
Amendments to bank disclosure requirements

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Banks are required to issue quarterly disclosure statements covering a wide range of financial and prudential data. The rules under which registered banks are required to make these disclosures are set out in Orders in Council. These Orders in Council have recently been republished with a number of amendments, relating to the disclosure of information about insurance business, rating-contingent limits on exposures to connected persons, credit rating information in respect of large credit exposures, and additional New Zealand balance sheet information by banks that are branches of overseas banks. There are also some miscellaneous amendments to improve the effectiveness of existing disclosure requirements. This article describes the amendments and the reasons for them.

Background

Section 81 of the Reserve Bank of New Zealand Act 1989 provides that Orders in Council may be made prescribing information or data that must be published by registered banks. These Orders in Council may be made by the Governor-General, on the advice of the Minister of Finance, in accordance with a recommendation of the Reserve Bank. Such Orders in Council were first made in 1995.

The Orders in Council form the basis of disclosure-related banking supervision requirements that are a critical part of New Zealand's banking supervision system, requiring quarterly disclosures of a range of financial and prudential information by all registered banks. The disclosure statements published by banks are designed to be an important mechanism for encouraging good risk management and governance within banks, as well as assisting the financial market to exert appropriate market discipline on banks. The original disclosure requirements have been described in detail in a previous *Bulletin* article.¹

The Orders in Council were first amended in 1998 to increase the range of information that banks must disclose. These amendments have been described in a previous *Bulletin* article.² Further amendments to the content of the Orders in Council have just been made (the Orders in Council have been re-published in a consolidated form). The latest amendments apply to the disclosure statements of all registered banks from the quarter ending 31 March 2005. The Reserve Bank consulted with banks and other interested parties in developing these amendments, as it is required to do by the Reserve Bank Act.

This article describes these latest amendments and the reasons for them. Copies of the full Orders in Council are available from the Reserve Bank's website.³

International financial reporting standards

A version of international accounting standards and international financial reporting standards approved by the International Accounting Standards Board has been approved by the New Zealand Accounting Standards Review Board for use in New Zealand. These standards are intended to apply to all New Zealand reporting entities, including banks, and will replace New Zealand-developed accounting policies and financial reporting standards that currently apply in New Zealand. From 1 January 2005, New Zealand reporting entities could voluntarily adopt the international standards. The use of international standards to produce financial statements will become mandatory for New Zealand entities from 1 January 2007.

Some banks have indicated that they want to become early adopters of the international standards. The Orders in Council were based around banks' financial statements being produced using New Zealand standards. Unless the Orders in Council were amended to allow for the use of international standards, banks that wished to use the international standards to produce their financial statements would have had to produce two sets of financial statements – one using New Zealand standards for disclosure statement purposes, and one using international standards for other purposes.

¹ Reserve Bank *Bulletin*, March 1996

² Reserve Bank *Bulletin*, September 1998

³ www.rbnz.govt.nz/finstab/banking/regulation/0094291.html

The Orders in Council have been amended to allow banks to use the international standards prior to 1 January 2007 if they choose to, while still allowing the use of the New Zealand standards by banks that do not wish to become early adopters of the international standards. The amendments involve inserting a number of new definitions that refer to the international standards, and inserting clauses that allow their use for the production of financial statements that are contained in disclosure statements. The Orders in Council also require disclosures additional to the international standards in areas such as set-offs, related party transactions, information on the composition of the banking group, and hedge effectiveness. These additional disclosures were included to enhance comparability and understanding of banks' financial information.

Insurance business

During 2004 the Reserve Bank implemented a policy on conglomerate activity by registered banks. This policy, which is implemented through a standard condition of registration, limits the amount of insurance business a bank may have to no more than 1 per cent of the assets of its New Zealand banking group. Excessive mixing of insurance and banking activities on the same balance sheet would make interpretation of financial disclosures more difficult, and reduce the usefulness of capital adequacy measures. The Orders in Council have been amended to require all registered banks to disclose the amount and the nature of insurance business that is conducted within the New Zealand banking group, and, in the case of overseas incorporated banks, information about insurance activities and non-financial activities that are conducted by them in New Zealand outside the banking group. The financial statements of such business must be available.

Exposures to connected persons

During 2004, the Reserve Bank redefined its policy in respect of registered banks' credit exposures to connected persons.⁴

⁴ The term 'connected person' is defined in the Reserve Bank document entitled 'Connected Exposure Policy BS8', which is available from the Reserve Bank's website.

