

Proposed changes to disclosure requirements: feedback statement and points of clarification

The Reserve Bank issued proposed changes to its disclosure requirements in September 2007, to implement Pillar 3 of Basel II, to reflect the introduction of NZ IFRSs, and to make certain other changes. The new requirements were finalised on 25 February 2008, taking account of comments received in the consultation. This note summarises the main comments received and our responses to them. It also includes (at the end) clarification on a few issues raised since the requirements were finalised.

Unless stated otherwise, references are to the location of the matter in question in the finalised new version of Registered Bank Disclosure Statement (Full and Half-Year – New Zealand Incorporated Registered Banks) Order 2008 (“OIC 1”). References to the other disclosure orders in council are abbreviated as follows –

- OIC 2: Registered Bank Disclosure Statement (Off-Quarter – New Zealand Incorporated Registered Banks) Order 2008
- OIC 3: Registered Bank Disclosure Statement (Full and Half-Year – Overseas Incorporated Registered Banks) Order 2008
- OIC 4: Registered Bank Disclosure Statement (Off-Quarter – Overseas Incorporated Registered Banks) Order 2008

Issue	Matters raised	Response	Reference
Timing			
Timing of first disclosure under Pillar 3	A number of banks pointed to the amount of work needed to bring in the new Basel II Pillar 3 disclosures on top of the new disclosures required by NZ IFRS 7, and noted that it would be difficult for them to produce disclosure statements with all the required new information by the publication deadline.	The timetable for Basel II implementation for New Zealand-incorporated banks has for some time involved an effective date during the first quarter of 2008. We think that a bank that is subject to a capital requirement based on Basel II as at 31 March 2008 should be in a position to disclose the details of the capital adequacy calculation associated with that requirement. We have not changed the commencement date of the new Orders for New Zealand-incorporated banks. On the other hand we recognise the scale of the challenges that banks are referring to, and note there are some options to help ease the transition. For instance, Clause 13 (in OIC 1) allows for the case of a bank being unable to disclose some information because of systems	Clause 2

Issue	Matters raised	Response	Reference
		limitations. The Reserve Bank is comfortable with that clause being invoked for the first Basel II disclosures.	
Timing of revised disclosure by branches	It was noted that it would be helpful for branches to make their first disclosure under the revised Orders for a period which is subject as a matter of course to an external audit requirement, that is, a half or full year disclosure.	Unlike locally-incorporated banks, branches are not switching from Basel I to Basel II capital requirements. It is therefore less important for them to implement the revised Orders at the end of Q1 2008. We have accepted this point and included a transition provision in OIC 4, which gives branches for which end-March 2008 is an off quarter the option of deferring their first disclosure under the revised orders until that relating to 30 June 2008.	OIC 4, clause 23
Parent bank's Basel II capital position	It was noted that the various disclosure requirements relating to parent bank capital adequacy might be problematic for Australian banks for end-March and end-June, given that the first required Basel II disclosure for the Australian parent banks will be at end-September.	We have made one small change to address this issue. All disclosures relating to parent bank capital adequacy are now required "if available", "to the extent publicly available" and such like.	Schedule 5A clause 14, Schedule 5B clause 17

Issue	Matters raised	Response	Reference
Pillar 3 qualitative			
Areas of overlap with accounting standards	A number of comments made under this general heading noted the degree of overlap with disclosure requirements in accounting standards, particularly new requirements in NZ IFRS 7 and NZ IAS 1.	In addition to revising the detail of our requirements in some cases, as described below, we have added a standard rider to these disclosures, namely “to the extent not otherwise disclosed to comply with [relevant accounting standard]”.	Schedule 9
General risk management framework	Three new areas of disclosure were proposed. Concerns were raised about the degree of overlap with the requirements of NZ IFRS 7 (paragraph 33), and that for two of these three clauses the proposal amounted to hard-coding material that is in the implementation guidance rather than in the body of NZ IFRS 7.	The three sub-clauses cover important areas for disclosure, and match exactly what is in the Basel Committee’s Pillar 3 text and in APRA’s implementation of Pillar 3. We have therefore left them in.	Schedule 9, subclauses 2(1), 2(2)(b) and 2(2)(d)(iv)
Assessment of capital adequacy	It was noted that the proposed disclosure overlaps with that required by paragraphs 124A – 124C of NZ IAS 1.	We have removed some wording which we believe is adequately covered by NZ IAS 1, but kept two areas which do not appear to be: the references to “adequacy of capital to support current and future activities”, and to the role of directors and senior management. We believe both areas are important enough to need spelling out, and the first also follows phrasing in the Pillar 3 text.	Schedule 9, clause 3.
Approach to measurement of impaired assets	In addition to the general description of the approach (which follows the same wording as the Basel Pillar 3 text), our proposed disclosure added five sub-clauses spelling out information to be included. One commenter was concerned that this required too much detail, and that the disclosure was adequately covered by NZ IFRS 7 (paragraph 21). It was also suggested that sub-clause 8(e) on fair-valued assets was not correctly worded.	We believe that the information required by sub-clauses 8(a) to 8(d) is sufficiently important to require spelling out, and would not necessarily be provided in compliance with NZ IFRS 7.21. We agree with the point about sub-clause 8(e), and believe in any case that NZ IFRS 7.11 requires disclosure of the information we had in mind here: we have therefore cut this sub-clause.	Schedule 9, clause 6

