amending the requirements in BS17, Part C2.4 to incorporate a degree of pre-positioning for the unfreezing of non-deposit liabilities, as described below. As per BS17, we would envisage the resolution manager suspending payment of (that is, freezing) these liabilities upon entry into OBR.

Capability to apply variable unfreezing for non-deposit liabilities

832. To facilitate transfer in resolution, deposit takers should have the capability to deliver the following outcomes when the liability in question is transferred as part of a resolution measure:

- liabilities that are transferred in full – liability unfrozen in full (that is, payments no longer suspended)
- liabilities that are partially transferred – liability unfrozen on a pro-rata basis reflecting the percentage of the liability that is transferred (that is, payments no longer suspended on the transferred amount)
- liabilities (or portions of liabilities) that are not transferred – no unfreezing applied (that is, continue to suspend any payment in respect of the liability, unless otherwise directed by the resolution manager).

833. Deposit takers should have processes in place to deliver these outcomes before the next payment is due for the liability in question.

Analysis

834. OBR is primarily a stabilisation tool. It supports a number of potential final outcomes for the failed deposit taker's business. One potential outcome is the transfer of assets and unfrozen liabilities to a healthy acquirer. The original entity, containing frozen liabilities and any remaining assets, can then be placed into liquidation. The transfer process thereby crystallises the loss to frozen creditors and shareholders of the original entity or the deposit taker in resolution.

835. In the Issues Paper, we explore resolution tools that involve the transfer of part or all of the deposit taker's business to an acquirer shortly after entry into resolution. Examples of transfer tools are:

- sale of business – where selected assets and liabilities of the failed deposit taker are purchased by a third party and any remaining assets and liabilities not transferred remain with the failed entity which is then liquidated
- bridge institution – where selected assets and liabilities of the failed deposit taker are transferred rapidly to a Reserve Bank-controlled bridge institution for a temporary period while a suitable buyer is identified.

836. To meet the purposes of section 259 of the DTA, we would need to execute transfers in a way that maintains continuity of systemically important activities, and potentially other banking services where doing so mitigated a loss of confidence in the financial system. The acquirer may therefore need to work with the resolution manager to use the failed deposit taker's systems temporarily until the acquirer can migrate customers and products onto its own systems. However, the acquirer will not be subject to the same statutory moratorium and suspension of payment as the deposit taker in resolution.

837. To support an orderly transfer of liabilities, we consider that the additional pre-positioning described above would be necessary. We are interested in understanding what further costs would be incurred in developing the proposed capability.

Summary

838. We propose to require Group 1 deposit takers to develop a variable unfreezing capability for non-deposit liabilities. This will support an orderly exit from the OBR process as well as other resolution strategies that will make use of OBR to provide continuity of banking services.

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?

2.5 Additional measures to support continuity of access to deposits

Preferred option

839. At this stage, we do not propose further additions to the requirements in BS17 to support continuity of access to deposits under the new OBR Pre-positioning Standard.

Analysis

840. We have considered whether the OBR Pre-positioning Standard should further require Group 1 deposit takers to address any residual legal and operational challenges to delivering continuity of access to deposits under OBR or other potential resolution tools (for example, a sale of business or a bridge institution). We are still considering how such tools could operate, and the precise nature of the legal and operational risks will depend on the particular resolution tools in question.

841. For example, risks to continuity of access to deposits could potentially arise if suppliers, financial market infrastructures and other counterparties terminate, suspend or modify their arrangements with the failed deposit taker on the grounds of:

- the deposit taker's entry into resolution
- transfer of the deposit taker's rights under the contract to an acquirer or bridge institution established by the resolution authority
- onward provision of these services by the deposit taker in resolution to an acquirer on a temporary basis.

842. Provisions in the DTA and other factors identified below may help mitigate these potential risks. However, we welcome your feedback on the extent of risk that may remain, to inform our resolution planning and development of any future resolution-related standards.

843. Under section 287 of the DTA, 'restriction on resolution trigger' means that if the deposit taker enters resolution, the agreement with the deposit taker or a party to the agreement other than the deposit taker is not allowed to do any of the following:

- deny any liability or obligation under the agreement
- accelerate payment or performance of a liability or obligation
- terminate or close out any transaction relating to the agreement
- enforce any security interest under the agreement.

844. Section B3.1(11) of BS17 refers to the review of service contracts. The provision states that the bank must ensure that "any agency banking arrangements or contracts with service providers incorporate arrangements necessary to have continuing access to services that may be critical to the bank's continued operations when it enters statutory management".

845. Banks subject to the BS11 Outsourcing Policy[244] are also required to include prescribed contractual terms in their outsourcing arrangement. This limits the ability of outsourced service providers to stop providing these services if the bank enters statutory management.

846. It is also useful to note that the Financial Stability Board's Guidance on Continuity of Access to Financial Market Infrastructures (**FMIs**) for a Firm in Resolution provides that FMI rules and contractual arrangements of critical FMI service providers should allow a third party acquirer, bridge or successor entity to maintain the failed bank's participation during a resolution process.[245] While this does not currently apply to New Zealand-based FMIs, it would be possible to impose these requirements on a designated FMI under the Financial Market Infrastructures Act 2021.[246]

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[244] Reserve Bank of New Zealand – Te Pūtea Matua. (2017). BS11 Outsourcing Policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/policy/2017-09-19---final-bs11-redraft_2.pdf

[245] Financial Stability Board. (2017).Guidance on Continuity of Access to Financial Market Infrastructures (FMIs) for a Firm in Resolution https://www.fsb.org/2017/07/guidance-on-continuity-of-access-to-financial-market-infrastructures-fmis-for-a-firm-in-resolu

[246] For example., by making a standard under sections 31(1) and 34(1)(k) of the Act, *see* Financial Market Infrastructures Act 2021. https://www.legislation.govt.nz/act/public/2021/0013/latest/whole.html

Summary

847. At this stage, we do not propose to address residual risks to providing continuity of access to deposits in the OBR Pre-positioning Standard. We are still working through how resolution tools might operate in practice, and potential impediments to utilising these tools effectively. This suggests that any additional requirements to facilitate these tools would be better adopted through longer-term resolution-related standards if required.

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?

3 Proposed approach for Group 2 deposit takers

Preferred option

848. We propose that Group 2 deposit takers are subject to the same requirements under the OBR Pre-positioning Standard as we propose for Group 1 deposit takers (see section 2 above). However, we may decide to continue not applying OBR requirements to some Group 2 deposit takers not currently in scope for OBR, should we decide that this is not relevant to our resolution plan for that deposit taker.

Analysis

849. The majority of Group 2 deposit takers, for whom the predominant business model hinges on retail banking (66%), are already subject to BS17. While Group 2 deposit takers are less systemically important compared to Group 1 deposit takers, they often serve large numbers of retail customers and have the potential for sectoral or regional importance or servicing specific markets.

850. Failure of a Group 2 deposit taker could have adverse consequences on the continuity of systemically important activities, the economy and public confidence. This is primarily because of their intermediation role and the complexity and length of time required for resolving a Group 2 deposit taker. If the deposit taker is closed whilst undergoing resolution, a potentially significant number of customers (households and businesses) would have no access to their funds or banking services, causing adverse impacts on public confidence. This outcome may run counter to the section 259 of the DTA purpose of maintaining the continuity of systemically important activities.

851. Open resolution schemes provide ongoing liquidity to households and businesses despite the failure of the deposit taker. Requiring Group 2 deposit takers to pre-position for OBR expands their resolution options by preserving a range of exit options.

852. That being said, we expect that there will be a range of resolution options available for Group 2 deposit takers. As such, the application of OBR pre-positioning requirements will be assessed on an entity-by-entity basis. If we do not expect this pre-positioning to be needed

for the chosen resolution strategy(s) for a given deposit taker, there is little merit (and potentially confusion) from applying the standard.

853. BS17 currently applies to banks with at least $1 billion in retail deposits. With the implementation of our Proportionality Framework, we propose to remove the $1 billion deposit threshold for OBR and propose that OBR apply to Group 1 and Group 2 deposit takers (potentially with some exceptions). We propose to carry over the ability for a deposit taker to opt into the proposed OBR Pre-positioning Standard if it wants to do so.

854. We currently do not plan to extend the OBR Pre-positioning Standard to Group 2 deposit takers not currently covered by BS17 as this will depend on the outcome of our ongoing review of resolution strategies for deposit takers. This will inform whether OBR pre-positioning is likely to be relevant to our resolution plans for these deposit takers. Before finalising the new OBR Pre-positioning Standard, we will confirm whether or not these deposit takers will be exempt from applying it.

Summary

855. Our preferred approach is that Group 2 deposit takers should be subject to the same requirements under the OBR Pre-positioning Standard as Group 1 deposit takers. However, we may decide to continue not applying OBR requirements for some Group 2 deposit takers, once we have completed our review of deposit takers' resolution strategies.

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?

4 Proposed approach for Group 3 deposit takers

Preferred option

856. We do not propose to apply OBR pre-positioning requirements to Group 3 deposit takers under the OBR Pre-positioning Standard.

Analysis

857. Proportionality in financial system regulation ensures that prudential requirements are aligned to the deposit taker's systemic importance and risk profile as per our Proportionality Framework. Group 3 deposit takers have lower operational capability to manage detailed requirements or to absorb additional regulatory burden.[247]

858. In general, we see a lower need to resolve Group 3 deposit takers on an 'open bank' basis. These deposit takers generally pose lower risks to financial stability should we choose to resolve them through liquidation and a DCS payout.

859. We continue to work on a DCS payout mechanism that aims to enhance depositor outcomes. This includes providing prompt payment and mitigating any adverse implications for depositors, for example by opening bank accounts in another deposit taker on behalf of the

[247] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2024). A proportionality framework allows for diversity while promoting financial stability. https://www.rbnz.govt.nz/hub/news/2024/03/a-proportionality-framework-allows-for-diversity-while-promoting-financial-stability

insured depositor, as part of the payout process. For Group 3 deposit takers, we think that this is a more cost-effective way than OBR pre-positioning to limit the impact of resolution on financial stability and financial inclusion.

860. In some scenarios, we may also look at resolution tools that involve selling all or parts of the failed Group 3 deposit taker to another deposit taker. This may also help preserve continuity of access to deposits. However, unlike for Group 2, we do not see a strong case for additional pre-positioning by Group 3 deposit takers to support these types of tools. Given the limited scale and complexity of these deposit takers, and the generally lower risks to financial stability, it is more feasible that these tools could be delivered on an ad-hoc basis without costly pre-positioning in business as usual.

Summary

861. We do not propose to apply OBR pre-positioning requirements to Group 3 deposit takers under the OBR Pre-positioning Standard. Given the prospect of a DCS payout, and potentially other tools to resolve these entities, we do not consider it proportionate to require this pre-positioning.

Q121	Do you support the proposal that the OBR Pre-positioning Standard should not apply to Group 3 deposit takers?

5 Conclusion

862. We propose largely carrying over BS17 requirements into the OBR Pre-positioning Standard and updating its requirements to incorporate the protection afforded by the DCS. In summary our proposed standard would update the current requirements in BS17 as follows:

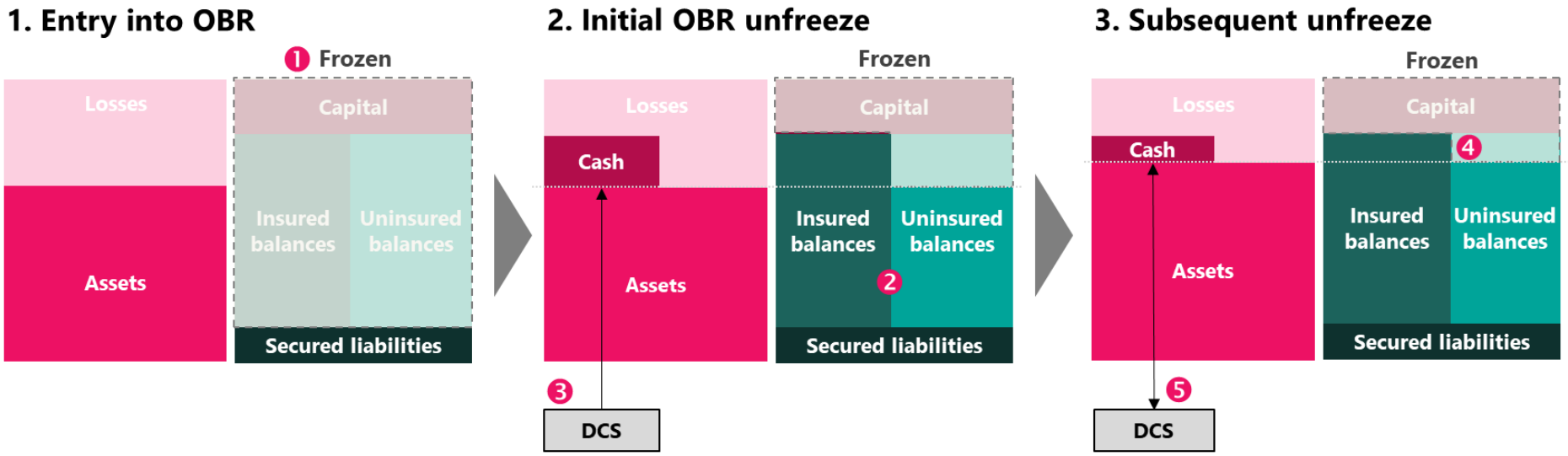
- expanding Part C3 to include the capability to identify insured and uninsured balances
- removing requirements in Part C4 to apply the *de-minimis*
- amending Part C5 to include capability to unfreeze insured balances
- expanding Part C7 to include the capability to subsequently release funds at customer account level
- introducing a new capability to report on amounts depositors are given access to
- introducing a new pre-positioning requirement to apply variable unfreezing to non-deposit liabilities
- replacing references to 'business day' with 'calendar day'.

863. We propose to apply the OBR Pre-positioning Standard to both Group 1 and Group 2 deposit takers with the ability to vary or waive the application of the standard depending on the expected resolution strategies for individual Group 2 deposit takers. This helps ensure that the application of the requirements would not be unduly burdensome on those Group 2 deposit takers not currently pre-positioned for OBR under BS17 and whose resolution strategy may not require such pre-positioning.

864. We do not propose to apply the standard to Group 3 deposit takers since the failure of a Group 3 entity would not pose a sufficient threat to financial stability to justify imposing the compliance costs of pre-positioning requirements on the group as a whole. A direct DCS payout is more likely to be a suitable and adequate resolution option for Group 3 deposit takers given that they do not perform systemically important activities, whilst still meeting the DTA objective of protecting eligible depositors.

865. Under the proposals, OBR pre-positioning would continue to facilitate the execution of resolution strategies to deal with deposit taker failures. The updated functionality would help accelerate depositors having access to their insured funds. This is important to meet the new purposes of the DTA resolution framework, including to protect depositors covered by the DCS, mitigate loss of confidence and where relevant, maintain continuity of systemically important activities.

Appendix 1: Diagrammatic overview of OBR–DCS integrated solution



Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 7

Deposit Takers Outsourcing Standard

Deposit Takers Non-Core Standards Consultation

21 August 2024

CONSULTATION PAPER

Non-technical summary

Outsourcing occurs when a deposit taker uses another party to perform business functions that would normally be undertaken by the deposit taker itself. Outsourcing can have a positive impact on a deposit taker's operations by reducing costs and allowing it to access specialist expertise that it cannot provide itself.

However, there is a risk that outsourcing arrangements complicate the resolution of a deposit taker should it fail. In particular, outsourcing could limit the range of resolution options available, and failure of a third party to perform the outsourced arrangements could also have the potential to disrupt the provision of everyday banking services. Our current Outsourcing Policy for Banks (BS11)[248] aims to ensure that a bank can continue to provide a basic level of banking services to customers even if it has failed, by placing restrictions on the ability to outsource key functions.

We propose to largely carry over the requirements in BS11 into our proposed Outsourcing Standard. We consider that the current BS11 requirements support the purposes of the DTA. Taking into account the principles in the DTA, and that the current version of BS11 was issued in 2017, we consider its requirements remain largely appropriate to carry over into the standard.

BS11 currently applies only to locally-incorporated banks whose New Zealand liabilities net of amounts due to related parties exceed $10 billion. This threshold currently captures the five largest banks, which present the greatest risk of significant damage to the financial system if they were to fail.

Although the rules in BS11 are largely fit for purpose, we are taking the opportunity to propose minor changes. These include updating references in relation to the new crisis management and resolution framework in the DTA, replacing the term 'business day' with 'calendar day' to align with similar proposed changes in the OBR Pre-positioning Standard, and moving references to 'guidance' to a separate Outsourcing Standard guidance document.

Overall, our policy proposal is that the core requirements of BS11, except for the minor changes mentioned above, be carried over to the new Outsourcing Standard under the DTA. We propose that the Outsourcing Standard will apply to all Group 1 deposit takers, and to Group 2 deposit takers that have either already been required to implement BS11 or who reach the threshold for BS11 before implementation of the Outsourcing Standard.

We do not propose that the standard apply to the rest of Group 2. However, we will review whether it is appropriate to apply any outsourcing requirements to other Group 2 deposit takers as part of our work on potential long-term standards for crisis preparedness. We do not propose to apply the Outsourcing Standard to Group 3 deposit takers.

