



# **Statement of Principles**

## **Bank Registration and Supervision**

Prudential Supervision Department  
Document BS1

Issued: December 2011

# TABLE OF CONTENTS

<b>Subject</b>	<b>Page</b>
A. INTRODUCTION .....	3
B. PURPOSES OF BANK REGISTRATION AND SUPERVISION.....	3
C. BANK REGISTRATION .....	4
D. SUPERVISION.....	20
E. CONDITIONS OF REGISTRATION.....	22
F. VARIATION AND REMOVAL OF CONDITIONS OF REGISTRATION .....	27
G. BREACHES OF CONDITIONS OF REGISTRATION.....	28
H. BREACH OF MINIMUM CAPITAL ADEQUACY RATIO REQUIREMENTS.....	28
I. DISCLOSURE REQUIREMENTS .....	29
J. CREDIT RATING REQUIREMENT .....	30
K. RESPONSIBILITIES FOR NEW ZEALAND CHIEF EXECUTIVE OFFICERS OF OVERSEAS INCORPORATED BANKS .....	31
L. DIRECTOR RESPONSIBILITIES .....	32
M. CHANGES OF OWNERSHIP .....	33
N. ESTABLISHMENT OF OVERSEAS BRANCHES, REPRESENTATIVE OFFICES OR SUBSIDIARIES .....	34
O. CRISIS MANAGEMENT .....	34
P. FOREIGN SUPERVISOR ACCESS TO INFORMATION HELD BY REGISTERED BANKS .....	37
Q. UNITED NATIONS' SANCTIONS .....	38
APPENDIX ONE – STANDARD CONDITIONS OF REGISTRATION .....	39
APPENDIX TWO – CREDIT RATING REQUIREMENT .....	49
APPENDIX THREE – APPROVAL OF CREDIT RATING AGENCIES .....	50

# 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 5 of the Act confers various powers on the Bank in order to permit it to carry out these functions.
2. As required by section 75 of the Act, this document 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.
3. In addition it sets out the principles on which the Reserve Bank acts in carrying out other aspects of its prudential supervision role.

## B. PURPOSES OF BANK REGISTRATION AND SUPERVISION

4. 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 that could result from the failure of a registered bank.
5. Bank registration policy is aimed at ensuring that only financial institutions of appropriate standing and repute, that can provide evidence of their ability to comply with all prudential requirements relating to the matters the Reserve Bank is required to have regard to when assessing an application for registration, are able to become registered banks. Subject to the above, 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.
6. 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 on banks which are naturally present.
7. In the event that a registered bank failure does occur, the Reserve Bank will seek to minimise damage to the financial system. This may involve the use of the crisis

management powers available 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 that is in difficulties.

## **C. BANK REGISTRATION**

8. The following section sets out the principles on which the Reserve Bank will act when determining applications for registration as a registered bank. The Reserve Bank document entitled "*Application for Status as a Registered Bank: Material to be Provided to the Reserve Bank*" (BS3) identifies the information which should be provided in support of an application to become a registered bank.
9. 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:
    - the incorporation and ownership structure of the applicant;
    - the size and nature of the applicant's business or proposed business or any part of the applicant's business;
    - the ability of the applicant to carry on its business or proposed business in a prudent manner;
    - the standing of the applicant in the financial markets;
    - the suitability for their positions of the directors and senior managers of the applicant;
    - the standing of the owner of the applicant in the financial markets; and
    - any other matters prescribed in regulations.
10. In terms of section 73A of the Act, if the applicant is an overseas person the Reserve Bank is required to have regard to the following additional matters:
  - the law and regulatory requirements of the applicant's home jurisdiction that relate to:
    - (i) the recognition and priorities of claims of creditors or classes of creditors in the event of the insolvency of the applicant;
    - (ii) the disclosure by the applicant of financial and other information of the kind that a registered bank must disclose under section 81;
    - (iii) the accounting and auditing standards applicable to the applicant;
    - (iv) the duties and powers of directors of the applicant; and
    - (v) the licensing, registration, authorisation and supervision of the applicant.
  - the nature and extent of the financial and other information disclosed to the public by the applicant.
11. In terms of section 73B of the Act, the Reserve Bank is required to have regard to the following additional matters if the applicant is a subsidiary of an overseas person:

- the law and regulatory requirements of the home jurisdiction of the overseas person that relate to:
    - (i) the disclosure by the overseas person of financial and other information of the kind that a registered bank must disclose under section 81;
    - (ii) the accounting and auditing standards applicable to the overseas person;
    - (iii) the duties and powers of the directors of the overseas person; and
    - (iv) the licensing, registration, authorisation and supervision of the overseas person.
  - the nature and extent of the financial and other information disclosed to the public by the overseas person.
12. The principles the Reserve Bank applies when considering each of these matters are set out below.

### **(I) Business of the applicant**

13. The Reserve Bank is required to satisfy itself that at a minimum the business carried on, or proposed to be carried on, by an applicant for registered bank status substantially consists of the borrowing or lending of money or the provision of other financial services. The manner in which this basic requirement is interpreted will vary depending on whether the applicant is incorporated locally or wishes to operate as a branch of an overseas incorporated company.
14. Where an applicant seeks to register as a locally incorporated registered bank, the Reserve Bank will require the applicant and its subsidiaries (ie the New Zealand banking group) not to conduct any material insurance underwriting business or any material activities of a non-financial nature. As these requirements do not apply to any New Zealand business activities of the applicant's owners conducted outside the New Zealand banking group, the effect is to constrain the manner in which insurance and non-financial business is structured, rather than to restrict the capacity of the owners to conduct that business.
15. Where an applicant wishes to register as a branch of an overseas incorporated entity, the applicant will be required to satisfy the Reserve Bank that non-financial activities and insurance business will not constitute a majority of its overall activities in New Zealand, including activities conducted through subsidiaries. Where insurance or non-financial operations are, or will be, material relative to total activities, the applicant will be required to "quarantine" these operations in separately incorporated companies. These separately incorporated companies will be specifically excluded from the applicant's New Zealand banking group. (The New Zealand banking group normally includes all of an overseas incorporated bank's New Zealand business, including business conducted in subsidiaries, in line with requirements specified in section 9(2) of the Financial Reporting Act).
16. Applicants for registered bank status are required to provide the Reserve Bank with a description of the nature and size of the businesses they conduct and/or intend to conduct, including details of business to be conducted via separately incorporated entities so that the Bank can assess whether or not these requirements will be met.
17. There is no requirement that certain types of financial services must be provided by registered banks.

18. The Reserve Bank has not attempted to define ‘financial’ or ‘non-financial’ business or services, as it recognises that the types of services 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**

19. 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.
20. 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.
21. The Reserve Bank will assess ownership structures in the light of these factors.
22. As noted above, both locally incorporated entities and branches of banks incorporated overseas may apply for registration.
23. The requirements which will apply to applicants wishing to operate a branch are as follows:

### **(a) Branches of overseas banks**

24. 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.
25. All applicants which fall within the following categories, or which are expected to fall within the following categories in the 5 years following registration, will be required to establish a locally incorporated entity rather than operate via a branch:
- Systemically important banks, that is, banks whose New Zealand liabilities, net of amounts due to related parties, exceed NZ\$15 billion.
  - Retail deposit takers incorporated in a jurisdiction that has legislation which gives deposits made, or credit conferred, in that jurisdiction a preferential claim in a winding up. Australia and the United States are examples of countries with such legislation.

- Retail deposit takers which do not provide adequate disclosure in the home jurisdiction.
- Applicants other than those listed above may also be required to incorporate locally, if the Reserve Bank is not satisfied that supervisory arrangements (including disclosure arrangements) and market disciplines in the country of incorporation are adequate.

26. *Systemically important banks*

Systemically important banks are required to incorporate locally to provide a degree of assurance that the Reserve Bank would have the ability to manage a failure affecting one of these banks. Systemically important banks are those which are so large that their failure could have flow on effects to the banking system as a whole and the wider economy. For the purposes of this requirement, systemically important banks are defined as those whose New Zealand liabilities, net of amounts due to related parties, exceed \$15 billion. This definition will normally be reviewed at three yearly intervals, and if appropriate, the size limit will be updated.

27. With a branch it may be difficult to determine what assets are, or would be, available to a statutory manager in a failure and which liabilities can be attributed to the branch. This problem is becoming more acute over time as increasing geographical centralisation and integration of critical banking functions occur. The usefulness of branch accounts is further undermined by the fact that there are no prohibitions on the transfer of assets between branches of the same legal entity.

28. A locally incorporated bank has its own board of directors and those directors are required under the Companies Act to act in the best interests of the company, to prevent the company from carrying on business in a manner likely to create a substantial risk of serious loss to the company's creditors and to ensure that the company does not incur an obligation unless they believe that the company will be able to perform the obligation when required to do so. They must also ensure that they do not authorise a distribution to shareholders unless they are satisfied that immediately after the distribution the company will satisfy a solvency test. The Reserve Bank considers that these directors' duties together with a legal entity structure provide much greater certainty in a failure situation and increase the likelihood that value will be retained in the local bank in the lead up to a failure.

29. Local incorporation also ensures that there is a clear delineation between the assets and liabilities of the New Zealand bank and those of its parent. This makes it more likely that, should it prove necessary, a statutory manager could quickly take control of the bank and, if appropriate, re-open it for business within a reasonably short time frame.

