



# Statement of Principles:

## Bank Registration and Supervision

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# STATEMENT OF PRINCIPLES - BANK REGISTRATION AND SUPERVISION

## A. INTRODUCTION

1. In terms of section 67 of the Reserve Bank of New Zealand Act 1989 ("the Act"), the Reserve Bank is required to register banks and to undertake prudential supervision of registered banks. Part V of the Act confers various powers on the Bank in order to permit it to carry out these functions.
2. This document sets out the Reserve Bank of New Zealand's approach to the registration and supervision of registered banks.
3. As required by section 75 of the Act, it sets out the principles on which the Bank acts:
  - in determining applications for registration; and
  - in imposing, varying, removing, or adding to conditions of registration.
4. In addition it sets out the principles on which the Bank acts in carrying out other aspects of its prudential supervision role.

## B. PURPOSES OF BANK REGISTRATION AND SUPERVISION

5. The Reserve Bank carries out its bank registration and supervision functions for the purposes of:
  - promoting the maintenance of a sound and efficient financial system;
  - avoiding significant damage to the financial system which could result from the failure of a registered bank.
6. Bank registration policy is aimed at ensuring that only financial institutions of appropriate standing and repute are able to become registered banks. Subject to this requirement, impediments to the entry of new registered banks are kept to a minimum in order to encourage competition in the banking system. This approach recognises that competition can bring significant benefits to users of the services provided by registered banks. There is no upper limit on the number of registered banks.
7. The incentives for registered banks and their customers to act prudently and the impact of normal market disciplines may be undermined to the extent that taxpayers are implicitly or explicitly underwriting the banking system. Therefore, supervision of registered banks is not aimed at preventing individual bank failures or at protecting creditors. Instead, supervision is aimed at encouraging the soundness and efficiency of

the financial system as a whole. To the extent possible, this is achieved by drawing on and enhancing the disciplines which are naturally present.

8. In the event that a registered bank failure does occur, the Reserve Bank will seek to minimise damage to the financial system, in a way which does not involve taxpayer funding. This approach will apply regardless of whether the registered bank concerned is large or small. It may involve the use of the crisis management powers available to the Reserve Bank under the Act. These crisis management powers include the ability to place a registered bank under statutory management and the ability to give directions to a registered bank which is in difficulties.

### C. BANK REGISTRATION

9. The following section sets out the principles on which the Reserve Bank will act when determining applications for registration as a registered bank.
10. In terms of section 73 of the Act, when determining an application for registration as a registered bank, the Reserve Bank is required:
  - to satisfy itself that the applicant's business will substantially consist of the borrowing and lending of money, or the provision of other financial services, or both; and
  - to have regard to the following matters:
    - incorporation and ownership structure;
    - size of business;
    - ability to carry on business in a prudent manner;
    - standing of the applicant in the financial market;
    - law and regulatory requirements in an overseas bank's country of domicile;
    - any other matters prescribed in regulations.
11. Within this framework, the Reserve Bank places particular emphasis on ensuring that only financial institutions of appropriate standing, which are able to demonstrate their ability to carry on business in a prudent manner, are able to qualify for registration.
12. The principles the Reserve Bank applies when considering each of these matters are set out below.
  - (i) **Business of the Applicant** - The Bank is required to satisfy itself that the business carried on, or proposed to be carried on, by an applicant for registered bank status substantially consists of the borrowing and lending of money or the provision of other financial services. Therefore, applicants for registered bank status are required to provide the Reserve Bank with a description of the business they intend to conduct, including details of business to be conducted via separately incorporated entities.

The Bank does not limit the types of activities which registered banks may undertake. However, applicants will be required to satisfy the Bank that the majority of their business will consist of the provision of financial services. For the purposes of this requirement the Bank will take into account activities which are carried out through subsidiaries as well as activities undertaken by the registered bank itself.

There is no requirement that certain types of financial services must be provided by registered banks.

The Bank has not attempted to define the term "financial services" as it recognises that the types of service provided by banks evolve and develop over time. However, when considering whether or not a particular service is "financial", it will have regard to the types of services commonly offered by banks in New Zealand and in other similar countries.

- (ii) **Incorporation and Ownership Structure** - The Reserve Bank seeks to ensure that a registered bank is in the ownership of entities or individuals who collectively have incentives to monitor its activities closely and to influence its behaviour in a way which will improve or maintain its soundness. Such incentives are most likely to be present when the owners as a group have made a substantial financial commitment to the bank, and where the form of that commitment is such that they will be the first to absorb any losses which arise as a result of poor performance. The owners' incentives are likely to be further enhanced where there is potential for their reputation to be adversely affected by any problems which become evident in the bank.

In addition, there will need to be sufficient separation between the board of a bank and its owners to ensure that the board does not have an unfettered ability to act in the interests of the owners where those interests diverge from those of the bank.

The Bank will take into account the standing of the owners, since this is likely to have a significant impact on the standing of the applicant.

