THE ROLE OF THE RESERVE BANK OF NEW ZEALAND IN SUPERVISING THE FINANCIAL SYSTEM

March 2001

CONTENTS

1. INTRODUCTION

(a) Structure of the banking system

The Reserve Bank of New Zealand Act 1989 confers powers on the Reserve Bank Of New Zealand ("RBNZ") to register banks and to undertake prudential supervision of registered banks.

Bank registration does not involve the licensing of the business of banking or deposit taking. It is only if an institution wishes to call itself a bank that there is a requirement for it to be registered by the RBNZ. Hence, non-licensed institutions are able to take deposits and conduct other aspects of banking business in New Zealand.

The RBNZ Act also makes provision for the RBNZ to approve the use of the name "bank" by representative offices of banks incorporated overseas. As at the beginning of March 2001 there was one representative office operating in New Zealand.

Banks in New Zealand can broadly be classified into three categories: multi-purpose, retail and wholesale banks. There are four multi-purpose banks which provide a full range of financial services (corporate and business lending, treasury services, trade finance, funds management and retail banking services). In aggregate, these banks dominate financial intermediation in New Zealand. The wholesale banks focus primarily on particular niches where they see themselves having a comparative advantage. This typically involves focusing on one or more of the following activities: top-tier corporate financing, funds management, proprietary trading in financial markets and asset-backed financing. Three of the four banks that specialise in the provision of retail services have a substantial proportion of their assets in loans secured by way of residential mortgages. The only New Zealand owned registered bank, TSB Bank Limited, falls into this latter category, and is a relatively small mainly regional bank.

The RBNZ seeks to have uniform conditions of registration for all banks, to the extent that this is practicable. This is intended to ensure that banks are operating on a level playing field. However, on occasions there may be a need for some bank-specific conditions to be applied - for example, to recognise the different nature of banking group structures. Where a need for different conditions of registration does arise, the RBNZ attempts to ensure that this is transparent to the marketplace, and that the economic substance of the conditions is consistent with the level playing field concept.

There were 18 registered banks operating in New Zealand at the beginning of March 2001 (see Annex 1). One of these is New Zealand owned and the remainder are 100% foreign owned. Of the foreign owned banks, seven are locally incorporated with the other 10 operating as branches of overseas incorporated banks.

(b) Structure of the non-bank financial system

Registered banks are by far the most important financial intermediaries in New Zealand, with about 75% of the total assets of the financial system as at 31 December 2000, followed by

managed funds (10%), finance companies (5%[1]) and life insurance offices (4%) in decreasing order of total assets. Registered banks have an even greater share (94%) of the business of M3, or deposit taking. There are also some specialist mortgage providers, merchant banks, and a number of building societies (16) and credit unions (89). However the significance of these institutions is relatively minor.

(i) Funds Management

Managed fund investments offered to the general public, that is, retail superannuation schemes and unit trusts, are mainly marketed by registered banks and life insurance companies, although a significant number are also marketed by independent investment managers. Employer-sponsored superannuation schemes, as well as collective investment schemes that focus on wholesale investors rather than the general public, represent the balance of activity in this sector.

(ii) Life Insurance

There are 34 life insurance offices currently operating in New Zealand, the majority of which are overseas owned or controlled. Although some important life offices operate in New Zealand as branches of mutuals or overseas incorporated companies, most of the overseas controlled offices conduct their business as locally incorporated companies.

(iii) Finance Companies

The majority of finance companies (there are 29 in all, including stock and station agents) are New Zealand owned, although the most important institutions, in terms of total assets, are overseas controlled.

(iv) Securities Business

There is no legislation in New Zealand providing for the separate establishment of securities firms. In principle, this business may be undertaken by any financial institution. In practice, the provision of risk management services, and most securities trading and underwriting business, is undertaken by the registered banks and their subsidiaries. Merchant banks, sharebrokers and futures and options dealers may also involve themselves in aspects of this business.

(c) Objectives of banking supervision

The RBNZ carries out its bank registration and supervision functions with the objectives of:

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[1] Two large finance companies are owned by registered banks and are included in the registered bank total.

(i) promoting the maintenance of a sound and efficient financial system;
(ii) avoiding significant damage to the financial system which could result from the failure of a registered bank.

These objectives are specifically outlined in the Reserve Bank of New Zealand Act 1989.

In pursuit of these objectives the approach taken is to:

(i) Encourage individual banks, as major players in the system, to carry out their business in a prudent manner; and to ensure that bank directors, managers and shareholders remain responsible for maintaining the soundness of their institutions.

(ii) Avoid imposing excessive administrative burdens or unnecessarily constraining banks from pursuing commercial objectives.

(iii) Minimise the perception that the Government underwrites the prudential soundness of individual banks. Should a bank fail, the RBNZ has statutory powers to limit the risk of that failure creating more widespread disruption to the financial system. The RBNZ's responsibility is not to provide a "safety net" for insolvent institutions, nor to shelter depositors from losses.

(d) International banking establishments

The RBNZ's role as a home supervisor of international banking establishments is very limited in nature. Currently there are no New Zealand incorporated banks with significant overseas operations.

(e) Recent developments in the financial system and supervisory regime

The number of registered banks fell from a peak of 23 in 1990 to a low of 15 in 1994, as unprofitable wholesale banks withdrew from the market and rationalisation of the retail banking sector occurred through mergers and acquisitions. In the period from late 1996 to mid 1997 the number of banks gradually increased again to 19 as a number of overseas banks established wholesale operations in New Zealand. More recently the number of banks has fallen slightly largely as a result of rationalisation in both the wholesale and retail/multi purpose sectors partially offset by several overseas banks establishing new operations in New Zealand. As at the beginning of March 2001 there were 18 registered banks.