30. *Retail deposit takers*

The restrictions on retail deposit takers' ability to operate a branch in New Zealand are aimed at ensuring that retail depositors have access to the information they need to assess the risk of dealing with a particular bank.

31. For the purposes of these requirements a retail deposit taker is defined as a financial institution that has more than \$200 million in New Zealand retail deposits on its books. Retail deposits are defined as deposit liabilities held by natural persons, excluding liabilities with an outstanding balance of more than \$250,000.

32. Where disclosure in the home jurisdiction is inadequate, depositors have no way of assessing the financial strength of the bank as a whole and the likelihood of the bank failing. In such circumstances the effectiveness of market disciplines may be undermined.
33. When assessing the adequacy of disclosure, the Reserve Bank will take into consideration the following:
- The quality of accounting standards used to prepare the applicant's accounts. Where necessary, the Reserve Bank will require an applicant to provide independent verification that the accounting standards being used to prepare accounts for the legal entity proposing to operate a branch in New Zealand are sufficiently similar to accounting standards used in New Zealand to allow users of the accounts to make an assessment of the entity's financial condition that would not differ materially from that which the user would make, if the accounts were prepared using New Zealand generally accepted accounting principles (GAAP);
  - The frequency of publication of the accounts. The Reserve Bank would normally expect accounts to be published on at least a 6 monthly basis;
  - The timeliness of published accounts. Generally the Reserve Bank would wish to satisfy itself that accounts are being published within 4 months of balance date;
  - The quality of auditing standards used by the auditors of the applicant's accounts. The Reserve Bank will wish to satisfy itself that these are reasonably equivalent to the standards applicable in New Zealand;
  - Disclosure of accounting policies. Without full disclosure of accounting policies it is difficult for users of the accounts to interpret those accounts;
  - Availability of both legal entity and consolidated accounts. Generally both sets of accounts are necessary to allow a full understanding of a bank's position;
  - Disclosure of key indicators of financial soundness such as capital adequacy ratios and impaired asset data.
34. Where legislation in an applicant's home jurisdiction gives depositors or creditors in that country a preferential claim on assets, it is very difficult for New Zealand depositors to assess their likely position, if the bank were to fail. In a failure situation, New Zealand depositors, depositors in the home jurisdiction, New Zealand creditors and creditors in the home jurisdiction would each have different claims on the same legal entity. Neither the legal entity accounts nor the branch accounts, nor both sets of accounts taken together, provide sufficient information for depositors and creditors to work out their position relative to other classes of creditor and depositor. The situation is even more complex when the legal entity has branches in other jurisdictions as well.
35. Wholesale depositors and creditors, while faced with the same information gap as retail customers, are generally able to understand the deficiencies in disclosure information and can take them into account when making investment decisions. Thus the Reserve Bank

will not require applicants which deal with wholesale clients to incorporate locally purely on the basis of inadequate disclosure or depositor preference legislation.

36. With a locally incorporated bank, depositors will have access to current financial statements prepared in accordance with New Zealand generally accepted accounting principles (GAAP) for the legal entity with which they are dealing and assurance that, in a winding up, their claims would rank *pari passu* with those of other unsecured creditors (other than priority creditors such as the Inland Revenue Department and employees).
37. *Other applicants*  
In assessing the adequacy of supervision in the home jurisdiction, the Reserve Bank will pay close attention to the adequacy of capital standards applied in the home country.
38. 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.
39. *Dual registration*  
Overseas banks may be permitted to have dual registration (ie to operate both a branch and a subsidiary in New Zealand) provided both entities comply with relevant prudential requirements relating to the matters that the Reserve Bank is required to have regard to when assessing an application. Banks with dual registration will not be permitted to take retail deposits through the branch operation. If banks with a dual registration were able to take deposits through both entities it is likely that depositors would be confused about which entity they were dealing with.

#### **(b) Locally incorporated applicants**

40. 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.
41. 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**

42. While the Reserve Bank would not rule out the possibility of entities with other forms of ownership 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.

### **(III) Size and nature of business or proposed business, or any part of the business or proposed business**

43. A locally incorporated bank will be required to have a minimum of NZD \$30 million in capital. 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.
44. 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 NZD \$30 million.
45. Restrictions on retail deposit taking will be imposed on some overseas incorporated banks. (See paragraphs 30 – 36)
46. Overseas incorporated banks which provide inadequate disclosure in their home jurisdiction or which come from a jurisdiction that has legislation that gives deposits made, or credit conferred, in that jurisdiction a preferential claim in a winding up, will not be permitted to take retail deposits of more than \$200 million.

### **(IV) Ability of the applicant to carry on business in a prudent manner**

47. 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:
  - (a) capital in relation to the size and nature of the business;
  - (b) loan concentration and risk exposures;
  - (c) separation of the business from other interests of those who own or control the bank;
  - (d) separation of the business or proposed business from other business;
  - (e) internal controls and accounting systems;
  - (f) risk management systems and policies;
  - (g) arrangements for any business, or functions relating to any business, of the applicant to be carried on by any person other than the applicant (outsourcing);
  - (h) such other matters as may, from time to time, be prescribed in regulations.

The following sections expand on items (a) to (h).

**(a) Capital in relation to size and nature of business**

48. An applicant must satisfy the Reserve Bank that it is able, on an ongoing basis, to meet the capital requirements that would be imposed as conditions of registration. An applicant will need to satisfy the Reserve Bank that it has sufficient capital to carry on its business in a prudent manner and that it is able to maintain a prudent level of capital both on a solo and a group basis.
- 48A. An applicant's capital requirements must be calculated under one of two broad approaches available under the Reserve Bank's capital adequacy framework. The first approach is the standardised approach and is set out in the Reserve Bank's "Capital Adequacy Framework (Standardised Approach)" (BS2A). This approach uses external credit assessments produced by approved credit rating agencies and is the default approach. The second approach permits an applicant's internal models to be used to measure the risks of their business and is set out in "Capital Adequacy Framework (Internal Models Approach)" (BS2B). This second approach is only available to the extent the Reserve Bank accredits the applicant to use the models based approach.
- 48B. An applicant must have a capital policy. A capital policy must take into account any constraints on access to further capital when needed to cater for situations including, for example, an increase in business or an unexpected loss. In addition, an applicant must satisfy the Reserve Bank that it has the capacity to implement and manage an internal capital adequacy assessment process ("ICAAP") that accords with the Reserve Bank's "Guidelines on a Bank's Internal Capital Adequacy Assessment Process" (BS12).
49. For a locally incorporated bank the capital requirements that would generally be imposed are set out in the Reserve Bank's standard conditions of registration in Appendix One. In some cases, however, higher than usual minimum requirements may be imposed to mitigate higher than usual risks.
50. For a branch of a bank incorporated overseas, an applicant will have to demonstrate to the Reserve Bank that the global bank complies with adequate capital standards, which are at least broadly comparable with those in New Zealand, and that it is subject to adequate supervision by the bank's home supervisor.
51. An applicant will be required to show that it has the ability to disclose capital adequacy information on its parent or the global bank.

**(b) Loan concentration and risk exposures**

52. Banks that do not have a diversified portfolio of risks or 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.

53. 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**

54. Boards 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. The shareholders or owners of a bank play an important role in monitoring the board and in monitoring the bank's performance. Where there is inadequate separation between a bank's board and its principal shareholders, these incentives and disciplines may be undermined.
55. 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. Therefore a branch will not be required to comply with the separation arrangements that apply to locally incorporated banks.
56. Where the applicant is a locally incorporated company, the applicant 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's constitution does not include any provision permitting a director to act other than in the best interests of the company (i.e. the bank); 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.
57. Specific requirements on board size and composition for registered banks are set out in the Reserve Bank document "Corporate Governance" (BS14). An applicant for registration must normally meet the following minimum requirements:
- The board of the proposed bank must have at least five members, of whom the majority must be non-executive, and at least half must be independent (as defined in BS14). Any alternates of non-executive directors must be also non-executive, and any alternates of independent directors must also be independent. At least half of the independent directors on the board must be ordinarily resident in New Zealand. In the case where the applicant's operations or proposed operations in New Zealand are very small, these conditions on the minimum board size and composition may be varied.
  - The chairperson of the applicant's board must be an independent director. The Reserve Bank may consider a variation to the standard criteria for independence in this case, to allow the chairperson to be a member of a parent company board and still qualify as independent, provided that the applicant is able to satisfy the Reserve Bank that the chairperson will be sufficiently independent from the parent bank in practice.

- The board must have an audit committee, or other committee however named that fulfils the role of an audit committee. It must have at least three members, all of whom must be non-executive directors. The majority of the members of the committee, including its chairperson, must also be independent directors.

These requirements are aimed at providing 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.

In some circumstances, it may be necessary to impose additional requirements in order to achieve this.