[248] Reserve Bank of New Zealand – Te Pūtea Matua. (2017). Outsourcing Policy for Banks. https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/banks-outsourcing-policy

1 Introduction

866. Our current outsourcing requirements in BS11 are designed to ensure that the deposit takers covered by the policy can continue with essential operations and provide a basic level of banking services to their customers even in the event of a failure. If a deposit taker is part of an overseas-based banking group, there is an added requirement to develop robust separation plans.

1.1 Purpose of the Outsourcing Standard

867. When a deposit taker outsources its business functions to a third party, it may improve its services to customers but at the expense of potentially increased risks to financial stability. If a deposit taker failed, there would be direct costs to its owners, creditors and employees. However, there can also be wider costs to society such as the public losing temporary or even permanent access to funds for transactions, which in turn could have significant adverse effects on the wider economy. The public may also lose confidence in the financial system, thereby harming other institutions.

868. Outsourcing arrangements are relevant to domestic financial stability as they have the potential to cause disruption to the provision of critical services. There are also risks relating to over-reliance on outsourced activities that are critical to the viability of the deposit taker and its obligations to customers.

869. In addition, outsourcing arrangements can frustrate the resolution of a deposit taker by preventing it from being able to operate as a stand-alone entity. This may occur in cases in which the deposit taker is part of a wider banking group reliant on vital services (for example, IT, treasury or staff) from the parent institution or other related parties. In New Zealand the potential risks of outsourcing in relation to resolution are high given that a large proportion of the banking industry is part of foreign-based banking groups. An over-reliance on outsourcing could prevent the New Zealand subsidiary from being able to operate as a stand-alone entity should it be necessary to protect the stability of New Zealand's financial system.

870. Our proposed Outsourcing Standard reduces the risk of adverse impacts on financial stability by enabling a failed deposit taker to continue to provide liquidity to the financial system and economy by carrying on basic banking business.

1.2 Current approach

871. We first introduced BS11 in 2006.[249] The original BS11 focused on the ability of a failed deposit taker to provide and circulate liquidity and to retain legal and practical control of core banking functions under both normal business conditions and in events of stress. The original BS11 also recognised the benefits of outsourcing and was largely non-prescriptive.

872. Since 2006, we have reviewed and (in 2017) updated BS11 to ensure that in-scope banks (those that meet the current $10 billion total liabilities less liability to related parties threshold) can continue essential operations and provide a basic level of banking services to their customers if they fail. If a bank is part of an overseas-based banking group, there is an added requirement to develop robust separation plans (see section B5 of BS11).

[249] Reserve Bank of New Zealand – Te Pūtea Matua. (2006). Outsourcing Policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs11-06.pdf

873. BS11 aims to ensure that operational dependencies between the New Zealand subsidiary and its parent entity or related parties do not prevent the subsidiary from operating as a stand-alone entity if placed into statutory management and separated from the group. This enables the deposit taker to continue providing basic banking services, monitoring its financial position and meeting its daily domestic settlement obligations. It also enables the statutory manager to have a range of options available for managing the deposit taker.

1.3 Proposed policy development approach

874. Section 3 of the DTA sets out the purposes of the DTA while Part 7 sets out the additional purposes for crisis management and resolution.[250] Part 3 of the DTA provides that a standard may regulate, deal with or otherwise relate to outsourcing and may include mechanisms to support separability.[251]

875. We consider the current version of BS11 to be largely fit-for-purpose in terms of managing the risks that outsourcing presents to the orderly resolution of the five largest banks. The requirements are, in our view, necessary and proportionate to advance the purposes of the DTA, including the additional purposes in Part 7. Therefore, we do not propose to make major revisions to the policy in converting it to a standard. Paragraph 888 explains how we have had regard to the DTA principles in reaching this view.

876. We propose that the standard includes minor changes to the requirements in BS11. These include:

- replacing the term 'business day' in B1.1 of BS11 with 'calendar day', given the introduction of Settlement Before Interchange 365 (SBI365) (see section 2.2 below)
- incorporating, where appropriate, aspects of informal guidance into a formal guidance document accompanying the proposed standard
- clarifying the matters that we will have regard to when considering various approvals contained in BS11 (as per section 91 of the DTA).

877. We propose that the Outsourcing Standard will apply to all Group 1 deposit takers, and to Group 2 deposit takers that have either already been required to implement BS11 or who reach the threshold for BS11 before implementation of the Outsourcing Standard. We do not propose that other Group 2 deposit takers and Group 3 deposit takers will be covered by the Outsourcing Standard. However, we will review whether it is appropriate to apply any outsourcing requirements to other Group 2 deposit takers as part of our work on potential long-term standards for crisis preparedness or via the Operational Resilience Standard, detailed in chapter 4 of this Consultation Paper. We note that the proposed Operational Resilience Standard does not aim to duplicate or change the requirements that deposit takers would be subject to under the Outsourcing Standard.

878. By limiting the application of the proposed standard to larger banks that are covered by the BS11 policy, we have taken a proportionate approach to regulation and adopted consistency in the treatment of similar institutions, noting that the social cost of a large-bank failure exceeds the direct losses to its shareholders and creditors.

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[250] Deposit Takers Act 2023, section 259. https://www.legislation.govt.nz/act/public/2023/0035/latest/LMS528402.html
[251] Deposit Takers Act 2023, section 90. https://www.legislation.govt.nz/act/public/2023/0035/latest/LMS579791.html

879. Implementing the proposed standard carries compliance costs. For example, banks will need to maintain robust back up arrangements (that is, the system/function is duplicated and kept on standby) or alternative arrangements. Prescribed contractual terms must continue to be written into contracts with third party providers. Limiting the proposed standard to the large deposit takers avoids unnecessary compliance costs for other deposit takers.

880. We have published an Issues Paper on the crisis management framework under the DTA alongside this Consultation Paper.[252] The Issues Paper out our initial thinking on potential resolution strategies, the potential role of statutory bail-in and our longer-term intentions to develop a broader crisis preparedness standard. We see both the OBR Pre-positioning Standard and the Outsourcing Standard as important ongoing elements of our crisis management framework to enable us to meet the DTA purposes when resolving an in-scope deposit taker.

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?

2 Proposed approach for Group 1 deposit takers

2.1 General approach

Preferred option

881. For Group 1 deposit takers, we propose that the BS11 requirements are carried over into the Outsourcing Standard with minor changes as set out in paragraph 876 and sections 2.2 to 2.4.

882. The current requirements (section B1.1 of BS11) are that the bank is able to achieve the outcomes described below:

- continue to meet its daily clearing, settlement and other time critical obligations, before the start of the first business day after the day of failure and thereafter
- monitor and manage its financial positions, including credit, liquidity and market risk positions, both on the start of the first business day after the day of failure and thereafter
- make available the systems and financial data necessary for the statutory manager and the Reserve Bank to have available a range of options for managing the failed bank before the start of the business day after the day of failure and thereafter
- provide basic banking services to existing customers including, but not limited to, liquidity (access to both deposits and credit lines as defined in section A2.1 of BS11 - Basic banking services) and account activity reporting, both on the start of the first business day after the day of failure and thereafter.

883. Further, a bank that is part of a foreign-owned banking group must be able to achieve the outcomes above as a stand-alone entity in the event of a separation from its parent.

[252] Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Crisis Management Issues Paper. https://consultations.rbnz.govt.nz/dta-and-dcs/crisis-management-under-the-deposit-takers-act/user_uploads/crisis-management-issues-paper-august-2024.pdf

Analysis

884. Deposit takers generally outsource business activities, functions and processes to improve efficiency and meet the challenges of technological innovation and increased specialisation. However, outsourcing can increase a deposit taker's dependence on third parties as well as related parties, which may increase the risk profile of that deposit taker.

885. Banks' compliance with the requirements in BS11 supports the section 3 of the DTA purpose of avoiding or mitigating risks to the stability of the financial system as well as risks from the financial system that may damage the broader economy. Our approach is focused on whether the outsourcing arrangement is critical or important for the deposit taker to be able to deliver the desired outcomes. It is essential that the deposit taker can continue to carry out its critical functions even if it has failed.

886. The desired outcomes include the deposit taker's ability to meet daily clearing and settlement obligations, manage its financial positions and continue the provision of basic banking services to customers even whilst it is under statutory management. This means that the deposit taker would be able to continue to operate and service its customers following its failure, or the failure of any of its outsourced function providers. This reduces the wider systemic impacts when a large deposit taker fails.

887. Carrying over BS11 requirements into the proposed Outsourcing Standard therefore supports the DTA purposes of avoiding or mitigating risks to the stability of the financial system and risks that may damage the broader economy. It also supports the additional purposes for crisis management and resolution set out in section 259 of the DTA. For example, it supports our ability to deal with a deposit taker that is in resolution in an orderly manner, and to maintain the continuity of systemically important activities.

888. We also consider that carrying over BS11 requirements into the proposed Outsourcing Standard is appropriate, having taken into account the principles in section 4 of the DTA. In particular:

- BS11 is broadly consistent with the Financial Stability Board's Guidance on Identification of Critical Functions and Critical Shared Services, which has identified functions that, if disrupted or discontinued, would have a material impact on third parties.[253, 254] In BS11, section A2.1, we have listed services that constitute basic banking services, where disruption or sudden discontinuation of the function would likely have a material negative impact on a significant number of third parties that rely on such services, and lead to contagion effects, including adverse effects on public confidence. One of the objectives of BS11 is to facilitate the carrying on of basic banking services by any new owner of all or part of the failed deposit taker.[255] In this regard, carrying over BS11 requirements into the

[253] Functions identified include deposit taking; lending and loan servicing; payments, clearing, custody and settlement; and finance-related services. According to the Financial Stability Board, a function is critical if its disruption is likely to have a material negative impact on a significant number of third parties.

[254] *See* Financial Stability Board. (2013). Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Identification of Critical Functions and Critical Shared Services. https://www.fsb.org/wp-content/uploads/r_130716a.pdf

[255] While we propose no changes to the term basic banking services as defined in BS11, our new prudential regime under the DTA has introduced the concept of 'systemically important activities' and we further intend to introduce the concept of 'critical operations' (*See* the proposed Operational Risk standard, also under consultation). We will consider how these terms will intersect with each other further when we consider and consult on the future Crisis Preparedness Standard which is discussed in the Issues Paper published alongside this Consultation Paper.

Outsourcing Standard responds to guidance from international organisations on financial system regulation.

- BS11 requires annual testing of end-to-end functionalities for backup arrangements and the testing of separation plans. This promotes a culture that is sensitive to weaknesses that may prevent the deposit taker from continuing to provide critical services if it fails. As such, carrying over BS11 requirements into the Outsourcing Standard promotes sound governance of banks' ongoing compliance.
- Lastly, carrying over BS11 requirements into the Outsourcing Standard helps to facilitate the option to put a large bank into resolution if it fails, thus promoting competition and effective risk management. During the 2007–08 GFC, large or systemic banks in many international jurisdictions received government bail-outs to avoid their failure. Thus, ensuring that even large banks can exit the market safely and in an orderly manner (a primary purpose of resolution) helps maintain competition, addressing the moral hazard created by too-big-to-fail institutions.

889. We do not foresee significant additional set-up and ongoing costs arising from the conversion of BS11 to a standard, as we are not proposing any substantial changes to the policy. Moreover, we are not extending the scope beyond deposit takers who are already covered by BS11 (or who come within scope of BS11 before the introduction of the Outsourcing Standard).

Summary

890. We are satisfied that the proposed standard is necessary or desirable for the purposes in sections 3 and 259 of the DTA, taking into account the principles in section 4. Therefore, we consider that BS11 requirements are appropriate to be carried over into the proposed Outsourcing Standard, subject to the amendments set out in sections 2.2–2.4 below.

Q123	Do you agree with our assessment of the requirements in the existing outsourcing policy, BS11, against the purposes and principles of the DTA?

2.2 Impact of SBI365

891. On 26 May 2023, the settlement of retail electronic payments amongst participants was extended to 7 days a week, 365 days a year. One benefit of this project, known as SBI365, is the reduced number of retail payments that remain in-flight (that is, pending settlement) during non-business days because of more frequent settlement.

Preferred option

892. We are proposing to replace references to 'business day' in BS11 with 'calendar day' in the Outsourcing Standard now that industry has adopted SBI365's 7-days-a-week settlement of payments. This change would only apply to the section of the policy about the settlement outcomes that the deposit taker must meet (section B1.1 of BS11). References to business day in relation to the processing time for assessing an application for temporary suspension in case of extreme events (section B2.10 of BS11), the processing time for considering an application for non-objection (section B3 of BS11) and the deadline for submitting the compendium (section B4 of BS11) would not be replaced with calendar day. Our proposal aligns with the approach we have proposed for the OBR Pre-positioning Standard.

Analysis

893. Both the proposed Outsourcing Standard and the OBR Pre-positioning Standard have implications for the resolution of deposit takers and associated consequences on payment flows and customers having access to their funds.

894. For instance, section B1.1 3(a) of BS11 specifies that banks must be able to meet their daily clearing, settlement and other time critical obligations before the start of the first business day after the day of failure. With our proposed change, deposit takers would need to be able to perform this function before the start of the next calendar day after a failure.

895. This proposal supports our ability to carry out orderly resolutions over a weekend in line with the Part 7 of the DTA Purposes. In particular, our proposal helps limit disruption to systemically important banking services and mitigates a potential loss of confidence in the financial system.

896. Implementing this change will involve some costs. Given that BS11 already requires banks to be able to reopen the next business day, we expect that the costs of moving to a calendar day will be relatively small (consistent with the need to avoid unnecessary compliance costs) and proportionate to the benefits (consistent with the desirability of taking a proportionate approach to regulation and supervision). However, we welcome your feedback on the potential scale of these costs.

897. Reference to the processing times for our assessments will not be replaced by calendar day, as this refers to our staff working on the application during the regular work week. This includes an application for the temporary suspension from risk mitigation requirements under section B2.10 of BS11 or considering a non-objection under section B3.3 of BS11. Similarly, the timeframe for deposit takers to update their compendium under section B4.3 of BS11 will remain as is.

Summary

898. We propose amending relevant references from 'business day' to 'calendar day' when carrying over the requirements of section B1.1 of BS11 into the Outsourcing Standard. This will help limit the disruptiveness of resolutions and other separation events taking place on non-business days.

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?

2.3 Treatment of informal guidance

Preferred option

899. The proposed standard will be accompanied by a separate guidance document. We propose to move existing guidance clauses in BS11 to this document, and to incorporate aspects of other informal policy documents in the guidance where appropriate. We expect to retain any content not incorporated in this guidance in some other form.

Analysis

900. There are some clauses within BS11 that are in the form of guidance. We are not currently planning to have guidance clauses embedded in the Outsourcing Standard and intend to reflect most of them in a separate guidance document for the standard.

901. In the process, we will consider whether any aspects of the guidance state something that in practice must be complied with. A potential example is the guidance stating that a critical service providers list will have to be agreed with us on a deposit taker-by-deposit taker basis. In such cases it may be appropriate to incorporate the requirement within the Outsourcing Standard rather than in the guidance document.

902. We propose to carry over the current guidance document for the Preparation of a Separation Plan.[256] We will also consider what aspects of other informal policy documents, such as the Exempt List, the List of pre-approved Functions and Services, as well as non-published FAQs and letters, should be included as guidance. Potential benefits include enhancing transparency, simplifying the currently dispersed range of guidance and supporting assurance.

Summary

903. We propose creating a guidance document to accompany the Outsourcing Standard, incorporating sections of BS11 that are guidance in nature rather than formal compliance requirements. The guidance document will also incorporate related supervisory and/or policy documents to formalise currently informal guidelines where appropriate.

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?

2.4 Approval requirements

Preferred option

904. In the Outsourcing Standard we intend to set out matters that the Reserve Bank will have regard to when considering the various approvals currently required under certain sections of BS11 (for example, the requirement in BS11, section D1.3), for the Reserve Bank to approve the appointment of a person to carry on an independent external review of the deposit taker's compliance with BS11, and the terms of reference for that review). These matters include:

- whether the approval is consistent with the purposes of the DTA (for example, protecting and promoting the stability of the financial system)
- the extent to which the proposal may impact the deposit taker's ability to deliver the outcomes currently set out in section B1.1 of BS11
- the extent to which the proposal may impact the Reserve Bank's ability to deal with distressed deposit takers in an orderly manner

[256] Reserve Bank of New Zealand – Te Pūtea Matua. (2017). Guidance for the Preparation of a separation plan for BS11: Outsourcing Policy. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/outsourcing-policy-for-registered-banks/completed/20170929-guidance-for-the-preparation-of-a-separation-plan.pdf

- that the approval should be no broader than reasonably necessary to address the matter giving rise to it.

905. Where appropriate, we may provide further detail on what the Reserve Bank must be satisfied of in making its assessment.

Analysis

906. BS11 contains a number of requirements or options to obtain the Reserve Bank's approval, agreement, or non-objection. In particular:

    - section B2.1(4) permits a bank to seek the Reserve Bank's agreement, by way of a notice of non-objection, to substitute the parallel rights component of the prescribed contractual terms with robust back-up capability or alternative arrangements
    - section B5.3(1) requires a bank to obtain non-objection from the Reserve Bank before the bank finalises its separation plan
    - section D1.3(1) requires the Reserve Bank's approval of both the person nominated by the bank to carry out the annual independent external review required under section D1.2, and the terms of reference for the review
    - section D2.2(1) imposes similar requirements for the three-yearly post-implementation review required under section D2.1.