In the retail/multi-purpose sector, Westpac Banking Corporation purchased Trust Bank New Zealand Limited in 1996 and The National Bank of New Zealand Ltd purchased Countrywide Banking Corporation Ltd in 1998. One overseas incorporated retail bank established a New Zealand branch in October 1998, AMP Bank Limited. In the wholesale sector Bankers Trust New Zealand Limited was taken over by Deutsche Bank AG in 1999, and BNP and Commonwealth Banking Corporation established New Zealand branches in 1997 and 2000, respectively.

The RBNZ recently completed a review of policy on bank organisational form. Under existing policy the RBNZ is largely indifferent as to whether overseas banks operate in New Zealand via a branch or a locally incorporated subsidiary. Under the proposed new policy banks falling into the following categories will be required to incorporate locally:

> **Systemically-important banks** – Systemically-important banks, that is banks whose failure could have a material impact on the financial sector as a whole and/or the wider economy, will be required to incorporate locally. For the purposes of this requirement a systemically important bank will be defined as one whose liabilities net of amounts due to related parties exceed $10 billion (an amount equivalent to approximately 7.5% of the banking system aggregate).
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> **Retail deposit takers from jurisdictions with statutory preferences** – Banks that have more than $200 million in retail deposits will be required to incorporate locally if legislation in the bank's home jurisdiction gives depositors or creditors from that country a preferential claim in a liquidation.
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> **Retail deposit takers with inadequate disclosure in the home jurisdiction** – Banks that have more than $200 million in retail deposits will be required to incorporate locally if the bank's disclosure in the home jurisdiction is inadequate.

The new policy has two main aims:

- To make it easier for the RBNZ to manage the failure of a systemically-important bank; and

- To ensure that retail depositors have access to the information they need to assess the risk of dealing with a particular bank.

Regulations to allow the RBNZ to introduce the new policy take effect on 1 April 2001.

The Bank is also proposing to introduce a mandatory credit rating requirement for registered banks. Currently, banks are required only to disclose whether or not they have a credit rating, and details of the rating if they do have one. Applicants for bank registration are now required to obtain a rating prior to registration.

2. LEGISLATION

(a) Banking legislation

The principal legislation that impacts on banks is the Reserve Bank of New Zealand Act 1989. This provides the policy parameters for the registration and supervision of banks, as well as the various powers that the RBNZ can use in the event that bank distress or failure threatens the soundness of the financial system. This legislation, which is described in more detail in subsequent sections, was updated in November 1995 and February 1996 to facilitate the introduction of a public-disclosure-based banking supervision regime.

This legislation does not explicitly provide for the Basel Committee's minimum capital standards to be met. However, the RBNZ would normally only register banks whose home supervisor applied the Basel minimum capital standards. Moreover, as a condition of registration, banks incorporated in New Zealand must maintain at all times a minimum capital ratio and tier one capital ratio for the banking group of 8% and 4% respectively, measured using the Basel Capital Accord. Banks incorporated in overseas jurisdictions and operating through a branch in New Zealand are required as a condition of registration to comply, on a global basis, with the minimum capital adequacy requirements developed by the Basel Committee as administered by the home supervisor (i.e. that the global bank maintains a minimum tier one capital ratio of 4% and a minimum capital ratio of 8%).

(b) Legislation covering non-bank financial institutions

New Zealand's financial system is structured to promote open and neutral competition among the different participants in the system. This means that there are generally no restrictions on the activities that financial institutions may undertake. Likewise, there are very few regulatory or other distortions that might favour the development of one financial institution or financial product or service over another. Nevertheless, many New Zealand financial institutions do undertake specialist roles, reflecting their perceived competitive advantages, or the targeting of particular market niches. This subsection first describes the general legislation that applies to non-bank financial institutions (and indeed to banks as well), and concludes with a brief description of some specific legislation.

General legislation

(i) Companies Act 1993

Company law in New Zealand sets down some basic requirements for good corporate governance, such as directors' duties:

- to exercise care, diligence and skill in the performance of tasks;
- to act in good faith and in the best interests of the company, and to avoid reckless trading.

Undischarged bankrupts, as well as persons convicted of crimes of dishonesty or offences in connection with the promotion, formation and management of a company, are prohibited from becoming directors of a company.

Before entering into new obligations, company directors are also required to satisfy themselves that the company will not become insolvent as a result of assuming those obligations.

(ii) The Securities Act 1978

The Securities Act 1978 sets out the basis on which the activity of soliciting funds from the general public must be conducted. Rather than imposing a merit based regulatory framework, the Act aims to promote public confidence in the integrity of the securities markets, and to provide for an informed and efficient securities market, through standardised disclosure mechanisms and generic activity-based securities regulation.

With respect to disclosure, information on the financial condition and organisational details of issuers must be disclosed in registered prospectuses. In addition, documents called "investment product statements" must be made available to the investing public. These statements contain key summary information, presented in a standardised format, on the nature of investment products, and the risks and returns associated with them, so as to enable "prudent, but non-expert" investors to make product comparisons across different issuers.

Under the Act, the term “securities” is broadly defined, and includes retail managed funds, life insurance policies, and debt securities such as ordinary cheque accounts and savings deposits. Thus the disclosure requirements of the Act apply to all financial institutions which issue securities to the public, including unit trusts, superannuation schemes, banks, finance companies, building societies, credit unions, friendly societies and life insurance companies, except where an explicit exemption applies.

Statutory exemptions apply in respect of debt securities offered by registered banks and the Reserve Bank. In the case of registered banks, the disclosure statements they issue in accordance with the RBNZ's disclosure regime substitute for the registered prospectus requirements applying to other public issuers of debt securities. In addition, offers of interests in call debt securities, call building society shares and bonus bonds are exempted under section 5(2D) of the Act.