58. Locally incorporated applicants will also need to satisfy the Reserve Bank that they will be in a position to comply with a condition of registration which limits aggregate credit exposures of a non-capital nature to connected parties under a ratings-contingent limit methodology, as outlined in the Reserve Bank document “Connected Exposures Policy” (BS8). The standard condition provides that the upper limit is 75 percent of tier one capital for banks rated AA/Aa2 and above, with the limit declining progressively based on a rating scale to 15% of tier one capital for banks rated BBB+/Baa1 and below. Within the rating-contingent limit, aggregate credit exposures of a non-capital nature to non-bank connected parties must not exceed 15 percent of tier one capital. For the purposes of this requirement, exposures to non-bank entities owned by a parent bank are treated as bank exposures. Exposures to connected persons of a capital nature are required to be deducted from tier one capital. The Reserve Bank may impose additional or bank specific conditions of registration where special circumstances apply. For example, the Bank may consider it appropriate to impose a lower than normal connected lending limit on a bank that is undercapitalised relative to the levels of risk it is facing, but which is not in a position to raise additional capital.
59. Connected exposures within these ratings-contingent limits are required to be calculated on a gross basis, except where netting is allowed. Where netting is used, credit exposures to connected persons can be calculated on a bilateral net basis, but subject to an additional limit on the aggregate gross exposures of the banking group to connected persons. Aggregate gross exposure to connected persons must not exceed 125% of the banking group’s tier one capital, i.e. the gross amount of exposures that have been netted plus the unnetted exposures. The balance of connected exposures after netting is capped at the applicable ratings-contingent limit.

**(d) Separation of the business or proposed business from other business**

60. New Zealand’s banking supervision framework is premised on the basis that banks’ business activities are largely confined to “traditional” banking activities, ie to the activities of borrowing and lending, and to the provision of treasury and payments services, and related financial services. Were material insurance underwriting activities or non financial activities to be conducted by banking groups, the accuracy and integrity of

capital adequacy measures, and the meaningfulness and comparability of disclosures would be materially degraded.

61. Where the applicant is a locally incorporated company, the applicant will need to satisfy the Reserve Bank that it will be in a position to comply with conditions of registration:
- that restrict the conduct of life and general insurance business of an underwriting nature to no more than 1% of a banking group's total consolidated assets (this condition does not restrict the marketing or distribution of insurance products by a banking group), and
  - that prohibit the conduct of any non-financial activities that in aggregate are material relative to the total activities of the banking group.
62. These conditions of registration will normally apply to the New Zealand banking groups of overseas incorporated banks as well.

**(e) Internal controls and accounting systems**

63. Applicants will be required to satisfy the Reserve Bank that they have, or will have, internal controls and accounting systems that 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, this may be accepted as evidence that this requirement can be met. Similarly, where a financial institution has been operating successfully for some time, this may be accepted as evidence of its ability to meet this requirement.
64. 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. In such cases, the Bank may also take into account arrangements designed to mitigate risks arising from unproven systems and controls, including capital adequacy policies. The Reserve Bank may impose higher minimum capital requirements by way of condition of registration in order to mitigate any increased risk, where individual circumstances warrant.

**(f) Risk management systems and policies**

65. Applicants will be required to satisfy the Reserve Bank that they have, or will have, risk management systems and policies that are appropriate for a registered bank and for the type of business to be conducted. An applicant's situation as a branch or subsidiary of a major international bank of standing and repute and intention to adopt the systems and policies used by the parent may be accepted as evidence that the requirement can be met. Similarly, a financial institution's successful operation for some time may be accepted as evidence of ability to meet the requirement.

66. If the applicant intends to operate in areas where it lacks experience or if there are doubts about the adequacy of its risk management systems and policies, the Reserve Bank may require the applicant to obtain a report from an independent expert on the adequacy of its risk management systems and policies, and to supply that report to the Reserve Bank. In such cases, the Bank may also take into account arrangements designed to mitigate risk arising from unproven systems and controls or other factors, including adequacy of capital in light of these risks. The Reserve Bank may impose higher capital adequacy ratio requirements by way of a condition of registration in order to mitigate any increased risk where individual circumstances warrant.
- 66A. In relation to liquidity risk, the applicant will need to satisfy the Reserve Bank that it will be able to comply with conditions of registration imposing minimum requirements on the applicant's liquidity risk management framework, as set out in the Reserve Bank document "Liquidity Policy" (BS13).
67. If the application for registration is successful, the registered bank's directors will be required regularly to attest in disclosure statements to the adequacy of the registered bank's systems to monitor and control material business risks.

**(g) Outsourcing**

68. Outsourcing can have a positive impact on a bank's efficiency, risk management and profitability and may allow it to access specialist expertise not available from within its own ranks. On the other hand, it can also increase the risk and possible magnitude of damage to the financial system in the event that the bank, or a service provider to the bank, should fail or become dysfunctional.
69. Where relevant, applicants for registration will need to satisfy the Reserve Bank that they will be able to comply with the Reserve Bank's outsourcing policy which is described in the Reserve Bank document "Outsourcing Policy" (BS11).
70. Applicants for registration whose New Zealand liabilities, net of amounts due to related parties, exceed NZD \$10 billion will need to satisfy the Reserve Bank that they have the legal and practical ability to control and execute any business, and any functions relating to any business, of the applicant that are carried on by a person other than the applicant, sufficient to achieve, under normal business conditions and in the event of stress or failure of the applicant or of a service provider to the applicant, the following outcomes:
- (a) that the applicant's clearing and settlement obligations due on a day can be met on that day;
  - (b) that the applicant's financial risk positions on a day can be identified on that day;
  - (c) that the applicant's financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and

- (d) that the applicant's existing customers can be given access to payments facilities on the day following any failure and on subsequent days.

71. Such applicants will also need to satisfy the Reserve Bank:

- (a) that the business and affairs of the applicant are managed by, or under the direction or supervision of, the board of the applicant;
- (b) that the employment contract of the chief executive officer of the applicant or person in an equivalent position (together "CEO") is with the applicant, and the terms and conditions of the CEO's employment agreement are determined by, and any decisions relating to the employment or termination of employment of the CEO are made by, the board of the applicant; and
- (c) that all staff employed by the applicant have their remuneration determined by (or under the delegated authority of) the board or the CEO of the applicant and are accountable (directly or indirectly) to the CEO of the applicant.

**(h) Such other matters as may, from time to time, be prescribed in regulations**

71A. Currently there is one matter prescribed in regulation. This matter is policies, systems, and procedures to detect and deter money laundering and terrorist financing.

71B. Applicants will be required to satisfy the Reserve Bank that they have, or will have, policies, systems and procedures, to detect and deter money laundering and terrorist financing that are consistent with the Reserve Bank's "Guidelines on Anti-Money Laundering and Countering Financing of Terrorism" (BS5).

**(V) Suitability for their positions of the directors and senior managers**

72. The Reserve Bank will have regard to the suitability of the applicant's proposed directors and senior management for their positions. The standard considerations are:

- (a) Integrity. The Reserve Bank will assess the integrity of directors and senior managers by—
  - (i) seeking the views of foreign banking regulators where the person has been resident in a foreign country and has been subject to a suitability check by the foreign regulator; and
  - (ii) reviewing the New Zealand criminal record information of the person where they have been resident in New Zealand.
  - (iii) reviewing the criminal record information of the person in other jurisdictions in which the person has been resident, where necessary.
- (b) Skills and experience. The applicant will need to satisfy the Reserve Bank that key executives have suitable expertise and experience to manage a registered bank, that the bank's board collectively has the range of experience and skills to govern a

registered bank, and that the directors and senior managers have sufficient skills and experience in the activities that the applicant proposes to undertake. Because it is impractical for each director individually to be an expert in all relevant areas, the skills and experience of directors will be assessed collectively. This evaluation of skills and experience will involve reviewing directors' and senior managers' curricula vitae.

73. The Reserve Bank may take into consideration other information if relevant.
74. If a proposed director or senior manager has already passed a foreign banking regulator's suitability assessment, the Reserve Bank will usually accept that assessment as evidence of suitability.
75. 'Senior managers' are defined as the chief executive officer and executives accountable directly to the chief executive officer for locally incorporated banks, and the New Zealand chief executive officer for overseas incorporated banks.
76. The Reserve Bank does some basic checks on whether or not there is any evidence to suggest that proposed directors or senior managers are not suitable for their positions, but does not give a positive affirmation of suitability. The primary responsibility for ensuring that appointees have the requisite skills, experience, and integrity to carry out their tasks successfully lies with the shareholders (for director appointments) and with the board (for senior management appointments), not with the Reserve Bank.

## **(VI) Standing of the applicant in financial markets**

77. An applicant's status as a branch or subsidiary of a major international bank of standing and repute with a record of sound performance will normally be accepted as evidence of an appropriate degree of standing.
78. When the applicant is not a branch or subsidiary of a reputable bank, additional emphasis will be placed on the suitability of directors and senior management for their positions (see section C(V)) in assessing the standing of the applicant in financial markets.
79. All applicants must obtain a credit rating before registration. This is to assist the Reserve Bank in assessing the applicant's standing and to ensure that the applicant is in a position to include a rating in their initial disclosure statement.
80. Applicants must obtain their credit rating from a rating agency approved by the Reserve Bank for the purposes of section 80 of the Reserve Bank of New Zealand Act 1989. These agencies are Standard & Poor's, Fitch Ratings and Moody's Investors Service. Applicants may only use another rating agency with the agreement of the Reserve Bank. In such cases, the Reserve Bank must first be satisfied that the rating agency meets the criteria set out in Appendix Three.

## **(VII) Standing of the owner of the applicant in financial markets**

81. The standing of the owner of the applicant in financial markets is likely to have a significant impact on the standing of the applicant itself.
82. 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.
83. 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.
84. In all cases, the Reserve Bank will take into consideration any impediments to the raising of further capital which arise as a result of the standing of the owner and the applicant's ownership structure.

