



Corporate Governance

Prudential Supervision Department
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Part 1—Introduction

1. Corporate governance and the Reserve Bank’s objectives

- (1) This document sets out the Reserve Bank of New Zealand’s (Reserve Bank’s) policy on registered banks’ arrangements for corporate governance.
- (2) The Reserve Bank has powers under Part 5 of the Reserve Bank of New Zealand Act 1989 (the Act) to register banks and undertake prudential supervision of registered banks.
- (3) Section 68 of the Act requires the powers under Part 5 of the Act to be exercised for the purposes of:
 - (a) promoting the maintenance of a sound and efficient financial system; or
 - (b) avoiding significant damage to the financial system that could result from the failure of a registered bank.
- (4) Section 68A of the Act requires that the Reserve Bank, when exercising its Part 5 powers, must support Australian authorities in pursuit of Australian financial stability and where reasonably practicable avoid actions that might be detrimental to Australian financial stability.
- (5) The objective of this Corporate Governance policy is to strengthen the underpinnings of financial stability, by imposing minimum standards and issuing guidance in those areas of corporate governance practice which are most directly relevant to these requirements in the Act.
- (6) In its implementation of banking supervision in pursuit of its section 68 objectives, the Reserve Bank has adopted an approach based on “three pillars”: regulatory discipline, market discipline and self-discipline. Under the self-discipline pillar, the Reserve Bank aims to ensure that the shareholders, board of directors and senior executives of a registered bank have strong incentives to run the bank prudently in the interests of financial stability. Influencing corporate governance outcomes is one of the Reserve Bank’s main tools to achieve this.

2. Principles and practices for good governance

- (1) The general principles of good corporate governance stem from attempts to resolve the principal-agent problems that can arise between shareholders of a company, and senior management responsible for its day-to-day operations. They do so broadly by ensuring that the interests of the shareholders are properly represented, via the board of directors, in such areas as risk management, the setting of corporate strategy, and ensuring that strategy is followed through.
- (2) Corporate governance practices in banks need also to take account of wider financial stability considerations. Bank shareholders would normally be concerned about the long-term preservation of a bank’s value, and the promotion of their interests therefore aligns to some extent with standard financial stability objectives. However, particularly in cases where a registered bank is a wholly-owned subsidiary, conflicts

can arise between the interests of the parent entity and the financial stability objectives of the Reserve Bank.

- (3) Reflecting this concern, the Reserve Bank states in its principles for determining applications to be registered as a bank¹ that it needs to be satisfied that there will be sufficient separation between the bank and its owners. Some of the requirements and guidance in this policy are directed specifically at promoting an appropriate degree of separation of this sort, both on initial registration and on a continuing basis. Otherwise they support the general objectives of good corporate governance.
- (4) This policy does not aim to be a comprehensive statement of good corporate governance practice. Comprehensive guidance is available elsewhere, and in particular there are two documents that are relevant for New Zealand-incorporated banks:
 - (a) “Corporate Governance in New Zealand Principles and Guidelines: A Handbook for Directors, Executives and Advisers”, published by the New Zealand Securities Commission in March 2004. These Principles are intended to be applied to the governance of entities that have economic impact in New Zealand or are accountable, in various ways, to the public.
 - (b) “Principles for enhancing corporate governance” published by the Basel Committee on Banking Supervision in October 2010. The guidance in this document is intended to assist banking organisations in enhancing their corporate governance frameworks.

3. Branches

This policy does not apply to New Zealand branches of overseas-incorporated banks. It is not meaningful to attempt to impose a degree of separation between the branch and the global bank of which it is legally a part, and the corporate governance arrangements of the global bank are outside the remit of the Reserve Bank. However, branches are subject to certain disclosure requirements relevant to corporate governance, under the Reserve Bank’s bank disclosure regime. These are summarised in the section on public disclosure below.