Issue	Matters raised	Response	Reference
Approach to credit risk mitigation	Concerns were raised about the overlap with disclosure required by NZ IFRS 7, and also with other disclosure requirements in the OICs.	We have cut sub-clauses (c) and (d) from this clause (numbering as in the consultation version of OIC 1), as we agree they are adequately covered within the general risk management disclosure in Schedule 9, clause 2. We have also cut proposed sub-clause (g), as it is not in the Pillar 3 text, and of lower priority for disclosure. We have left sub-clause (b) as it provides useful information for minimal compliance cost, and the other sub-clauses as they are in the Pillar 3 text.	Schedule 9, clause 7
Information about credit and operational risk models	There were concerns about the volume of additional information entailed in these requirements.	On the one hand, this information is core to Pillar 3 disclosure for modelling banks. On the other hand, we stress that we are only expecting banks to disclose high-level descriptions here, and note that we have watered down the Pillar 3 text accordingly (“a broad overview”, “a general description”). We have also moved this disclosure out of the General Disclosure Statement (“GDS”) into the Supplemental Disclosure Statement (“SDS”). This adds flexibility to how banks disclose this information: a bank can publish it separately in the SDS, which does not have to be audited, or can still include it all in the GDS.	Schedule 10

Issue	Matters raised	Response	Reference
Pillar 3 quantitative			
Asset quality breakdown by type of credit exposure	For banks subject to the standardised approach to Basel II, “retail lending” is not a term defined in BS2A, contrary to the way that this requirement was drafted.	The required disclosure is now of all lending not falling into any of the other main loan categories. This is the closest available proxy for “Other retail lending”.	Schedule 4, sub-clause 11(2)(a)(iii)
Previous period comparisons of capital ratios	The disclosure of total and Tier 1 capital ratios under Basel II includes the requirement to disclose previous period comparative data. Some banks were unsure of what will be required for comparison Basel II ratios covering periods before the Basel II framework applied.	Clause 15 of OIC 1 requires previous period comparators to be restated to correspond to the current period information, but it also says that banks need not disclose comparative information that is not readily available. We do not expect banks to disclose their earlier internal estimates of overall Basel II capital ratios if they were calculated on a basis different from their final Basel II implementation. Nor we do we expect them to rework earlier numbers using their latest methodology, unless the outcome qualifies as “readily available”.	Schedule 5A, clauses 11, 12, and 13; Schedule 5B, clauses 14, 15 and 16
Comparison Basel I and Basel II ratios	There was comment on the continuing burden for internal models banks of disclosing Basel I capital ratios when they are subject to Basel II capital requirements. It was suggested that the OICs should specify an end-date for this requirement.	Disclosure of comparison Basel I ratios will remain in place while internal models banks are subject to a “floor” capital requirement based on Basel I. We do not intend that to be permanent, but we are not committing to a firm date for removing the floor at this stage. Any review of the capital floor will take into account how comfortable we are with the robustness of banks’ modelled capital requirements, and developments in the economic environment.	Schedule 5B, clause 15