## **(VIII) For an overseas applicant, the law and regulatory requirements of the home jurisdiction relating to:**

- **the recognition and priorities of claims of creditors or classes of creditors in the event of the insolvency of the applicant;**
  - **the disclosure of financial and other information;**
  - **applicable accounting and auditing standards;**
  - **duties and powers of directors;**
  - **licensing, registration authorisation and supervision.**
85. Where an applicant is 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. If necessary, the applicant will be required to incorporate locally or will be made subject to a condition of registration limiting its ability to take retail deposits, in order to provide some degree of insulation from the effects of foreign laws and regulations, or of licensing arrangements in the home jurisdiction. (See Paras 19 – 42 for more information.)

## **(IX) For an overseas applicant, the nature and extent of financial and other information disclosed to the public**

86. Applicants which do not disclose sufficient information to the public will either be required to incorporate locally or alternatively will be made subject to a condition of registration limiting their ability to take retail deposits in New Zealand. (See Paras 30 – 36 for more information.)

**(X) For a subsidiary of an overseas person, the law and regulatory requirements of the overseas person's home jurisdiction relating to:**

- the disclosure of financial and other information;
- applicable accounting and auditing standards;
- duties and powers of the directors; and
- licensing, registration, authorisation and supervision in the home jurisdiction.

87. In assessing an application for registration, the Reserve Bank will take into account any aspects of the law and regulatory requirements relating to bank licensing, supervision or disclosure of information in the home jurisdiction of an applicant's parent company which could impact adversely on a subsidiary's operations in New Zealand.

**(XI) For a subsidiary of an overseas person, the extent of financial and other information disclosed to the public**

88. Where relevant the Reserve Bank will take into account the nature and extent of disclosure made by the parent company of an applicant and any impact this would have on the ability of a New Zealand customer of the subsidiary bank to assess the financial position of that bank.

**(XII) Disclosure**

89. The Reserve Bank will require an applicant 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 year disclosure statement. The Reserve Bank specifies the balance date for the initial disclosure statement, which may be a date before the applicant is registered as a registered bank, and also specifies the accounting period to be covered by the initial disclosure statement.

**(XIII) Money laundering**

90. [Now addressed in paragraphs 71A and 71B above.]

**(XIV) General**

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

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

## D. SUPERVISION

93. 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.
94. 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, and in the case of an overseas incorporated registered bank, its New Zealand chief executive officer, 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.
95. 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 minimum prudential requirements applied through conditions of registration. These include constraints on connected exposure, minimum capital adequacy requirements, and minimum standards for liquidity risk management.
  - (iii) The Reserve Bank monitors each registered bank's financial condition and compliance with conditions of registration, principally by analysing published disclosure statements and prudential returns that are regularly provided to the Bank. 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 meets to discuss matters of prudential interest with the senior management of banks on a regular basis.
  - (v) The Reserve Bank carries out basic pre-appointment suitability checks on proposed directors or senior managers, including a review of the applicant's CV, criminal record checks and checks with other relevant regulators. However, primary responsibility for ensuring that appointees have the requisite skills and integrity to carry out their tasks successfully lies with the shareholders (for director appointments) and with the board (for senior management appointments).
  - (va) The Reserve Bank is able to issue guidelines for banks under section 78(3) of the Act. The Act provides for guidelines to be issued for the purposes interpreting the matters the Reserve Bank may consider when having regard to whether a bank is carrying on business in a prudent manner. These matters are set out in paragraph 47 of this document.

- (vb) The Reserve Bank “Guidelines on Anti-Money Laundering and Countering Financing of Terrorism” (BS5) were issued under section 78(3) of the Act. The Reserve Bank expects banks to have policies, systems and procedures, to detect and deter money laundering and terrorist financing that are consistent with these guidelines.
- (vc) The Reserve Bank “Guidelines on a Bank’s Internal Capital Adequacy Process (“ICAAP”)” (BS12) were issued under section 78(3) of the Act. These guidelines apply to any New Zealand-incorporated registered bank that is subject to a condition of registration requiring it to have an ICAAP, and provide guidance on how a bank should establish, operate and maintain its ICAAP.
- (vd) Section D.2 of the Reserve Bank document “Liquidity Policy” (BS13) contains guidelines issued under section 78(3) of the Act. These guidelines cover the factors that a registered bank should consider when deciding on its arrangements for liquidity-risk management, subject to their relevance given the nature of the bank’s business and risks.
- (ve) Part 3 of the Reserve Bank document “Corporate Governance” (BS14) contains guidelines issued under section 78(3) of the Act. These guidelines address the skills, experience and personal qualities of the individual directors of a registered bank in relation to the board’s ability collectively to exercise effective governance of the bank.
- (vi) The Bank may make use of the powers it has under sections 93, 94, and 95 of the Act:
  - Section 93 allows the Reserve Bank to obtain information, data and forecasts from registered banks.
  - Section 94 allows the Reserve Bank to require a registered bank to obtain an audit, by an auditor approved by the Reserve Bank, of any information required to be supplied under section 93.
  - Section 95 empowers the Reserve Bank to require a registered bank to supply it with a one or more reports prepared by a person approved by the Bank on:
    - (a) the corporate matters of the registered bank;
    - (b) the financial matters of the registered bank;
    - (c) the prudential matters of the registered bank;
    - (d) any other matters relating to the business, operation or management of the registered bank;
    - (e) any of the above matters in relation to any associated person of the registered bank, a body incorporated in New Zealand or an overseas company registered under section 337 of the Companies Act 1993 in which a holding company of the registered bank has a substantial interest.

The Reserve Bank may require a report obtained under section 95 to be published in a specified form.

- (vii) 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.
- (viii) 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**

- 96. Section 74 of the Reserve Bank of New Zealand Act 1989 permits the Reserve Bank to impose conditions on a bank's registration.
- 97. Standard conditions of registration are set out in Appendix One. These should be treated as indicative of the conditions that could apply to any particular bank. Although the Reserve Bank uses the standard conditions as far as practicable, in some circumstances different or additional conditions may be imposed to recognise, for example, specific banking group structures or risks.
- 98. A bank's actual conditions of registration must be made publicly available in the bank's disclosure statements: the full year disclosure statement must include the full set of conditions that applied at the balance date, and other disclosure statements must report any changes in the conditions between the reporting dates of the current and the previous disclosure statement. This requirement is intended to help enhance public understanding of the requirements of registration. Moreover, directors must also attest to the bank's compliance with its conditions of registration each quarter. For an overseas incorporated registered bank, this attestation must also be made by the New Zealand chief executive officer. The attestation requirements are designed to reinforce the responsibility of directors for ensuring a bank complies with its conditions of registration.
- 99. Under a bank's conditions of registration capital requirements may be determined under one of two possible approaches: the standardised approach or the internal models based approach. The internal models based approach, however only applies to the extent the Reserve Bank accredits a bank to use it. The details of these approaches are set out in the Reserve Bank's capital adequacy framework: in documents BS2A for the standardised approach and BS2B for the internal models based approach.
- 100. A registered bank must have an internal capital adequacy assessment process ("ICAAP") that accords with the Reserve Bank's "Guidelines on a Bank's Internal Capital Adequacy Assessment Process" (BS12).
- 101. The Reserve Bank may consider and have regard to the whole of this Statement of Principles when imposing a condition of registration (whether on registration or subsequently).

102. The banking group will normally be defined in the conditions of registration as the financial reporting group for the registered bank, although the Reserve Bank may agree to, or require, the inclusion or exclusion of any entity or part of any entity.
- 102A. In addition to the requirements imposed on a bank in relation to its banking group, requirements may also be imposed on the bank on a solo (i.e. stand alone) basis. For example, a solo capital requirement could be imposed to counter double gearing.

**(I) Locally incorporated banks**

103. Locally incorporated banks will normally be subject to the standard conditions of registration set out in Appendix One. These conditions are:
- That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities;
  - That the banking group's insurance business is not greater than 1% of its total consolidated assets;
  - That the capital of the banking group is not less than NZD \$30 million;
  - That the banking group has a total capital ratio of at least 8% and a tier 1 capital ratio of at least 4%, measured in accordance with the Reserve Bank's capital adequacy framework in BS2A or BS2B;
  - That the bank has an internal capital adequacy assessment process ("ICAAP") that accords with the "Guidelines on a Bank's Internal Capital Adequacy Assessment Process" (BS12), which identifies and measures the "other material risks" not captured in the calculation of the bank's total capital ratio and tier 1 capital ratio for the banking group.
  - That the aggregate credit exposures (of a non-capital nature and net of any allowances for impairment) of the banking group to all connected persons do not exceed the rating-contingent limit determined in accordance with the Reserve Bank of New Zealand document entitled "Connected Exposures Policy" (BS8).

The purpose of this condition of registration is 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.

- That exposures to connected persons must not be on more favourable terms (e.g. as relates to such matters as credit assessment, tenor, interest rates, amortisation schedules and requirement for collateral) than corresponding exposures to non-connected persons.
- That the bank's board has at least five directors, of whom a majority are non-executive, and at least half are independent (as defined in BS14). Any person who

may act as an alternate director in place of an independent director must also be independent, and any person who may act as an alternate director in place of a non-executive director must also be non-executive.

- That at least half of the bank's independent directors must be ordinarily resident in New Zealand.
- That the chairperson of the board of the bank is independent.
- That the bank's constitution does 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 (i.e. the bank).
- That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, shall be made unless:
  - (i) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
  - (ii) the Reserve Bank has advised that it has no objection to that appointment.