Where an applicant is owned by a major international bank of standing and repute, it is likely that the Reserve Bank will accept this as evidence that the applicant has an appropriate level of standing for a registered bank. Other applicants will need to satisfy the Bank that they have a degree of standing which is appropriate for a registered bank. In such cases, the Reserve Bank will also take into consideration any impediments to the raising of further capital which arise as a result of the applicant's ownership structure.

Where the applicant is a subsidiary or branch of an overseas bank, the Reserve Bank will seek the views of the parent supervisor before determining the application for registration.

The Reserve Bank will assess ownership structures in the light of these factors.

Both locally incorporated entities and branches of companies incorporated overseas may apply for registration.

(a) **Branches of Overseas Banks**

Where an applicant wishes to register as a branch of an overseas incorporated entity, that entity will need to have bank status in its home jurisdiction. Furthermore, the Bank will wish to satisfy itself as to the adequacy of disclosure and supervisory requirements, or the effectiveness of market disciplines, in the country of incorporation. Where the Bank is not satisfied on these points it may require the applicant to operate via a locally incorporated entity rather than via a branch.

Where key prudential disclosures are not publicly available in the home jurisdiction or the frequency and timeliness of disclosures is inadequate, the Bank may take into consideration the availability of alternatives such as credit ratings from reputable rating agencies and the extent to which supervisory requirements imposed in the home jurisdiction are publicly disclosed.

In assessing the adequacy of supervision in the home jurisdiction, the Bank will pay close attention to the application of capital standards, and, in particular, whether the Basle capital adequacy framework (or a close alternative) is applied in the home country.

Applicants which wish to operate as a branch of an overseas bank will also need to satisfy the Reserve Bank that the operations of the New Zealand branch will not constitute a predominant proportion of the business of the global bank.

(b) **Locally Incorporated Applicants**

Application for registration as a locally incorporated entity may be made by companies which are in widespread ownership, or which are wholly or substantially owned by corporates, trusts or another bank.

Locally incorporated entities will need to satisfy the Reserve Bank that a substantial proportion of their business will be conducted in and from New Zealand.

(c) **Other Forms of Ownership**

While the Reserve Bank would not rule out the possibility of entities with other forms of ownership (eg partnerships) becoming registered banks, such entities would need to satisfy the Reserve Bank that the degree of separation between ownership and management is sufficient to

ensure that checks and balances are adequate and that appropriate incentive structures apply.

There is no restriction on the number of companies within a group which may be registered.

- (iii) **Size of Business or Proposed Business** - Locally incorporated banks will be required to have a minimum capital (as defined in the Reserve Bank's Capital Adequacy Framework document (BS2)) of NZ\$15 million. This minimum capital requirement is intended to ensure that an applicant has sufficient substance to carry on business as a registered bank and to demonstrate that the owners have made a reasonable commitment to the business.

Branches of overseas banks will not be subject to a minimum size requirement, in recognition of the fact that a branch will be operating on the basis of the global bank's balance sheet. However, in such cases the Reserve Bank will wish to satisfy itself that the global bank has a level of capital which exceeds NZ\$15 million.

- (iv) **Ability of the Applicant to Carry on Business in a Prudent Manner** - In having regard to whether or not an applicant for registration has the ability to carry on business in a prudent manner, the Reserve Bank is required to confine its consideration to the following matters:

- capital in relation to the size and nature of the business;
- loan concentration and risk exposures;
- separation of the business from other interests of those who own or control the bank;
- internal controls and accounting systems;
- such other matters as may, from time to time, be prescribed in regulations. (Currently there are no matters so prescribed.)

Each of these is dealt with in turn below:

- (a) **Capital in relation to size** - The Bank will have regard to the applicant's ability to meet minimum capital adequacy ratio requirements imposed by way of condition of registration, on an ongoing basis.

In the case of a bank incorporated locally, this would require the applicant to demonstrate that it will be able to comply with the minimum capital adequacy ratio of 8% and the tier one capital ratio requirement of 4%, in respect of the banking group. It would also require the applicant's capital policy to take into account the need to maintain sufficient capital to carry on business in a prudent manner at all times. In some cases this

will require that the policy takes into account any constraints on access to further capital, should it be needed either to cater for an increase in business or to cover unexpected losses. All applicants should have a capital policy which takes into account the need to hold capital against risks which are not captured by the Basle capital adequacy framework.

In the case of branches of banks incorporated overseas, the Reserve Bank would require the applicant to demonstrate that the global bank complies with the internationally agreed Basle capital standards and/or the standards imposed by the home supervisor.

All applicants will be required to show that they have the ability to disclose information on capital adequacy, including, where applicable, the Basle capital adequacy ratios of the parent or global bank.

- (b) **Loan Concentration and Risk Exposures** - Banks which do not have a diversified portfolio of risks, or which do not monitor risks adequately, are vulnerable to substantial losses. In such cases the bank's capital can be severely depleted as a result either of the failure of a single customer (or group of related customers) or of problems arising in one particular area of the bank's business. Therefore, applicants for registration will be required to demonstrate that they will have in place policies and systems which will allow them to monitor and control loan concentrations and risk exposures in a manner which is appropriate for a bank, and that they will be able to comply with the exposure concentration disclosure and director attestation requirements applicable to registered banks.