The Commission also has the power to exempt any person or class of person from the requirements of the Securities Act and Regulations, subject to such terms and conditions as it thinks fit. Exemptions are granted to remove rigidities in the law and to facilitate the offer of new investment products in a timely and cost effective manner. In determining its policy in respect of exemptions, the Commission considers the need to avoid conferring a competitive advantage on particular investment providers.

In addition to specifying disclosure requirements, the Securities Act contains some basic mechanisms designed to strengthen the integrity of the securities markets. The most important of these apply to non-bank issuers of debt securities, such as building societies and finance companies, which must come under the supervision of an independent trustee, and register, for public inspection purposes, a trust deed which sets out the basis on which that supervision is to be conducted. These deeds contain financial covenants which must be met throughout the term of the investments being offered.

The Securities Act also provides basic protections for public investors in the event of false or misleading representations being made by issuers in prospectuses, investment statements, or advertisements and imposes minimum disclosure requirements on investment advisers. Investment advisers must disclose information on their qualifications and experience, the types of securities on which advice is given, conflicts of interest which the advisers might have in giving investment advice, and their money handling procedures.

The Securities Act also provides that any futures exchange or futures dealer must obtain the authorisation of the Securities Commission to act in that capacity. As a general condition of authorisation, the exchange must undertake to obtain the Commission's approval to the rules for the conduct of business on that exchange and any changes to those rules.

The Securities Act is administered by the New Zealand Securities Commission.

(iii) Other Legislation

Other legislation provides protections for consumers in relation to other aspects of financial institutions' activities. The most important statutes are:

- The Fair Trading Act 1986 generally provides that no person may engage in business conduct that is misleading or deceptive, or that is likely to mislead or deceive.

- The Credit Contracts Act 1981 requires disclosure, on a uniform basis, of the full cost of credit and all other terms and conditions associated with credit contracts offered to members of the public, both before the contract is entered into, and over the life of the contract. A "cooling-off" period is provided during which a borrower may repay a loan without penalty.

- The Consumer Guarantees Act 1993 indicates that certain implied guarantees are embodied in the provision of investment advice and investment products. In particular, investment advice must be provided with reasonable care and skill, and investment products must deliver the outcomes expected where an investor makes known a desired purpose or result.

- The Financial Reporting Act 1993 requires issuers of securities to the public to file financial statements that comply with generally accepted

accounting practice and give a true and fair view of their affairs. It also gives legal force to accounting standards.

- The Investment Advisers (Disclosure) Act 1996 prescribes minimum disclosure requirements for people who give investment advice to the public or who receive money or property for investment from the public as intermediaries.

Specific Legislation

(i) Life Insurance Offices Legislation

Life Insurance Offices are regulated by the Life Insurance Act 1908. Some important features of this Act are:

- financial disclosure requirements for life offices are specified, and annual audited returns are required to be forwarded to the Ministry of Economic Development;

- moneys obtained from policy holders must be held separately in a Life Insurance Fund and may not be used for any other business of the life office;

- actuarial reports must be undertaken on an annual basis, unless the Minister of Commerce permits actuarial assessments to be made less frequently;

- the Minister of Commerce may request a court to appoint a judicial manager if it is considered the life office will be unable to meet its ongoing obligations to policyholders.

(ii) Unit Trusts Legislation

Unit trusts are governed by the Unit Trusts Act 1960, which requires:

- schemes to be established as trusts under a trust deed.

- the appointment of a manager and a trustee, who are both charged with the same fiduciary duty to act in the best interests of the unit holders. The manager and the trustee must not be controlled by the same persons (i.e. they must be independent).

- only trustee corporations, or other companies approved by the Minister of Commerce, may be appointed as trustees of the funds.

The Minister of Commerce, or the High Court, on application by unit holders holding one tenth in number or value of units issued, may appoint inspectors to investigate and report on the affairs of any unit trust and its manager.

(iii) Superannuation Schemes Legislation

The Superannuation Schemes Act 1989 governs all superannuation schemes that have been registered with the Government Actuary. The Act defines a superannuation scheme to be any trust established for the purposes of providing retirement benefits for its beneficiaries. Each scheme may have one or more trustees, and one or more managers, who are appointed by the trustee(s). The trustees, in turn, may be individuals, corporations, or trustee corporations.

The Government Actuary is the authority with jurisdiction over registered superannuation schemes. The Actuary registers schemes, investigates complaints, and monitors schemes to ascertain whether they are operating in accordance with the Act, and whether the financial position, security of benefits, or the management of schemes is adequate.

3. Structure of the supervisory system

(a) Organisational structure of the supervisory authority

The RBNZ is the sole bank supervisor in New Zealand. The organisational chart at Annex 2 outlines the range of functions performed by the RBNZ, the departmental structure and senior management positions. While the Governor, as empowered by the RBNZ Act, is responsible for the banking supervision function, direct day to day responsibility rests with the Chief Manager Banking System Department.

(b) Number and distribution of staff

Banking System Department does not have a formal hierarchical organisation structure. It is a relatively small team of 12 people, comprising 10 with policy development, implementation and analytical responsibilities, and two with support and administration responsibilities. Job descriptions and skills are broad in nature to provide flexibility in meeting the required outputs. Within the department there are pockets of expertise in law, accounting, economics and finance, which are drawn on to oversee particular projects or to lead project teams. All analytical staff are involved in supervising banks, with any one person having responsibility for up to three banks.

Over a typical year, the department's staff resource would be engaged in banking supervision policy development (about 35 % of the resource), bank supervision (35 %), advice on efficiency and soundness of the financial system such as payments system reform (20 %), and reviewing and administering bank legislation (10 %).