The Reserve Bank will make a decision on whether or not to object to a particular appointment if basic suitability checks (a review of the applicant's curriculum vitae, criminal record checks and checks with other relevant regulators) produce any evidence that the applicant is clearly unsuitable for the position. Primary responsibility for ensuring that appointees have the requisite skills, experience and integrity to carry out their jobs lies with the shareholders (for director appointments) and with the board (for senior management appointments) not the Reserve Bank. See BS10 for further details.

- That a person must not be appointed as chairperson of the board of the registered bank unless:
  - (i) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
  - (ii) the Reserve Bank has advised that it has no objection to that appointment.

If a person proposed to be appointed as chairperson will not meet the standard criteria for independence set out in BS14 because he or she is currently, or is proposed to be, a member of the board of a holding company of the bank, the Reserve Bank will decide whether the person can nevertheless be treated as independent on the basis of his or her experience and current situation.

- That the bank has an audit committee or other committee whose mandate includes audit matters. The committee must have at least three members, all of whom are non-executive directors of the bank, and the majority of whom are independent. The chair of the committee must be an independent director of the bank and must not be the chair of the bank.
- That a substantial proportion of the bank's business is conducted in and from New Zealand.

- That the banking group maintains one week and one month liquidity mismatch ratios of at least zero percent, and a one year core funding ratio of at least 70%, at the end of each business day. The calculations and definitions for these ratios are set out in “Liquidity Policy” (BS13) and “Liquidity Policy Annex: Liquid Assets” (BS13A).

The standard minimum for the one year core funding ratio is currently set at 70 per cent (from 1 July 2011), although the Reserve Bank intends to increase the minimum to 75 per cent from 1 July 2012, subject to a review of the impact of the proposed increase.

- That the bank has an internal framework for liquidity risk management that is adequate in the registered bank’s view for managing the bank’s liquidity risk at a prudent level, and satisfies in particular the four high-level principles set out in Section D.1 of BS13.

In determining its internal arrangements for managing liquidity risk, the bank should consider the guidelines on liquidity risk management given in Section D.2 of BS13, as appropriate to the nature of its business and risks.

- That the value of the banking group’s assets encumbered for the benefit of covered bond holders is no more than 10% of the total.
- That no member of the banking group may give effect to a qualifying acquisition or business combination that is above the “notification threshold” unless the registered bank has given the Reserve Bank notice in writing of the intended acquisition or business combination, accompanied by specified information, and—
  - in the case where the proposed transaction is below the “non-objection threshold”, at least 10 days have passed; or
  - in the case where the proposed transaction is above the “non-objection threshold”, the Reserve Bank has given the registered bank a notice of non-objection.

The definitions of “qualifying acquisition or business combination”, “notification threshold” and “non-objection threshold”, and the information requirements, are set out in “Significant Acquisitions Policy” (BS15).

**(IA) Locally incorporated banks whose New Zealand liabilities, net of amounts due to related parties, exceed \$10 billion**

104. In addition to the conditions of registration that normally apply to all locally incorporated banks, locally incorporated banks whose New Zealand liabilities, net of amounts due to related parties, exceed NZD \$10 billion will normally be subject to conditions of registration (see Appendix One for the standard conditions of registration):

- that the registered bank has legal and practical ability to control and execute any business, and any functions relating to any business, of the bank that are carried on

by a person other than the bank, sufficient to achieve, under normal business conditions and in the event of stress or failure of the bank or of a service provider to the bank, the following outcomes:

- (a) that the bank's clearing and settlement obligations due on a day can be met on that day;
  - (b) that the bank's financial risk positions on a day can be identified on that day;
  - (c) that the bank's financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and
  - (d) that the bank's existing customers can be given access to payments facilities on the day following any failure and on subsequent days.
- that the business and affairs of the bank are managed by, or under the direction or supervision of, the board of the bank;
  - that the employment contract of the chief executive officer of the bank or person in an equivalent position (together "CEO") is with the bank, and the terms and conditions of the CEO's employment agreement are determined by, and any decisions relating to the employment or termination of employment of the CEO are made by, the board of the bank; and
  - that all staff employed by the bank have their remuneration determined by (or under the delegated authority of) the board or the CEO of the bank and are accountable (directly or indirectly) to the CEO of the bank.

## **(II) Banks incorporated overseas**

105. Banks incorporated overseas will normally be subject to the standard conditions of registration set out in Appendix One. In this context "registered bank" refers to the overseas incorporated bank as a legal entity (that is, the whole bank). References to the business, or to particular aspects of the business, "of the registered bank in New Zealand" normally refer to activities of the New Zealand branch that are required to be reported in financial statements by New Zealand financial reporting standards: this is specified in standard definitions in the conditions of registration, which may be varied in particular circumstances. "Banking group", which is also defined in the conditions of registration, normally refers to the New Zealand business of the bank and its subsidiaries, as described in section 9(2) of the Financial Reporting Act 1993. The conditions are:

- That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities.
- That the banking group's insurance business is not greater than 1% of its total consolidated assets.
- That the business of the registered bank in New Zealand does not constitute a predominant proportion of the total business of the registered bank.

- That no appointment to the position of the New Zealand chief executive officer of the registered bank shall be made unless:
  - (i) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
  - (ii) the Reserve Bank has advised that it has no objection to that appointment.
- That the registered bank complies with the minimum capital adequacy requirements applied by the home country supervisor. Normally this will require that the bank complies with at least the Basel minima (ie a minimum tier one capital ratio of 4% of risk weighted exposures and a minimum capital ratio of 8%).
- That the registered bank complies with the requirements imposed by the home supervisor.
- That liabilities of the registered bank in New Zealand, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the registered bank), do not exceed NZ\$15 billion.
- That the registered bank has an internal framework for liquidity risk management that is adequate in the registered bank's view for managing the bank's liquidity risk at a prudent level, and satisfies in particular the four high-level principles set out in Section D.1 of BS13.

In determining its internal arrangements for managing liquidity risk, the bank should consider the guidelines on liquidity risk management given in Section D.2 of BS13, as appropriate to the nature of its business and risks.

A branch will also normally be subject to a condition of registration requiring it to meet specified minimum quantitative requirements for liquidity risk. However, the Reserve Bank will adapt the standard locally-incorporated bank requirements to branches on a case-by-case basis, taking into account a number of factors which are set out in Section B.1 of BS13.

The following condition will apply only to banks which are incorporated in jurisdictions which have legislation which gives deposits made, or credit conferred, in that jurisdiction a preferential claim in a winding up or which do not provide adequate disclosure in the home jurisdiction:

- That retail deposits of the registered bank in New Zealand do not exceed \$200 million. For the purposes of this condition retail deposits are defined as deposits by natural persons, excluding deposits with an outstanding balance which exceeds \$250,000.

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

106. 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, substitute or remove

conditions of registration when there is a change in supervision policy that must be effected by way of a change in conditions of registration or by removal of an existing condition. The Reserve Bank may also vary, add to, substitute or remove conditions of registration where the circumstances of a bank have changed or when the Reserve Bank otherwise considers it necessary in relation to its section 68 objectives (refer para 4). For example, a variation may be required in order to mitigate risk with respect to a registered bank's internal controls or risk management systems.

107. In accordance with the Act, banks will be given at least seven days' notice of a proposed change, which notice will include a statement of the Reserve 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 affected registered banks before it puts any such changes into effect.
108. The Reserve Bank may consider and have regard to the whole of this Statement of Principles when varying, adding to, substituting or removing conditions of registration.
- 108A. Transitional arrangements may be provided in a bank's conditions of registration where, for example, a change in policy has a substantial effect on the bank. An example of this is the move from the Basel I to the Basel II capital framework.

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

109. 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 O. However, where the breach relates to the minimum capital adequacy requirements, the following process will apply.

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

110. Where a bank breaches its minimum capital adequacy ratio requirements (that is, the 4% tier one capital ratio and the 8% total capital ratio that normally apply to a banking group), the following framework will apply:
1. Where the tier one capital ratio falls below the registered bank's required level (normally 4%) and/or the capital ratio falls below the registered bank's required level (normally 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 the Reserve Bank will expect the registered bank to publish the plan at the earliest practicable opportunity.
  2. The plan should 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.
111. These measures may be supplemented or reinforced by relevant conditions of registration. Where a bank does not provide a plan including the elements listed above, or does not abide by the plan it has provided to the Reserve Bank, and/or does not comply with any special conditions of registration, 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 O).

## **I. DISCLOSURE REQUIREMENTS**

112. 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 Reserve Bank considers that quarterly disclosure reinforces disciplines on the management and directors of the banks to maintain prudent banking practices.
113. 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 must make their disclosure statements readily accessible on their New Zealand website. If a bank receives a request for copies of any of its disclosure statements, it must offer to provide them in printed form or by other suitable means (depending on how the request is made), and if the offer is accepted it must despatch them within two working days.

- Banks are required to disclose information relating to the bank entity (mainly in the full year disclosure statement) and the banking group (every quarter). For banks incorporated overseas, “bank entity” refers to the bank’s branch in New Zealand, and “banking group” refers to the bank’s New Zealand banking group.
- Banks incorporated overseas are additionally required to make available on their New Zealand website the financial statements of the bank (as a whole) and of its overseas banking group (where these are publicly available in the bank's country of domicile).
- Banks are required to disclose in each quarterly disclosure statement a credit rating applicable to their long term senior unsecured New Zealand dollar debt payable in New Zealand.