Issue	Matters raised	Response	Reference
Solo capital ratios	We proposed that disclosure of capital adequacy on a solo bank basis should be reduced to only overall capital ratios. One respondent saw no purpose in even retaining this amount of solo capital disclosure, if a solo bank's risk weighted assets make up the vast majority of the group's.	We still believe that it is important for not just the banking group but also the registered bank as solo legal entity to have adequate capital. We are considering whether we should introduce solo capital adequacy requirements to apply generally to New Zealand incorporated banks. Pending a decision on that, we do not want to drop disclosure of solo capital adequacy altogether.	Schedule 5A clause 12, Schedule 5B clause 15
Meaning of "exposure-weighted"	Respondents expressed some uncertainty about the calculation of exposure-weighted figures in the disclosure of credit risk subject to the IRB approach.	We have added an explanation.	Schedule 5B, subclause (3)(a)
Specialised lending subject to the slotting approach and credit risk exposure subject to the standardised approach	One respondent suggested that the disclosure here should refer to "EAD" (a Basel II IRB concept) rather than "credit equivalent amounts" (a Basel I concept), and also that the disclosure should be consistent with Pillar 3.	For off-balance sheet exposures falling within the category of specialised lending, we have substituted EAD as suggested. However, credit conversion factors are still used in the standardised approach so we have kept that terminology there. We have also kept single average risk weight numbers rather than requiring a breakdown into individual risk weights as in Pillar 3: we are not expecting material amounts to be disclosed here.	Schedule 5A, clauses 5 and 6
IFRS-related			
<i>Credit risk adjustments on financial assets at fair value through P&L</i>			
(i) impaired asset disclosure in KIS and historical summary	It was noted that the key information summary ("KIS") includes amounts of individually impaired assets, and individual and collective credit impairment allowances. The former include fair valued financial	NZ IFRS 7.9 requires disclosure of changes in the value of fair valued loans and receivables that are in effect attributable to changes in credit risk. This may not be exactly equivalent to impairment allowances on loans held at	Schedule 2 clause 7 and Schedule 3 clause 15

Issue	Matters raised	Response	Reference
	<p>assets, but the latter exclude the amount of credit impairment on such assets. There is a similar issue with the historical summary, where the only relevant items are “total impaired asset expense” and “total individually impaired assets”.</p>	<p>amortised cost, as it may for instance include a reduction in fair value as a result of a credit rating downgrade. As the KIS and historical summary are both intended to provide brief summary items, we have decided not to make any change to them at this stage to try and reflect these distinctions.</p> <p>However, we intend to keep under review the approach to the disclosure of credit impairment on fair valued loans.</p>	
(ii) detailed breakdown of asset quality	<p>One commenter was under the impression that we intended to exclude fair-valued assets from the breakdown of asset quality, and made suggestions accordingly.</p>	<p>We do in fact intend the disclosure of total balances of restructured assets, other individually impaired assets, 90 past day due assets etc to be comprehensive, and hence to include any such assets which are designated as at fair value through P&L. We have added sub-clause 5(2) to Schedule 4 to clarify this.</p> <p>But some of the items in the asset quality disclosure, such as balances of impairment allowances, clearly cannot relate to fair valued assets.</p> <p>We note that the disclosure in NZ IFRS 7.9 relating to fair valued assets covers the broad equivalent of what would be impairment allowances for other assets, but does not extend to total balances of fair valued assets falling within various doubtful and impaired loan categories.</p>	Schedule 4, sub-clause 5(2)

Issue	Matters raised	Response	Reference
Breakdown of collective credit impairment allowance	We proposed to replace the breakdown of general provisions into each of seven classes of problem asset with the same for collective credit impairment allowances. It was noted that it would not normally be possible to break down allowances in this way.	Point accepted. Adequate disclosure is in Schedule 4, Clause 10, which requires an analysis of the collective credit impairment allowance in aggregate.	Removed from Schedule 4, clause 6
Off-quarter Statement of Changes in Equity	We proposed that in off-quarter short-form financial statements, banks should provide a condensed statement of changes in equity showing all changes in equity in accordance with paragraph 8(c)(i) of NZ IAS 34. One bank noted that it complies with the alternative paragraph 8(c)(ii) of NZ IAS 34, which allows disclosure of a reduced number of items, which must be described as “a statement of recognised income and expense”.	For accounting periods starting from 1.1.2009, revised NZ IAS 1 comes into effect with consequential impact on NZ IAS 34. This will in effect remove the reduced reporting option from the accounting standards. We do not think the additional items are sufficiently important that we need to require their disclosure before then. Proposal amended to allow either of the options available under NZ IAS 34.	In OIC 2 – Schedule 3, Clause 4
Defined term “individually impaired financial asset”	Concern was expressed that this term, separately defined in the Orders, could be confused with the term “other individually impaired asset” defined in NZ IFRS 7.	We intended the terms to be linked. “Other individually impaired asset” is a financial asset assessed as impaired in accordance with NZ IAS 39 paragraphs 58 to 62, that is not a restructured asset or a financial asset acquired through the enforcement of security. Our term is intended to capture <u>all</u> individually impaired financial assets, being the sum of restructured assets, financial assets acquired through the enforcement of security that have been determined to be individually impaired since the date of acquisition, and “other individually impaired assets”. We have removed the word “financial” from the defined term in the Orders to emphasise further the link.	Clause 4