The Reserve Bank sets exposure limits to connected persons (as a percentage of tier 1 capital) that New Zealand incorporated registered banks may have, in order to prevent excessive de facto reduction of capital. Previously a standard limit applied to all New Zealand incorporated registered banks. The policy change was to replace this standard limit with rating-contingent limits. That is, the higher the credit rating of the bank, the higher the limit the bank is allowed. These rating-contingent limits are defined and implemented through a condition of registration that applies to New Zealand incorporated registered banks.

The Orders in Council applying to New Zealand incorporated registered banks have been amended to require the disclosure by each bank of: the rating-contingent limit that applies to the bank; changes to the limit; whether limits have been complied with over the latest quarter; and, if not, the nature of any breaches. Also, banks must disclose whether their credit exposure to connected persons has been calculated on a gross or bilateral net basis. If it is on a bilateral net basis, the bilateral netting agreement must be contained in the disclosure statement. If the bilateral netting agreement is not an industry standard agreement, then expert third party validation of the agreement must also be disclosed.

Concentrations of credit exposures

Amendments have been made to the manner in which the concentrations of credit exposures to individual counterparties is disclosed. Previously, all registered banks were required to disclose the number of exposures they had to individual counterparties that exceeded 10 per cent of the bank's equity (in bands of 10 per cent). Exposures to banks and other parties are disclosed separately. Banks are still required to disclose this information, but must now also break down the aggregate of such exposures into three categories: rated exposures that are of an investment grade credit rating (BBB- and above); rated exposures that are below investment grade; and other exposures. The reason for this amendment is to help indicate the relative financial strength of a bank's large creditors, as well as the number of such creditors.

Branch balance sheet information

Overseas incorporated registered banks are now required to disclose the amount of retail deposits they have (as defined in conditions of registration). This disclosure is related to the Reserve Bank's policy on local incorporation. A registered bank must be locally incorporated if it has retail deposits in New Zealand exceeding \$200 million, and it is domiciled in a country whose law gives priority in the event of a winding-up to depositors in that country ahead of New Zealand depositors, or there is inadequate disclosure in its home jurisdiction.

Overseas incorporated registered banks must also now disclose the amount of their New Zealand branch liabilities net of related party funding. Reserve Bank policy is that banks must be locally incorporated if their New Zealand liabilities net of related party funding exceed \$10 million.

Miscellaneous amendments

A new category of assets, called 'other assets under administration', is now required to be disclosed as part of the information about asset quality. This new category is designed to capture assets which are not 'impaired assets' or 'past due assets', and on which losses are not necessarily expected, but which are subject to some form of external administration (eg, a loan to a company that is in receivership).

Locally incorporated banks are now required to disclose the name of each person who has a direct or indirect ownership interest in the registered bank of 5 per cent or more, or who can appoint 25 per cent or more of the directors. This new disclosure follows amendments to the Reserve Bank Act in 2003 requiring any person who wants to obtain such a significant interest to first obtain the approval of the Reserve Bank. The amendments to the Act have been described in a previous *Bulletin* article.⁵

Some amendments have been made that provide for the disclosure of additional corporate governance information. Independent directors must be identified, and details of any board audit committee must be disclosed. If disclosure

statements are signed for directors or chief executives by an agent, the persons on whose behalf the agent is signing must be identified.

All banks are required to obtain a credit rating from a rating agency approved by the Reserve Bank. Most banks have ratings from more than one approved agency. The Orders in Council have been amended to clarify that all such credit ratings must now be disclosed.

If a bank is subject to overseas laws that might restrict its ability to support its New Zealand operations by giving priority to overseas creditors, details of those laws must be disclosed. This information helps New Zealand creditors make an informed decision about their dealings with the bank in New Zealand.

Previously, all disclosures were subject to a materiality criterion – ie, information need only be disclosed if it is considered material. This criterion has been removed from some disclosures relating to prudential information because some prudential information may be of interest even if not material in a numeric sense.

Future amendments

The amendments made to the Orders in Council that relate to the voluntary use of international accounting standards are temporary in nature. The Orders in Council will need to be amended again from 1 January 2007 when the use of international accounting standards will become mandatory for all registered banks. From that date the Orders in Council will only permit the use of international accounting standards for the production of financial statements included in disclosure statements. It is intended that the Orders in Council will be amended in 2006 to provide for this.

It is likely that the opportunity will also be taken at this time to make other amendments to the Orders in Council that may be appropriate. The Reserve Bank intends, within the next 12–18 months, to review the disclosure system to ensure that it remains effective and in keeping with international best practice. Harmonisation between New Zealand and Australian disclosure requirements will also be a factor taken into consideration.

⁵ Reserve Bank *Bulletin*, March 2004