907. Section 91 of the DTA permits us to include approval requirements in standards. In doing so, we must set out an appropriate manner in which we must decide whether to give approval and any conditions of the approval (for example, by specifying the matters that we must have regard to, or be satisfied of, when deciding those matters).

908. Our assessment of the approvals under the proposed standard must ultimately be made in reference to the relevant purposes and principles of the DTA. We consider that the requirements of BS11 (including the outcomes in section B1.1) are necessary and appropriate to pursue the purposes of the DTA, and therefore would also influence our assessment of requests for approval, agreement or non-objection.

Summary

909. In line with our statutory obligations, the proposed Outsourcing Standard will provide additional detail on the matters we will have regard to when considering approvals under the proposed standard, based on the purposes and principles of the DTA.

3 Proposed approach for Group 2 deposit takers

910. BS11 currently applies to Group 2 deposit takers that meet the $10 billion (total liabilities less liability to related parties) threshold. Current outsourcing requirements are narrower for banks that are not part of a foreign-owned banking groups. The focus of BS11 for banks that are not part of foreign-owned banking groups is to remediate existing and new independent third-party supplier arrangements by including relevant prescribed contractual terms and assessing suppliers' business continuity plans.

Preferred option

911. We do not propose applying the Outsourcing Standard to all Group 2 deposit takers. We propose that the standard apply only to deposit takers already required to implement BS11 or required to implement BS11 before the introduction of the Outsourcing Standard.

912. We intend to review which outsourcing-related requirements could be required to deliver the orderly resolution of Group 2 deposit takers in general. However, we propose to do so as part of our work on potential longer-term standards for crisis preparedness, rather than in the (initial) Outsourcing Standard. This approach will provide further time to consider the resolution strategies we may apply to Group 2 deposit takers under the DTA, and the potential risks that outsourcing arrangements could present to the effective execution of these strategies.

Analysis

913. Applying the existing BS11 requirements to all Group 2 deposit takers would entail compliance costs. These costs may be particularly significant if a bank is part of an overseas-based banking group and subject to separation planning requirements. Unless (or until) these costs are clearly justified by the benefits to those banks' orderly resolution, we do not consider it proportionate to extend BS11 to all Group 2 deposit takers.

914. We also need to consider transitional arrangements. To date, Kiwibank Limited is the only deposit taker in Group 2 that has exceeded the $10 billion (total liabilities less liabilities to related parties) threshold and it has already implemented BS11. There may also be other Group 2 deposit takers that cross the BS11 threshold between now and when the Outsourcing Standard comes into force (expected mid-2028).

915. To provide a degree of continuity, we propose applying the Outsourcing Standard requirements to a given Group 2 deposit taker if it has already been required to implement BS11. This approach retains the benefits of BS11 compliance while longer-term requirements for Group 2 deposit takers are finalised. We do not expect that implementing the Outsourcing Standard will result in significant additional compliance costs for deposit takers that have already implemented BS11, given that we are carrying over the majority of the BS11 requirements (with minor updates). We will also endeavour to consult on the longer-term requirements for other Group 2 deposit takers before issuing the final Outsourcing Standard.

916. An alternative option would be to not apply the initial Outsourcing Standard to any Group 2 deposit takers. However, we do not favour this option for two reasons:

- it could limit our ability to effectively deal with a potential failure of a Group 2 deposit taker (given that one is in scope of BS11) during the transition period before any longer-term standards are implemented
- it could increase overall compliance costs for deposit takers, for example if the deposit taker entered into outsourcing arrangements during the transition period which subsequently needed to be changed or updated in response to longer-term outsourcing requirements.

917. We recognise that our proposed approach may result in a degree of inconsistency of treatment over different Group 2 deposit takers. However, we view this as a pragmatic and reasonable outcome while we work towards a more consistent approach over time.

918. Finally, BS11 requirements are significantly less burdensome if a bank is not part of an overseas-based banking group. This also helps ensure a proportionate approach for Group 2 deposit takers that are New Zealand-owned, which includes the only Group 2 deposit taker that has been required to implement BS11 to date (Kiwibank Limited).

Summary

919. We propose to not apply outsourcing requirements to all Group 2 deposit takers, at least initially. We intend to review the need for this as part of our longer-term crisis preparedness standard. We propose applying the Outsourcing Standard to specific Group 2 deposit takers if they have already been required to implement BS11.

Q126	Do you agree with the proposal for the new Outsourcing Standard to apply only to deposit takers already required to implement BS11 or required to implement BS11 before the introduction of the Outsourcing Standard?

4 Proposed approach for Group 3 deposit takers

Preferred option

920. We propose that the Outsourcing Standard does not apply to Group 3 deposit takers, in light of the proportionality framework which includes consideration of deposit takers' size and nature of business and their relative importance to the stability of the financial system.

Analysis

921. Group 3 deposit takers are smaller deposit takers composed mainly of credit unions, building societies and finance companies. There is a relatively high regulatory burden or compliance cost in applying our proposed Outsourcing Standard requirements to Group 3 deposit takers, given the stringent requirements we set including external assurance reviews.

922. Furthermore, the proposed requirements may be less relevant to the orderly resolution of Group 3 deposit takers. In general, we see a lower need to resolve Group 3 deposit takers on an 'open bank' basis. These deposit takers generally pose lower risks to financial stability should we choose to resolve them through liquidation and a DCS payout.

Summary

923. The policy is not relevant to Group 3 deposit takers given their business model, size and ability to be resolved potentially using a DCS payout rather than on an open-bank basis.

5 Conclusion

924. Overall, our policy proposal is that all aspects of BS11 except for the updates mentioned above will be carried over from the existing regime to the new Outsourcing Standard under the DTA. We propose that certain aspects of BS11 and other relevant policy documents be incorporated as a separate guidance document.

925. We also propose that the policy continue to apply and be limited to Group 1 deposit takers along with those Group 2 deposit takers who are currently in scope of BS11, or who fall in scope of BS11 before the introduction of the Outsourcing Standard.

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 8

Deposit Takers Restricted Activities Standard

Deposit Takers Non-Core Standards Consultation

21 August 2024

CONSULTATION PAPER

Non-technical summary

The proposed Restricted Activities Standard covers a range of restrictions or prohibitions on deposit takers' activities. These are designed to promote the safety and soundness of each deposit taker and protect and promote the stability of the financial system.

The proposed standard sets out the restrictions or prohibitions on deposit takers' activities carried out other than in their capacity as a deposit taker or otherwise outside New Zealand. We also propose to include a restriction relating to covered bonds. These restricted activities are derived from existing prudential requirements for registered banks. We consider these restrictions to be an important aspect of an effective prudential regime for deposit takers and propose to consolidate them into the Restricted Activities Standard.

This chapter sets out key aspects of the proposed Restricted Activities Standard. In particular, we propose that the standard set out four types of restrictions:

- restrictions on deposit takers conducting insurance business
- restrictions on deposit takers conducting material non-financial activities
- restrictions on locally-incorporated banks setting up overseas subsidiaries or branches
- restrictions on the proportion of assets that may be encumbered when issuing covered bonds.[257]

For NBDTs, which would be licensed as Group 3 deposit takers, the proposed standard would impose new restrictions and prohibitions. However, we understand that no NBDTs currently engage in activities that would be subject to the proposed prohibitions or restrictions. Therefore, we consider that the proposals will have little to no impact on their business.

We propose to restrict the ability of branches to conduct insurance business and material non-financial activities.

[257] A covered bond is a debt instrument, generally issued by a bank, that is secured by a specific pool of assets.

1 Introduction

926. This chapter outlines the content of our proposed Restricted Activities Standard for deposit takers.

1.1 Purpose of the Restricted Activities Standard

927. The proposed Restricted Activities Standard will contribute to financial stability by restricting activities we have assessed as posing a risk to the safety and soundness of individual deposit takers and, in some cases, the stability of the financial system. It will also promote public confidence in the financial system.

928. The proposed restrictions are drawn from the current prudential regime for registered banks and are not currently features of the NBDT regime (see section 1.2). The ability to make a restricted activities standard is granted under Part 3 of the DTA, which provides an opportunity to group these restrictions into one standard.

929. The proposed standard would apply to Group 1, Group 2 and Group 3 deposit takers, as we consider a consistent approach across all deposit takers would best manage the risks to individual deposit takers as well as the financial stability risks associated with these activities.

1.2 Current approach

930. The restrictions that would be covered by the proposed Restricted Activities Standard are currently set out in the banking prudential requirements and Banking Supervision Handbook documents, in particular the Statement of Principles – Bank Registration and Supervision (BS1).[258]

931. BS1 sets out the following restrictions and prohibitions on an applicant seeking to register as a locally-incorporated registered bank:

- the banking group must not conduct any material insurance underwriting business,[259] and must restrict the conduct of life and general insurance business of an underwriting nature to no more than 1% of its total consolidated assets[260]

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[258] Reserve Bank of New Zealand – Te Pūtea Matua. (2021). BS1 – Statement of Principles – Bank Registration and Supervision. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs1-statement-of-principles.pdf. All further references to BS1 in this chapter will just consist of BS1 followed by a paragraph or section number.

[259] *See* BS1, paragraph 14. 'Insurance business' means the undertaking or assumption of liability as an insurer under a contract of insurance. 'Insurer' and 'contract of insurance' have the same meaning as provided in the Insurance (Prudential Supervision) Act 2010, sections 6 and 7. *See* BS1, Appendix One, section I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 3.

[260] *See* BS1, paragraph 61. Where the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity. Where the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity's insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business. *See* BS1, Appendix One, section I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 3.

- the banking group must not conduct any material activities of a non-financial nature, using a materiality threshold based on generally accepted accounting practice (GAAP)[261]
- if it wants to establish a subsidiary, branch or representative office in another country, the bank must seek our approval before making an application to the host supervisor or licensing authority[262]
- the bank must conduct a substantial proportion of its business in and from New Zealand[263]
- no more than 10% of the banking group's total assets may be beneficially owned by a covered bond special purpose vehicle (SPV).[264]

932. Similarly, BS1 imposes the following restrictions and prohibitions on overseas banks seeking to set up a branch in New Zealand:

- the banking group must not conduct insurance underwriting business greater than 1% of a banking group's total consolidated assets[265]
- the banking group must not conduct any material activities of a non-financial nature, using a materiality threshold based on GAAP[266]
- the business of the branch in New Zealand must not constitute a predominant proportion of the total business of the registered bank.[267]

1.3 Proposed policy development approach

933. This chapter sets out the proposed approach to requirements under a restricted activities standard for each Group of deposit takers under the Proportionality Framework.[268] It discusses specific policy proposals for each Group and seeks stakeholder feedback.

934. Our starting point for developing the Restricted Activities Standard was to begin with the restrictions in the current bank prudential regime (in particular, in BS1) and then to evaluate whether they remain relevant and appropriate for a standard under the DTA.

935. For locally-incorporated deposit takers, we have identified existing restrictions that we consider should be in the scope of the proposed Restricted Activities Standard (see section 1.2). These include:

- a restriction on deposit takers conducting insurance business

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[261] *See* BS1, paragraph 14. BS1 does not define 'financial' or 'non-financial' business or services, as it recognises that the types of services provided by banks evolve and develop over time (*see* BS1 Appendix One, section I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 2). However, when considering whether or not a particular service is 'financial', the Reserve Bank will have regard to the types of services commonly offered by banks in New Zealand and in other similar countries (*see* BS1 paragraph 18). Traditional banking activities include the activities of borrowing and lending, the provision of treasury and payments services and related financial services (*see* BS1, paragraph 60).

[262] BS1, paragraph 136.

[263] BS1 Appendix One, section I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 10.

[264] BS1 Appendix One, section I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 13.

[265] BS1 Appendix One, section II Conditions of Registration for Overseas Incorporated Registered Banks, paragraph 2.

[266] BS1 Appendix One, section II Conditions of Registration for Overseas Incorporated Registered Banks, paragraph 1.

[267] BS1 Appendix One, section II Conditions of Registration for Overseas Incorporated Registered Banks paragraph 3.

[268] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2024, 14 March) Proportionality Framework for Developing Standards Under the Deposit Takers Act. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf

- a restriction on deposit takers conducting material non-financial activities
- restrictions relating to locally-incorporated deposit takers setting up subsidiaries or branches overseas
- a restriction on the amount of assets a deposit taker may encumber when issuing covered bonds.

936. We consider that the proposed restrictions should be applied across Group 1, Group 2 and Group 3 deposit takers. We believe this is necessary and prudent as the restrictions help to reduce the risks facing individual deposit takers (and in certain cases their depositors and/or creditors). Therefore, we consider that no distinction between Groups of deposit takers is warranted. Application of the Proportionality Framework to each proposed restriction is discussed in the sections below.

937. For branches of overseas deposit takers, we propose to continue to restrict the conduct of insurance business and material non-financial activities. The existing restriction that the branch in New Zealand must not constitute a predominant proportion of the total business of the overseas bank, has been proposed in the Branch Standard and so is out of scope of this standard.

938. We consider that this approach would help to protect and promote the stability of the financial system, and the safety and soundness of individual deposit takers. Additionally, applying the restrictions across all deposit takers promotes consistency and minimises compliance costs for deposit takers that move between the Groups. We seek your feedback on this matter.

939. Given that registered banks are already subject to the proposed restrictions, we consider our proposed approach will avoid unnecessary compliance costs for Group 1, Group 2 and Group 3 deposit takers that are registered banks and for branches of overseas deposit takers. Generally, transposing current restrictions or prohibitions to the new standard is the simplest and most effective way of avoiding unnecessary compliance costs, as it avoids the need for restructuring of business arrangements should an entity move between Groups. Expected compliance costs in relation to each proposed restriction are discussed further in the sections below.

940. As noted in section 1.2, it is important to acknowledge that, while some of these restrictions already apply to registered banks in some form, they will largely be new for Group 3 deposit takers that are NBDTs. However, we understand that no NBDTs currently engage in activities that would be subject to the proposed prohibitions or restrictions, therefore we consider that the proposals will have little to no impact on their business. We seek feedback from NBDTS on this matter. Compliance costs and impacts of the proposed restrictions for Group 3 deposit takers are discussed further at section 4 below.

941. We have proposed restrictions relating to deposit takers setting up an overseas branch or subsidiary (see section 2.3). As set out in the Introduction, we currently do not have a comprehensive group supervision policy for groups comprised of a New Zealand-incorporated bank with overseas branches or subsidiaries. We are actively considering how to develop a group supervision framework under the DTA and, as part of this work, may consider whether there is a need to introduce a separate licensing regime for groups in future. However, this is not in scope of this consultation paper.

Q127	Do you agree with our proposed approach to developing the Restricted Activities Standard?
Q128	What do you think the compliance costs associated with the restrictions and prohibitions in the proposed standard are likely to be? Is there another way that we can achieve our policy intent with lower compliance costs?

2 Proposed approach for Group 1 deposit takers

942. In the following sections, we discuss the proposed restricted activities for Group 1 deposit takers, which would be implemented via the proposed standard. This would replace the existing restricted activities by banks, as set out in section 1.2 above.

2.1 Restriction on insurance business

Preferred option

943. We propose to carry over the existing requirements in BS1 that restrict the ability of deposit takers to conduct insurance business.[269]

944. We propose to retain the current quantitative threshold of the deposit taker's group insurance business being no more than 1% of total consolidated assets, likely using the entity-based formulation in BS1.[270]

Analysis

945. We believe that this restriction should be maintained in the DTA context. This restriction is a response to the difficulty that arises in establishing capital-adequacy measures, and the meaningfulness and comparability of disclosures, where insurance business and deposit taking are conducted by the same legal entity.[271]

946. The nature of risk involved in insurance business is different from that of deposit taking because of the loss that may arise from inappropriately calculated underwriting risk or unexpected catastrophic events resulting in an excessive quantity of claims. The proposed restriction would therefore reduce the level of risk that deposit takers are exposed to and support more effective management of capital, liquidity and risk by deposit takers. This will contribute to the safety and soundness of each deposit taker and, by extension, the stability of the financial system.

947. We propose to retain the current quantitative threshold of the deposit taker's group insurance business being no more than 1% of total assets, likely using the entity-based formulation outlined in BS1.[272] We believe the 1% limit previously applied is most appropriate as it allows for some flexibility where insurance underwriting is incidentally undertaken during the course of deposit-taking business. We seek feedback on whether this limit is appropriate, too low or too high.

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[269] BS1, paragraphs 14 and 61.
[270] BS1 Appendix One, section I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 3.
[271] BS1, paragraph 60.
[272] BS1 Appendix One, I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 3.

948. We considered whether we should carry across the 'material degree' limitation from BS1[273] and have determined the limitation is not necessary. We consider that a quantitative threshold is more useful for transparency, compliance and enforceability, and that a streamlined approach will reduce compliance costs for entities.

949. There are not likely to be any unnecessary compliance costs for Group 1 deposit takers associated with the proposed restriction. It is currently a part of our prudential regime, and we expect banks already to be compliant. Transposing the existing restriction to the new standard is the simplest and most effective way of minimising the compliance costs that Group 1 deposit takers would face under the transition to the DTA.