Issue	Matters raised	Response	Reference
Defined term “90 day past due asset”	We proposed to define this term with reference to the definition in NZ IFRS 7, but with an additional clause “to avoid doubt”, spelling out a particular case in which an asset should be regarded as 90 days past due. One comment was concerned with our providing this point of interpretation, and also thought this meant that our definition did not have the exclusions in the NZ IFRS 7 definition.	The point of interpretation arises from an actual case that has occurred in the past, and as we would want to apply the same interpretation if such a case arose again, we prefer to spell it out. We have added the exclusions in the NZ IFRS 7 definition to the “avoid doubt” clause, to further avoid doubt on that front.	Clause 4 (“interpretation”)
Market risk	Respondents pointed to the new disclosure of market risk required by NZ IFRS 7. This requires banks to use a sensitivity analysis approach (which can include Value-at-Risk modelling) to disclosing exposure to different categories of market risk. There were concerns that it could be confusing for the specific market risk exposure measures defined in the Reserve Bank’s disclosure requirements to be disclosed alongside the new NZ IFRS 7 approach to market risk disclosure.	We accept these points. We have made changes to underline the fact that the measures of market risk exposure defined in the OICs relate to specific calculations of capital requirements. These changes include deleting the separate market risk schedules in each of the OICs, moving the material they contain into the capital adequacy schedules, and renaming each item as a “capital charge” rather than “exposure” to each type of market risk. For branches, the disclosure is now of the “notional capital charge”, alongside disclosure of risk-weighted assets.	<u>OIC 1:</u> Schedule 5A, clauses 7 to 9 and Schedule 5B, clauses 10 to 12. <u>OIC 3:</u> Schedule 5, clauses 3 to 5. Similarly in OICs 2 & 4.

Issue	Matters raised	Response	Reference
Overlaps between NZ IFRSs and OIC requirements			
Gross amounts of assets & liabilities set off	<p>(1) We proposed to require disclosure of gross amounts set off if residual risk remains. It was suggested that we should rely on the criteria in NZ IAS 32.42-50: if these are not met, then NZ IFRS 7 requires disclosure of gross amounts in any case; if they are met, only the netted-off amounts are relevant.</p> <p>(2) Our criteria for determining if residual risk remains refer to “differing issuers, interest bases or currencies”: it was suggested that “differing issuers” does not make sense, and it was noted that it was not in the equivalent test in FRS-27</p>	<p>(1) We believe that it is still important to know what the underlying gross amounts are in all cases to ensure that comparison between banks (balance sheet ratios etc) is not distorted by one bank having large amounts set off and another not. Requirement retained.</p> <p>(2) Point accepted: we have removed the “differing issuers” test.</p>	Schedule 4, Clause 1
Related party information	There were comments that the proposed disclosure of related party information is either partly or fully covered by NZ IAS 24: if partly, there was a suggestion that we should only highlight the information additional to NZ IAS 24 that we are seeking.	We accept that the draft version asks, in general terms, for the information already required by NZ IAS 24. However, we do not believe there is certainty that banks will disclose the specific items we ask for in order to comply with NZ IAS 24, since that is expressed as a form of purpose test. Response: we have retained the list of specific items, but these are now to be disclosed “to the extent not otherwise disclosed to comply with NZ IAS 24”.	Schedule 4, clause 2
Supplementary information relating to hedging and certain fair valued items	It was noted that there is a lot of overlap between the proposed disclosures here and those required by NZ IFRS 7.	Three of the four items have exact matches in NZ IFRS 7.20(a)(i) and NZ IFRS 7.24. We have dropped these items. We have retained the one item not explicitly required by the accounting standard disclosures.	Schedule 4, clause 3