## **J. CREDIT RATING REQUIREMENT**

114. 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.
115. 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.
116. 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 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:
- (1) *The Bank may, by notice in writing to any registered bank or to all registered banks or to all members of any class of registered banks, require each of those banks to:*
- (a) *obtain a rating of its creditworthiness or financial condition by a person or organisation nominated or approved by the Bank; and*
- (b) *maintain a current rating of the type referred to in paragraph (a).*
- (2) *The Bank may require a registered bank to publish the registered bank’s current rating, and all the qualifications to that rating, in the manner and with the frequency that the Bank directs.*
117. A copy of the Section 80 notice issued to registered banks is attached as Appendix Two.
118. 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 ordinarily 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.

119. New applicants for registration must obtain a credit rating before registration. Where the applicant is a new company this may be an indicative rating, provided the indicative rating is accompanied by an undertaking from the rating agency that it will assign the indicative rating to the applicant in the event that registration is successful. The rating must be published in the bank's initial disclosure statement.
120. Applicants must obtain their rating from a credit rating agency approved by the Reserve Bank for the purposes of section 80 of the Reserve Bank of New Zealand Act 1989. These agencies are Standard & Poor's, Fitch Ratings and Moody's Investors Service. Applicants may only use another rating agency with the agreement of the Reserve Bank. In such cases, the Reserve Bank must first be satisfied that the rating agency meets the criteria set out in Appendix Three.

## **K. RESPONSIBILITIES FOR NEW ZEALAND CHIEF EXECUTIVE OFFICERS OF OVERSEAS INCORPORATED BANKS**

121. As required by section 82 of the Act, all overseas incorporated banks must notify the Reserve Bank of the name and address of their New Zealand chief executive officer and update this information as necessary. The Act defines a New Zealand chief executive officer as the most senior officer of the bank who is ordinarily resident in New Zealand, or, subject to the written agreement of the Reserve Bank, another person nominated by the bank. If a registered bank fails to nominate a New Zealand chief executive officer, the Bank may, after giving 14 days' notice of its intention to do so, specify a particular employee to be the New Zealand chief executive officer. This requirement does not apply to New Zealand incorporated banks because the Chief Executive officer is normally a member of the board of directors and subject to the director responsibilities outlined in section L.
122. New Zealand chief executive officers of overseas incorporated banks or their agent authorised in writing, are required to sign every disclosure statement issued by the registered bank and to make certain statements (attestations). These attestations are also required of directors as set out in paragraphs 125-129.
123. A New Zealand chief executive officer may appoint an agent to make the attestations and sign the disclosure statements but responsibility for the veracity of the disclosure statements and the attestations remains with the New Zealand chief executive officer (and the directors).
124. Where the New Zealand chief executive officer believes the information contained within a disclosure statement is false or misleading, they should decline to sign the statement. In such a case the New Zealand chief executive officer 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, the New Zealand chief executive officer remains liable for the content of the disclosure statement, regardless of

whether or not they signed the statements. A New Zealand chief executive who signs, or has an agent sign, a disclosure statement which includes false or misleading information may be subject to civil or criminal liability.

## **L. DIRECTOR RESPONSIBILITIES**

125. Directors are required to sign bank disclosure statements which must include certain statements by the directors (attestations). 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.
126. Directors are required to attest whether, after due enquiry by them, over the accounting period, they believe:
- The registered bank has had 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 risk and other business risks and that those systems are being properly applied.
  - Exposures to connected persons (if any) have not been contrary to the interests of the banking group. (This applies only to locally incorporated banks.)
  - The bank has been complying with its conditions of registration.
127. Directors are required to attest whether, after due enquiry by them, as at the date on which the disclosure statement is signed, they believe:
- The disclosure statement is not false and misleading.
  - The disclosure statement contains all the required information.
128. 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.
129. 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 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 civil or criminal liability.
- 129A. It is the responsibility of 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. Board members should be and remain qualified for their positions.

## M. CHANGES OF OWNERSHIP

130. As specified in section 77A of the Act a person must obtain the written consent of the Reserve Bank before giving effect to a transaction that would result in that person having a “significant influence” over the registered bank or increasing the person’s level of significant influence beyond the level previously approved by the Reserve Bank. A significant influence is defined in the Act as:
- the ability to directly or indirectly appoint 25% or more of the board of directors (or other persons exercising powers of management, however described) of the registered bank; or
  - a direct or indirect qualifying interest in 10% or more of the voting securities issued or allotted by the registered bank.
131. A qualifying interest, in relation to a specified security, means:
- the legal or beneficial ownership of the specified security;
  - the power to exercise, or control the exercise of, any voting right attached to the specified security;
  - the power to acquire or dispose of the specified security;
  - the power to control the acquisition or disposition of the specified security by another person; or
  - the powers referred to above under, or by virtue of, any trust, agreement, arrangement or understanding relating to the specified security.
132. The Reserve Bank will generally assess applications for consent to acquire or increase significant influence over a registered bank having regard to the matters specified in section 73 of the Reserve Bank of New Zealand Act 1989 for the purposes of determining registration applications. Those matters are explained in section C of this document. The information that an applicant will need to provide is indicated in the Reserve Bank document entitled *‘Application for Consent to Acquire or Increase Significant Influence Over a Registered Bank: Material to be provided to the Reserve Bank’ (BS9)*.
133. The Reserve Bank may require additional information in order to determine a particular application and will advise the applicant accordingly.
134. In giving consent to acquire or increase significant influence over a registered bank, the Reserve Bank, under section 77A of the Act, may:
- specify the level of significant influence that a person may have or acquire over any registered bank without the need for a further consent; and
  - impose any terms and conditions that it thinks fit.

## **N. ESTABLISHMENT OF OVERSEAS BRANCHES, REPRESENTATIVE OFFICES OR SUBSIDIARIES**

135. 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.

## **O. CRISIS MANAGEMENT**

136. 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.
137. The crisis management powers the Bank has available are as follows:

### **(I) Section 77 of the Act - Power to recommend deregistration**

138. Where the Reserve Bank considers that any of the following applies:
- a registered bank was registered on the basis of false or misleading information;
  - there has been a change in any of the matters to which the Bank must have regard when it considers an application for registration which has had a materially adverse effect on the registered bank's standing or financial position;
  - there has been a transfer of direct or indirect control of the registered bank which is materially adverse to the registered bank's standing or financial position;
  - for a registered bank incorporated overseas, there has been a change in any of the matters relating to the law and regulatory requirements or disclosure practices in the home jurisdiction which is materially adverse;
  - for a registered bank which is a subsidiary of an overseas person, there has been a change in any of the matters relating to the law and regulatory requirements or disclosure practices in the overseas person's home jurisdiction which is materially adverse;
  - 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 or regulations made under the Act.

The Reserve Bank may recommend to the Minister of Finance 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 99 of the Act - Power to obtain information and documents**

139. Where the Reserve Bank believes that information provided to it, or which has been published in a disclosure statement, is false or misleading or where a registered bank has failed to provide or publish 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.

**(III) Section 101 of the Act - Power to investigate the affairs of a registered bank**

140. 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 give directions, it may appoint someone to investigate the affairs of a registered bank.

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

141. 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 a registered bank:

- its business has not been, or is not being, conducted in a prudent manner;
- it has failed to comply with a condition of registration;

or that any of the following persons has failed to comply with any requirement imposed by the Act or regulations made under the Act or has been convicted of an offence against the Act:

- the registered bank
- a director of a registered bank

- the New Zealand chief executive officer of an overseas incorporated registered bank

the Reserve Bank may, with the prior consent of the Minister, give written directions to the bank or an associated person of the registered bank.

### **Scope of directions**

A direction issued under section 113 may require a registered bank or associated person to:

- consult with the Bank about their circumstances and the methods of resolving any difficulties facing them;
- carry on any business or any part of its business in accordance with the direction;
- cease to carry on its business or any part of its business;
- ensure that any officer or employee ceases to take part in the management or conduct of its business, except to the extent permitted by the Bank;
- remove or replace its auditor or appoint an auditor;
- remove or replace a director of an associated person of a registered bank;
- take any action specified to address a breach of any condition of registration;
- take any action specified to address any financial difficulties;
- take any other action specified.

### **(V) Section 113B of the Act - Power to remove, replace or appoint directors**

142. Where any of the circumstances outlined in section 113 apply the Reserve Bank may, subject to the consent of the Minister, remove, replace or appoint a director of a registered bank or of an associated person.

### **(VI) Section 117 of the Act - Power to recommend statutory management**

143. Where the Reserve Bank is satisfied on reasonable grounds that any of the following applies:
- a registered bank or an associated person of the registered bank is insolvent, or likely to become insolvent;
  - a registered bank or an associated person of the registered bank has suspended payment or is about to do so or is unable to meet its obligations;

- 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 business of the registered bank has not been or is not being conducted in a prudent manner;

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

144. A statutory manager has wide powers, 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 to 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.