(c) Supervision of non-bank financial business

The New Zealand Securities Commission has responsibility for the administration of the Securities Act 1978, the law that governs primary offers of securities to the New Zealand market. Under that law, the Securities Commission has an oversight role in respect of the securities markets, which are broadly defined to include the activities of issuing ordinary deposits and investments in managed funds. That role principally takes the form of the administration of disclosure and advertising requirements for public issuers, the authorisation of futures exchanges and futures dealers and approving the rules which govern the conduct of business on securities exchanges, such as the New Zealand Stock Exchange and the New Zealand Futures & Options Exchange. The Act also enshrines certain statutory rules relating to the regulation of insider trading and the disclosure of substantial security holder interests. However, the principal market, the New Zealand Stock Exchange, is established and regulated under the Sharebrokers Amendment Act of 1981.

The Securities Act also requires non-bank deposit-issuing financial institutions to be supervised by independent trustee corporations, and to register, for public inspection purposes, a trust deed which sets out the basis on which that supervision is to be conducted. These deeds contain financial covenants which must be met throughout the term of the investments being offered.

The Securities Act also prescribes a role for the Registrar of Companies in registering prospectuses, deeds of participation and trust deeds. He may refuse to register a prospectus, a deed of participation or a trust deed if it contains any misdescription or error and may refuse to register a prospectus if it contains false or misleading information.

Other legislation requires unit trusts to be monitored by independent trustee corporations, and superannuation schemes by both trustees and the Government Actuary. The Actuary monitors superannuation schemes to ascertain whether the financial position, security of benefits, or the management of schemes is adequate. There are no legislative requirements applying similar monitoring arrangements to collective investment schemes offered to wholesale investors, although most are voluntarily established under a trust structure.

The Insurance and Savings Ombudsman considers complaints against insurance companies and savings organisations who are participants in the Insurance and Savings Ombudsman Scheme. Decisions made by the Insurance and Savings Ombudsman are binding on insurance companies or savings organisations that participate in the scheme.

The RBNZ does not have supervisory responsibility for managed funds, insurance, or securities activities as such. Banking supervision in New Zealand is conducted primarily in respect of the banking group, that is, the consolidated operations of the registered bank, which generally includes the business of subsidiaries involved in banking activities and the provision of related financial services. Where securities trading or underwriting business is undertaken by banks or their subsidiaries, or where banks own finance company subsidiaries, the RBNZ's prudential and disclosure requirements (including the market risk disclosure requirements) are applied to the consolidated group, which will include those activities.

Banking groups can encompass subsidiaries that provide insurance, funds management, or nominee securities services. To date, such activities have not generally been material relative to the total activities of the bank. However, it is unlikely that this will remain the case given that conglomerates are becoming increasingly common in many other countries. We are therefore in the process of developing a policy to deal with financial conglomerates offering a diverse range of services.

4. Authorisation process

(a) Licensing requirements

The RBNZ "registers" rather than "licenses" banks in New Zealand. Domestic and foreign applicants are both subject to the same requirements. An entity can be considered for registration only if its business consists of, or to a substantial degree consists of, the borrowing and lending of money, or the provision of financial services, or both.

When determining an application for registration as a registered bank, the RBNZ is required to have regard to the following matters:

(i) Incorporation and ownership structure

The RBNZ 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 that will improve or maintain its soundness.

Both locally incorporated entities and branches of companies incorporated overseas may apply for registration. As mentioned in paragraph 1(e) we are in the process of introducing a policy requiring systemically important banks (banks which have liabilities excluding related party liabilities exceeding $10 billion) and some retail deposit takers to incorporate locally.

(ii) Size of business

Locally incorporated banks are required to have a minimum capital of NZ$15 million. 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.

Branches of overseas banks are not subject to a minimum size requirement, in recognition of the fact that a branch operates on the basis of the global bank's balance sheet. However, in such cases the RBNZ needs to satisfy itself that the global bank has a level of capital which exceeds NZ$15 million.

(iii) Ability to carry on business in a prudent manner

In having regard to whether or not an applicant for registration has the ability to carry on business in a prudent manner, the RBNZ looks at:

- capital in relation to the size and nature of the business;
- loan concentration and risk exposures;

- separation of the business from other interests of those who own or control the bank;

- internal controls and accounting systems.

(iv) Standing of the applicant in the financial market

Where applicants are branches or subsidiaries of a major international bank of standing and repute with a record of sound performance, the RBNZ normally accepts this as evidence of an appropriate degree of standing.

Where the bank is in widespread ownership, or it is in the majority ownership of a corporate or trust, the RBNZ assesses the applicant's standing by considering the following matters:

- the standing of the owner in financial markets;

- where the applicant is already operating as a non-bank financial institution, the standing of the applicant itself;

- the experience and standing of the board of directors, chief executive and other key personnel.

Where neither the entity seeking registration nor its owners have an established track record in financial markets, and the board of directors and executive staff of the proposed bank collectively lack appropriate experience, it is unlikely that an applicant would be in a position to satisfy the RBNZ that it has sufficient standing to gain registration.

(v) Law and regulatory requirements in an overseas bank's country of domicile

Where an applicant is incorporated overseas or is owned by a bank incorporated overseas, the RBNZ has 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 are weighed against the benefits to be derived from the applicant's presence in the local market.

In some cases the applicant may be required to incorporate locally in order to provide some degree of insulation from the effects of foreign laws and regulations.

(vi) Other

As from 1 April 2001, the Bank will also be required to take into account the following additional matters:

- For overseas applicants, the law and regulatory requirements of the home jurisdiction relating to the recognition, and priorities, of claims of creditors or classes of creditors in an insolvency.

- For overseas applicants, the law and regulatory requirements of the home jurisdiction relating to the disclosure of financial and other information.

- For overseas applicants, the nature and extent of the financial and other information actually disclosed in the home jurisdiction.

- The size and nature of any part of the applicant's business or proposed business.

Within this framework, particular emphasis is placed on ensuring that only financial institutions of appropriate standing, which are able to demonstrate their ability to carry on business in a prudent manner, are able to qualify for registration. The principles the RBNZ applies when considering each of these matters are set out in more detail in Annex 3.