Issue	Matters raised	Response	Reference
General			
Proposed disclosure of changes in conditions of registration	The proposal was to add to the current disclosure around conditions of registration a description of any changes since the previous signing date and the dates on which they happened, plus, if there have been any cases of non-compliance, a description of their nature and extent. Concerns were raised about the additional volume of disclosure entailed.	In signing disclosure statements, directors attest that the conditions of registration have been complied with at all times. We believe it is important that readers of the statements know what it is that directors are attesting to. No change in proposal.	Schedule 3, Clause 12
Notification of direct banking customers	Clarification was sought on the publication requirements for customers whose account is direct banking only, not associated with a physical branch.	The intention is for this requirement to be broadly equivalent to that for customers of physical branches, who have the opportunity to see the KIS whenever they visit the branch. Thus if the customer is sent regular bank statements, the requirement could be met by adding the notification to those statements. It does not entail the bank contacting every customer as soon as the new KIS is available.	Subclause 9(1)(f)
Legal proceedings	It was proposed to widen the scope of disclosure about legal proceedings or arbitration from those concerning <u>any member of the banking group</u> , to those concerning <u>the registered bank or any associated person of the registered bank</u> . There were comments that this would be hard to comply with and add little value.	Point accepted – reverted to current wording.	Schedule 3, Clause 13
“Other asset under administration”	The question was raised whether this definition includes counterparties subject to a no asset procedure.	This was the intention. We have changed the definition to refer to no asset procedure, and also (to avoid doubt) to voluntary administration.	Clause 4

Issue	Matters raised	Response	Reference
Historical summary of financial statements – profit or loss retained	In the list of items in the historical summary, “profit or loss retained” immediately follows “the amount paid or provided for dividends”. One respondent asked if this is meant to be net profit or loss <u>after</u> payment of / provision for dividend. If so, they are concerned that that could be misleading, as a net loss may arise only because of a dividend that has been paid out of previous periods’ retained earnings.	Point accepted – we have removed “profit or loss retained” from this summary as it does not add materially to the usefulness of the disclosure.	Schedule 3, clause 15
Asset quality – unrecognised amounts	Various classes of problem assets are required to be disclosed (restructured assets, 90 day past due assets, etc). The proposed disclosure included “the aggregate amount that has not been recognised”, in respect of each of these classes. Some responses sought clarification on what this would mean.	We accept that this was not clear. The intention is to capture undrawn amounts on loan commitments for which the drawn amount would fall into the respective category. The proposals have been adapted accordingly.	Schedule 4, sub-clause 6(4)
Credit exposure concentrations – definition	The proposed disclosure of credit exposure concentrations stated that it must relate only to exposures held in the financial records of the banking group. There were questions what the point of this condition was.	This condition is only relevant for branches of overseas banks. It restricts the measure of exposure to lending from the New Zealand banking group, excluding any lending by the banking entity elsewhere. We have removed it from OIC 1 and OIC 2.	OIC 3, Schedule 6, Clause 2 and OIC 4, Schedule 5 clause 2
Mortgage LVR information	Two banks were concerned that the proposed breakdown of residential mortgage lending by loan-to-valuation ratio would mean disclosing commercially sensitive information.	Other banks did not express concerns about this, and as the requirement applies to all banks, we do not believe that it will disadvantage any one of them in particular. Improved risk sensitivity is the key concept behind Basel II, and LVR is an important risk indicator for mortgage lending. We believe that these benefits outweigh concerns about potential commercial sensitivity. We have not changed the proposal.	Schedule 5A clause 4, Schedule 5B clause 4

Points of clarification

Issue	Clarification	Reference
Capital adequacy detail: previous period comparisons	In the detailed analysis of capital requirements, previous period comparisons for any component of the disclosure are only required where explicitly stated in the clause relating to that component. Broadly, this applies only to overall capital ratios and, for banks subject to Basel II, to market risk capital requirements.	OIC 1 Schedules 5, 5A and 5B, OIC 2 Schedules 4, 4A and 4B
Asset quality: undrawn amounts under lending commitments	Disclosure of undrawn balances on lending commitments to a counterparty for whom drawn balances fall into one of the specified problem asset categories depends on the facility, not the counterparty. Thus, if a bank has more than one facility to a counterparty, and drawn amounts on one facility are current but on another facility are (for instance) 90 days past due, undrawn balances on the first facility should not be disclosed, but undrawn balances on the second should be disclosed as undrawn amounts associated with 90 day past due assets.	Schedule 4, sub-clause 6(4)
Asset quality in the KIS	The asset quality summary in the key information summary includes “total individual credit impairment allowance expressed as percentage of total impaired assets”. There may be some uncertainty around the term “total impaired assets”, as it is not defined in the Orders in Council. Our intention was that this should be the same as the total of “individually impaired assets”.	Schedule 2, sub-clause 7(d)