

Consultation on Corporate Governance Policy for Registered Banks

Introduction

Among the Reserve Bank's prudential requirements for registered banks, and principles for determining applications for registration as a bank, there are a few that relate to registered banks' corporate governance arrangements. The Reserve Bank has been reviewing the adequacy of these.

We have concluded that although there is no justification for the Reserve Bank to introduce a full set of rules and guidance covering all aspects of corporate governance, the current requirements are too limited in some respects. Among other things, some of the requirements that an applicant for registration is expected to satisfy apply only at the point of registration, not on a continuing basis after a bank is registered. The Reserve Bank has on occasion been unable to prevent arrangements (or planned arrangements) that have posed potential threats to its financial stability objectives.

We are therefore proposing to issue a new stand-alone Banking Supervision Handbook document BS14, dealing with corporate governance. The proposed BS14 will also entail changes to handbook document BS1 (Statement of Principles: Bank Registration and Supervision), in order to remove the requirements in BS1 that will be covered in BS14, and to update the standard conditions of registration in BS1.

Draft new handbook document BS14 and a proposed revised version of BS1 are attached. New text in BS1 is shown in red and deletions are shown with strike-throughs.

These proposals do not affect New Zealand branches of overseas-incorporated banks. Branches are required to disclose certain information relating to corporate governance, but we are not proposing here to change those requirements or introduce any new corporate governance requirements on branches.

Objectives of the proposed policy changes

The broad objective of the proposals is to tighten a few key requirements to strengthen the underpinnings of financial stability.

The introduction to BS14 aims to explain how good corporate governance practices in banks can help the Reserve Bank achieve its financial stability objectives. Spelling this out and drawing together the requirements and guidance in a separate document are intended to raise the profile of good corporate governance as an important element of the Reserve Bank's supervisory approach.

BS14 is not intended to provide a comprehensive guide to sound corporate governance arrangements for banks. Instead, it refers to two of the most relevant

sources for such guidance, namely documents published by the New Zealand Securities Commission and by the Basel Committee on Banking Supervision.

Trans-Tasman considerations

The Australian Prudential Regulation Authority (APRA) has issued Prudential Standard APS510 on Governance. APS 510 sets requirements in a much wider range of areas than BS14, but in areas that are covered by both, the Reserve Bank is proposing similar requirements unless it sees a strong reason to do otherwise. The key differences reflect Reserve Bank of New Zealand concerns about systemic subsidiaries and the need for local directors to bring a fully independent perspective.

Guarantee from AAA-rated parent

Currently, BS1 provides that a locally-incorporated bank which is fully, unconditionally and irrevocably guaranteed by an overseas parent bank with an AAA credit rating is not subject to the general requirement on separation from other interests of the owner, nor to the standard conditions of registration concerning corporate governance. It is proposed to discontinue this special case exemption. The draft BS14 makes no reference to it, and the existing reference in BS1 would be removed.

Basel Committee principles

The Basel Committee issued a consultative version of “Principles for enhancing corporate governance” in March 2010. This is revised and expanded from the existing Basel document “Enhancing corporate governance for banking organisations” published in February 2006. Comments were due on the draft new version by 15 June 2010, although it is not yet known when it will be finalised. The intention in BS14 is to cross-refer to the Basel Committee’s principles, and also to draw on some of the Basel text in the section setting out formal guidance. We are working on the assumption that the new Basel document will be available by the time BS14 is finalised, and the attached draft reflects that. However, if there are changes to the Basel text that we are using, or delays in finalising the document, we will adapt our approach accordingly.

Disclosure requirements

The description in BS14 of the corporate governance disclosure requirements is based on the current disclosure Orders in Council. A major review of the Reserve Bank’s disclosure requirements is under way at the moment. It is possible that changes to the disclosure on corporate governance may be proposed as part of that review, and there will be the opportunity to comment on any such proposals then. However, respondents to this consultation are welcome to give us any views on the existing disclosure requirements on corporate governance matters. Such views would feed in to the disclosure review, rather than being reflected in the initial release of BS14.

Compliance and transition periods

Based on the composition of existing locally-incorporated bank boards, we expect that most banks will be able to comply with the requirements proposed in BS14 relatively

easily. However, one significant area of uncertainty is around whether current independent directors will satisfy the proposed tighter definition of independence. In providing feedback on these proposals, it will be particularly helpful if banks can let the Reserve Bank know which of its directors would meet the new test of independence.

Also, some banks may take the view that a variation from the standard conditions of registration, within the parameters set out in BS14, will be appropriate for them. The Reserve Bank will need to assess whether it can agree to any such proposed variations on a case-by-case basis. This will clearly have a bearing on what changes, if any, a bank would need to make to its board to comply with the policy.

Subject to feedback received, the Reserve Bank plans to finalise the new policy by end-September. The Reserve Bank will discuss transition periods with any banks that expect to be unable to comply with the new corporate governance conditions of registration initially.

Submissions

The Reserve Bank invites submissions on the draft BS14 and proposed revisions to BS1 by 27 August 2010. Submissions and any queries about the consultation should be addressed, in the first instance, to:

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