In assessing the appropriateness of policies and systems for controlling loan concentrations and risk exposures, the Reserve Bank will have regard to the extent to which various aspects of risk will be diversified.

- (c) **Separation from other interests of the owners** - Owners of banks have an important role to play in ensuring that bank managers are monitored closely and that they are subject to appropriate disciplines and incentives. Where there is inadequate separation between a bank's board and its principal shareholders, these incentives and disciplines may be undermined.

Where the applicant is a branch of an overseas bank, the local operations are legally part of the operations of the global bank. Consequently, it is not meaningful to attempt to impose a degree of separation between the two. Where a bank is fully, unconditionally and irrevocably guaranteed by an overseas parent bank, the arrangement is, in some respects, similar in substance to a branch operation because the creditors have a claim on the assets of the overseas bank, rather than just on the assets of the local entity. Neither branches nor guaranteed subsidiaries are required to comply with the separation arrangements applied to locally incorporated banks.

Where the applicant is a locally incorporated company, applicants will be required to satisfy the Reserve Bank that there will be sufficient separation between the bank and its owners. Generally this will require:

- that the proposed bank has in place policies to monitor and limit exposures to related parties;
- that the company does not have a constitution which permits the directors to act in the interests of the holding company when this would conflict with the interests of the bank in New Zealand, to the detriment of creditors; and
- that the composition of the board is such that it does not give rise to concerns about the bank's ability to pursue its own interests when these conflict with those of the shareholders.

At least two of the applicant's directors should be independent (ie not employees of the applicant in New Zealand and not directors or employees of any holding company of the applicant or of any other entity able to control or significantly influence the applicant in New Zealand). The chairperson should not be an employee of the applicant. This policy is intended to ensure that there is a degree of objective scrutiny of:

- exposures to the parent or other related parties;
- exposures to unrelated parties undertaken at the request of the parent;
- any other matters where the interests of the bank and parent, or the interests of the bank and management, could potentially conflict.

Locally incorporated applicants will also need to satisfy the Bank that they will be in a position to comply with a condition of registration which limits aggregate exposures to connected parties (excluding risk layoffs to a parent bank) to 75 percent of tier one capital and, within this limit, aggregate exposure to non-bank connected parties to 15 percent of tier one capital. For the purposes of this requirement, exposures to non-bank entities owned by a parent bank will be treated as bank exposures.

- (d) **Internal Controls and Accounting Systems** - Applicants will be required to satisfy the Reserve Bank that they have, or will have, internal controls and accounting systems which are appropriate for a registered bank and for the type of business to be conducted. Where the applicant is a branch or subsidiary of a major international bank of standing and repute and is intending to adopt the systems and controls used by the parent, it is likely that this will be accepted as evidence that this requirement can be met. Similarly, a financial institution which has been

operating successfully for some time may also be in a position to satisfy the Bank of its ability to meet this requirement.

Where the applicant intends to operate in areas where it lacks experience or where there are doubts about the adequacy of internal controls and accounting systems, the applicant will need to satisfy the Bank that it has, or will have, appropriate systems and controls. This may require that the applicant obtains a report on the adequacy of systems and controls from an independent party such as an auditor. Directors will be required to attest to the adequacy of systems to monitor and control material business risks in disclosure statements.

- (v) **Standing of the Applicant in Financial Markets** - Where applicants are branches or subsidiaries of a major international bank of standing and repute with a record of sound performance, the Reserve Bank will normally accept this as evidence of an appropriate degree of standing.

Where the bank is in widespread ownership, or it is in the majority ownership of a corporate or trust, the Reserve Bank will assess the applicant's standing by considering the following matters, as applicable

- the standing of the owner in financial markets;
- where the applicant is already operating as a non-bank financial institution, the standing of the applicant itself;
- the experience and standing of the board of directors, chief executive and other key personnel.

The experience and standing of the board of directors and key executives will be particularly important where the applicant is not owned by a reputable bank. In such cases the Reserve Bank would need to be satisfied that a majority of the directors have relevant experience, and that the board as a whole has appropriate expertise in banking, financial, legal, accounting and technological matters. The applicant will also need to satisfy the Reserve Bank that key executives have a suitable range of expertise and experience to manage a registered bank.

Where neither the entity seeking registration nor its owners have an established track record in financial markets, and the board of directors and executive staff of the proposed bank collectively lack appropriate experience, it is unlikely that an applicant will be in a position to satisfy the Reserve Bank that it has sufficient standing to gain registration.

All applicants will be required to obtain a credit rating before registration. This will assist the Bank in assessing the applicant's standing and will ensure that the applicant is in a position to include a rating in their initial disclosure statement.

Applicants may obtain their rating from any of the rating agencies commonly used by New Zealand banks ie Fitch IBCA, Moody's or Standard and Poor's. Applicants wishing to use an alternative agency will need to seek consent from the Bank first. The Bank will generally be prepared to permit the use of an alternative agency where it is satisfied that the agency has a satisfactory track record and its ratings are broadly comparable with those of the agencies normally used by New Zealand banks.