(b) Business of the applicant

Applicants are required to provide a description of the business they intend to conduct, including details of business to be conducted via separately incorporated entities.

The RBNZ does not limit the types of activities which registered banks may undertake. However, applicants are required to satisfy the RBNZ that the majority of their business will consist of the provision of financial services. For the purposes of this requirement the RBNZ takes into account activities which are carried out through subsidiaries as well as activities undertaken by the registered bank itself.

There is no requirement that certain types of financial services must be provided by registered banks.

(c) Disclosure

Where necessary, the RBNZ requires applicants 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 is the same as that required in a normal full or half year disclosure statement.

(d) General

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

Applicants are required to confirm that they will abide by the BIS "Statement of Principles on Prevention of the Criminal Use of the Banking System for the Purpose of Money Laundering".

(e) "Fit & proper" tests on management of applicant

There are no specific "fit & proper" tests applied on the management of applicants. However, as described above, the experience and reputation of management is an important factor that is taken into account when considering financial market standing.

(f) Authorisation of non-bank financial institutions

Non-bank financial institutions must meet the administrative requirements of the legislation under which they are established, and as applicable, comply with the requirements of the Securities Act 1978 in order to take deposits, or issue debt and other securities to the public (see sections 2 (b) and 3 (c) above). In particular, where non-bank financial institutions issue deposits to the public, they must adhere to the financial covenants imposed on them by trustee corporations under trust deeds, and the registered prospectuses and investment statements they are required to issue in respect of those investments must not be false or misleading.

Superannuation schemes may be registered by the Government Actuary. The actuary has the ability to cancel the registration of a registered superannuation scheme, or to order the scheme to be wound up, if the financial position, security of benefits, or management of the scheme is assessed as being inadequate.

5. SUPERVISION OF CROSS-BORDER BANKING

(a) As home supervisor

As outlined in section 1(d) above, the RBNZ's role as a home supervisor of international banking establishments is very limited. Where New Zealand banks have an offshore branch or subsidiary these institutions are included in consolidated reporting under the public disclosure regime for banks in New Zealand. There is also a requirement, under this regime, that the names of subsidiaries of locally incorporated banks be disclosed at six monthly intervals.

Registered banks are required to seek approval from the RBNZ before setting up branches, subsidiaries or representative offices in other countries.

There are no restrictions on the type of persons or entities that may own registered banks, and the RBNZ has no direct powers to control changes of ownership. The RBNZ will assess the implications for a bank's standing (on which its registration is based) where there are changes in shareholdings in excess of 10% of voting shares. If the RBNZ considers that the standing of a registered bank is materially damaged as a result of a change in ownership, it may initiate a process of deregistration. Accordingly, bank management and prospective purchasers of an interest in a bank (where the 10% threshold is to be exceeded) are encouraged to approach the RBNZ to discuss their plans, and any implications those plans might have for the continued registration of the bank.

The RBNZ has no powers to approve banking related corporate affiliations or structures. It would, however, take corporate affiliations and structures into account when deciding whether to register a bank or (where a significant change has occurred) whether to continue a registration. Organisation structure is monitored through the public disclosure regime and informally through contact with banks.

Under the public disclosure regime, financial and prudential information is provided by banks on a global consolidated basis. This includes banking activities undertaken through an intermediate non-bank holding company. Information on the nature and amount of a banking group's involvement in non-banking activities, such as funds management, is also required to be disclosed, as is the extent to which the banking group is financially independent of these activities (this independence is controlled by limits imposed under the RBNZ's capital adequacy requirements). The RBNZ does not conduct on-site examinations of foreign operations, or indeed of New Zealand operations.

(b) As host supervisor

When an application for registration is considered, home supervisors are consulted to establish whether the activities of the applicant are subject to consolidated supervision by the home supervisor. As described in section 4 (a) above, the quality of home supervision is a factor taken into account when deciding whether to register an applicant. Moreover, the RBNZ would normally only register banks whose home supervisor applied the Basel Minimum Capital Standards. After registration, the practices of the home supervisor are monitored on an on-going basis.

The method by which the RBNZ supervises banks within its jurisdiction is described in detail in section 6 below. It should be noted that there are no significant differences between the supervisory methods applied to overseas and locally incorporated banks.

6. SUPERVISORY METHODS

(a) Supervisory approach

To the extent possible, the RBNZ's system of supervision draws on and enhances the market disciplines which are naturally present in the financial system.

As a consequence, the RBNZ'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 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.

The main elements of the RBNZ's supervisory approach are as follows:

(i) The RBNZ administers disclosure and director attestation requirements for registered banks.

(ii) All banks are required to comply with certain minimum prudential requirements, which are applied through conditions of registration. The only quantitative restrictions which apply relate to constraints on connected exposure and minimum capital adequacy requirements.

(iii) The RBNZ monitors each bank's financial condition and compliance with conditions of registration on a quarterly basis, off-site, and principally on the basis of published disclosure statements. On-site monitoring is not conducted. Monitoring is intended to ensure that each bank is complying with its conditions of registration, that disclosure statements contain the required information, that the RBNZ 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 RBNZ also formally consults with the senior management of banks, generally on an annual basis, to keep informed of each bank's strategic direction and developments in the banking industry.

(v) The RBNZ will use the crisis management powers available to it under the RBNZ Act to intervene where a bank distress or failure situation threatens the soundness of the financial system.

(vi) The RBNZ 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 apply in respect of host supervisors.

Banks are required to provide an external audit opinion on the financial statements and supplementary information contained in their year-end disclosure statements. Auditors are appointed by a bank (with no involvement in the appointment by the RBNZ) to give an opinion (which is incorporated in the disclosure statement) as to whether the bank's disclosure statement complies with generally accepted accounting practice, and whether a true and fair view is represented. For the half-year disclosure statements, either a full audit opinion or an audit review is required. An audit review involves the external auditor preparing a report stating that a review has been undertaken, with a statement as to whether anything has come to their attention which would cause them to believe that the information contained in the statements does not present a true and fair view (i.e. a negative assurance approach).