4. Conditions of registration

- (1) Section 74 of the Act permits the Reserve Bank to impose conditions of registration that relate to, among other things, the matters referred to in the following sections of the Act:
 - (a) 73(2)(a) and (e); and
 - (b) 78(1)(e), (f) and (fa).
- (2) Those sections address, among other things, matters that can include: the incorporation and ownership structure of the bank; the suitability for their positions of the directors and senior managers of the bank; separation of the business carried on by the bank from other business and from other interests of any person owning or controlling the registered bank; the bank’s internal controls and accounting systems; and the bank’s risk management systems.

¹ *Statement of Principles: Bank Registration and Supervision*, Banking Supervision Handbook document BS1
Ref #4269713

5. Guidelines

Under section 78(3) of the Act, the Reserve Bank may issue guidelines for the purpose of interpreting certain matters identified in section 78(1) of the Act that the Reserve Bank may take into account in determining whether a registered bank is carrying on business in a prudent manner, or whether an applicant for registration will be able to carry on its business in a prudent manner. The matters in section 78(1) that are of interest here are:

- “(e) separation of the business or proposed business from other business and from other interests of any person owning or controlling the applicant or registered bank;
- “(f) internal controls and accounting systems or proposed internal controls and accounting systems; and
- “(fa) risk management systems and policies or proposed risk management systems and policies.”

6. Public disclosure

Under section 81 of the Act, the Governor General may, on the advice of the Minister and in accordance with a recommendation by the Reserve Bank, prescribe information or data that registered banks must publish in disclosure statements.

Part 2—Conditions of registration

7. Standard conditions

Under the Reserve Bank’s Corporate Governance policy, a New Zealand-incorporated registered bank is normally subject to the standard conditions of registration set out in Appendix 1.

8. Definitions

For the purposes of this document, including for conditions of registration imposed under the Act,—

“control” has the same meaning as in section 5 of the Companies Act 1993;

“director” has the same meaning as in section 2(1) of the Act;

“group” means the registered bank together with all subsidiaries of the registered bank, all holding companies of the registered bank, and all subsidiaries of holding companies of the registered bank;

“holding company” has the same meaning as in section 2(1) of the Act;

“independent”, in relation to a person, means a person who meets the criteria for independence set out in section 10 of this document;

“non-executive”, in relation to a person, means a person who is not employed by the registered bank;

“officer”, in relation to an entity, means—

- (a) a director of the entity; or
- (b) another person—
 - (i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the entity; or
 - (ii) who has the capacity to affect significantly the entity’s financial standing; or
 - (iii) in accordance with whose instructions or wishes the directors of the entity are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person’s professional capacity or their business relationship with the directors or the entity);

“significant influence” has the same meaning as in section 2(1) of the Act;

“sister company” in relation to the registered bank means any company in the group that is not a holding company of the registered bank or a subsidiary of the registered bank; and

“subsidiary” has the same meaning as in section 2(1) of the Financial Reporting Act 1993.

9. Board size and composition

The standard requirements are that the board of the bank has at least five members, that the majority of those members are non-executive, that at least half of those members are independent, and that at least half of the independent directors on the board are ordinarily resident in New Zealand. Thus, for instance, a board with eight members must have at least four independent directors, at least two of whom must be New Zealand resident, and at least one of the remaining four directors must be non-executive. Any alternate of a non-executive director must also be non-executive, and any alternate of an independent director must also be independent.

10. Criteria for independence

- (1) For the purposes of this policy, a person is *independent* in relation to the registered bank if that person:
 - (a) does not control or have significant influence over the registered bank, and is not an officer of an entity that controls or has significant influence over the registered bank, and has not met either of the foregoing conditions at any point during the three years immediately before their current appointment to the board, except that a person may fail this criterion and still be considered independent in the cases set out in sections 11 and 12 below;
 - (b) is not employed, and has not previously been employed, in an executive capacity by the registered bank or another group member, unless there has been a period of at least three years between ceasing such employment and serving on the board;
 - (c) is not a director of any sister company of the registered bank, except that a person may fail this criterion and still be considered independent if the Reserve Bank has confirmed that none of the sister company directorships held by that

person disqualify him or her from being an independent director of the registered bank; and