(vi) **Law and Regulatory Requirements in Home Jurisdiction**

Where an applicant is incorporated overseas or is owned by a bank incorporated overseas, the Reserve Bank will have regard to any aspects of the law and regulatory requirements in that country which could impact adversely on the operation of the applicant's business in New Zealand. These will be weighed against the benefits to be derived from the applicant's presence in the local market.

In some cases the applicant may be required to incorporate locally in order to provide some degree of insulation from the effects of foreign laws and regulations.

(vii) **Disclosure**

Where necessary, the Bank will require applicants to publish an initial disclosure statement so that there is no lag between the time the applicant commences business as a bank and the time appropriate information is made available to customers and potential customers. The information to be provided in an initial disclosure statement will be the same as that required in a normal full or half year disclosure statement.

(viii) **General**

All bank registrations will be made subject to certain conditions. These conditions of registration are designed to ensure that banks comply with certain minimum prudential requirements on an ongoing basis.

See Section E for details of the conditions of registration which registered banks are required to meet.

Applicants will also be required to confirm that they will abide by the BIS Statement of Principles on Prevention of the Criminal Use of the Banking System for the Purpose of Money Laundering.

**D. SUPERVISION**

13. To the extent possible, the Reserve Bank's system of supervision draws on and enhances the market disciplines which are naturally present in the financial system.

14. As a consequence, the Reserve Bank's system of supervision places considerable emphasis on a requirement that banks disclose on a quarterly basis, information on financial performance and risk positions, and on a requirement that directors regularly attest to certain key matters. These measures are designed to strengthen market disciplines and to ensure that responsibility for the prudent management of banks lies with those who are best placed to exercise that responsibility, the directors and management.
15. The main elements of the Reserve Bank's supervisory role are as follows:
- (i) The Reserve Bank administers disclosure and director attestation requirements for registered banks.
  - (ii) All banks are required to comply with certain minimum prudential requirements, which are applied through conditions of registration. The only quantitative restrictions which apply relate to constraints on connected exposure and minimum capital adequacy requirements.
  - (iii) The Reserve Bank monitors each registered bank's financial condition and compliance with conditions of registration, principally on the basis of published disclosure statements. This monitoring is intended to ensure that the Reserve Bank maintains familiarity with the financial condition of each bank and the banking system as a whole, and maintains a state of preparedness to invoke crisis management powers should this be necessary.
  - (iv) In this context, the Reserve Bank also formally consults with the senior management of banks, generally on an annual basis.
  - (v) The Bank will use the crisis management powers available to it under the Reserve Bank Act to intervene where a bank distress or failure situation threatens the soundness of the financial system.
  - (vi) The Bank maintains close working relationships with parent bank supervisors on bank-specific issues, policy issues and general matters relating to the condition of the financial system in New Zealand and in the countries where parent banks are domiciled. Where New Zealand domiciled banks have branches or subsidiaries in overseas jurisdictions similar arrangements will apply in respect of host supervisors.

## **E. CONDITIONS OF REGISTRATION**

16. Registered banks are required to adhere to requirements which are set down in conditions of registration issued under section 74 of the Reserve Bank Act.
17. The Reserve Bank seeks to have uniform conditions of registration for all banks, to the extent that this is practicable. This is intended to ensure, to the extent possible, that banks are operating on a level playing field. However, on occasions there will be a need

for some bank-specific conditions to be applied - for example, to recognise the different nature of banking group structures. Where a need for different conditions of registration does arise, the Bank will attempt to ensure that the economic substance of the conditions is consistent with the level playing field concept.

18. Directors will be required to make quarterly attestations as to their bank's compliance with conditions of registration.
19. In addition, banks will be required to disclose their conditions of registration, upon request from a member of the public. This approach is intended to enhance public understanding of the requirements of registration and to give greater meaning to the requirement that directors attest to a bank's compliance with its conditions of registration.
20. A list of standard conditions of registration is attached as Appendix One.

### **Locally Incorporated Banks**

21. Locally incorporated banks will be subject to conditions of registration relating to the following:
  - That the banking group remains primarily in the business of borrowing and lending money, or providing other financial services, or both.
  - That the capital of the banking group is not less than 8% of risk weighted exposures and that tier one capital is not less than 4% of risk weighted exposures. The framework for measuring capital for the purposes of this condition of registration is in line with the internationally accepted Basle capital adequacy framework.
  - That the capital of the banking group is not less than NZ\$15 million.
  - That aggregate exposure of the banking group to connected persons (excluding risk lay-offs to a parent bank) does not exceed 75% of tier one capital and that, within this limit, exposures to non-bank connected parties do not exceed 15% of tier one capital. For the purposes of this limit, exposures to subsidiaries and associates of bank parents will be treated as bank exposures. This condition of registration is intended to ensure that the owner of a bank does not effectively decapitalise the bank, thereby undermining the incentives which would normally apply where an owner has committed capital to a subsidiary. It also places an upper bound on the extent to which a bank can be directed to lend to a parent or the interests of a parent, possibly on other than arm's length terms and conditions. Where the bank's obligations are fully, irrevocably and unconditionally guaranteed by a parent bank, this condition of registration will not apply.
  - That the bank has at least two independent directors (not being employees of the registered bank or directors or employees of any holding company of, or any

other entity capable of controlling or significantly influencing, the bank in New Zealand). Where the bank's obligations are fully, irrevocably and unconditionally guaranteed by a parent bank, this condition will not apply.