## **P. FOREIGN SUPERVISOR ACCESS TO INFORMATION HELD BY REGISTERED BANKS**

145. Under section 98A of the Act, a foreign supervisor wishing to carry out an on-site inspection of, or obtain information from, a registered bank or a member of a registered bank's banking group for the purposes of the foreign supervisor's supervisory functions may request authorisation to do so from the Reserve Bank of New Zealand. The Reserve Bank will grant authorisation only if it is satisfied that sufficient provision exists in the foreign supervisor's jurisdiction to protect the confidentiality of the information, data and forecasts obtained or required by the foreign supervisor.
146. If the Reserve Bank authorises a foreign supervisor to carry out an on-site inspection of, or to obtain information from, a registered bank or a member of a registered bank's banking group, then the registered bank is required under section 98B of the Act to supply the foreign supervisor with any information, data, or forecasts, including information relating to individual customers, that the foreign supervisor requires in order to carry out its supervisory functions.
147. If the Reserve Bank authorises a foreign supervisor to inspect and require information from a registered bank or a member of a registered bank's banking group, the Reserve Bank will notify the registered bank that such an authorisation has been made and the terms of that authorisation.

**Q. UNITED NATIONS' SANCTIONS**

148. In order to assess the standing of an applicant (or its owner), the Reserve Bank will additionally have regard to New Zealand's responsibilities pursuant to resolutions made by the United Nations Security Council under Chapter VII of the Charter of the United Nations that impose sanctions relating to the banking sector, in particular, for the purposes of:
- registration as a registered bank;
  - consent to a change of ownership; and
  - approval of the establishment of a subsidiary, branch or representative office in another country.

## APPENDIX ONE – STANDARD CONDITIONS OF REGISTRATION

This appendix sets out the standard conditions of registration that normally apply for a registered bank. However, the conditions of registration imposed on an individual bank may vary depending on the circumstances of the bank. The standard conditions for New Zealand incorporated banks will vary depending on whether a bank's capital requirements are calculated under the standardised approach (in BS2A) or the internal models based approach (in BS2B) of the Reserve Bank's capital adequacy framework.

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

#### *Capital requirements – conditions for the standardised approach*

1. That the banking group complies with the following requirements:
  - (a) the total capital ratio of the banking group is not less than 8 percent;
  - (b) the tier one capital ratio of the banking group is not less than 4 percent; and
  - (c) the capital of the banking group is not less than \$30 million.

For the purposes of this condition of registration, capital, the total capital ratio and the tier one capital ratio must be calculated in accordance with the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated [month year].

- 1A. That—
  - (a) the bank has an internal capital adequacy assessment process ("ICAAP") that accords with the requirements set out in the document "Guidelines on a Bank's Internal Capital Adequacy Assessment Process ("ICAAP")" (BS12) dated [month year];
  - (b) under its ICAAP, the bank identifies and measures its "other material risks" defined as all material risks of the banking group that are not explicitly captured in the calculation of tier one and total capital ratios under the requirements set out in the document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated [month year]; and
  - (c) the bank determines an internal capital allocation for each identified and measured "other material risk".

#### *Capital requirements – conditions for the models based approach*

1. That the banking group complies with the following requirements:
  - (a) the total capital ratio of the banking group calculated in accordance with the Reserve Bank of New Zealand document "Capital adequacy framework (internal models based approach)" (BS2B) dated [month year] is not less than 8%;

- (b) the tier one capital ratio of the banking group calculated in accordance with the Reserve Bank of New Zealand document “Capital adequacy framework (internal models based approach)” (BS2B) dated [month year] is not less than 4%; and
- (c) the capital of the banking group calculated in accordance with the Reserve Bank of New Zealand document “Capital adequacy framework (internal models based approach)” (BS2B) dated [month year] is not less than \$30 million.

For the purposes of this condition of registration the scalar referred to in the Reserve Bank of New Zealand document “Capital adequacy framework (internal models based approach)” (BS2B) dated [month year] is 1.06.

[If applicable—] For the purposes of this condition of registration, the supervisory adjustment referred to in the Reserve Bank of New Zealand document “Capital adequacy framework (internal models based approach)” (BS2B) dated [month year] is the sum of:

[any applicable supervisory adjustments]

1A. That—

- (a) the bank has an internal capital adequacy assessment process (“ICAAP”) that accords with the requirements set out in the document “Guidelines on a bank’s internal capital adequacy assessment process (‘ICAAP’)” (BS12) dated [month year];
- (b) under its ICAAP the bank identifies and measures its “other material risks” defined as all material risks of the banking group that are not explicitly captured in the calculation of tier one and total capital ratios under the requirements set out in the document “Capital adequacy framework (internal models based approach)” (BS2B) dated [month year]; and
- (c) the bank determines an internal capital allocation for each identified and measured “other material risk”.

1B. That the banking group complies with all requirements set out in the Reserve Bank of New Zealand document “Capital adequacy framework (internal models based approach)” (BS2B) dated [month year].

### ***General conditions of registration***

2. That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities.

In this condition of registration, the meaning of “material” is based on generally accepted accounting practice.

3. That the banking group’s insurance business is not greater than 1% of its total consolidated assets.

For the purposes of this condition of registration, the banking group’s insurance business is the sum of the following amounts for entities in the banking group:

- (a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the banking group whose business

predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and

- (b) if the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity’s insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business.

In determining the total amount of the banking group’s insurance business—

- (a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and
- (b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

For the purposes of this condition of registration,—

“insurance business” means the undertaking or assumption of liability as an insurer under a contract of insurance:

“insurer” and “contract of insurance” have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.

4. That the aggregate credit exposures (of a non-capital nature and net of any allowances for impairment) of the banking group to all connected persons do not exceed the rating-contingent limit outlined in the following matrix:

<b>Credit rating of the registered bank<sup>1</sup></b>	<b>Connected exposure limit (% of the Banking Group’s Tier 1 capital)</b>
AA/Aa2 and above	75
AA-/Aa3	70
A+/A1	60
A/A2	40
A-/A3	30
BBB+/Baa1 and below	15

Within the rating-contingent limit, credit exposures (of a non-capital nature and net of any allowances for impairment) to non-bank connected persons shall not exceed 15 percent of the banking group’s tier 1 capital.

For the purposes of this condition of registration, compliance with the rating-contingent connected exposure limit is determined in accordance with the Reserve Bank of New Zealand document entitled “Connected Exposures Policy” (BS8) dated [month year].

<sup>1</sup> This table uses the rating scales of Standard & Poor’s, Fitch Ratings and Moody’s Investors Service. (Fitch Ratings’ scale is identical to Standard & Poor’s.)

5. That exposures to connected persons are not on more favourable terms (e.g. as relates to such matters as credit assessment, tenor, interest rates, amortisation schedules and requirement for collateral) than corresponding exposures to non-connected persons.
6. 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 (i.e. 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].

7. 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.
8. 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.
9. 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].

- 10. That a substantial proportion of the bank's business is conducted in and from New Zealand.
- 11. That the banking group complies with the following quantitative requirements for liquidity-risk management:
  - (a) the one-week mismatch ratio of the banking group is not less than zero per cent at the end of each business day;
  - (b) the one-month mismatch ratio of the banking group is not less than zero per cent at the end of each business day; and
  - (c) the one-year core funding ratio of the banking group is not less than 70 per cent at the end of each business day.

For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled “Liquidity Policy” (BS13) dated [month year] and “Liquidity Policy Annex: Liquid Assets” (BS13A) dated [month year].

- 12. That the registered bank has an internal framework for liquidity risk management that is adequate in the registered bank's view for managing the bank's liquidity risk at a prudent level, and that, in particular:
  - (a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;
  - (b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;
  - (c) identifies the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and
  - (d) considers the material sources of stress that the bank might face, and prepares the bank to manage stress through a contingency funding plan.

13. That no more than 10% of total assets may be beneficially owned by a SPV.

For the purposes of this condition,—

“total assets” means all assets of the banking group plus any assets held by any SPV that are not included in the banking group’s assets:

“SPV” means a person—

- (a) to whom any member of the banking group, has sold, assigned, or otherwise transferred, any asset;
- (b) who has granted, or may grant, a security interest in its assets for the benefit of any holder of any covered bond; and
- (c) who carries on no other business except for that necessary or incidental to guarantee the obligations of any member of the banking group under a covered bond:

“covered bond” means a debt security issued by any member of the banking group, for which repayment to holders is guaranteed by a SPV, and investors retain an unsecured claim on the issuer.

14. That—

- (a) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the notification threshold, and does not meet the non-objection threshold, unless:
  - (i) the registered bank has notified the Reserve Bank in writing of the intended acquisition or business combination and at least 10 working days have passed; and
  - (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the registered bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document “Significant Acquisitions Policy” (BS15) dated [month year]; and
- (b) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the non-objection threshold unless:
  - (i) the registered bank has notified the Reserve Bank in writing of the intended acquisition or business combination;
  - (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the registered bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document “Significant Acquisitions Policy” (BS15) dated [month year]; and
  - (iii) the Reserve Bank has given the registered bank a notice of non-objection to the significant acquisition or business combination.

For the purposes of this condition of registration, “qualifying acquisition or business combination”, “notification threshold” and “non-objection threshold” have the same meaning as in the Reserve Bank of New Zealand Banking Supervision Handbook document “Significant Acquisitions Policy” (BS15) dated December 2011.

In these conditions of registration, —

“banking group” means [X Bank’s] financial reporting group (as defined in section 2(1) of the Financial Reporting Act 1993):

“generally accepted accounting practice” has the same meaning as in section 2 of the Financial Reporting Act 1993.