- (d) is not a current principal of a material professional adviser or a material consultant to the registered bank or another group member, and has not within the last three years been a principal of such a firm with primary responsibility for the service provided, and is not currently and has not within the last three years been an employee of such a firm materially associated with the service provided.
- (2) The definition of independence is intended to ensure that an independent director is free from any business or other association that could materially interfere with the exercise of their independent judgement.
- (3) In respect of the criterion in subsection (1)(c), when proposing to appoint a new director to the board, if the registered bank intends the appointee to qualify as an independent director and the appointee holds any existing or proposed directorships of sister companies, the registered bank must provide details of those sister company directorships to the Reserve Bank. (This will be as part of, or in addition to, the curriculum vitae already required by BS10, “Review of Suitability of Bank Directors and Senior Managers”.) The registered bank must also notify the Reserve Bank when it is proposed that an existing independent director of the bank be appointed to the board of a sister company. In either case the Reserve Bank will confirm whether or not the current or proposed director is disqualified from being independent by being a director of any sister companies.

11. Independence of board chairperson

- (1) The chairperson plays an important leadership role on the board, promoting co-operation, mediating between different perspectives, and leading informed debate and decision-making. The chairperson also acts as the main link between the CEO and the board. For these reasons, the policy requires the chairperson of a registered bank to be independent, and this is included in the standard conditions of registration.
- (2) In the case of the chairperson, the Reserve Bank may allow a specific variation from the normal criteria for independence, to accommodate the case where the chairperson of the bank board also sits on the board of a holding company or parent bank.
- (3) The chairperson in this case would not meet the normal criterion for independence in subsection 10(1)(a). But the Reserve Bank may be satisfied that the chairperson will in practice be sufficiently independent. To achieve this, the chairperson must only fail the criteria in section 10(1) as a whole to the extent of being a member of the parent bank or holding company board. The Reserve Bank will also need to be satisfied that the chairperson’s experience and background is 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).
- (4) Any appointment of a person to be chairperson of a registered bank is subject to the Reserve Bank confirming that it has no objection. If the proposed chairperson is a current or intended member of a parent company board, the Reserve Bank will only give its non-objection if it is satisfied that the chairperson is independent on the basis

described above, and if so will confirm that the bank may treat the chairperson as independent for the purposes of this policy.

- (5) If it is proposed to appoint the existing chairperson of the registered bank to a parent company board, the bank will need to seek the Reserve Bank's confirmation that the chairperson would still qualify as independent after the appointment, to ensure that the condition of registration on the chairperson being independent continues to be met.

12. Other exceptions to independence criterion in 10(1)(a)

- (1) A registered bank may have one or more intermediate holding companies, that is, companies that own the registered bank and are owned in turn by its ultimate parent bank or ultimate holding company.
- (2) Despite subsection 10(1)(a), a director of any such intermediate holding company is not disqualified as an independent director of the registered bank provided that the intermediate holding company's functions are limited to acting as a legal vehicle to hold investments in its various subsidiaries and it does not undertake any direct revenue-generating activity.
- (3) In a corporate restructuring, a newly-incorporated, newly-registered bank may take over a substantial part of the business of a predecessor company that becomes the holding company of the bank following the restructuring. A director of the predecessor company who transfers to the board of the new bank would not be ruled out as independent by subsection 10(1)(a), despite having been on the board of a holding company of the bank within the three years prior to their appointment to the bank board.

13. Acting in best interests of the bank

- (1) The aim of the conditions discussed above is to ensure as far as possible that 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. There is also a condition which prohibits the registered bank from having in its constitution a provision permitting a director, when exercising power or performing duties as a director, to act other than in what he or she believes is the best interests of the bank.
- (2) Although a director of a company, when exercising powers or performing duties as a director, is normally required under the Companies Act 1993 to act in good faith and in what the director believes to be the best interests of the company, section 131(2) of the Companies Act allows a director of a subsidiary to act in a manner which he or she believes is in the best interests of its holding company even though it may not be in the best interests of the subsidiary, if expressly permitted by the subsidiary's constitution. Therefore this condition of registration prohibits the registered bank's constitution from allowing a director to act other than in the bank's best interests.