- That the bank has a chairperson who is not an employee of the bank in New Zealand. This condition will not apply to banks which are fully, irrevocably and unconditionally guaranteed by a parent bank.
- That the bank's constitution does not allow the bank's directors to act in the interests of a holding company where to do so would conflict with the interests of the bank in New Zealand, to the detriment of creditors. Where the bank's obligations are fully irrevocably and unconditionally guaranteed by a parent bank, this condition will not apply.
- That a substantial proportion of the bank's business is conducted in and from New Zealand.

### **Banks Incorporated Overseas**

22. Banks incorporated overseas will be subject to conditions of registration relating to the following matters:

- That the business of the bank in New Zealand continues to comprise primarily the borrowing and lending of money, or the provision of other financial services, or both.
- That the business of the bank in New Zealand does not constitute a predominant proportion of the business of the global bank.
- That the bank, on a global basis, complies with the minimum capital adequacy requirements applied by the parent supervisor. Normally this will require that the bank complies with at least the Basle minima (ie a minimum tier one capital ratio of 4% of risk weighted exposures and a minimum capital ratio of 8%).
- That the bank on a global basis complies with the requirements imposed by the home supervisor.

## **F. VARIATION AND REMOVAL OF CONDITIONS OF REGISTRATION**

23. Section 74 of the Act gives the Reserve Bank power to vary, add to, or remove conditions of registration. In general, the Reserve Bank will vary, add to, or remove conditions of registration only when there is a change in supervision policy which must be effected by way of a change in conditions of registration or by removal of an existing condition, or in the event of a material change in the status of an individual bank. Banks will be given at least seven days notice of a proposed change, which notice will include a statement of the Bank's reasons. They will have a reasonable opportunity to make submissions before any change is made to conditions of registration. The Reserve Bank

will have regard to any submissions made by registered banks before it puts any such changes into effect.

#### **G. BREACHES OF CONDITIONS OF REGISTRATION**

24. Where a bank is operating in breach of its conditions of registration, the Reserve Bank will, unless it can be satisfied that the breach can be promptly rectified, invoke its crisis management powers. This may involve giving directions to the bank or recommending that the bank be placed in statutory management. A complete list of crisis management powers is contained in section N. However, where the breach relates to the minimum capital adequacy requirements, the following process will apply.

#### **H. BREACH OF MINIMUM CAPITAL ADEQUACY RATIO REQUIREMENTS**

25. Where a bank breaches the minimum capital adequacy ratio requirements (a 4% tier one capital ratio and an 8% capital ratio, applied to the banking group), the following framework will apply:
1. Where the tier one capital ratio falls below 4% and/or the capital ratio falls below 8%, the registered bank will be required to draw up a plan for restoring its capital to at least the minimum required level. The registered bank will be required to submit this plan to the Reserve Bank as soon as practicable after the first occurrence of the breach and to publish it in the bank's disclosure statement at the earliest practicable opportunity.
  2. The plan will need to include the following elements:
    - (a) A statement that no distributions to shareholders or to holders of capital instruments which qualify as capital for the purposes of the Reserve Bank's capital adequacy framework will be made until the bank's compliance with minimum capital adequacy requirements has been restored, unless the bank is contractually obliged to make such distributions (this will only arise with lower tier two capital, where it is likely that the bank will be under a contractual obligation to make interest or dividend payments).
    - (b) A statement that there will be no increase in the amount of the banking group's exposure to connected persons from the level which prevailed at the time of the first occurrence of the breach (where the level of the exposure is below the maximum limit) until tier one and capital ratios are restored to the minimum levels.
    - (c) Where a banking group's tier one capital ratio is less than 3 percent, a statement that there will be no increase in gross credit exposures from the level which prevailed at the time of the first occurrence of the breach, until such time as the tier one ratio exceeds 3 percent.

26. Where a bank does not publish a plan including the elements listed above, or does not abide by the plan it has provided to the Reserve Bank and published in its disclosure statement, the Bank may give directions to the bank or make use of the other crisis management powers it has under the Reserve Bank Act (see Section N).

## **I. DISCLOSURE REQUIREMENTS**

27. Registered banks are required to make quarterly disclosures of key accounting and prudential information. These disclosure requirements have been developed by the Reserve Bank in consultation with banks and auditors. The information which banks must disclose is set out in Orders in Council issued in terms of section 81 of the Act. The Bank considers that quarterly disclosure is a very effective means of reinforcing disciplines on the management and directors of the banks to maintain prudent banking practices.
28. The main elements of the disclosure requirements are as follows:
- Disclosure statements for the year end must be subject to a full external audit, while statements for the half year must be subject to either a full audit or a limited scope review.
  - Disclosure statements for the "off-quarters" need not be audited.
  - Banks will be required to display a Key Information Summary of information about the bank in all branches.
  - Banks must make copies of their full disclosure statements available immediately at their head offices and within five working days from a branch or agency.
  - Banks are required to disclose information relating to the bank entity, the banking group and the parent bank (where this is publicly available in the parent bank's country of domicile).
  - Banks are required to disclose a credit rating applicable to their long term senior unsecured New Zealand dollar debt payable in New Zealand in both the Key Information Summary and the full disclosure statement.