950. Where deposit takers undertake insurance business, we expect there would be compliance costs to ensure that the quantitative threshold is not breached. We consider that any impact will be marginal and is justified when considering the purpose of the DTA as well as the other relevant DTA principles, our financial stability objectives and the public interest.

951. We note that is it possible for insurance business to be conducted by a legal entity separate from the deposit taker, but within the same group, that is not a subsidiary of the deposit taker (for example, a sister company). This could support a greater diversity of institutions and competitiveness within the deposit-taking market, while ensuring balance sheet separation of deposit takers and insurers to mitigate the risks identified above.

Summary

952. We propose to restrict the insurance business of a deposit taker to no more than 1% of the deposit-taking group's total assets.

Q129	Do you agree with our proposal to restrict insurance business by deposit takers?
Q130	Do you agree with our proposed quantitative threshold of no more than 1% of the deposit-taking group's total assets? Do you think this limit remains appropriate, or is there a risk of this threshold being breached where insurance underwriting is incidentally undertaken during the course of deposit-taking business?

2.2 Restriction on material non-financial activities

Preferred option

953. We propose to carry over into the Restricted Activities Standard the existing requirement in BS1 that restricts the ability of deposit takers to conduct material non-financial activities.[274]

954. When considering whether a particular service is financial, we propose to have regard to the types of services commonly offered by deposit takers in New Zealand and in other similar

[273] BS1, paragraph 14; BS1 Appendix One, section I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 2.
[274] BS1, paragraph 14; BS1 Appendix One, section I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 3.

countries.[275] This may include the business of borrowing and lending money[276] or other types of financial services, as set out in the FMCA.[277] The types of services provided by deposit takers may evolve and develop over time.

Analysis

955. We believe that this restriction should be maintained in the DTA context. The rationale for this restriction is similar to that for restricting insurance activities, namely that including both deposit taking and non-financial activities on the balance sheet affects the accuracy and usefulness of capital-adequacy measures, as well as the meaningfulness and comparability of disclosures.

956. This restriction would help prevent issues in measuring risk whilst also reducing the impact of exposing deposit takers to a greater variety of business risks associated with non-financial activities. For example, a deposit taker's assessment of the profitability of a non-financial venture may not consider the harm to the financial system should the non-financial business run into difficulty, and this could pose a risk to the deposit-taking business.

957. The proposed restriction would therefore support more effective management of capital, liquidity and risk by deposit takers. It would also contribute to the safety and soundness of deposit takers and, by extension, the stability of the financial system.

958. We propose to maintain a materiality threshold and we seek your feedback on what this should look like. The current approach in BS1 is based on the definition of materiality in GAAP.[278] We understand that the current approach is well understood by industry, as GAAP-based materiality thresholds are used for financial reporting purposes.

959. A qualitative limit, like the GAAP-based limit, has some benefits as it avoids arbitrary cutoffs, can be proportionate to the size of the entity engaging in non-financial activities and allows for some regulator discretion where a breach is not intentional. For example, it may be easier for a smaller depositor taker to unintentionally breach a quantitative limit following an insolvency event, whereas the limit may not be so easily breached with a qualitative limit. We are also considering whether another qualitative threshold, not reliant on GAAP, and supported by guidance, could be more appropriate.

960. As an alternative, a quantitative threshold (for example, 1% of total assets or 5% of net income) would provide clarity. We seek your feedback on whether the likelihood of an insolvency event, resulting in a breach of a quantitative materiality threshold of 1% of total assets or 5% of net income, would be a meaningful risk and would there be a need to accommodate this risk within the proposed restriction?

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[275] BS1, paragraph 18.

[276] Deposit Takers Act 2023, Schedule 2, Clause 2.

[277] Financial services are defined in the Financial Markets Conduct Act 2013, section 6, as well as in the Financial Service Providers (Registration and Dispute Resolution) Act 2008, section 5.

[278] BS1 Appendix One, I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 2. Under GAAP, the materiality threshold is reached if, given full consideration of the surrounding circumstances at the time of completion of the financial statements, a statement or fact is of such a nature that its disclosure, or the method of treating it, would be likely to influence the making of decisions by the users of the financial statements. Materiality is a matter of professional judgement, but some quantitative rule-of-thumb methods include any amount that exceeds 5% pre-tax income, 0.5% of total assets, 1% of shareholder equity or 1% of total revenue (*see* External Reporting Board –Te Kāwai Ārahi Pūrongo Mōwaho. (1985). Materiality In Financial Statements. https://www.xrb.govt.nz/dmsdocument/759

961. There are not likely to be any unnecessary compliance costs for Group 1 deposit takers associated with the proposed restriction. The restriction is currently a part of our prudential regime, and we expect banks already to be compliant. This approach would avoid unnecessary transition costs for Group 1 deposit takers under the transition to the DTA.

962. Where deposit takers undertake non-financial activities, we expect there would be monitoring costs to ensure that the quantitative threshold is not breached. We consider that these minor/moderate costs are justified when considering the benefits to financial stability from Group 1 depositors not being exposed to risks from non-financial activities, and from the depositors and other market participants having an accurate understanding of the risks that Group 1 deposit takers are exposed to.

963. We recognise that this proposed restriction may make it more difficult for businesses undertaking non-financial activities to enter the deposit-taking market, as they would need to establish a separate legal entity. This may have a negative impact on competition within the deposit-taking sector as well as in the diversity of institutions providing access to financial products and services. However, we consider that the impact is justified when considering the purpose of the DTA as well as other the relevant principles and our financial stability objectives.

Summary

964. We propose to restrict the conduct of material non-financial activities by deposit takers.

Q131	Do you agree with our proposal to restrict the conduct of material non-financial 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?
Q133	Do you consider that there is a material risk that, in a scenario where a deposit taker assumes control of a non-financial business following an insolvency event, a quantitative materiality threshold of 1% of total assets or 5% of net income could be breached? If so, what do you think we could do to accommodate this risk within the proposed restriction?

2.3 Restrictions on setting up an overseas branch or subsidiary

Preferred option

965. We propose that deposit takers wanting to set up a branch or subsidiary overseas notify us before approaching the host supervisor and then seek our approval once the host supervisor has given their approval. Figure 5 below provides an overview of the proposed process.

966. This would amend the existing requirement in BS1 for banks wanting to establish a branch or subsidiary overseas to first seek our approval before approaching the host supervisor.[279]

967. We also propose to develop an approvals regime, which would set out the factors upon which we would decide to approve the setting up of an overseas branch or subsidiary under section 91(2) of the DTA.

Figure 5: Process for deposit takers establishing an overseas branch or subsidiary

Analysis

968. When a deposit taker sets up operations overseas (for example, by establishing or purchasing an international entity), we become the home regulator of an internationally active deposit taker. We currently do not have a formal regulatory framework for groups comprised of a New Zealand-incorporated bank with overseas branches or subsidiaries, meaning that there could be a regulatory gap that could create additional risks to the New Zealand financial system. This is because overseas entities can create jurisdictional issues for our regulation, which is especially the case when there is not an existing close regulatory relationship between the home and host regulators:

- overseas branches or subsidiaries can pose a financial stability risk to New Zealand.[280] For example, cross-border deposit takers can be affected by economic shocks or macroprudential policy in overseas jurisdictions, which can threaten the viability of the group or entity through contagion risk
- there are challenges in effectively regulating and supervising deposit takers operating overseas on a group level. For example, as subsidiaries would be incorporated overseas, we would encounter jurisdictional issues in effective regulation, supervision (including limited on-site supervisory powers) and enforcement of New Zealand prudential standards.[281]

969. The approach outlined above would allow us time to ensure that there are appropriate mechanisms in place between the home and host regulators to ensure there is sufficient supervisory oversight over the group or entity, supporting the safety and soundness of each deposit taker and mitigating the effects of risks to the stability of the financial system.

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[279] BS1, paragraph 136. Under sections 90(1)(b), 90(1)(c) and 91(1) of the Deposit Takers Act 2023, the Reserve Bank is empowered to issue a standard restricting banks establishing an overseas branch or subsidiary.

[280] *See* Basel Committee on Banking Supervision. (1983, May). Principles for the supervision of banks' foreign establishments (Basel 1983 Concordat). https://www.bis.org/publ/bcbsc312.pdf

[281] *See* Basel Committee on Banking Supervision. (1983, May). Principles for the supervision of banks' foreign establishments (Basel 1983 Concordat). https://www.bis.org/publ/bcbsc312.pdf

Notification and approval requirements to set up a branch or subsidiary overseas

970. We consider it appropriate for deposit takers to notify us before approaching a host supervisor about establishing a branch or subsidiary in the host supervisor's jurisdiction, and then to seek our agreement to establish the branch or subsidiary in this jurisdiction after the host supervisor has given their approval. This reflects the fact that close collaboration and engagement are needed between us and the host regulator when a New Zealand deposit taker is establishing a subsidiary or branch overseas. We seek your feedback on this proposed approach.

971. Requiring deposit takers to first notify us would allow us to develop formal regulatory relationships, including memorandums of understanding, with the host regulator. This would allow for a better regulatory environment, which can then reduce financial stability risks and mitigate the risk of regulatory or supervisory gaps for deposit takers with foreign establishments.

972. We have considered international practice. The BCBS Principles for the supervision of banks' foreign establishments (Basel 1983 Concordat) recognises the importance of effective cooperation between home and host regulators to ensure adequate supervision.[282] This is reflected in Principle 13 of the Basel Core Principles – Home–host relationships. To ensure that we can establish effective cooperation, a deposit taker would be required to engage both the home and host regulators.

Approval factors to set up a branch or subsidiary overseas

973. We are considering developing an approval regime for deposit takers establishing an overseas branch or subsidiary. This would set out factors upon which we would decide to approve the setting up of an overseas branch or subsidiary under section 91(2) of the DTA. This may include, for example:

- incorporation and ownership structure
- size and nature of proposed business
- law and regulatory requirements in the host jurisdiction
- degree of our regulatory and supervisory cooperation with the host jurisdiction
- ability to carry on business in a prudent manner (for example, prudential policies, risk management, internal controls, outsourcing arrangements, etc.)
- the proportion of business (measured, for example, in risk-weighted assets) conducted overseas relative to in New Zealand.

974. We would subject the approval to licensing conditions that may need to be imposed as part of our approvals to manage any prudential issues (for example, a requirement that the deposit taker must conduct a certain percentage of its business in New Zealand).

975. There are registered banks in New Zealand that currently have branches or overseas subsidiaries. As regulatory approvals were given under the BPSA regime, these approvals

[282] *See* Basel Committee on Banking Supervision. (1983, May). Principles for the supervision of banks' foreign establishments (Basel 1983 Concordat). https://www.bis.org/publ/bcbsc312.pdf

would need to be reassessed in a DTA context in light of the criteria for the proposed approvals regime.

976. We expect that there would be compliance costs associated with our proposed approach but consider that these are appropriate and necessary to address the risks that can be raised by deposit takers establishing branches or subsidiaries in other jurisdictions. Deposit takers would face compliance costs if and when that deposit taker seeks to set up a branch or subsidiary overseas. While we recognise that this could hinder the ability of our deposit takers to expand internationally, we want to ensure that deposit takers operating from New Zealand are not unreasonably exposed to risks by any overseas business they have and that we can appropriately regulate and supervise them. We do not expect that current Group 1 deposit takers will be affected by the proposed approvals regime.

977. Furthermore, the current regime already includes a requirement to obtain our approval before establishing a branch or subsidiary in another jurisdiction. We believe that our proposed approach reduces compliance costs relative to the current regime and better reflects the process for deposit takers when looking to establish a branch or subsidiary overseas.

Summary

978. We propose to require deposit takers wanting to establish a branch or subsidiary in another jurisdiction to notify us before approaching the host regulator, and then to seek our approval after the host regulator has agreed to the establishment of the branch or subsidiary.

979. We propose to develop an approval regime, which would set out criteria or factors upon which we would decide to approve the setting up of an overseas branch or subsidiary by a deposit taker, under section 91(2) of the DTA.

Q134	Do you agree with our proposal to require deposit takers wanting to establish a branch or subsidiary overseas to notify us before approaching the host regulator?
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?

2.4 Restriction on covered bonds

980. Covered bonds are bonds that provide investors with a security interest over a pool of the deposit taker's assets (the cover pool). They are a particularly reliable funding source for deposit takers because the cover pool normally consists of high-quality assets.

Preferred option

981. We propose to carry over into the proposed standard the existing requirement in BS1 that banks cannot have more than 10% of their assets beneficially owned by an SPV for the purposes of covered-bond issuance.[283]

Analysis

982. We believe that this restriction should be maintained in the DTA context. While covered bonds are a particularly reliable funding source for deposit takers, excessive covered-bond issuance can disadvantage depositors and other unsecured creditors in the event that a deposit taker fails (because of the way it reduces the pool of assets available to cover their claims). Excessive covered-bond issuance could, in the event of any financial instability in the deposit-taking market, undermine public confidence in the financial system, especially in relation to deposits over $100,000 (that is, those not covered by the Depositor Compensation Scheme (DCS)).

983. In considering the appropriateness of this kind of limitation, we have considered approaches by overseas regulators. In particular, APRA sets a similar type of limit at 8% rather than 10%.[284] We note that the Australian parent banks of Group 1 deposit takers in New Zealand are subject to this lower limit of 8%.

984. Therefore, we have considered whether to increase or decrease the existing limit of 10%. As covered bonds are a cheaper source of funding for deposit takers to access (as the lower risk for purchasers associated with covered bonds leads to relatively low premiums), there is a risk that lowering the limit would force deposit takers to resort to relatively more expensive funding sources, which could adversely affect the deposit-taking market. We do not consider that the benefits of a lower limit would outweigh the costs.

985. We consider that the 10% limit is relatively similar to APRA's 8% limit and that the difference is unlikely to impact outcomes for public confidence and ultimately financial stability.

986. Additionally, as Group 1 deposit takers have not been issuing up to the 10% limit, the limit is not currently constraining banks' abilities to access funding. Therefore, we consider that the current 10% limit likely remains sufficient to meet our proposed policy objective of limiting asset encumbrance through the issuance of covered bonds to acceptable levels.

987. We therefore propose to retain the current limit of 10%. We consider the 10% limit strikes an appropriate balance between allowing deposit takers to use covered bonds as a source of funding and protecting creditors' interests in the event of a deposit-taker failure, and therefore promoting public confidence in the financial system. Additionally, maintaining the current limit reduces potential transition costs for deposit takers.

Summary

988. We propose to require deposit takers to not have more than 10% of total assets beneficially owned by an SPV for the purposes of covered-bond issuance.

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[283] Under sections 87(c) and 90(1)(c) of the Deposit Takers Act 2023, the Reserve Bank is empowered to issue a standard restricting the proportion of assets that can be encumbered as part of covered-bond issuance.

[284] Banking Act 1959 (Australia), section 28. *See* https://classic.austlii.edu.au/au/legis/cth/consol_act/ba195972/s28.html#:~:text=An%20ADI%20must%20not%20issue,the%20ADI's%20assets%20in%20Australia.

Q136	Do you agree with our proposal to limit to 10% the total proportion of a deposit taker's assets that may be encumbered for the purpose of covered-bond issuance?

3 Proposed approach for Group 2 deposit takers

989. In the following sections, we discuss the proposed restricted activities for Group 2 deposit takers, which would be implemented via the proposed standard. This would replace the existing restricted activities for registered banks set out in section 1.2 above.

Preferred option

990. We propose that Group 2 deposit takers are subject to the same requirements as Group 1 deposit takers.

Analysis

991. As outlined in section 1.3, we consider it desirable to apply the same restrictions and prohibitions to Group 2 deposit takers as we propose to apply to Group 1 deposit takers. We consider that the same assessments outlined above in section 2 apply to Group 2 deposit takers. The proposed restrictions will help to reduce the risks faced by Group 2 deposit takers (and, where relevant, their depositors and/or creditors). This contributes to the safety and soundness of individual deposit takers and the stability of the financial system.

992. Additionally, applying the restrictions across all deposit takers promotes consistency and minimises compliance costs for deposit takers that move between the Groups.

993. There are not likely to be any unnecessary compliance costs for existing registered banks that would be licensed as Group 2 deposit takers associated with the proposed restrictions. The proposed restrictions are all currently a part of our prudential regime and we expect banks to already be compliant. Transposing the existing restriction to the new standard is one way of minimising the compliance costs, by avoiding unnecessary transition costs that Group 2 deposit takers would face under the transition to the DTA.

994. We recognise that the proposed restrictions relating to insurance business (see section 2.1) and non-financial activities (see section 2.2) may mean that deposit takers face monitoring costs to ensure that the proposed thresholds are not breached. However, we consider that these minor costs are justified when considering the benefits to the financial stability of Group 2 deposit takers of not being exposed to risks from insurance business and non-financial activities, and the benefits to depositors and other market participants of having an accurate understanding of the risks that Group 2 deposit takers are exposed to.

995. Including both deposit-taking and insurance business or non-financial activities on the balance sheet impacts the accuracy and usefulness of capital-adequacy measures, as well as the meaningfulness and comparability of disclosures. The proposed restrictions would therefore support more effective management of capital, liquidity and risk by Group 2 deposit takers. It would, for the same reason, support depositors in having access to accurate and understandable information to assist them in making decisions.