External auditors are also required to disclose to the RBNZ, after informing the registered bank of an intention to do so, information which in the auditor's opinion indicates that the bank is in serious financial difficulties, and information that is likely to assist the RBNZ exercise its supervision powers. Auditors are protected, under the RBNZ Act, from legal action brought against them, arising from the disclosure, in good faith, of any such information to the RBNZ.

(b) Collection of financial information

The RBNZ Act gives the RBNZ powers to require banks to publicly disclose financial and other information, and to collect information for the purpose of prudential supervision. These powers can be exercised by prescribing the information in a notice by Order in Council made on the advice of the Treasurer, or in some circumstances by notice in writing from the RBNZ to a bank.

In normal circumstances, the RBNZ relies on the information that is provided through public disclosure. The range of public information that is provided is described in section 6(c) below. Private information could be sought, but this power would most likely only be exercised in unusual circumstances. Such information could relate to the business, operation or management of a bank, hence it is potentially widespread in nature. The RBNZ is able to require any information provided to be audited by an auditor approved by the RBNZ. In addition, a bank could be required to supply the RBNZ with a report, prepared by a person approved by the RBNZ, on the financial and accounting systems and controls of that bank. Currently, the RBNZ is not collecting any private information of this sort from banks.

The RBNZ also collects a vast array of other financial information to enable it to carry out other functions (e.g. monetary policy). This information is used for such purposes as compiling monetary and credit aggregates and tracking developments in monetary conditions more generally. While this data has contextual relevance for prudential policy, it plays a relatively minor role in the prudential supervision of banks.

(c) Risk management systems

Monitoring of banks is essentially carried out by the private sector through extensive quarterly public disclosures by banks. Information on the bank's systems for monitoring and managing the banking group's risks (comprising credit risk, market risk, liquidity risk and any other material business risk) is contained in a bank's General Disclosure Statement. Directors'

attestations on the appropriateness of their bank's risk management systems and whether they are being properly applied is also contained in the General Disclosure Statement. More details are given in the following section.

(d) Supervisory policies and practices

The supervisory regime for banks that has been developed in New Zealand has the usual three elements - rules, monitoring, and enforcement provisions. However, in the first two areas, the approach taken is somewhat different from that in most other countries. (For example, New Zealand does not use a CAMEL[2] rating system to rate the quality of banks.)

There are only a small number of prudential rules. Locally incorporated banks must have a minimum capital level of NZ$15 million. All banks are subject to minimum tier one and total capital requirements of 4% and 8% respectively of risk weighted assets, calculated in line with the Basel framework. The RBNZ considers that capital adequacy is fundamental in two respects. First, it provides a buffer so that losses of reasonable size can be absorbed without bringing the bank down. Secondly, it helps ensure that the owners of a bank have a sufficiently large stake in its activities and its risk management methods. Although the RBNZ is confident that disclosure of banks' capital positions creates strong incentives for banks to hold capital equivalent to international norms, it was considered appropriate to retain the BIS standards as mandatory minima for reasons of international credibility and as a trigger for intervention where that minimum level is breached. Locally incorporated banks also need to comply with a condition of registration which limits aggregate exposures to connected persons to 75% of tier one capital and, within this limit, aggregate exposures to non-bank connected persons to 15% of tier one capital. This prudential rule is aimed at preventing a bank from being decapitalised through the back door. There are no prudential rules applying to asset quality, large exposures (except connected person exposures), country risk, liquidity, or market risk. There are no capital requirements for market risk.

Monitoring of banks is essentially carried out by the private sector through extensive quarterly public disclosures by banks. The disclosure regime is now described in more detail.

Disclosure regime

The principal objectives of the disclosure regime are to:

(i) Strengthen the incentives for banks to monitor and prudently manage their banking risks.

(ii) Provide a more focused role for bank directors in overseeing, and taking ultimate responsibility for, the management of banking risks.

(iii) Provide depositors, financial planners, investment advisers and others with higher quality and more timely information on banks, so as to improve investors' ability to decide where to place their funds. Much of the information required to

[2] CAMEL is an internationally recognized framework for assessing a bank's Capital adequacy, Asset quality, Management, Earnings and Liquidity.

be disclosed by banks is aimed at "financial professionals", in their capacity as agents for the non-expert investor.

Disclosure statements are in two main forms: a brief "Key Information Summary", for the non-expert investor, and a larger and more comprehensive "General Disclosure Statement", for readers with greater knowledge of financial matters. In addition, banks are required to publish a Supplemental Disclosure Statement, containing information relating to guarantees and a bank's conditions of registration, unless that information is contained in the General Disclosure Statement.

The Key Information Summary must be displayed prominently in every bank branch and must be made available free of charge immediately on request. It must also be displayed on the bank's website if it has one. The General Disclosure Statement need not be displayed in bank branches, but must be made available free of charge within five working days of a request being made for it, or immediately if the request is made at a bank's head office.

The financial disclosures required to be contained in the General Disclosure Statement at the half-year and end-of-year are comprehensive, while those required in the off-quarters (i.e. the first and third quarters of a bank's financial year) are of an abbreviated nature. Banks have up to three months (from balance date or interim balance date) to publish their disclosure statements at the end-of-year or half-year, and two months for the off-quarter disclosure statements.

In the Key Information Summary, disclosures are generally required only for a bank's banking group, while in the General Disclosure Statement, disclosures are generally required in respect of both the bank itself and its banking group. The banking group generally comprises the registered bank and its subsidiaries and in-substance subsidiaries. Disclosure for the banking group is considered important, given the potential for difficulties arising in a bank's subsidiaries to cause financial difficulties for the bank itself.

