

**Ashley Tomlinson**

Prudential Supervision Department  
Reserve Bank of New Zealand  
PO Box 2498  
Wellington 6140

By e-mail: [part4consultation@rbnz.govt.nz](mailto:part4consultation@rbnz.govt.nz)

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Dear Ashley

**Consultation paper: Authorisations for the use of restricted words by overseas banks**

**1. Introduction**

The purpose of this letter is to make certain submissions, on behalf of the International Swaps and Derivatives Association, Inc. (**ISDA**)<sup>1</sup> and its member banks, on the Reserve Bank's consultation paper titled *Authorisations for the use of restricted words by overseas banks* (April 2018) (the **Consultation Paper**).

Before we set out our submissions, we thought it would be helpful, for the purposes of providing some context for those submissions, to provide a brief overview of the derivatives-related activity of ISDA member banks in New Zealand.

**2. Derivatives-related activity of ISDA member banks in New Zealand**

The OTC derivatives market is, increasingly, a global market. While local banks, fund managers, large corporates and Crown-owned entities in New Zealand trade derivatives between themselves, often their counterparty will be an overseas bank. Sometimes that overseas bank will be a registered bank under the Reserve Bank of New Zealand Act 1989 (the **RBNZ Act**). Sometimes it will not.

All New Zealand counterparties to OTC derivatives transactions with offshore counterparties are invariably "wholesale investors" for the purposes of the Financial Markets Conduct Act 2013 (the **FMC Act**). Accordingly, none of the participants in the OTC derivatives market is required to be licensed as a "derivatives issuer" under the FMC Act. Also, the FMC Act's disclosure rules do not apply to this market.

While the circumstances of each overseas bank and its relationship with its New Zealand counterparties are of course different, derivatives trading typically involves some or all of the following elements:

- active solicitation by the overseas bank or reverse enquiry from the New Zealand counterparty;
- at the beginning of the relationship, the negotiation and execution of a master agreement and, perhaps, a credit support document;

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<sup>1</sup> Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: [www.isda.org](http://www.isda.org).

- the subsequent negotiation and execution of a confirmation for each transaction entered into between the parties;
- the making of reciprocal payments/deliveries by the parties over the term of each transaction; and
- the delivery of margin as required by any credit support document.

In many instances, in line with the global trend regarding the clearing of OTC derivatives contracts, transactions entered into as described above are submitted to clearing houses who act as the centralised contractual counterparty to each transaction and facilitate the payment, delivery and margin activities set out above. With the exception of any visits to New Zealand made by employees of an overseas bank, that bank would regard all the above activities as being performed by it *outside New Zealand*. Specifically, for the purposes of section 64(1)(c) of the RBNZ Act, that bank would not consider itself to be “carry[ing] on any activity directly or indirectly *in New Zealand*”.<sup>2</sup>

### 3. Submissions

#### *Submissions on Part A*

While the Reserve Bank has invited submissions on the specific questions asked in Appendix C of the Consultation Paper, ISDA has chosen not to submit on those questions. This is because those questions relate to the authorisation process, which, for the reasons set out below, ISDA does not believe should apply to its member banks when trading OTC derivatives with New Zealand counterparties.

Instead, the focus of ISDA’s submissions is on the Reserve Bank’s approach to interpreting section 64(1)(c), as set out in Appendix A of the Consultation Paper. Specifically, ISDA’s focus is on paragraph 18 of Part A (Applicability to wholesale activities involving New Zealand wholesale customers), which is the logical place to consider whether section 64(1)(c) should apply to derivatives activity.

Paragraph 18 already notes the Reserve Bank’s view that section 64(1)(c) should not apply to:

transactions between registered banks and overseas banks participating in the international interbank market. The interbank market is carried on through a global network of banks borrowing and lending among themselves.

The same policy reasons that justify this exemption for interbank *lending* should, ISDA believes, also justify (1) interbank *derivatives trading* and/or *derivatives clearing*, and (2) derivatives trading and / or derivatives clearing that, while not interbank, occurs as between an overseas bank and a New Zealand “wholesale investor”. ISDA therefore suggests that paragraph 18 be amended accordingly. For example, the following two sentences could be added at the end of that paragraph:

Another wholesale market in which overseas banks engage with New Zealand customers is the derivatives market. Where the New Zealand counterparty of an overseas bank is a “wholesale investor” (as defined in the Financial Markets Conduct Act 2013), that bank’s derivatives-related activity will not be considered to engage section 64(1)(c).

ISDA believes such an exemption is appropriate in the light of the policy behind the section 64(1)(c) prohibition, and is consistent with the other paragraph 18 exemptions.

#### *As an alternative – a class authorisation?*

We understand from our New Zealand legal counsel, Bell Gully, that, at a meeting on 16 May, you confirmed that the Reserve Bank would consider issuing a class authorisation that would cover (perhaps among others) derivatives counterparties. Such a step, if it were taken, would be an alternative to the Guidance Note exemption ISDA suggests above.

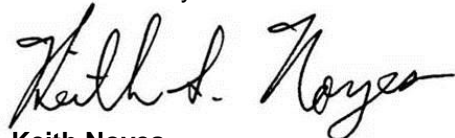
Given that the terms of such a class authorisation have not yet (we understand) been proposed to, or by, the Reserve Bank, it is impossible for us to comment definitively on whether we believe that would be a

<sup>2</sup> In saying this, ISDA recognises that some of its member banks have activities in New Zealand beyond merely trading derivatives with New Zealand counterparties. Those other activities would, of course, also need to be assessed as against the prohibition in section 64(1)(c).

satisfactory alternative to the exemption we suggest. However, we *can* say that, to the extent a class authorisation imposes on derivatives counterparties the conditions and ongoing obligations contemplated in Appendix B of the Consultation Paper, we would not support such a step. The Guidance Note exemption would provide a more appropriate, and internally consistent, outcome.

We are happy to discuss with the Reserve Bank any part of this letter. Please would you ensure any correspondence in relation to this submission is copied to David Craig at Bell Gully ([david.craig@bellgully.com](mailto:david.craig@bellgully.com)).

Yours sincerely

A handwritten signature in black ink, appearing to read "Keith Noyes". The signature is written in a cursive, flowing style.

**Keith Noyes**  
Regional Director, Asia Pacific