996. Additionally, we recognise that the proposed restrictions relating to insurance business and non-financial activities are likely to make it more difficult for businesses undertaking insurance

business or non-financial activities to enter the deposit-taking market, as they would need to establish a separate legal entity. This may have a negative impact on competition within the deposit-taking sector as well as in the diversity of institutions providing access to financial products and services. However, we consider that the impact is justified given the benefits that the proposed policy has on the effective management of risk, the importance of depositors having access to accurate information and the individual soundness of Group 2 deposit takers.

997. It is possible for insurance business or non-financial activities to be conducted by a separate legal entity to the deposit taker within the same group, that is not a subsidiary of the deposit taker (for example, a sister company). This could support a greater diversity of institutions and competitiveness within the deposit-taking market, while ensuring balance-sheet separation of deposit takers and insurers to mitigate the risks identified.

998. We want to understand if there are any issues for Group 2 deposit takers with the material non-financial activities restriction should a deposit taker take over a non-financial business as part of an insolvency event. We want to understand the likelihood of an insolvency event causing a non-financial activity becoming material for a Group 2 deposit taker.

Summary

999. We propose that Group 2 deposit takers be subject to the same requirements as Group 1 deposit takers, given that Group 2 deposit takers are already subject to these requirements, and the proposed approach will support the safety and soundness of these deposit takers and, by extension, the stability of the financial system.

Q137	Do you agree with our proposal to take the same approach to restricted activities for Group 2 deposit takers as we propose for Group 1 deposit takers?
Q138	What are the compliance costs associated with our proposed approach to Group 2 deposit takers likely to be? Is there another way that we can achieve our policy intent with lower compliance costs for Group 2 deposit takers?
Q139	Do you consider there is a risk that, in a scenario in which a deposit taker assumes control of a non-financial business in an insolvency event, the materiality threshold could be breached for a Group 2 deposit taker? If so, what do you think we could do to accommodate this risk within the proposed restriction?

4 Proposed approach for Group 3 deposit takers

1000. In the following sections, we discuss the proposed restricted activities for Group 3 deposit takers, which would be implemented via the proposed standard.

1001. While the proposed restrictions already apply in some form to Group 3 entities that are registered banks, they will largely be new for Group 3 entities that are NBDTs. Compliance costs and anticipated impacts of the proposed restrictions for Group 3 deposit takers are discussed further below.

4.1 Restriction on insurance business

Preferred option

1002. We propose to take the same approach to Group 3 deposit takers as proposed for Group 1 and Group 2 deposit takers.

Analysis

1003. As set out at section 2.1, we propose to restrict the ability of deposit takers to conduct material insurance business.

1004. We consider that the same assessments outlined in section 2.1 apply to Group 3 deposit takers. This restriction is a response to the difficulty that arises in establishing capital-adequacy measures, and the meaningfulness and comparability of disclosures, where insurance business and deposit taking are conducted by the same legal entity. The proposed restriction would therefore:

- reduce the level of risk that individual Group 3 deposit takers are exposed to (and, where relevant, their depositors and/or creditors)
- support more effective management of capital, liquidity and risk by deposit takers
- support depositors having accurate and understandable information to support them to make decisions about their deposits.

1005. Additionally, applying the restrictions across all deposit takers promotes consistency and minimises compliance costs for deposit takers that move between the Groups.

1006. As outlined in section 2.1, we propose to retain the current quantitative threshold of the deposit taker's group insurance business being no more than 1% of total assets, likely using the entity-based formulation outlined in BS1.[285] We believe the 1% limit previously applied is most appropriate as it allows for some flexibility where insurance underwriting is incidentally undertaken during the course of deposit-taking business.

1007. For Group 3 entities that are banks, there are not likely to be any unnecessary compliance costs associated with the proposed restrictions. They are all currently a part of our prudential regime and we expect banks to already be compliant. Transposing the existing restriction to the new standard is one way of avoiding unnecessary transition costs that Group 3 deposit takers would face under the transition to the DTA.

1008. For Group 3 entities that are NBDTs, we note that there is currently no equivalent restriction in the NBDT regime. We understand that there are NBDTs who currently offer insurance business. However, as this is done through a separate legal entity, these businesses would not be affected by this proposed restriction, for the reasons discussed in section 2.1 above.

1009. We therefore do not expect any unnecessary compliance costs for Group 3 entities that are NBDTs, or any negative impact on competition within the deposit-taking sector as well as in the diversity of institutions providing access to financial products and services.

1010. Another option we considered would be to exempt Group 3 deposit takers from this proposed restriction. This would maintain the current approach (where NBDTs are not subject

[285] BS1, Appendix One, section I Conditions of Registration for New Zealand-incorporated Registered Banks, paragraph 3

to this requirement) and recognise that smaller deposit takers are generally less systemically important. However, we do not consider that this option is appropriate because of the risks to the safety and soundness of individual deposit takers identified in section 2.1 if insurance business and deposit taking are conducted by the same legal entity.

Summary

1011. We propose to take the same approach to Group 3 deposit takers as to Group 1 and Group 2 deposit takers, by restricting the ability of deposit takers to conduct insurance business to no more than 1% of the deposit-taking group's total assets.

Q140	Do you agree with our proposal to take the same approach to Group 3 deposit takers as to Group 1 and Group 2 deposit takers, by restricting insurance business by deposit takers?
Q141	Do you agree with our proposed quantitative threshold of no more than 1% of the deposit-taking group's total assets? Do you think this limit is appropriate, or is there a risk of this threshold being breached if insurance underwriting is incidentally undertaken during the course of deposit-taking business?

4.2 Restriction on material non-financial activities

Preferred option

1012. We propose to take the same approach to Group 3 deposit takers as proposed for Group 1 and Group 2 deposit takers.

Analysis

1013. As discussed in section 2.2, we propose to carry over into the proposed standard the existing requirement in BS1 that restricts the ability of deposit takers to conduct material non-financial activities.

1014. We consider that the same assessments outlined in section 2.2 apply to Group 3 deposit takers. The rationale for this proposed restriction is similar to that for restricting insurance activities, namely that including both deposit-taking and non-financial activities on the balance sheet impacts the accuracy and usefulness of capital-adequacy measures, as well as the meaningfulness and comparability of disclosures.

1015. The proposed restriction would help prevent issues in measuring risk whilst also reducing the impact of exposing deposit takers to a greater variety of business risks associated with non-financial activities. This would therefore support more effective management of capital, liquidity and risk by deposit takers. It would also contribute to the safety and soundness of Group 3 deposit takers.

1016. Additionally, applying the restrictions across all deposit takers promotes consistency and minimises compliance costs for deposit takers that move between the groups.

1017. For Group 3 entities that are registered banks, there are not likely to be any transition costs associated with the proposed restriction. The restriction is currently a part of our prudential

regime and we expect registered banks to already be compliant. This approach would avoid unnecessary transition costs that Group 3 deposit takers that are registered banks would face under the transition to the DTA.

1018. For Group 3 entities that are NBDTs, we note that there is currently no equivalent restriction in the NBDT regime. However, we are not aware of any NBDTs that conduct non-financial business so we do not believe this restriction would have an impact on existing NBDTs unless they undertake non-financial activities.

1019. Where Group 3 deposit takers undertake non-financial activities, we expect there would be monitoring costs to ensure that the quantitative threshold is not breached. We consider that these minor/moderate costs are justified when considering the benefits to the safety and soundness of deposit takers.

1020. We want to understand if there are any issues for Group 3 deposit takers with the material non-financial activities restriction should a deposit taker take over a non-financial business as part of an insolvency event. We want to understand the likelihood of an insolvency event causing a non-financial activity becoming material for a Group 3 deposit taker.

1021. We recognise that this proposed restriction may make it more difficult for businesses undertaking non-financial activities to enter the deposit-taking market, as they would need to establish a separate legal entity. This may have a negative impact on competition within the deposit-taking sector as well as in the diversity of institutions providing access to financial products and services. However, we consider that the impact is justified when considering the purpose of the DTA as well as other the relevant principles and our financial stability objectives.

1022. Another option we considered would be to exempt Group 3 deposit takers from this proposed restriction. This would maintain the current approach (in which NBDTs are not subject to this requirement) and recognise that smaller deposit takers are generally less systemically important. However, we do not consider that this option is appropriate because of the risks to financial stability identified in section 2.2 if non-financial activities and deposit taking are conducted by the same legal entity.

Summary

1023. We propose to take the same approach to Group 3 deposit takers as to Group 1 and Group 2 deposit takers, by restricting the ability of Group 3 deposit takers to conduct material non-financial activities.

Q142	Do you agree with our proposal to take the same approach to Group 3 deposit takers as to Group 1 and Group 2 deposit takers, by restricting their ability to carry on material non-financial activities?
Q143	Do you consider that there is a risk that, in a scenario in which a Group 3 deposit taker assumes control of a non-financial business in an insolvency event, the materiality threshold could be breached? If so, what do you think we could do to accommodate this risk within the proposed restriction?

4.3 Restrictions on setting up an overseas branch or subsidiary

Preferred option

1024. We propose to take the same approach to Group 3 deposit takers as proposed for Group 1 and Group 2 deposit takers.

Analysis

1025. As discussed in section 2.3, we propose that deposit takers wanting to set up a branch or subsidiary overseas notify us before approaching the host supervisor and then seek our approval once the host supervisor has given their approval. This would amend the existing requirement in BS1 that requires registered banks wanting to establish a branch or subsidiary overseas to first seek our approval before approaching the host supervisor.[286]

1026. We also propose to develop an approvals regime, which would set out the factors upon which we would decide to approve the setting up of an overseas branch or subsidiary under section 91(2) of the DTA, as outlined in section 2.3 above.

1027. We consider that the same assessments outlined in section 2.3 apply to Group 3 deposit takers. We currently do not have a regulatory framework for groups comprised of a New Zealand-incorporated bank with overseas branches or subsidiaries, so there are financial stability risks to deposit takers from international branches or subsidiaries. Our proposed approach would allow us to develop formal regulatory relationships with the host regulator, which would support a better regulatory environment for deposit takers with foreign establishments. It is also consistent with guidance from international organisations.

1028. We expect that there would be compliance costs associated with our proposed approach but consider that these are appropriate and necessary to address the risks that can be raised by deposit takers establishing branches or subsidiaries in other jurisdictions. Deposit takers would face compliance costs if and when that deposit taker seeks to set up a branch or subsidiary overseas. While we recognise that this could hinder the ability of our deposit takers to expand internationally, we want to ensure that deposit takers operating from New Zealand are not unreasonably exposed to risks by any overseas business they have and that we can appropriately regulate and supervise them. We are not aware of any Group 3 deposit takers who want to operate in other jurisdictions.

1029. Furthermore, the current regime for registered banks already includes a requirement to obtain our approval before establishing a branch or subsidiary in another jurisdiction. For Group 3 deposit takers that are currently registered banks, we believe that our proposed approach reduces compliance costs relative to the current regime and better reflects the process involved when looking to establish a branch or subsidiary overseas.

Summary

1030. We propose to take the same approach to Group 3 deposit takers as to Group 1 and Group 2 deposit takers, by requiring Group 3 deposit takers wanting to establish a branch or subsidiary in another jurisdiction to notify us before approaching the host regulator, and then

[286] BS1, paragraph 136. Under sections 90(1)(b), 90(1)(c) and 91(1) of the Deposit Takers Act 2023, the Reserve Bank is empowered to issue a standard restricting banks establishing an overseas branch or subsidiary.

seek our approval after the host regulator has agreed to the establishment of the branch or subsidiary.

Q144	Do you agree with our proposal to take the same approach to Group 3 deposit takers wanting to establish a branch or subsidiary overseas as to Group 1 and Group 2 deposit takers, by requiring deposit takers to notify us before approaching the host regulator, and then seek our approval after the host regulator has agreed to the establishment of the branch or subsidiary?

4.4 Restriction on covered bonds

Preferred option

1031. We propose to take the same approach to Group 3 deposit takers as proposed for Group 1 and Group 2 deposit takers.

Analysis

1032. As discussed in section 2.4, we propose to adopt the existing requirement in BS1 that registered banks cannot have more than 10% of their assets beneficially owned by an SPV for the purposes of covered-bond issuance.

1033. We consider that the same assessments outlined in section 2.4 above would apply to Group 3 deposit takers. While covered bonds are a particularly reliable funding source for deposit takers, excessive covered-bond issuance can disadvantage depositors and other unsecured creditors in the event that a deposit taker fails (because of the way it reduces the pool of assets available to pay their claims). Excessive covered-bond issuance could, in the event of any financial instability in the deposit-taking market, undermine public confidence in the financial system, especially in relation to deposits not covered by the DCS.

1034. We consider that the 10% limit is appropriate for Group 3 deposit takers. As discussed in section 2.4, covered bonds are a cheaper source of funding for deposit takers to access (as the lower risk for purchasers associated with covered bonds leads to relatively low premiums). But there is a risk that lowering the limit would force deposit takers to resort to relatively more expensive funding sources, which could adversely affect the deposit-taking market. We do not consider that the benefits of a lower limit would outweigh the costs.

1035. For Group 3 entities that are banks, maintaining the current limit reduces potential transition costs for deposit takers.

1036. For Group 3 entities that are NBDTs, we note that there is currently no equivalent restriction in the NBDT regime.

1037. However, no Group 3 deposit takers currently have covered-bonds programmes.

Summary

1038. We propose to take the same approach to Group 3 deposit takers as to Group 1 and Group 2 deposit takers, by requiring them to not have more than 10% of total assets beneficially owned by an SPV for the purposes of covered-bond issuance.

Q145	Do you agree with our proposal to take the same approach to Group 3 deposit takers as to Group 1 and Group 2 deposit takers, by restricting to 10% the proportion of their assets that can be encumbered as a result of covered-bond issuance?

5 Proposed approach for branches of overseas deposit takers

1039. In the following sections, we discuss the proposed restricted activities for branches, which would be implemented via the proposed standard. This would replace the existing restricted activities by branches, as set out in section 1.2 above.

Preferred option

1040. We propose to carry over the existing requirements in BS1 that restrict the ability of branches to conduct insurance business[287] and material non-financial activities.[288] This would mean that branches are subject to the same requirements as Group 1 deposit takers in relation to these restrictions (see sections 2.1 and 2.2).

1041. We propose to retain the current quantitative threshold of the branch's insurance business being no more than 1% of total consolidated assets.[289] We expect that the total assets would be calculated by reference to the total assets of the New Zealand business of the body corporate and its subsidiaries (if any) as specified in the financial statements or the group financial statements for that New Zealand business.[290] Further clarification on this would be provided through the exposure draft of the Restricted Activities Standard.

Analysis

1042. We believe that these restrictions should be maintained in the DTA context. The proposed approach was consulted on in 2022 as part of the Review of policy for branches of overseas banks).[291] We consider the same assessments outlined in sections 2.1 and 2.2 above would apply to branches.

1043. For the restriction relating to insurance business, we propose to retain the current quantitative threshold of the branch's insurance business being no more than 1% of total assets of the New Zealand business of the overseas deposit taker.[292] We believe the 1% limit previously applied is most appropriate as it allows for some flexibility if insurance underwriting is incidentally undertaken during the course of deposit-taking business.

1044. For the restriction relating to non-financial activities, we propose to maintain a materiality threshold but, as set out in section 2.2, we seek your feedback on what this should look like. The current approach in BS1 is based on the definition of materiality in GAAP.[293] An

[287] BS1, Appendix One, section II Conditions of Registration for Overseas Incorporated Registered Banks, paragraph 2.
[288] BS1, Appendix One, section II Conditions of Registration for Overseas Incorporated Registered Banks, paragraph 1.
[289] BS1, Appendix One, section II Conditions of Registration for Overseas Incorporated Registered Banks, paragraph 2.
[290] Deposit Takers Act 2023, section 158(2).
[291] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2022, August). Review of Policy for Branches of Overseas Banks. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/overseas-branches/review-of-policy-for-branches-of-overseas-banks---consultation-paper-august-2022.pdf
[292] BS1, Appendix One, section II Conditions of Registration for Overseas Incorporated Registered Banks, paragraph 2. *See also* Deposit Takers Act 2023, section 158(2).
[293] BS1, Appendix One, section II Conditions of Registration for Overseas Incorporated Registered Banks, paragraph 1.

alternative option would be to introduce a quantitative threshold. We seek stakeholder feedback on this matter.

1045. There are not likely to be any unnecessary compliance costs for branches associated with the proposed restrictions. They are currently a part of our prudential regime, and we expect branches to already be compliant. Transposing the existing restriction to the new standard is the simplest and most effective way of minimising the compliance costs that branches would face under the transition to the DTA.

1046. There are not likely to be any transition costs associated with the proposed restriction. The restriction is currently a part of our prudential regime, and we expect registered branches to already be compliant. If branches undertake insurance or non-financial business, we expect there would be ongoing compliance costs to ensure that the thresholds are not breached. We consider that any impact will be marginal and is justified when considering the purpose of the DTA as well as the other relevant DTA principles, our financial stability objectives and the public interest.

Summary

1047. We propose to restrict the insurance business of a branch to no more than 1% of total assets of the New Zealand business of the overseas deposit taker.