14. Board audit committee

- (1) Among the board's key responsibilities is to ensure the integrity of the bank's financial controls, reporting systems and internal audit standards. Having a separate, suitably constituted committee covering such matters ensures that greater focus and expertise is brought to bear on them, and also enhances the objectivity of the board's oversight of this important area. While the Reserve Bank would normally expect a registered bank also to have other board committees covering other areas, because of

the particular importance it attaches to audit-related matters there is a separate condition of registration specifically requiring the bank to have a separate committee with responsibility for this area, with sub-conditions designed to ensure its independence.

- (2) This condition does not require a registered bank to have a dedicated board audit committee named as such. Rather the aim is to ensure that the bank has a suitably independent committee whose activities include in substance an oversight role of the bank's financial controls, reporting systems and internal audit standards. (Note that there are also guidelines in section 17 below on the qualifications and experience of committee members.)

15. Variations to standard conditions of registration

- (1) The Reserve Bank is prepared to consider variations to the standard conditions of registration. This may be possible where a registered bank, or applicant for registration as a bank, is able to satisfy the Reserve Bank that it can meet the substance of the standard arrangements by alternative means.
- (2) One specific case where this may arise is where a registered bank's operations in New Zealand are very small. In this case the Reserve Bank may agree to vary the conditions on the minimum board size and composition. The following gives guidance on the factors the Reserve Bank may take into account:
 - (a) This is most likely to arise when the Reserve Bank is considering an application for registration for a New Zealand subsidiary of an overseas bank. The initial scale of operation of the subsidiary, in terms of number of employees and projected balance sheet size, may not for instance justify the requirement to have five directors.
 - (b) After an applicant has been registered as a bank, the Reserve Bank would keep the nature and scale of its operations under review, and would propose changes in the bank's conditions of registration on corporate governance, as appropriate to its growth over time, to bring them eventually into line with the standard conditions.
 - (c) The Reserve Bank would not normally vary the condition in respect of the audit committee.
- (3) The Reserve Bank may also impose different or additional conditions in relation to corporate governance to recognise, for example, specific banking group structures or risks.

Part 3—Guidelines

16. Introduction

- (1) Guidelines follow, issued under section 78(3) of the Act, on matters in relation to a bank's corporate governance arrangements that the Reserve Bank will take into account in—
 - (a) having regard to the ability of an applicant for registration to carry on its business in a prudent manner; or

- (b) determining whether a New Zealand-incorporated registered bank has carried on its business in a prudent manner.

These guidelines cover matters that the Reserve Bank judges to be particularly worth highlighting in relation to the skills and experience of the board, and, with the exception of subsection 17(5), are drawn from the Basel Committee corporate governance principles referred to above.

- (2) These guidelines and the standard conditions of registration are not intended as an exhaustive list of matters the Reserve Bank regards as important for good corporate governance. Beyond complying with the requirements in the bank's conditions of registration and taking account of the following guidelines, it is the responsibility of the directors to satisfy themselves that the detailed corporate governance arrangements of the bank are appropriate to the particular nature of the bank's business and risks. The full text of the Basel document, and the Securities Commission Handbook referred to above, are comprehensive sources of guidance on the subject.

