
Review of Policy for Branches of
Overseas Banks
November 2022

Payments NZ Limited submission

16 November 2022

Introduction

Payments NZ Limited (Payments NZ) governs the New Zealand payment system, including the settlement before interchange system (SBI), which enables participants in our bulk electronic clearing system (BECS) and consumer electronic clearing system (CECS) to settle retail payments and, once this has occurred, exchange the payment information with other participants. From the perspective of Payments NZ, we have a particular interest in the proposals set out in the Reserve Bank's consultation on the review of policy for branches of overseas banks relating to the ability of branches to take retail deposits and to participate in our retail clearing systems – BECS and CECS.

Payments NZ acknowledges the issues set out in the consultation document relating to the Reserve Bank's oversight of registered branches operating in New Zealand and the challenges which the Reserve Bank faces in ensuring that Te Pekanga – its regulated entities, including registered banks – are sound and efficient. In particular, we note the Reserve Bank's concerns in relation to managing risks with branches (particularly if a branch were to fail) and the costs and issues involved if the Depositor Compensation Scheme were to apply to branches. However, this needs to be weighed with the negative impact on competition, efficiency and innovation which could result from the policy and we would like to better understand the impact of the policy in this regard. We also note that, while the proposed policy is for registered branches of overseas banks, under the recently introduced Deposit Takers Bill there will no longer be separate registrations for banks and non-bank depositor takers and so, presumably, the policy will, in time, apply to all deposit takers. This could affect the ability of innovators (like neo banks and fintechs) to access the payment system by requiring them to incur the full costs associated with local incorporation and all the regulation which will accompany that.

Interoperable, innovative, safe, open and efficient payment systems

Payments NZ promotes interoperable, innovative, safe, open and efficient payments systems. One of our key objectives is to encourage and facilitate new entities becoming participants in clearing systems based on fair and reasonable public access criteria. Payments NZ access rules do not restrict access to locally incorporated financial institutions and we currently have participants in our retail payment systems who are branches of overseas banks.

Payments NZ's access rules are objective, fair and risk-based, without imposing any unwarranted barriers to access. In determining appropriate requirements, a risk-based approach has been adopted which acknowledges that financial and operational failure pose significant risk to the payment system, but liquidity/credit risk can be mitigated through the requirement to have adequate support from a third party.

The access rules require an applicant to satisfy one overarching access criterion, namely that an applicant will not, if it becomes a participant in a clearing system:

- adversely affect the integrity or reputation of the clearing system; or
- introduce significant risk into the clearing system.

The rules specify prudential, operational risk management, and operational requirements in relation to clearing systems and provide that an applicant can satisfy the access criterion by demonstrating it complies with these requirements. It is noted that the prudential requirements largely reflect those matters which the Reserve Bank takes into consideration when regulating banks, non-bank deposit takers and insurers. While Payments NZ can rely on assessments

which the Reserve Bank undertakes as part of its role as regulator, Payments NZ rules do not require an applicant to be a regulated entity and the independent directors, who determine applications to participate, can seek a report from a qualified person as to whether an applicant meets the access requirements.

The process of determining whether an applicant satisfies the access criterion is holistic. While the procedures specify certain requirements which must be met (e.g. an applicant must have adequate risk management policies and systems), other matters require the independent directors to undertake an assessment (e.g. whether the jurisdiction of incorporation is likely to introduce risk).

It is noted, however, that all applicants must have an Exchange Settlement Account System (ESAS) account with the Reserve Bank. The Reserve Bank is currently undertaking a review of its access criteria for ESAS accounts. The Reserve Bank website notes that: “the review is designed to ensure that the access policy and criteria are appropriate for promoting the development of a payments system which:

- is efficient, open and flexible;
- has a high level of integrity;
- is robust in the face of financial crises”.

The Reserve Bank has indicated that, following the review, ESAS accounts could be more readily available to a broader range of institutions, such as non-bank payment services providers (subject to maintaining the integrity and robustness of the ESAS system). Payments NZ would like to understand whether there will be a requirement for all ESAS account holders who wish to participate in SBI to be locally incorporated (i.e. will this extend to other non-bank payment service providers) or will there be different requirements.

Impact on open access, competition and innovation

The establishment of Payments NZ in 2010 opened up direct access to the payment system to non-banks for the first time and, through improved transparency and governance arrangements, ensures that New Zealand’s payment system complies with the relevant Principles for Financial Market Infrastructures issued by the Committee on Payments and Market Infrastructure and the International Organization of Securities Commission. Over the years, we have continued to develop and refine our access requirements to ensure that the right balance is found between competition, innovation, efficiency and safety, so that access to the payment system benefits all stakeholders.

The consultation document acknowledges that the proposal to require all branches to locally incorporate could have a negative effect on competition in retail banking. However, the Reserve Bank notes that: “there is little or no evidence that branches provide material price-based competition to locally-incorporated retail banks.”

The Reserve Bank notes that the role of branches in retail banking is “immaterial” and that it is unlikely that allowing branches to take retail deposits (subject to thresholds) would encourage new entrants. In light of this, we would like to better understand the Reserve Bank’s concerns in relation to branches, given that they do not pose a systemic risk to the financial system. We also note that, while branches are part of a legal entity incorporated overseas (and therefore not subject to many of the requirements imposed on banks incorporated in New Zealand), there are

a number of existing restrictions and thresholds which apply to their operation in New Zealand. These, together with the requirements that apply in their home jurisdictions, have ensured that branches do not introduce systemic risk and have been able to effectively participate in New Zealand's payment system, including BECS and CECS governed by Payments NZ.

In relation to the Reserve Bank's view that the thresholds for retail deposits would not create sufficient economies of scale to allow overseas banks (including challenger banks) to "engage in material price-based competition with incumbent banks", we would like to understand whether the Reserve Bank has given consideration to the potential innovation which overseas banks could bring to the New Zealand market and the impact of this on competition. We are concerned that the need for overseas challenger/neo banks to locally incorporate may result in these banks not participating in the New Zealand payment system, which could slow down or limit innovations being brought to market in New Zealand.

Impact on cross-border transactions

The Reserve Bank also acknowledges the loss of efficiency in terms of cross border services offered to retail customers. We would like to better understand the long-term impacts on efficiency, particularly in relation to the role of payments in the South Pacific. There may be opportunities for some of these smaller markets (with insufficient banking activities to sustain their own systems) to participate in the New Zealand payment system. We would like to understand whether the Reserve Bank sees a role for branches in offering retail services to customers for this purpose – provided that the customer is aware of the different outcomes that could occur as a result of the branch being incorporated in another jurisdiction.

Conclusion

In developing a more consistent and transparent regime in relation to the Reserve Bank's policy for branches, Payments NZ believes that further consideration should be given to the impact of the proposal to restrict branches from taking retail deposits or offering products or services to retail customers. From the perspective of Payments NZ, we are concerned about the effect which this could have on access, competition, efficiency and innovation in the payment system. In particular we would like to better understand how this will integrate with the Reserve Bank's review of ESAS, which seeks to deliver an efficient, open and flexible payment system, and the impact of the recently introduced Deposit Takers Bill which will no longer separate registrations for banks and non-bank depositor takers.

As the range of organisations who may wish to participate in the New Zealand payment system expands, a requirement to locally incorporate may result in some financial institutions choosing not to operate in New Zealand. The challenge, remains as always, finding the right balance between competition and openness and protecting the integrity and stability of the system.



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