In the case of an overseas bank operating in New Zealand as a branch, the branch is required to make disclosures in respect of the New Zealand branch and its New Zealand banking group along essentially the same lines as for a locally incorporated bank. In addition, it is required to publish information on the "global" bank of which it is part, and the global bank's banking group, based on information disclosed publicly by the global bank in its country of incorporation.

The information required to be disclosed in a bank's Key Information Summary includes:

(i) <u>Credit ratings</u>

A statement as to whether or not the bank has a credit rating applicable to its long term senior unsecured liabilities payable in New Zealand (e.g. deposit liabilities with a term of 12 months or more). If there is such a rating, the bank must disclose the rating and any qualifications to it (such as "credit watch" status), the name of the rating agency, and any changes made to the rating in the two years preceding the balance date applicable to that disclosure statement. However, we are in the process of making it mandatory for banks to maintain and publish a current credit rating.

(ii) Guarantees

A statement as to whether or not the liabilities of the bank are guaranteed and, if so, information on the guarantee arrangements.

(iii) Capital adequacy

The risk-weighted capital ratios of the banking group, measured using the standard Basel capital requirements.

(iv) Impaired assets

The amount of impaired assets of the banking group and specific provisions held in relation to them.

(v) Exposure concentration

The number of individual counterparties and groups of closely related counterparties to which the banking group has a credit exposure exceeding 10% of the group's equity. The number of counterparties are disclosed in two categories, banks and non-banks, in 10% bands relative to the banking group's equity. In the case of overseas banks operating in New Zealand as branches, the disclosure is based on credit exposures entered into by the New Zealand branch (or other members of its New Zealand banking group), where the amount of the individual exposure equals or exceeds 10% of the overseas banking group's equity. The disclosures are based on the banking group's peak lending to individual customers over the period.

(vi) Exposures to connected persons

The amount of credit exposures which the banking group has to connected persons, based on the peak exposure over the period.

(vii) Profitability and size

Key financial information, such as profitability, size of balance sheet and asset growth.

A bank's General Disclosure Statement contains all of the information contained in the bank's Key Information Summary (but in greater detail) and, in addition, includes items such as:

(i) Corporate information

The country of the bank's incorporation, the names and a description of the activities of each member of the New Zealand banking group and the names of directors.

(ii) Credit rating information

Where the bank has a credit rating applicable to its long term senior unsecured liabilities payable in New Zealand, a description of the applicable rating scale used by the rating agency.

(iii) Financial statements for the bank and banking group

At the half-year and end-of-year, comprehensive financial statements covering on- and off-balance sheet items must be disclosed, for both the bank and its banking group, based on the financial reporting requirements specified in Accounting Standards. In the off-quarters, the financial disclosures need only be made in abbreviated form.

(iv) Capital and exposure information

Detailed information on tier one and tier two capital, and credit exposures (both on and off balance sheet), for the bank and banking group.

(v) Funds management

Information on a banking group's funds management activities (such as securitisation, unit trusts, superannuation funds and other fiduciary activities) and the measures put in place to minimise the risk of difficulties which might arise in those activities spreading to the banking group's balance sheet.

(vi) Impaired assets and provisioning

Comprehensive information on components of impaired assets and provisioning, including information on movements in provisions.

(vii) Sectoral information

Information on sectoral exposure concentration, such as a banking group's credit exposures to commercial or industrial sectors and geographical areas. Disclosure of a banking group's main sources of funding, by country and by product and counterparty types is also required.

(viii) Risk management systems

Information on the bank's systems for monitoring and managing the banking group's risks (comprising credit risk, market risk, liquidity risk and any other material business risk), a description of the nature and scope of its internal audit function, and an outline of the extent to which the bank's risk management systems have been subject to review (including a statement as to whether those reviews were conducted by an external party).

(ix) Conditions of registration

The conditions of registration applied by the RBNZ to the registered bank. This information may be disclosed either in the General Disclosure Statement or in a Supplemental Disclosure Statement.

(x) Market risk exposures

Information on a banking group's exposure to "market risk" - i.e. exposure to changes in interest rates, foreign exchange rates and equity prices, measured on a value-at-risk basis at the end of each quarter and in respect of peak exposures over the reporting period. Banks are required to report exposure figures using either a prescribed benchmark model, which is based on the Basel standard model, or banks' own internal models (as long as the results obtained using internal models are not less conservative than the results that would have been obtained using the standard models). The New Zealand benchmark model is applied to the whole of a bank's balance sheet, not just the trading book (assets and liabilities which are held for the purpose of making short-term trading gains) as in the Basel model. The reason for this wider coverage is that banks can have significant interest rate exposures in their banking books (the part of their balance sheet that includes their deposit and lending operations) - it was considered important to capture interest rate risk irrespective of where that risk arises. Another departure from the Basel market risk framework is that New Zealand banks are not required to hold capital above the 8% minimum to cover their market risks.

Directors' attestations

An important feature of the disclosure framework is the emphasis it places on the role of directors in overseeing and taking ultimate responsibility for the management of their bank. In this context, each disclosure statement is required to contain a number of "attestations" signed by every bank director or their appointed agent. These include statements:

(i) as to whether exposures to connected persons are contrary to the interests of the banking group;

(ii) as to whether all conditions of registration are being complied with;

(iii) as to whether the bank has systems in place to monitor and control adequately the banking group's risks (widely defined), and whether those systems are being properly applied.

The disclosure statement must be signed by each bank director or an appointed agent as being not false or misleading. Directors potentially face serious criminal and civil penalties (including a three year jail term, fines and personal liability for depositors' losses) where a disclosure statement is found to be false or misleading. A director may authorise another person to sign on his or her behalf, but if they do so the penalties still rest with the directors.