17. Guidelines

- (1) Board members should be and remain qualified, including through training, for their positions. They should have a clear understanding of their role in corporate governance and be able to exercise sound and objective judgment about the affairs of the bank. (Basel Principle 2.) This principle applies to a board member in his or her capacity as a member of the full board and as a member of any board committee.
- (2) The board should possess, both as individual board members and collectively, appropriate experience, competencies and personal qualities, including professionalism and personal integrity.
- (3) The board collectively should have adequate knowledge and experience relevant to each of the material financial activities the bank intends to pursue in order to enable effective governance and oversight.
- (4) The audit committee (or other separate board committee responsible for audit matters) should as a whole have recent and relevant experience and should possess a collective balance of skills and expert knowledge – commensurate with the complexity of the banking organisation and the duties to be performed – in financial reporting, accounting and auditing.
- (5) At least one member of the audit committee (or other separate board committee responsible for audit matters) should have appropriate qualifications and experience in finance and accounting.
- (6) To support board performance, it is a good practice for the board to carry out regular assessments of both the board as a whole and of individual board members. The board should periodically review the effectiveness of its own governance practices and procedures, determine where improvements may be needed, and make any necessary changes.
- (7) To the extent that it is involved in identifying potential board members, the board should ensure that the candidates are qualified to serve as board members and are able to commit the necessary time and effort to fulfil their responsibilities.

Part 4—Public disclosure

18. Disclosure requirements

- (1) A registered bank must comply with the Reserve Bank's requirements for public disclosure in relation to corporate governance. These requirements apply to branches of banks incorporated overseas as well as to New Zealand incorporated banks. Further, directors of a registered bank, and the New Zealand Chief Executive Officer for a registered bank incorporated overseas, must attest in disclosure statements that the registered bank has, at the reporting date and over the accounting period, complied with the requirements set out in the bank's conditions of registration.
- (2) The requirements for public disclosure are set by Order in Council, from which the following summarises the corporate governance related disclosure requirements applying to registered banks.
- (3) In its full year disclosure statements, a registered bank must disclose:
 - (a) The following information for each director: name; occupation(s); technical or professional qualifications; country of residence; whether they are executive; whether they are independent; other directorships held outside the banking group; and details of any transaction between the director or a closely-related party of the director, and any part of the banking group, which is not on an arm's length basis or could materially influence the director in carrying out their duties. In the case of branches, this information must also be disclosed in respect of the New Zealand Chief Executive Officer.
 - (b) A statement on whether there is a board audit committee or other separate board committee covering audit matters, and if so, how many members it has in total, how many are independent directors, and how many are directors other than independent.
 - (c) The board's policy for avoiding or handling conflicts of interest which may arise from any of the directors' personal, professional or business interests.
- (4) In its half year and off quarter disclosure statements, a registered bank must state whether there have been any changes in the composition of its board since the balance date of its most recent full year disclosure statement, and if so, the nature of the changes.

Appendix 1 – Standard conditions of registration

In general, New Zealand-incorporated registered banks will be subject to the following standard conditions of registration.

1. That the registered bank complies with the following corporate governance requirements:
 - (a) the board of the registered bank must have at least five directors;
 - (b) the majority of the board members must be non-executive directors;
 - (c) at least half of the board members must be independent directors;
 - (d) an alternate director,—
 - (i) for a non-executive director must be non-executive; and
 - (ii) for an independent director must be independent;
 - (e) at least half of the independent directors of the registered bank must be ordinarily resident in New Zealand;
 - (f) the chairperson of the board of the registered bank must be independent; and
 - (g) the bank’s constitution must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the company (ie the registered bank).

For the purposes of this condition of registration, “non-executive” and “independent” have the same meaning as in the Reserve Bank of New Zealand document entitled “Corporate Governance” (BS14) dated [month year].

2. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the registered bank unless:
 - (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - (b) the Reserve Bank has advised that it has no objection to that appointment.
3. That a person must not be appointed as chairperson of the board of the registered bank unless:
 - (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - (b) the Reserve Bank has advised that it has no objection to that appointment.
4. That the registered bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:
 - (a) the mandate of the committee must include: ensuring the integrity of the bank’s financial controls, reporting systems and internal audit standards;
 - (b) the committee must have at least three members;
 - (c) every member of the committee must be a non-executive director of the registered bank;
 - (d) the majority of the members of the committee must be independent; and
 - (e) the chairperson of the committee must be independent and must not be the chairperson of the registered bank.

For the purposes of this condition of registration, “non-executive” and “independent” have the same meaning as in the Reserve Bank of New Zealand document entitled “Corporate Governance” (BS14) dated [month year].