## **J. CREDIT RATING REQUIREMENT**

29. As there is no deposit insurance in New Zealand and the Government does not guarantee bank deposits it is important that depositors have access to information about banks in a form that they can readily comprehend. A credit rating provides a simple summary measure of relative risk, easily understood by relatively unsophisticated retail depositors. The availability of a rating allows such depositors,

as well as other creditors, to assess the relative riskiness of individual banks and to make informed investment decisions.

30. A rating requirement is also likely to further enhance incentives for banks to operate their businesses prudently in order to avoid a rating downgrade. This benefits both the bank and its customers.
31. For these reasons, all registered banks are required to obtain and subsequently maintain a current credit rating applicable to their long-term senior unsecured New Zealand dollar obligations payable in New Zealand and to publish that rating in quarterly disclosure statements. The Reserve Bank periodically issues notices to banks pursuant to Section 80 of the Reserve Bank of New Zealand Act 1989 in order to bring this policy into effect. Section 80 of the Act states that:

*The Reserve Bank may, from time to time, by notice in writing to all registered banks, or to all members of any class of registered banks, require each of those banks:*

- (a) *to undergo an independent assessment of its credit worthiness or financial stability by a person or organisation nominated or approved by the Bank; and*
- (b) *to publish the results of that assessment in such a manner as the Bank directs.*

32. A copy of the Section 80 notice issued to registered banks is attached as Appendix Two.
33. Banks which are guaranteed by a parent or some other party are subject to the rating requirement, whether or not the guarantor is rated. This is because an issue rating of the type required takes into account the strength and enforceability of the guarantee and the strength of the incentives that exist for the guarantor to make payment under the guarantee in a timely manner. It may be difficult for individuals to make such an assessment themselves.
34. New applicants for registration will be required to obtain a rating before registration, so that the rating can be published in the bank's initial disclosure statement.
35. Banks may obtain a rating from any of following rating agencies: Standard and Poor's, Moody's or Fitch IBCA Duff and Phelps (the agencies commonly used by New Zealand banks). However, the Bank would be prepared to permit banks to use an alternative agency where it was satisfied that the agency had a satisfactory track record and its ratings were broadly comparable with those of the agencies normally used by New Zealand banks. Banks wishing to use an alternative agency should seek the concurrence of the Reserve Bank.

## **K. DIRECTOR RESPONSIBILITIES**

36. Directors are required to sign bank disclosure statements including certain attestations which are published in the statements. This policy is intended to emphasise the fact that directors have ultimate responsibility for the ongoing viability of their bank and to strengthen incentives for them to take an active interest in key matters affecting the soundness of their bank.
37. Directors are required to attest whether, after due enquiry by them, as at the date of the disclosure statement, they believe:
- The registered bank has systems in place to monitor and control adequately the banking group's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risks and other business risks and that those systems are being properly applied.
  - Exposures to connected persons (if any) are not contrary to the interests of the banking group. (This applies only to locally incorporated banks.)
  - The bank is complying with its conditions of registration.
  - The disclosure statement is not false and misleading as at the date on which the statement is signed.
  - The disclosure statement contains all the required information.
38. Directors may appoint an agent to sign these attestations on their behalf, but responsibility for the veracity of the attestations remains with the directors themselves.
39. Where directors believe the information contained within a disclosure statement is false or misleading, they should decline to sign the statement. In such a case directors would need to give notice to the Reserve Bank and to the public that the disclosure statement had been issued without their consent. In the absence of such notice, directors remain liable, civilly, for the content of the disclosure statement, regardless of whether or not they signed the statements. Directors who sign, or who have an agent sign, a disclosure statement which includes false or misleading information may be subject to criminal liability.

## **L. OWNERSHIP**

40. The Reserve Bank will assess the implications for a bank's standing where there are changes in shareholdings in excess of 10 percent of voting shares. If the Reserve Bank considers that the standing of a registered bank is materially damaged as a result of a change in ownership, it may recommend to the Treasurer that the bank be deregistered. Accordingly, prospective purchasers of an interest in a bank which would exceed the 10 percent threshold should approach the Reserve Bank at an early stage to discuss their plans and any implications those plans might have for the continued registration of the bank.

**M. ESTABLISHMENT OF OVERSEAS BRANCHES, REPRESENTATIVE OFFICES OR SUBSIDIARIES**

41. Locally incorporated banks wishing to establish a subsidiary, branch or representative office in another country should seek the approval of the Reserve Bank before making application to the host supervisor or licensing authority.