1048. We propose to restrict the conduct of material non-financial activities by branches.

Q146	Do you agree with our proposal to take the same approach to branches as to Group 1, Group 2 and Group 3 deposit takers, by restricting insurance business by branches?
Q147	Do you agree with our proposed quantitative threshold of no more than 1% of total assets of the New Zealand business of the overseas deposit taker?
Q148	Do you agree with our proposal to take the same approach to branches as to Group 1, Group 2 and Group 3 deposit takers, by restricting the conduct of material non-financial activities by branches?
Q149	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?

6 Conclusion

1049. In conclusion, we consider that a Restricted Activities Standard is necessary to protect and promote the stability of the financial system by restricting activities we have assessed to pose a risk to the safety and soundness of deposit takers and the stability of the financial system.

1050. The proposed Restricted Activities Standard would include a number of restrictions carried over from the existing regime for banks and would consolidate the existing restrictions and prohibitions into one standard.

1051. We consider these restrictions to be important aspects of an effective prudential regime for deposit takers and propose to apply the restrictions to Group 1, Group 2 and Group 3 deposit takers and branches. We consider that this will provide consistency in treatment, improve comparability across deposit takers, and contribute to the safety and soundness of each deposit taker.

Reserve Bank of New Zealand
Te Pūtea Matua

Chapter 9

Deposit Takers Branch Standard

Deposit Takers Non-Core Standards Consultation

21 August 2024

CONSULTATION PAPER

Non-technical summary

An overseas deposit taker wanting to operate as a licensed deposit taker in New Zealand can either apply to be licensed as a locally-incorporated subsidiary (**subsidiary**) or to be licensed as a branch of the overseas deposit taker (**branch**).

In some cases, we grant licences for an overseas bank to operate both a subsidiary and a branch in New Zealand. We expect to refer to this in our new framework as **dual operation** and the respective branch as a **dual-operating branch**.

The key difference between a subsidiary and a branch is that a branch is part of a legal entity incorporated overseas. A branch operates its banking business in New Zealand (the **host jurisdiction**), but the legal entity of which it forms part is incorporated in another country (the **home jurisdiction**).

As a result, branches cannot be made subject to many of the requirements we impose on deposit takers incorporated in New Zealand, and we rely on a branch's compliance with regulation and supervision in its home jurisdiction in important ways.

Branches play an important role in the provision of sophisticated financial services to large customers. They also support the economy and contribute to a diverse, competitive, innovative and resilient financial system, mostly by catering to the business sector.

Our rules for branches strike a balance between allowing branches to play their important role in the economy while reducing our reliance on overseas supervisors to promote the stability of the New Zealand financial system. The rules do this by putting appropriate requirements in place for branches that determine how they operate and who they can do business with. Such requirements could include a limit on the total size of branches and defining the characteristics of customers they can do business with. We view this as the best way to promote financial stability.

Our proposed Branch Standard will cover certain requirements that apply only to branches of overseas deposit takers. However, it will not contain all requirements that will apply to branches (for example, any disclosure requirements for branches will be included in the Disclosure Standard).

In short, we propose our Branch Standard would require that:

- branches can only conduct business with wholesale clients
- the total size of a branch cannot exceed NZ$15 billion in total assets
- dual-operating branches can only conduct business with large corporate and institutional clients.

Under these new policy settings, overseas deposit takers will continue to play an important role in New Zealand's financial system. To do business with retail customers, overseas deposit takers will be required to incorporate in New Zealand and comply with our full suite of prudential regulation, as described through this Consultation Paper and the core standards. Those overseas deposit takers that only want to do business with wholesale clients will be able to operate as branches. Locally-incorporated deposit takers may dual-operate with a branch as well, if that branch only does business with large corporate and institutional clients, who are a subset of wholesale clients.

1 Introduction

1052. Branches are an important part of New Zealand's financial system. They differ from locally-incorporated subsidiaries of overseas deposit takers in that they are part of a legal entity incorporated outside New Zealand. They offer benefits to the New Zealand economy through the provision of products and services to wholesale customers. It would be impractical for us to apply the full suite of prudential regulation to branches because of the nature of their operations and legal structure. The proposed Branch Standard will include certain requirements specifically for branches (primarily relating to how branches carry on business).

1.1 Purpose of the Branch Standard

1053. While our proposed Branch Standard covers certain requirements that apply solely to branches, it does not contain all the requirements we propose to apply to branches. For example, any disclosure requirements for branches would be included in the Disclosure Standard (as outlined in the Deposit Takers Core Standards Consultation Paper).[294] Examples of requirements included in the Branch Standard include a size cap for branches and a requirement that they can only do business with wholesale clients.

1054. Our proposed standard will implement decisions made as part of our Review of policy for branches of overseas banks (the **Branch Review**).[295] In our November 2023 Branch Review Regulatory Impact Statement (**RIS**),[296] section 6.1, we stated our expectation that all existing branches will have to apply for a licence under the DTA. If granted, they will have to meet all of the relevant policy decisions described in the Branch Review RIS and further refined in this chapter by the time the standards start, which is expected to be in July 2028. We state our rationale for each decision and give a complete description of the current approach and problem definition in the Branch Review RIS.

1055. In summary, the Branch Review was required because:

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

1056. We propose to implement our Branch Review policy decisions through a Branch Standard issued under the DTA, Part 3.

1057. We have considered the DTA's purposes and accounted for the principles when making decisions on the Branch Review. We consider that meeting Principles 1 and 3 of the Branch Review also meets the main purpose of the DTA, section 3(1), and therefore our subsequent

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[294] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Deposit Takers Core Standards Consultation Paper. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/deposit-takers-core-standards-consultation-paper.pdf

[295] Reserve Bank of New Zealand – Te Pūtea Matua. (2023). Review of policy for branches of overseas banks. https://www.rbnz.govt.nz/have-your-say/review-of-policy-for-branches-of-overseas-banks

[296] Reserve Bank of New Zealand – Te Pūtea Matua. (2023). Review of policy for branches of overseas banks – Regulatory Impact Statement. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/overseas-branches/review-of-policy-for-branches-of-overseas-banks-ris.pdf

decisions promote financial stability. For more details of our analysis refer to the Branch Review RIS, section 3.2.[297]

1058. Our proposed Branch Standard aims to protect and promote the stability of the New Zealand financial system (section 3(1) of the DTA). The proposed requirements will achieve this in several ways, by:

- limiting the maximum size of a branch to NZ$15 billion in total assets, which puts a cap on the risks they pose to New Zealand's financial system
- restricting branches to engaging in business with wholesale clients only
- ensuring that any dual-operating branch and its related subsidiary are sufficiently separated (mitigating any identified risks) and restricting dual-operating branches to conduct business with large corporate and institutional clients.

1059. All 3 of these requirements seek to achieve the purpose of avoiding or mitigating the risks listed in sections 3(2)(d)(i) and (ii) of the DTA. The second and third of these requirements aim to reduce risks posed to retail customers in particular. In addition, these requirements also mitigate some of the risks to the financial system that arise from global financial cycles and can be associated with branches (see the section 4.1 of the Branch Review RIS). In this respect, our requirements also promote public confidence in the financial system (section 3(2)(b) of the DTA). We also considered the forthcoming implementation of the DCS in developing our proposals (see sections 2.1, 2.2 and 4.1 of the Branch Review RIS for a complete analysis of interactions with the DCS).[298]

1060. We consider that our proposals account for the benefits that branches bring to our financial system and the economy through maintaining competition (section 4(b) of the DTA) and contributing to the diversity of institutions in the deposit-taking sector (sections 3(2)(c) and 4(a)(iii) of the DTA), without imposing unnecessary compliance costs on industry (section 4(c) of the DTA). We have also taken into account the desirability of ensuring that the risks referred to in section 3(2)(d) of the DTA are managed (section 4(e) of the DTA), as described in the paragraph above. We consider the requirements are proportional to the risks that branches pose to New Zealand's financial system (section 4(a)(i) of the DTA) and also take into account the desirability of consistency in the treatment of similar institutions (section 4(a)(ii) of the DTA), since levelling the playing field was one of the objectives of the Branch Review. See sections 3 and 3.1 of the Branch Review RIS for a full explanation of the assessment criteria used in the Branch Review.

1.2 Current approach

1061. Our existing branch policy is outlined in BS1 – Statement of Principles: Bank Registration and Supervision (**BS1**).[299] It states that a foreign-owned bank (which is referred to as an 'overseas

[297] Reserve Bank of New Zealand – Te Pūtea Matua. (2023). Review of policy for branches of overseas banks – Regulatory Impact Statement, section 3.2. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/overseas-branches/review-of-policy-for-branches-of-overseas-banks-ris.pdf

[298] *See* Reserve Bank of New Zealand – Te Pūtea Matua. Depositor Compensation Scheme. https://www.rbnz.govt.nz/regulation-and-supervision/depositor-compensation-scheme

[299] Reserve Bank of New Zealand – Te Pūtea Matua. (2021). Statement of Principles, Bank Registration and Supervision, BS1. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs1-statement-of-principles.pdf

deposit taker' under the DTA) is required to incorporate locally (that is, is not allowed to be registered as a branch) if it meets one or more of the following:

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

1062. Note that the second condition applies only to banks "which are incorporated in a jurisdiction which has legislation which gives deposits made… in that jurisdiction a preferential claim in a winding up or which do not provide adequate disclosure in the home jurisdiction" (see BS1, paragraph 25 for further background to our existing policy).

1063. Our existing policy is to allow dual registration of a branch (equivalent to the proposed 'dual operation' term) if the criteria above are met and the branch is not permitted to take retail deposits (see BS1, paragraph 39 for further background to our existing policy).

1.3 Proposed policy development approach

1064. We have recently conducted the Branch Review. We published the Branch Review RIS in November 2023, which outlined the policy development approach we took to reach our key decisions in the Branch Review. This chapter references relevant sections in the Branch Review RIS to minimise duplication. The decisions outlined in the Branch Review RIS, section 4, will form the substance of our proposed Branch Standard.

1065. We ran 3 consultations in the Branch Review, which are described in the Branch Review RIS, section 7, and the summary of submissions to the third Consultation Paper (C3). We consulted CoFR agencies throughout the Branch Review and will consult them further on the exposure draft of the standard.

1066. Implementing the Branch Review key decisions will protect and promote the stability of the financial system by recognising and mitigating both:

- inherent limitations on our ability to apply regulatory standards to branches
- inherent conflicts of interest between home and host supervisors.

1067. This purpose is consistent with the problem definition of the Branch Review, which is described in section 2.3 of the RIS. The assessment principles used during the Branch Review are further discussed in section 3.1 of the Branch Review RIS, and their relationship to the DTA is discussed in section 3.2 of the Branch Review RIS.

1068. We have taken into account the principles outlined in section 4 of the DTA, when conducting the Branch Review and developing the proposed Branch Standard.

2 Proposed approach for branches of overseas deposit takers

2.1 Retail deposits and wholesale definition

Preferred option

1069. We propose that branches only be permitted to engage in wholesale business, that is, they will not be permitted to engage in business with retail customers (as per our decision in the Branch Review). However, in a slight refinement of the decisions in the Branch Review, we propose that branches only be permitted to undertake business with 'wholesale clients', as defined in section 459(3) of the DTA, rather than use the definition of 'wholesale investors' used in the Financial Markets Conduct Act 2013 (FMCA).

Analysis

1070. In the Branch Review we decided to not permit branches to take retail deposits, which was consistent with the assessment principles of the Branch Review. It also recognises that the status quo application of our existing policy is not compatible with the introduction of the DCS (see section 4.1 of the Branch Review RIS for further analysis). Restricting branches to engaging in wholesale business (that is, with corporates, institutions and other wholesale investors) means they will not be able to take retail deposits or offer products or services to retail customers.

1071. We stated in the Branch Review RIS that we would use the FMCA's definition of wholesale investor when restricting branches to only undertake business with 'wholesale investors'.[300]

1072. Following the previous consultation,[301] we have reconsidered whether the DTA's wholesale clients definition (see section 459(3) of the DTA) would be a more appropriate definition than the FMCA's wholesale investors definition. The DTA definition is slightly broader than the FMCA definition, with the main difference being that a small number of customers who do not receive products or services under the FMCA definition will be classified as wholesale clients under the DTA definition.

1073. We have considered industry feedback, undertaken bilateral engagements with stakeholders and done further analysis. We have also considered the role that branches will play in the financial system once the policy settings are fully implemented, including the proposal that branches will be exempt from the DCS. We consider that using the section 459(3) definition of the DTA would more effectively align with the broader policy intent of the DTA and the DCS, including public expectations of DCS coverage.

1074. The section 459(3) definition of the DTA draws on section 49 of the Financial Service Providers (Registration and Dispute Resolution) Act 2009, which in turn draws on clauses 3(2) and 3(3) of Schedule 1 of the FMCA. The key difference between these definitions is that investors can be designated as wholesale in relation to a wider range of financial services, including transactional banking. We judge that the DTA definition is therefore slightly more permissive than the FMCA definition in terms of who it considers to be wholesale. As it would

[300] "Wholesale investor" as defined in the FMCA, Schedule 1, Clause 3(2) and Clause 3(3). *See* Implementation of Option 2 – Definition of 'Retail Deposits' in the Branch Review RIS, section 4.1.

[301] For further discussion of the relevant feedback *see* Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Summary of Submissions from the Branch Review third consultation paper, section 2.4. https://www.rbnz.govt.nz/have-your-say/review-of-policy-for-branches-of-overseas-banks

improve consistency of treatment within the DTA and is consistent with terms used in the implementation of the DCS, we believe that there could be merit in making this change.

1075. We consider that the difference between the two definitions is sufficiently marginal that this proposal still gives entities enough certainty to prepare for implementing the Branch Review decisions and making any necessary preparations for DCS implementation.

1076. Further, using a definition from the DTA is simpler and thus avoids imposing unnecessary compliance costs on industry (see section 4(c) of the DTA). The additional analysis to support this preferred approach, including comparison with other options and the status quo, is discussed in section 4.1 of the Bank Review RIS.

Summary

1077. We propose that branches only be permitted to engage in wholesale business and that branches only be permitted to undertake business with wholesale clients, as defined in the section 459(3) of the DTA.

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?

2.2 Local incorporation threshold

Preferred option

1078. We propose to include in the Branch Standard the local incorporation threshold of NZ$15 billion in total assets, which was one of our final policy decisions on the Branch Review. This includes our decision to use total assets instead of net liabilities in the threshold. For the purpose of this requirement, we expect that a branch's total assets will be calculated in line with the definition in section 158(2) of the DTA. Further clarification on this will be provided through the exposure draft of the Branch Standard.

Analysis

1079. The analysis to support this preferred approach, including comparison with other options and the status quo, is discussed in section 4.2 of the Branch Review RIS. In short, the preferred option:

- complements the preferred option relating to retail deposits and wholesale business described in section 2.1
- aligns more closely with our existing monitoring and assessment of the financial stability risks and benefits that branches bring to the financial system and the economy
- places a firm ceiling on branch size, which limits the systemic importance of a single branch
- is the clearest and most transparent option, meaning it would also be practical to administer and minimise supervisory costs
- would support a level playing field for branches, which both enables competition within the deposit-taking sector and supports the diversity of institutions in the sector.

Summary

1080. We propose to use the local incorporation threshold of NZ $15 billion in total assets (that was decided during the Branch Review) in the Branch Standard.

2.3 Dual operation and large corporate and institutional client definition

Preferred option

1081. We propose to carry over the allowance for dual-registered branches into the Branch Standard, but we will use the term 'dual-operating branches' instead. This reflects the expected nomenclature for a standard under the DTA in which deposit takers are licensed rather than registered. Our proposal matches our policy decision in the Branch Review to allow dual-operating branches, subject to further risk mitigation including only being permitted to conduct business with large corporate and institutional clients. We aim to strike a balance with this approach between the efficiency benefits of dual operation and the risks posed to New Zealand's financial stability.

1082. Regarding the definition of a large corporate and institutional client, we propose to further refine our proposals from C3 of the Branch Review. We now propose that a large corporate and institutional client be defined as a client that has one or more of the following:

- consolidated annual turnover of over NZ$50 million
- total assets of over NZ$75 million
- total assets under management of over NZ$1 billion (for funds management entities only).

Analysis

1083. To implement our Branch Review decision to continue to allow dual operation, we proposed in C3 that a 'large corporate and institutional customer' be defined as a customer that has one or more of the following:[302]

- consolidated annual turnover of over NZ$50 million
- net assets of over NZ$50 million.

1084. We received feedback regarding the scope of this definition.[303] Some respondents suggested that the net assets test would exclude project finance and funds management clients, which would not align with the policy intent. Three of these respondents proposed using a total assets test instead of net assets, while one proposed a specific carve-out for project finance entities. We have considered this feedback, undertaken bilateral engagements with stakeholders and carried out further analysis.

1085. We agree that including project finance and funds management entities is consistent with the policy intent and the relevant DTA principles. Respondents commented that using net assets would exclude some customers from the definition because of the nature of their business

[302] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2023). Review of policy for branches of overseas banks Consultation Paper, Implementation Considerations. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/overseas-branches/review-of-policy-for-branches-of-overseas-banks-consultation-paper-3.pdf

[303] For further discussion of the relevant feedback *see* Reserve Bank of New Zealand – Te Pūtea Matua. (2024). Summary of Submissions from the Branch Review third consultation paper, section 2.1. https://www.rbnz.govt.nz/have-your-say/review-of-policy-for-branches-of-overseas-banks

and that they believed this was inconsistent with the policy intent. We provide our analysis on each point in the sections below.