**(IA) LOCALLY INCORPORATED BANKS WHOSE NEW ZEALAND LIABILITIES, NET OF AMOUNTS DUE TO RELATED PARTIES, EXCEED \$10 BILLION (ADDITIONAL TO THOSE NORMALLY APPLYING TO ALL LOCALLY INCORPORATED BANKS)**

1. That the registered bank has legal and practical ability to control and execute any business, and any functions relating to any business, of the bank that are carried on by a person other than the bank, sufficient to achieve, under normal business conditions and in the event of stress or failure of the bank or of a service provider to the bank, the following outcomes:
  - (a) that the bank’s clearing and settlement obligations due on a day can be met on that day;
  - (b) that the bank’s financial risk positions on a day can be identified on that day;
  - (c) that the bank’s financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and
  - (d) that the bank’s existing customers can be given access to payments facilities on the day following any failure and on subsequent days.

For the purposes of this condition of registration, the term “legal and practical ability to control and execute” is explained in the Reserve Bank of New Zealand document entitled “Outsourcing Policy” (BS11) dated [month year].

2. That:
  - (a) the business and affairs of the bank are managed by, or under the direction or supervision of, the board of the bank;
  - (b) the employment contract of the chief executive officer of the bank or person in an equivalent position (together “CEO”) is with the bank, and the terms and conditions of the CEO’s employment agreement are determined by, and any decisions relating to the employment or termination of employment of the CEO are made by, the board of the bank; and

- (c) all staff employed by the bank have their remuneration determined by (or under the delegated authority of) the board or the CEO of the bank and are accountable (directly or indirectly) to the CEO of the bank.

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

1. That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities.

In this condition of registration, the meaning of “material” is based on generally accepted accounting practice.

2. That the banking group’s insurance business is not greater than 1% of its total consolidated assets.

For the purposes of this condition of registration, the banking group’s insurance business is the sum of the following amounts for entities in the banking group:

- (a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and
- (b) if the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity’s insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business.

In determining the total amount of the banking group’s insurance business—

- (a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and
- (b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

For the purposes of this condition of registration,—

“insurance business” means the undertaking or assumption of liability as an insurer under a contract of insurance:

“insurer” and “contract of insurance” have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.

3. That the business of the registered bank in New Zealand does not constitute a predominant proportion of the total business of the registered bank.

4. That no appointment to the position of the New Zealand chief executive officer of the registered bank shall be made 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.
5. That [name of bank] complies with the requirements imposed on it by [name of the supervisory authority in the bank's jurisdiction of domicile].
6. That [name of bank] complies with the following minimum capital adequacy requirements, as administered by [name of supervisory authority in the bank's jurisdiction of domicile]:
  - (a) tier one capital of [name of bank] is not less than 4 percent of risk weighted exposures;
  - (b) capital of [name of bank] is not less than 8 percent of risk weighted exposures.
7. That liabilities of the registered bank in New Zealand, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the registered bank), do not exceed NZD \$15 billion.
8. That retail deposits of the registered bank in New Zealand do not exceed \$200 million. For the purposes of this condition retail deposits are defined as deposits by natural persons, excluding deposits with an outstanding balance which exceeds \$250,000.  
 This condition applies only to banks which are incorporated in a jurisdiction which has legislation which gives deposits made, or credit conferred, in that jurisdiction a preferential claim in a winding up or which do not provide adequate disclosure in the home jurisdiction.
9. That the registered bank has an internal framework for liquidity risk management that is adequate in the registered bank's view for managing the bank's liquidity risk at a prudent level, and that, in particular:
  - (a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;
  - (b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;
  - (c) identifies the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and
  - (d) considers the material sources of stress that the bank might face, and prepares the bank to manage stress through a contingency funding plan.

There will also normally be a condition requiring the registered bank in New Zealand to comply with one or more minimum quantitative requirements for liquidity risk, but the specification of these requirements will vary from branch to branch.

In these conditions of registration,—

“banking group” means the New Zealand business of the registered bank and its subsidiaries as required to be reported in group financial statements for the group’s New Zealand business under section 9(2) of the Financial Reporting Act 1993:

“business of the registered bank in New Zealand” means the New Zealand business of the registered bank as required to be reported in financial statements under section 8(2) of the Financial Reporting Act 1993:

“generally accepted accounting practice” has the same meaning as in section 2 of the Financial Reporting Act 1993:

“liabilities of the registered bank in New Zealand” means the liabilities of the registered bank as required to be reported in financial statements under section 8(2) of the Financial Reporting Act 1993.

## **APPENDIX TWO – CREDIT RATING REQUIREMENT**

### **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 and maintain 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 Investors Service  
Fitch Ratings

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

Head of Prudential Supervision  
Reserve Bank of New Zealand

## APPENDIX THREE – APPROVAL OF CREDIT RATING AGENCIES

### 1. Approval criteria

- (1) This appendix sets out the Reserve Bank’s criteria for approving rating agencies for the purposes of Part 5 of the Reserve Bank of New Zealand Act 1989.
- (2) When making decisions in relation to the approval of a rating agency, the Reserve Bank considers how a rating agency or its activities compare to the criteria set out in this appendix on:
  - (a) independence;
  - (b) resources;
  - (c) objectivity;
  - (d) third party access to ratings;
  - (e) disclosure;
  - (f) consistency and comparability; and
  - (g) credibility.

### 2. Independence

- (1) A rating agency should be independent and should conduct itself in a manner that supports its independence. It should have processes designed to prevent it from being subject to political or economic pressures that could influence a credit rating or its credit assessment processes.
- (2) A rating agency should have clear operational policies and procedures to identify and manage potential conflicts of interest, including between the credit rating activities of the rating agency and other interests of its shareholders or directors.
- (3) A rating agency should—
  - (a) have high standards of corporate governance that are effective in safeguarding the independence and integrity of its credit risk assessment processes;
  - (b) have periodic, rigorous and formal reviews that are independent of the business lines under review and that review—
    - (i) its methodologies and models; and
    - (ii) any significant changes to its methodologies and models;
  - (c) have firewalls separating its credit rating activities from any affiliated businesses to help prevent conflicts of interest; and
  - (d) adopt and adhere to a code of conduct that reflects market standards and internationally recognised principles.

### 3. Resources

- (1) A rating agency should have sufficient financial and human resources to carry out high quality credit assessments.
- (2) A rating agency should—
  - (a) be able to develop and maintain systems on an ongoing basis to produce timely, consistent and credible credit assessments and ratings;
  - (b) allocate a sufficient number of appropriately qualified and competent people to the analysis, review and approval processes for the production of ratings; and
  - (c) have sufficient resources to allow for regular substantive interaction with the subjects of its credit assessments.
- (3) A rating agency's financial viability should not depend upon a small number of clients.
- (4) Rating decisions should be made by a rating committee composed of adequately qualified and experienced individuals in accordance with the rating agency's methodologies.

### 4. Objectivity

- (1) A rating agency's assessment methodologies should be—
  - (a) documented;
  - (b) rigorous and systematic;
  - (c) applied consistently;
  - (d) where possible, validated by substantial historical experience;
  - (e) based on both qualitative and quantitative approaches; and
  - (f) subject to ongoing review.
- (2) A rating agency's assessment methodologies should, where possible, be established for a sufficient period of time to provide for them to be rigorously back-tested and refined to a high level of confidence.
- (3) The ratings produced by its assessment methodologies should—
  - (a) provide credible and consistent measures of credit risk;
  - (b) be responsive to changes in financial condition;
  - (c) be continuous (that is, not be point in time ratings); and
  - (d) be subject to ongoing review, including—
    - (i) after all significant events; and
    - (ii) at least annually.
- (4) Paragraphs (3)(c) and (3)(d) do not apply to a rating that is not subject to ongoing monitoring or surveillance if the rating clearly indicates that it is not subject to any ongoing monitoring or surveillance.

## 5. **Third party access to ratings**

- (1) A rating agency's publicly disseminated credit rating opinions, analysis, reports and similar or related products should be accessible on equivalent terms to persons who have a legitimate interest in them, regardless of the jurisdiction in which they operate.
- (2) A rating agency should not use unsolicited ratings to pressure the subjects of those ratings to obtain solicited ratings.
- (3) A rating agency should not prevent the subjects of its credit rating assessments from disseminating that subject's public credit ratings.

## 6. **Disclosure**

A rating agency should publicly disclose and maintain in a readily accessible form the following information:

- (a) its ownership and corporate structure;
- (b) its code of conduct;
- (c) its process for assigning, monitoring and changing its credit ratings;
- (d) definitions for each of its rating categories and rating modifiers, including:
  - (i) the definition of default;
  - (ii) the time horizons, where applicable; and
  - (iii) the full rating scale;
 (these definitions should be in a form that enables comparisons with ratings in other sectors and, to the extent possible, those produced by other rating agencies);
- (e) the actual default rates experienced in each rating category over time;
- (f) the probabilities associated with transitions between rating categories, (for example, the likelihood of AA ratings becoming A over time);
- (g) its policy on the release of ratings, including changes in ratings or rating modifiers; and
- (h) its policy on unsolicited ratings.

## 7. **Consistency and comparability**

- (1) Ratings should represent credit risk in a consistent and comparable manner with regard to established practices for ratings.
- (2) The nomenclature associated with ratings should be established with regard to existing practices and with particular regard to default rates.

## 8. **Credibility**

In addition to the extent to which credibility is supported by the other criteria in this appendix, the Reserve Bank may have regard to other factors in assessing a rating agency's credibility including, for example, the extent to which its credit assessments and ratings are used in the market by participants such as issuers, investors, bankers, insurers, securities traders and other financial services regulators, or the extent to which a rating agency is recognised under other regulatory regimes.