**N. CRISIS MANAGEMENT**

42. The Act sets out various powers which the Reserve Bank can use in the event that a bank distress or failure situation threatens the soundness of the financial system. In dealing with a crisis situation, the Bank will seek to ensure that the situation is resolved without the need for the provision of government funding.
43. The crisis management powers the Bank has available are as follows:

(i) **Section 77 of the Act - Power to recommend deregistration.**

Where the Reserve Bank considers that any of the following applies:

- a registered bank was registered on the basis of false or misleading information;
- a registered bank has suffered a material loss of standing;
- a registered bank is in receivership or liquidation, or some other equivalent;
- a registered bank has not complied with a condition of registration;
- a registered bank has not carried on business in a prudent manner;
- a registered bank has failed to comply with an obligation imposed under the Reserve Bank Act;

the Reserve Bank may recommend to the *Treasurer* that the registration of the bank be cancelled. The Reserve Bank is required to give a registered bank at least seven days notice of its intention to make such a recommendation and to provide a statement of its reasons. It must give the registered bank a reasonable opportunity to make submissions, and must have regard to those submissions.

(ii) **Section 93 of the Act - Power to require a bank to supply information.**

The Reserve Bank has the power to obtain information, data and forecasts from registered banks.

(iii) **Section 95 of the Act - Ability to require a report on financial and accounting systems.**

Where the Reserve Bank has reason to believe that a registered bank is not maintaining adequate internal controls and accounting systems, it may use its powers to obtain an independent report on financial and accounting systems, prepared by a person approved by the Reserve Bank.

(iv) **Section 99 of the Act - Powers to obtain information and documents.**

Where the Bank believes that information provided to it is false or misleading or where a registered bank has failed to provide required information, the Reserve Bank may, if it considers it necessary, appoint a person to enter and search the bank's premises in order to obtain the information required.

(v) **Section 101 of the Act - Powers to investigate the affairs of a registered bank.**

Where the Reserve Bank is satisfied that it is necessary or desirable to do so in order to determine whether or not it should exercise its power to recommend statutory management or its power to require a bank to consult with it, it may appoint someone to investigate the affairs of a registered bank.

(vi) **Section 111 of the Act - Power to require a registered bank to consult.**

If the Reserve Bank has reasonable grounds to believe that any of the following applies to a registered bank or an associated person of a registered bank:

- it is insolvent, or is likely to become, insolvent;
- it is about to suspend payment or is unable to meet its obligations;
- its affairs are being conducted in a manner prejudicial to the soundness of the financial system;
- its circumstances are prejudicial to the soundness of the financial system;

or that any of the following applies to the registered bank:

- its business has not been, or is not being, conducted in a prudent manner;
- it has failed to comply with any requirement imposed under the Act (or regulations issued under the Act);
- it has been convicted of an offence under the Act;
- it has failed to comply with a condition of registration;

the Reserve Bank may require the registered bank and any associated person of the registered bank to consult with it regarding the resolution of the difficulties it faces.

(vii) **Section 113 of the Act - Power to give directions.**

Where the Reserve Bank has given notice of a requirement to consult, it may, with the prior consent of the *Treasurer*, give written directions to the bank or an associated person of the registered bank.

(viii) **Section 117 of the Act - Power to recommend statutory management.**

Where the Reserve Bank is satisfied on reasonable grounds that any of the following applies:

- a registered bank is insolvent, or likely to become insolvent;
- a registered bank has suspended payment or is about to do so or is unable to meet its obligations;
- the bank or an associated person has failed to consult as required;
- the registered bank or an associated person has failed to comply with a direction;
- the affairs of the registered bank or an associated person are being conducted in a manner prejudicial to the soundness of the financial system;
- the circumstances of the registered bank or an associated person are such as to be prejudicial to the soundness of the financial system;

the Reserve Bank has the power to recommend to the Treasurer that the registered bank and any associated person be placed under statutory management.

Statutory management is similar to a receivership, but a statutory manager has wider powers than those available to a receiver, including the power to suspend payment of money owing and the power to convert a branch of an overseas bank into a locally incorporated entity. In addition, where a registered bank is declared subject to statutory management, this creates a moratorium on legal proceedings. When exercising their powers under the Act, statutory managers are required to have primary regard to the need to maintain public confidence in the operation and soundness of the financial system, and the need to avoid significant damage to the financial system. They are also required to have regard to the need to resolve the difficulties of the registered bank as quickly as possible and preserving the position and maintaining the ranking of creditors' claims, to the extent that this is not inconsistent with the primary objectives specified in the Act. They are also required to carry out any directions given by the Reserve Bank.

## APPENDIX ONE - CONDITIONS OF REGISTRATION

### I. CONDITIONS OF REGISTRATION - NEW ZEALAND INCORPORATED REGISTERED BANKS

1. That the banking group complies with the following requirements:

**Capital** of the banking group is not less than 8 percent of **risk weighted exposures**.

**Tier one capital** of the banking group is not less than 4 percent of **risk weighted exposures**.

**Capital** of the banking group is not less than NZ \$15 million.

For the purposes of this condition of registration, **capital**, **tier one capital** and **risk weighted exposures** shall be calculated in accordance with the Reserve Bank of New Zealand document entitled "Capital Adequacy Framework" (BS2) dated .....