From net assets to total assets

1086. Having considered the options put forward by respondents we believe amending the proposed definition would better meet the intent of this policy, taking into account the relevant DTA principles. While adding a set of specific carve-outs could also meet the policy objectives, we considered that it would overcomplicate the definition, adding unnecessary compliance costs (see section 4(c) of the DTA). Further, adding a bespoke third limb to the definition for project finance entities would not entirely rule out the possibility of leaving other types of businesses out of scope.

1087. We believe that, while using net assets could be consistent with definitions used to assess the size of investors in the FMCA, total assets is a better metric to define large corporate and institutional clients and more effectively meet the policy intent. Total assets is a simple metric that tests the size of the business, regardless of how its operations are financed (liabilities or equity). Most cases would be captured by this metric, minimising the risk of leaving large customers out of scope. This is why we now propose to change the net assets limb to a total assets limb.

1088. Having analysed data from the Stats NZ Annual Enterprise Survey,[304] we found that keeping the calibration of the threshold at NZ$50 million (total assets) would almost double the number of eligible companies. This would widen the scope of the large corporate and institutional client definition significantly compared to the previous proposal. This would be supportive of maintaining competition (see section 4(b) of the DTA) in this market segment and the deposit-taking sector comprising a diversity of institutions (see section 4(a)(iii) of the DTA).

1089. Setting the threshold at NZ$100 million (total assets) would result in a reduction of approximately 2% in the number of entities captured, relative to the proposal in C3. This option is not significantly different, in terms of scope, to the original proposal.

1090. However, the available data does not allow us to assess the impact of the change at a granular level. Here we refer to the total companies captured. This means that, even if the total number of entities increases with the preferred option, the makeup of those entities might change significantly as there could be individual companies that would no longer be eligible under the new proposal. However, we consider that the risk of this is low and is further decreased by the proposed calibration of the threshold.

1091. We judge that the NZ$100 million threshold would be more restrictive than our policy intent and the NZ$50 million threshold would be more permissive than our policy intent. Having analysed the impact of other possible thresholds within this range, we propose to set the new (total assets) threshold at NZ$75 million, which would more effectively meet the policy intent than either of the other two options. This represents an increase of around 22% in the number of eligible companies, relative to our proposal in C3. We consider that our proposed option is proportionate (see section 4(a)(i) of the DTA) and simple to administer.

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[304] *See* Stats NZ Tatauranga Aotearoa. (2023). Annual enterprise survey: 2022 financial year (provisional). https://www.stats.govt.nz/information-releases/annual-enterprise-survey-2022-financial-year-provisional/

1092. An additional option is to keep the net assets limb, along with the total assets limb. We believe that this option is not justified. It would make the definition less simple and more costly to apply. It would also be effectively overlapping with the total assets limb to a large extent, in terms of the scope of covered entities.

Funds management entities

1093. The one case not captured by the amended total assets metric is funds management entities. Some submissions noted that these entities control assets that would generally far exceed the NZ$50 million total asset threshold, but the assets are not recorded on their balance sheets as the funds belong to other parties. Since the large entities of this type should be in scope and would likely not be captured by either total or net assets, we believe adding a third limb for these cases is necessary.

1094. Our Managed Funds Survey covered 67 entities for Q3 2023.[305] The survey classifies entities as 'large' if they are above NZ$1 billion in total assets under management (AUM). The distribution of AUM does not appear to have a natural break point, but the largest and smaller companies are extremely different in size.

1095. Setting the threshold at NZ$1 billion would include more than half (37) of the entities, representing approximately 97% of total AUM in New Zealand. We believe that this threshold would capture the large entities in this segment. The funds management sector has a different business nature from the companies captured by the other limbs of the definition. Part of this difference is reflected by the fact that their size is better measured by the AUM, rather than by their own assets. In other words, 'large' has a different meaning in this context from that in the Annual Enterprise Survey.

1096. Therefore, we believe the proposal to classify funds management entities as large corporate and institutional clients if they have total assets under management of over NZ$1 billion helps ensure the standard will be proportionate (see section 4(a)(i) of the DTA) and simple to administer, avoiding unnecessary compliance costs (see section 4(c) of the DTA). It is also supportive of competition in this market segment (see section 4(b) of the DTA) and the deposit-taking sector comprising a diversity of institutions (see section 4(a)(iii) of the DTA).

Summary

1097. We decided through the Branch Review that dual-operating branches will only be able to do business with large corporate and institutional clients. We propose that a large corporate and institutional client be defined as a client that has one or more of the following:

- consolidated annual turnover of over NZ$50 million
- total assets of over NZ$75 million
- total assets under management of over NZ$1 billion (for funds management entities only).

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.

[305] For more details, *see* Reserve Bank of New Zealand – Te Pūtea Matua. (2023, 27 November). Managed Funds Survey – Q3 2023. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/statistics/series/shared/t40-41/managed-funds-survey-q3-2023.pdf

2.4 Carried over requirements from BS1

Preferred option

1098. As stated in the Branch Review RIS and C3, we propose to implement Branch Review decisions in the Branch Standard and we have discussed our proposals for implementing these decisions in sections 2.1, 2.2 and 2.3 above. We propose to carry over several of the existing requirements for branches outlined in the current BS1 (paragraphs 24 to 42 and Appendix 1, Part II).[306] The requirements in other proposed standards that will be applicable to branches will not be duplicated in the Branch Standard. See Table W for an overview of the requirements that are matters for other standards.

Analysis

1099. In the Branch Review, we identified these requirements in the current BS1 as fundamental parts of our supervisory approach. We consider that this approach remains appropriate under the DTA. This is described in the Branch Review's first Consultation Paper.[307] Appendix 2, Annex 1 of the second Consultation Paper (C2) then included an exposure draft of standard conditions of registration that would apply to branches once the Branch Review proposals were implemented.[308] We have subsequently decided that the Branch Review policy decisions will be implemented through the proposed Branch Standard, rather than through conditions of registration.

1100. We propose the standard comprises substantively the same requirements as the exposure draft in C2, with some drafting changes to reflect the broader approach to issuing standards under the DTA.

1101. The rationale for including each of these requirements is summarised below in Table W. Some of the requirements are modified to reflect the proposals in this chapter and changes relative to BS1 are identified in red line changes for transparency. Some requirements will need to be redrafted to be consistent with the approach taken across the DTA Standards. This proposed wording of individual requirements will be a matter for the next phase of consultation on the non-core standards. Table W is intended to help the reader understand how requirements will carry over from both BS1 and the exposure draft in C2.

Summary

1102. We propose to carry over several of the existing requirements for branches outlined in the current BS1 (paragraphs 24 to 42 and Appendix 1, Part II).

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[306] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2021). Statement of Principles, Bank Registration and Supervision, BS1, paragraphs 24 to 42 and Appendix 1, Part II. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs1-statement-of-principles.pdf

[307] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2021). Review of policy for branches of overseas banks Consultation Paper. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/overseas-branches/review-of-policy-for-branches-of-overseas-banks-consultation-paper.pdf

[308] *See* Reserve Bank of New Zealand – Te Pūtea Matua. (2022). Review of policy for branches of overseas banks Consultation Paper, Appendix 2, Annex 1. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/overseas-branches/review-of-policy-for-branches-of-overseas-banks---consultation-paper-august-2022.pdf

Table W: mapping of existing standard conditions of registration for branches on to Branch Standard requirements, as proposed in the Branch Review C2 and modified by new proposals in this chapter

Note that we are not seeking views on the drafting of individual requirements at this stage and this will be consulted on through the exposure draft of the Branch Standard.

We have prepared this table for the purpose of helping the reader to understand how the existing standard requirements for branches will carry over from both BS1 and from the changes proposed in the exposure draft in C2.

Standard conditions of registration, as described in BS1 and the Branch Review C2 exposure draft	Standard we propose the requirement is carried over to	Changes made in implementing this requirement under DTA Standards
That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities. In this condition of registration, the meaning of 'material' is based on generally accepted accounting practice.	Restricted Activities	This requirement is out of scope for the Branch Standard.
That the banking group's insurance business is not greater than 1% of its total consolidated assets.	Restricted Activities	This requirement is out of scope for the Branch Standard.
That the business of the registered bank in New Zealand does not constitute a predominant proportion of the total business of the registered bank.	Branch	This requirement will be carried over from BS1 into the Branch Standard with some possible drafting revisions.
That no appointment to the position of the New Zealand chief executive officer of the registered bank shall be made unless…	Governance	This requirement is out of scope for the Branch Standard.
That [name of bank] complies with the requirements imposed on it by [name of the supervisory authority in the bank's jurisdiction of domicile].	Branch	This requirement will be carried over from BS1 into the Branch Standard with some possible drafting revisions.

Standard conditions of registration, as described in BS1 and the Branch Review C2 exposure draft	Standard we propose the requirement is carried over to	Changes made in implementing this requirement under DTA Standards
That [name of bank] complies with the following minimum capital adequacy requirements, as administered by [name of supervisory authority in the bank's jurisdiction of domicile]	Branch	This requirement will be carried over from BS1 into the Branch Standard with some possible drafting revisions.
That ~~liabilities~~ total assets of the registered bank in New Zealand~~, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the registered bank),~~ do not exceed NZD$15 billion.	Branch	Section 2.2 above describes the changes to this requirement in more detail. This new requirement will be included in the Branch Standard with some possible drafting revisions.
That ~~retail deposits of~~ the registered bank in New Zealand undertakes wholesale business only. For the purpose of this requirement, 'wholesale business' means business transacted with 'wholesale clients', as defined in section 459(3) of the Deposit Takers Act 2023. ~~Do not exceed $200 million. For the purposes of this condition retail deposits are defined as deposits by natural persons, excluding deposits with an outstanding balance which exceeds $250,000~~.	Branch	Section 2.1 above describes the changes to this requirement in more detail. This new requirement will be included in the Branch Standard with some possible drafting revisions.
That the registered bank notify the Reserve Bank of any material changes in the home regulatory or supervisory regime that would impact [name of overseas bank], and by extension the registered bank.	Branch	This requirement was proposed in the Branch Review C2 and we propose that it will be included in the Branch Standard with some possible drafting revisions.
That the registered bank in New Zealand undertakes business with large corporate and institutional clients only. For the purposes of this condition of registration, 'large corporate and institutional clients' means those with either: • consolidated annual turnover of over NZ$50 million; or • total assets of over NZ$75 million; or	Branch	Section 2.3 above describes the changes to this requirement in more detail. This new requirement will be included in the Branch Standard with some possible drafting revisions.

Standard conditions of registration, as described in BS1 and the Branch Review C2 exposure draft	Standard we propose the requirement is carried over to	Changes made in implementing this requirement under DTA Standards
• total assets under management of over NZ$1 billion (for funds management entities only).		
Non-standard requirements (numbers 11–15 in the Branch Review C2 exposure draft).	Branch	These requirements will only apply to a branch if it is judged to be an appropriate risk mitigant following a jurisdiction and/or institution level assessment, as described in the Branch Review RIS, section 4.5. These requirements may also require some drafting revisions to be fit for purpose in a Branch Standard.
Loan-to-Value Ratio requirements	None	As proposed in the Branch Review C2, these requirements will no longer apply to branches. This is described in further detail in the Lending Standard (see chapter 2).

3 Conclusion

1103. Our proposed Branch Standard will include certain requirements that will apply only to branches of overseas deposit takers. In short, these requirements are that:

- branches only conduct business with wholesale clients
- the total size of a branch cannot exceed NZ$15 billion in total assets
- dual-operating branches can only conduct business with large corporate and institutional clients
- branches meet the minimum requirements as currently described in BS1 (as we propose to largely carry these over into the standard)
- where necessary, branches may have to meet additional bespoke requirements to address specific risks identified by supervisors.

1104. The Branch Standard will not preclude branches also having to comply with branch-specific requirements in any other standard (for example, any branch-specific disclosure requirements in the Disclosure Standard).

Q152	Do you have any comments on the proposed approach for branches of overseas deposit takers?
Q153	How can we make it easier for current and prospective branches to understand the requirements that will apply to them under the DTA?

Final remarks

1105. There is much to do to prepare for this change to continue to evolve as a modern prudential regulator, and we seek your help to create a cohesive and effective prudential framework. We also hope this document provides some clarity on the process ahead. Please take the opportunity to engage with us in this process, by written submissions, workshops or through bilateral meetings. We look forward to working with you in developing the new framework for prudential regulation in New Zealand.

Annex A: Glossary

Term	Meaning
ADI	Authorised Deposit-Taking Institution
AMA	Advanced Measurement Approach
APRA	Australian Prudential Regulation Authority
AUM	Assets under management
Banking group	in relation to a registered bank,— (a) means the financial reporting group; or (b) if the Reserve Bank has, by notice in writing to the registered bank, after consultation with the registered bank, agreed to or required the inclusion or exclusion of any entity or any part of any entity, means the financial reporting group including or excluding that entity or that part of that entity, as the case may be.
Basel Core Principles	the Core Principles for Effective Banking Supervision issued by the Basel Committee for Banking Supervision
BCBS	Basel Committee for Banking Supervision
BCBS CGP	Basel Committee on Banking Supervision Guidelines – Corporate Governance Principles for Banks
Board	Board of directors
BPSA	Banking (Prudential Supervision) Act 1989
BPR	Banking Prudential Requirements
BPR100	BPR100 Capital Adequacy document
BPR131	BPR131 Standardised Credit Risk RWAs document
BPR151	BPR151 AMA Operational Risk document
Branches	Branches of overseas deposit takers. Has the same meaning as "overseas licensed deposit taker" in section 6 of the DTA.
Branch Review	Review of policy for branches of overseas banks
Branch Review RIS	Branch Review Regulatory Impact Statement
BSH	Banking Supervision Handbook, being superseded by the BPR
BS1	BS1 – Statement of Principles: Bank Registration and Supervision
BS7A	Disclosure requirements for banks in New Zealand
BS10	Review of Suitability of Bank Directors and Senior Managers

Term	Meaning
BS11	Outsourcing Policy for Banks
BS13	Liquidity policy for banks, implemented in 2010 by the Reserve Bank
BS13a	Liquidity policy for banks, Annex of Liquid Assets
BS14	Reserve Bank Corporate Governance document
BS17	The Reserve Bank's Open Bank Resolution (OBR) Pre-positioning Requirements Policy
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CoFR	Council of Financial Regulators
Company	Has the same meaning as in section 2(1) of the Companies Act 1993 and includes an overseas company within the meaning of that Act
CoR	Conditions of Registration
Covered bond	Means bonds that provide investors with a security interest over a pool of the deposit taker's assets (the cover pool).
Cover pool	See **Covered bond**
CPS 220	Australian Prudential Regulation Authority's Prudential Standard CPS 220 Risk Management
CPS 230	Australian Prudential Regulation Authority's Prudential Standard CPS 230 Operational Risk Management
CPS 234	Australian Prudential Regulation Authority's Prudential Standard CPS 234 Information Security
CRO	Chief Risk Officer
C2	Second consultation paper for the Branch Policy Review, released in 2022
C3	Third consultation paper for the Branch Policy Review, released in 2023
D-SIBs	Domestic systemically important banks
DCS	Depositor Compensation Scheme, has the same meaning as in Part 6 of the Deposit Takers Act 2023
DTA	Deposit Takers Act 2023
Dual operation	Where an overseas deposit taker operates both a branch and a locally-incorporated subsidiary in New Zealand
Dual-Operating branch	A branch where the overseas deposit taker also operates a locally-incorporated subsidiary licensed by the Reserve Bank of New Zealand

Term	Meaning
ESAS	Exchange Settlement Account System
Financial reporting group	For branches, means the New Zealand business of the registered bank and its subsidiaries as required to be reported in group financial statements under section 461B(2) of the Financial Markets Conduct Act 2013. For locally-incorporated deposit takers, has the same meaning as "group".
FMA	Financial Markets Authority
FMCA	Financial Markets Conduct Act 2013
FMI	Financial Market Infrastructures
Freeze/frozen	In relation to accounts or other liabilities, means all or part of the account or other liability for which the moratorium has not been waived and payment is suspended
FSAP	Financial Sector Assessment Programme
GAAP	Generally accepted accounting practice, has the same meaning as in section 8 of the Financial Reporting Act 2013
GFC	Global Financial Crisis
Governance Thematic	Governance Thematic Review Report 2023
Group	Has the same meaning as in section 6(1) of the Financial Markets Conduct Act 2013.
IADI	International Association of Deposit Insurers
ICAAP	Internal Capital Adequacy Assessment Process
ICT	Information and communication technology
IMF	International Monetary Fund
IMF FSAP	International Monetary Fund Financial Sector Assessment Program 2017
In-flight payments	Payments that have been initiated but not fully processed as at the time the deposit taker enters resolution
Insured balances	The account balances for which the depositor would have had an entitlement to compensation under the DCS if the Reserve Bank had issued a specified event notice, with a quantification time equivalent to the time at which the deposit taker was placed into resolution
Licensed NBDT	Has the same meaning as in section 4(1) of the NBDT Act
Local incorporation	means the process of becoming incorporated as a company in New Zealand under the Companies Act 1993.