2. That the business of the banking group consists of, or substantially consists of, the borrowing and lending of money, or the provision of other financial services, or both.
3. That aggregate **credit exposures** (net of specific provisions and gross of set-offs) of the banking group to all **connected persons** do not exceed 75 percent of the banking group's **tier one capital** and that, within this limit, aggregate **credit exposures** (net of specific provisions and gross of set-offs) to **non bank connected persons** do not exceed 15 percent of the banking group's **tier one capital**. For the purposes of this condition of registration:
- (i) **tier one capital** shall be calculated in accordance with the Reserve Bank of New Zealand document entitled "Capital Adequacy Framework" (BS2) dated .....
  - (ii) an **owner** means any person who has a **substantial interest** in the registered bank.
  - (iii) **connected person** means any person, other than a government of a country which is a member of the Organisation for Economic Co-operation and Development, which is:
    - (a) an **owner**; or
    - (b) an entity in which an **owner** has a **substantial interest** (other than the registered bank and entities in which the registered bank itself has a **substantial interest**); or
    - (c) a person which has a **substantial interest** in an **owner**.

- (iv) A person has a **substantial interest** in an entity if that person:
- (a) holds (whether directly or indirectly) more than 20 percent of the issued securities of an entity, other than securities that carry no right to participate beyond a specified amount in a distribution of either profits or capital; or
  - (b) is entitled to receive (whether directly or indirectly) more than 20 percent of every dividend (or, in the case of an entity which is not a company, distributions of a similar nature) paid on securities issued by the entity, other than securities that carry no right to participate beyond a specified amount in a distribution of either profits or capital; or
  - (c) is in a position to exercise, or control the exercise of, more than 20 percent of the maximum number of votes that can be exercised at a meeting of an entity or the owners of the entity; or
  - (d) controls or significantly influences the composition of the board of the entity, or, if the entity does not have a board of directors, the body which has the power to manage or direct or supervise the management of the business and affairs of the company.
- (v) In determining whether a person has a **substantial interest** in an entity Sections 7 and 8 of the Companies Act 1993 shall apply with all necessary modifications.
- (vi) **Non bank connected person** means any connected person other than a bank or an entity in which a bank has a **substantial interest**.
- (vii) **Credit exposure** means the amount of the maximum loss that a party to a contract could incur as a result of the counterparty to that contract failing to discharge its obligations, without taking into account the value of collateral, guarantees, indemnities, other support arrangements, and any potential recoveries, and excluding contingent exposures arising as a result of risk lay-offs to a bank **owner**, where the maximum loss in relation to:
- (a) a market related contract means the credit equivalent amount of the contract determined in accordance with the Reserve Bank document entitled "Capital Adequacy Framework" (BS2) dated....
  - (b) any other contract means the full value of the contract; provided that a financial liability may not be offset against any such loss even if to do so would accord with generally accepted accounting practice as defined in the Financial Reporting Act 1993.
- (viii) Securities shall have the same meaning as in the Reserve Bank of New Zealand Act 1989.

- (ix) For the purposes of this condition of registration the term person includes a corporation sole, a company or other body corporate (whether incorporated in New Zealand or elsewhere), an unincorporated body of persons and a public body.
4. That the board of the registered bank contains at least two independent directors. In this context an independent director is a director who is not an employee of the registered bank, and who is not a director, trustee or employee of any holding company of the registered bank, or any other entity capable of controlling or significantly influencing the registered bank.
  5. That the chairperson of the bank's board is not an employee of the registered bank.
  6. That the bank's constitution does not permit the bank's directors to act in the interests of any holding company of the registered bank, where to do so would conflict with the interests of the bank in New Zealand, to the detriment of creditors.
  7. That a substantial proportion of the bank's business is conducted in and from New Zealand.

## **II. CONDITIONS OF REGISTRATION - OVERSEAS INCORPORATED REGISTERED BANKS**

1. That the business of the banking group, consists of, or substantially consists of, the borrowing and lending of money, or the provision of other financial services, or both.
2. That the business of the registered bank does not constitute a predominant proportion of the business of the [name of global bank].
3. That [name of global bank] complies with the requirements imposed on it by [name of the supervisory authority in the bank's jurisdiction of domicile].
4. That [name of global bank] complies with the following minimum capital adequacy requirements, as administered by [name of supervisory authority in the bank's jurisdiction of domicile]:

tier one capital of [name of global bank] is not less than 4 percent of risk weighted exposures;

capital of [name of global bank] is not less than 8 percent of risk weighted exposures.

**APPENDIX TWO**

**SECTION 80 NOTICE issued to registered banks**

With effect from [date], the Reserve Bank of New Zealand hereby requires [name of bank]:

1. to obtain a current credit rating applicable to its long term senior unsecured obligations payable in New Zealand, in New Zealand dollars; and
2. to publish the rating in quarterly disclosure statements.

The rating may be obtained from any of the following rating agencies:

Standard and Poor's  
Moody's Investor Service  
Fitch IBCA, Duff & Phelps

This notice is issued pursuant to Section 80 of the Reserve Bank of New Zealand Act 1989.

Chief Manager, Banking System Department  
Reserve Bank of New Zealand