Term	Meaning
Look-through	Means certain deposits where funds are being held on behalf of an eligible depositor
Locally-incorporated deposit taker	means a deposit taker that is incorporated as a company in New Zealand under the Companies Act 1993.
MBIE	Ministry for Business, Innovation and Employment
Moratorium	The moratorium provided for in the DTA, section 284, which prevents a person from taking certain actions against or in respect of a deposit taker in resolution
MoU	Memorandum of Understanding
MSP	Material Service Providers
NBDT	Non-bank deposit takers, has the same meaning as in section 5 of the NBDT Act
NBDT Act	Non-bank Deposit Takers Act 2013
NBDT capital regulations	Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposure) Regulations 2010
NBDT liquidity regulations	Deposit Takers (Liquidity Requirements) Regulations 2010
New Zealand CEO	New Zealand Chief Executive Officer, as defined in the DTA
Non-D-SIBs	Banks that are not domestic systemically important banks
NZD	New Zealand Dollar
NZX	New Zealand's stock exchange
NZX code	NZX's Corporate Governance Code
OBR	Open Bank Resolution
OCR	Official Cash Rate
OIA	Official Information Act 1982
OIC	Order in Council
Proportionality framework	*Proportionality Framework for Developing Standards under the Deposit Takers Act*, published by the Reserve Bank on 14 March 2024
RBA	Reserve Bank of Australia
RB bill	Reserve Bank bill
Registered bank	Has the same meaning as in section 2(1) of the Banking (Prudential Supervision) Act 1989
Reserve Bank	The Reserve Bank of New Zealand – Te Pūtea Matua
Resolution manager	One or more persons appointed by the Reserve Bank under the DTA, section 357, to act as resolution manager, or the Reserve Bank if it has appointed itself as resolution manager, or if no other

Term	Meaning
	person holds office as resolution manager. Under the DTA, Part 7, the resolution manager has certain powers and duties in relation to a deposit taker in resolution
RIA	Regulatory Impact Assessment
RWA	Risk weighted assets
SBI	Settlement Before Interchange payment system
SBI365	Settlement Before Interchange 365 payment system
SDV	Single Depositor View
SME	Small and medium-sized enterprise
SoFA	Statement of Funding Approach
SPV	Special Purpose Vehicle
Standards	Refer to the four core Deposit Taker Standards to be made under the Deposit Takers Act 2023
SVB	Silicon Valley Bank
T-bill	Treasury bill
Unfreeze/unfrozen	In relation to accounts or other liabilities means all or part of the account or other liability for which the moratorium has been waived and payment has not been suspended
Uninsured balances	Customer account balances that are not insured balances

Annex B: Consolidated consultation questions

Introduction

Q1	What do you think the cumulative impact of the proposed standards will be on the relevant principles?
Q2	What do you think of the way we have taken into account the proportionality principle in developing the proposed standards?
Q3	What do you think the implications of the proposed standards will be on the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services and on financial inclusion more generally? If possible, please provide specific feedback on how these requirements might impact the accessibility and affordability of financial services.
Q4	What do you think the impact of the proposed standards will be for the Māori economy, in particular on: a) the role of the financial system and deposit takers in supporting the Māori economy; and b) Māori customers, iwi and individuals and Māori businesses, trusts and entities?
Q5	What do you think the cumulative impact of the proposed standards will be on competition? How do you think competition should be factored into our broader analysis of the principles?
Q6	Do you think that this approach to developing standards is appropriate? Is there anything else we should take into account when developing the prudential framework?
Q7	What transitional arrangements would be appropriate? Are there any particular requirements that would take longer to comply with than others?

Chapter 1: Governance

Q8	Do you have comments on the proposed outcomes and requirements for the responsibilities of boards of Group 1 deposit takers?
Q9	Do you have comments on the proposed board size and composition requirements for Group 1 deposit takers?

Q10	Do you have comments on the proposed criteria for independence of directors for Group 1 deposit takers?
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?
Q12	Do you have comments on the proposed requirements for board committees of Group 1 deposit takers?
Q13	Do you have comments on the proposed fit and proper requirements for the boards and senior managers 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?
Q15	Do you have comments on the proposed outcomes and requirements for the responsibilities of boards of Group 2 deposit takers?
Q16	Do you have comments on the proposed board size and composition requirements for Group 2 deposit takers?
Q17	Do you have comments on the proposed criteria for independence of directors for Group 2 deposit takers?
Q18	Do you have comments on the proposed fit and proper requirements for the boards and senior managers 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?
Q20	Do you have comments on the proposed outcomes and requirements for the responsibilities of boards of Group 3 deposit takers?
Q21	Do you have comments on the proposed board size and composition requirements for Group 3 deposit takers?
Q22	Do you have comments on the proposed criteria for independence of directors for Group 3 deposit takers?
Q23	Do you have comments on the proposed fit and proper requirements for the directors and senior managers of Group 3 deposit takers?

Q24	Are there alternative options that we could consider to deliver the outcomes of the proposed Governance Standard for Group 3 deposit takers?
Q25	Do you have comments on our initial assessment of the impact of our proposals on Group 3 deposit takers?
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 comments on our initial assessment of the impact of our proposals on branches?
Q29	Do you have 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?

Chapter 2: Lending

Q31	Do you agree that the Lending Standard should only apply to residential mortgage lending (with a regulation made under the DTA to enable that)?
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)?
Q33	Do you agree with including the proposed set of LVR and DTI threshold and speed limit requirements in the Lending Standard?
Q34	Do you agree with not including an option to apply the Lending Standard at an Auckland/non-Auckland level?
Q35	Do you agree with our proposed approach to carry over the existing borrower-based macroprudential policy requirements to Group 2 deposit takers (which includes a six-month measurement period)?
Q36	Do you agree that the proposal in section 2.2 should apply to Group 2 deposit takers?

Q37	Do you agree that the proposal in section 2.3 should apply to Group 2 deposit takers?
Q38	Do you agree with our proposed approach of not requiring Group 3 deposit takers to comply with borrower-based macroprudential policy requirements as set out in the Lending Standard?

Chapter 3: Risk Management

Q39	Do you agree with our proposed approach to developing the Risk Management Standard?
Q40	What do you think the compliance costs associated with the requirements in the proposed standard are likely to be? Is there another way that we can achieve our policy intent with lower compliance costs?
Q41	Are there certain requirements for which transitional provisions would be useful?
Q42	Do you agree with our proposed approach in relation to the requirement for deposit takers to have a risk management framework?
Q43	Do you agree with our proposed requirements relating to risk management at the deposit taker and group levels?
Q44	Do you agree with our proposed approach that the risk management framework addresses all material risks?
Q45	Do you agree with our proposal to set out a non-exhaustive list of material risk categories? If so, do you agree with our proposed non-exhaustive list of material risk categories?
Q46	Do you consider that we should define 'material risk' and what do you think would be an appropriate definition?
Q47	Do you agree with our proposed approach relating to the responsibilities of the board?
Q48	Do you agree with our proposal that deposit takers must have a board-approved risk management strategy?

Q49	Do you agree with our proposal that deposit takers must have a board-approved risk appetite statement?
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 the soundness and adequacy of risk management cultures? Do you think there is an alternative way we could achieve the desired policy outcomes?
Q51	Do you agree with our proposal relating to risk management policies and processes?
Q52	Do you agree with our proposal that the risk management framework be regularly reviewed and adjusted?
Q53	What do you consider to be appropriate for the breadth and frequency of the review requirement?
Q54	Do you agree with our proposal to require deposit takers to have appropriate internal processes for assessing their overall capital adequacy?
Q55	Do you agree with our proposal to require deposit takers to have appropriate internal processes for assessing their overall liquidity risk management?
Q56	Do you agree with our proposal relating to stress testing?
Q57	What stress testing would be appropriate for the different material risks that Group 1 deposit takers assess? Do you think our existing guidance is an appropriate starting point?
Q58	Do you agree with our proposed approach to information and data management?
Q59	Do you agree with our proposal to require deposit takers to have adequate risk management functions?
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?
Q61	Do you agree with our proposal that the risk management function be subject to regular review by the internal assurance function?

Q62	Do you agree with our proposal to require Group 1 deposit takers to have a dedicated risk management unit overseen by a CRO or equivalent function?
Q63	Do you agree with our proposal to require deposit takers to have adequate internal control frameworks?
Q64	Do you agree with our proposal to require deposit takers to have a compliance function?
Q65	Do you agree with our proposed approach to require deposit takers to have an internal assurance function?
Q66	Do you agree with our proposal relating to reporting and notification requirements?
Q67	Do you agree with our proposal to take the same approach to risk management requirements for Group 2 deposit takers as we propose for Group 1?
Q68	What do you think the compliance costs associated with our proposed approach to Group 2 deposit takers are likely to be? Is there another way that we can achieve our policy intent with lower compliance costs for Group 2 deposit takers?
Q69	Do you agree with our proposal to take the same approach to risk management requirements for Group 3 deposit takers as we propose for Group 1 and Group 2 deposit takers, except for the requirements identified?
Q70	What do you think the compliance costs associated with our proposed approach to Group 3 deposit takers are likely to be? Is there another way that we can achieve our policy intent with lower compliance costs for Group 3 deposit takers?
Q71	Do you agree with our proposal to require Group 3 deposit takers to undertake stress testing covering material risks that are capital, liquidity and operational risks?
Q72	Do you agree with our proposal to not require Group 3 deposit takers to have a dedicated risk management unit overseen by a CRO or equivalent function, but to require that Group 3 deposit takers who do not have a CRO to have an executive responsible for risk management?

Q73	Do you agree with our proposal to require Group 3 deposit takers to have a compliance function, but allow this to be outsourced?
Q74	Do you agree with our proposed approach to require Group 3 deposit takers to have an internal assurance function, but allow this to be outsourced?
Q75	Do you agree with our proposal to take the same approach to risk management requirements for branches as we propose for Group 1 and Group 2 deposit takers, except for the requirements identified?
Q76	What do you think the compliance costs associated with our proposed approach to branches are likely to be? Is there another way that we can achieve our policy intent with lower compliance costs for branches?
Q77	Do you agree with our proposed approach to the requirement for branches to have a risk management framework?
Q78	Do you agree with our proposed requirements for risk management at the branch and group levels?
Q79	Do you agree with our proposal to apply the proposed requirements for responsibilities of New Zealand CEOs of branches of overseas deposit takers?
Q80	Do you agree with our proposal to not impose requirements for stress testing on branches?
Q81	Do you agree with our proposal to not require branches to have a dedicated risk management unit overseen by a CRO or equivalent function?
Q82	Do you agree with our proposal to require branches to have a compliance function, but allow this to be outsourced or resourced by the home entity?
Q83	Do you agree with our proposed approach to require branches to have an internal assurance function, but allow this to be outsourced or resourced by the home entity?

Chapter 4: Operational Resilience

Q84	Do you have comments on our proposed definition of 'critical operations'?
Q85	Do you have comments on our proposed operational risk management requirements for Group 1 deposit takers?

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?
Q87	Do you have comments on our proposed ICT risk management requirements for Group 1 deposit takers?
Q88	Do you have comments on our proposed definitions?
Q89	Do you have comments on our proposed business continuity planning and management requirements for Group 1 deposit takers?
Q90	Do you have comments on our analysis and cost of compliance assessment?
Q91	Do you have comments on our proposal to apply the same requirements for Group 1 deposit takers to Group 2?
Q92	Do you have comments on our analysis and cost compliance assessment for Group 2?
Q93	Do you have comments on our proposal to apply the same requirements for Group 1 deposit takers to Group 3?
Q94	Are there alternative options that we could consider to deliver the outcomes of the proposed Operational Resilience Standard?
Q95	Do you have comments on our analysis and cost compliance assessment for Group 3?
Q96	Do you have comments on our proposed operational resilience requirements for branches?
Q97	Do you have comments on our analysis and cost compliance assessment for branches?

Chapter 5: Related Part Exposures

Q98	Do you agree with the proposed approach for Group 1 deposit takers?
Q99	Are there any developments or changes since our BS8 review that we should be aware of?

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?
Q102	Do you agree that not continuing to include governance bodies 'overlapping by 40%' as part of the definition of related party is reasonable in light of the risks the standard seeks to manage?
Q103	Do you consider the inclusion of entities controlled by a director of the NBDT will result in aggregate exposures that remain within the 15% limit?
Q104	Do you agree the definition of family member, and adjusted thresholds for 'significant influence' and control are reasonable in light of the risks the standard seeks to manage?
Q105	Do you agree with the proposed approach for Group 3 deposit takers?
Q106	Do you agree that the calculation of aggregate net exposures in the Related Party Exposure Standard remains aligned with the Capital Standard for Group 3 deposit takers?
Q107	Is our evaluation of the impact of requiring Group 3 deposit takers to prevent abuses in transactions with related parties accurate?

Chapter 6: OBR Pre-positioning

Q108	Do you have views on whether and how we should rename 'OBR pre-positioning' to better reflect the aims of the policy?
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?
Q110	Do you support the integration of DCS with OBR and the proposed solution?
Q111	Are there any other solutions that would achieve the same outcomes (or better) for depositors?
Q112	Do you agree that the compendium of liabilities will need to be updated to reflect DCS-eligible products?

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.
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?
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?
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?
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?
Q121	Do you support the proposal that the OBR Pre-positioning Standard should not apply to Group 3 deposit takers?

Chapter 7: Outsourcing

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?
Q123	Do you agree with our assessment of the requirements in the existing outsourcing policy, BS11, against the purposes and principles of the DTA?

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?
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?
Q126	Do you agree with the proposal for the new Outsourcing Standard to apply only to deposit takers already required to implement BS11 or required to implement BS11 before the introduction of the Outsourcing Standard?

Chapter 8: Restricted Activities

Q127	Do you agree with our proposed approach to developing the Restricted Activities Standard?
Q128	What do you think the compliance costs associated with the restrictions and prohibitions in the proposed standard are likely to be? Is there another way that we can achieve our policy intent with lower compliance costs?
Q129	Do you agree with our proposal to restrict insurance business by deposit takers?
Q130	Do you agree with our proposed quantitative threshold of no more than 1% of the deposit-taking group's total assets? Do you think this limit remains appropriate, or is there a risk of this threshold being breached where insurance underwriting is incidentally undertaken during the course of deposit-taking business?
Q131	Do you agree with our proposal to restrict the conduct of material non-financial 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?
Q133	Do you consider that there is a material risk that, in a scenario where a deposit taker assumes control of a non-financial business following an insolvency event, a quantitative materiality threshold of 1% of total assets or 5% of net income could be breached? If so, what do you think we could do to accommodate this risk within the proposed restriction?

Q134	Do you agree with our proposal to require deposit takers wanting to establish a branch or subsidiary overseas to notify us before approaching the host regulator?
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?
Q136	Do you agree with our proposal to limit to 10% the total proportion of a deposit taker's assets that may be encumbered for the purpose of covered-bond issuance?
Q137	Do you agree with our proposal to take the same approach to restricted activities for Group 2 deposit takers as we propose for Group 1 deposit takers?
Q138	What are the compliance costs associated with our proposed approach to Group 2 deposit takers likely to be? Is there another way that we can achieve our policy intent with lower compliance costs for Group 2 deposit takers?
Q139	Do you consider there is a risk that, in a scenario in which a deposit taker assumes control of a non-financial business in an insolvency event, the materiality threshold could be breached for a Group 2 deposit taker? If so, what do you think we could do to accommodate this risk within the proposed restriction?
Q140	Do you agree with our proposal to take the same approach to Group 3 deposit takers as to Group 1 and Group 2 deposit takers, by restricting insurance business by deposit takers?
Q141	Do you agree with our proposed quantitative threshold of no more than 1% of the deposit-taking group's total assets? Do you think this limit is appropriate, or is there a risk of this threshold being breached if insurance underwriting is incidentally undertaken during the course of deposit-taking business?
Q142	Do you agree with our proposal to take the same approach to Group 3 deposit takers as to Group 1 and Group 2 deposit takers, by restricting their ability to carry on material non-financial activities?
Q143	Do you consider that there is a risk that, in a scenario in which a Group 3 deposit taker assumes control of a non-financial business in an insolvency event, the materiality threshold could be breached? If so, what do you think we could do to accommodate this risk within the proposed restriction?

Q144	Do you agree with our proposal to take the same approach to Group 3 deposit takers wanting to establish a branch or subsidiary overseas as to Group 1 and Group 2 deposit takers, by requiring deposit takers to notify us before approaching the host regulator, and then seek our approval after the host regulator has agreed to the establishment of the branch or subsidiary?
Q145	Do you agree with our proposal to take the same approach to Group 3 deposit takers as to Group 1 and Group 2 deposit takers, by restricting to 10% the proportion of their assets that can be encumbered as a result of covered-bond issuance?
Q146	Do you agree with our proposal to take the same approach to branches as to Group 1, Group 2 and Group 3 deposit takers, by restricting insurance business by branches?
Q147	Do you agree with our proposed quantitative threshold of no more than 1% of total assets of the New Zealand business of the overseas deposit taker?
Q148	Do you agree with our proposal to take the same approach to branches as to Group 1, Group 2 and Group 3 deposit takers, by restricting the conduct of material non-financial activities by branches?
Q149	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?

Chapter 9: Branch

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?
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.
Q152	Do you have any comments on the proposed approach for branches of overseas deposit takers?
Q153	How can we make it easier for current and prospective branches to understand the requirements that will apply to them under the DTA?