Accounting systems

In normal circumstances, the RBNZ relies on the framework of company and financial reporting law, as well as the market disciplines created by its disclosure framework, to ensure that banks maintain adequate accounting systems.

The following requirements are the most relevant:

(i) All companies in New Zealand are required under the Companies Act 1993 to maintain accounting records that:

- correctly record and explain the transactions of the company;
- enable, at any time, the financial position of the company to be determined with reasonable accuracy;
- enable the financial statements (including group financial statements) of the company to be prepared in accordance with the Financial Reporting Act 1993;
- enable the financial statements of the company to be readily and properly audited.

(ii) The Financial Reporting Act 1993 requires:

- Companies to prepare financial statements in accordance with generally accepted accounting practice, including Financial Reporting Standards that have received the force of law through approval by the Accounting Standards Review Board (see Annex 4 for a description of the accounting standards framework in New Zealand).
- Auditors' reports to be prepared which must state whether proper accounting records have been kept, whether the financial statements comply with generally accepted accounting practice, and whether those financial statements give a true and fair view of the matters to which they relate.

The RBNZ has back-up powers to ascertain whether proper accounting systems are being maintained. For example, under the RBNZ Act the RBNZ has the power to require an independent report on the financial and accounting systems and controls of a registered bank.

(d) Relationship with internal auditors

The extent of the RBNZ's relationship with, and requirements on, internal auditors in normal circumstances is confined to prescribing that certain information on the internal audit function should . (See also section 6(a) above.)

(e) Measures/actions to deal with problem banks

Where a bank is operating in breach of its conditions of registration, the RBNZ 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 to the Treasurer that the bank be placed in statutory management or be deregistered. For a more detailed description of the RBNZ's crisis management powers, and the circumstances in which they can be used, refer to section 7 below.

Where the tier one capital ratio of a bank falls below 4% and/or the total capital ratio falls below 8%, the bank will be required to draw up a plan for restoring its capital to at least the minimum required level. The precise requirements are outlined in section 7.

In a situation where the RBNZ considers that a bank's disclosure statement is false or misleading, various actions can be taken depending on the circumstances, but might involve:

(i) formally raising questions with the bank;

(ii) formally raising questions with the bank's auditor where the information to which the questions relate was audited or reviewed, in liaison with the bank;

(iii) where, following the above enquiries, the RBNZ remains of the view that a disclosure statement is, or could be, materially false or misleading, appointing a person to investigate the matters in question;

(iv) where, after all enquiries have been made, the RBNZ is of the view that a disclosure statement is materially false or misleading, directing the bank to publish a new or corrected disclosure statement.

A hierarchy of possible responses is shown in Annex 5.

(f) Other supervisory methods

There are no other significant techniques or methods used in the supervision of New Zealand banks.

(g) Supervision of non-bank financial business

The supervisory approach for other major non-bank financial institutions is discussed in sections 2 (b) and 3 (c) above.

7. FAILURE MANAGEMENT

One of the RBNZ's statutory objectives for supervising the banking system is to avoid significant damage to the financial system which could result from the failure of a bank. Within this overall objective, failure management policy in New Zealand adheres to the following broad principles:

(i) The RBNZ's powers under the RBNZ Act to respond to financial system distress can generally only be exercised in respect of registered banks. The exception to this is the RBNZ's ability to provide lender of last resort facilities to any entity, where systemic circumstances justify this.

(ii) The RBNZ would generally only use its failure management powers where the bank failure or other crisis event posed a significant threat to the soundness and efficiency of the financial system.

(iii) The RBNZ would seek to resolve the affairs of the failed bank in an orderly manner, so as to minimise disruption to the financial system and minimise contagion risks.

(iv) Any intervention would seek to avoid putting taxpayers' funds at risk in responding to the bank failure. The RBNZ would generally attempt to ensure that losses are borne by the bank's shareholders and creditors.

(v) In the event of a bank failure, depositors would not be paid in priority to other equal-ranked creditors of the bank. There is no depositor preference provision in New Zealand. The pari passu principle would generally be adhered to.

The specific statutory powers available to the RBNZ include the ability to require a bank to have its financial and accounting systems independently reviewed; the power to have a bank investigated; the ability to give directions to a bank; the power to recommend to the government that a bank be placed into statutory management; and the power to recommend to the Treasurer that a bank be deregistered. These are covered in more detail in Annex 6 attached.

The RBNZ is empowered to provide liquidity support to the financial system where this is considered necessary in order to promote systemic stability. However, the RBNZ gives no commitment that such support will be provided. Banks have been advised that they should operate on the clear presumption that it is very unlikely that liquidity support would be provided by the RBNZ.

If the RBNZ did provide liquidity support, it would generally only do so where there was no material doubt over the financial soundness of the entity in question, where the entity's situation posed a serious threat to the soundness and efficiency of the financial system and where liquidity support was likely to assist in resolving the situation. Generally, liquidity support would only be provided on a fully secured basis.

Generally, the RBNZ would only intervene in the affairs of an insolvent bank where the bank's situation posed a significant threat to the soundness and efficiency of the financial system (e.g. prolonged interruption to the payments system, contagion risk, prolonged instability in the

money and foreign exchange markets). In the absence of these factors, an insolvent bank would generally be dealt with using standard liquidation procedures under the Companies Act. In the case of a bank of systemic importance, the RBNZ would consider a number of options for resolving the failure. The options would generally include selling the bank, in part or in whole, to another bank; restructuring the liabilities of the bank in order that it continues in business, in part or in whole; or liquidating the bank under statutory management, possibly in such a way that a proportion of creditors' money is released at an early stage in the liquidation process.

The RBNZ would generally recommend against any form of taxpayer-funded rescue. However, the ultimate decision on this matter would be made by the government of the day.

The liquidation of an insolvent bank of importance to the financial system would generally be dealt with by statutory management, rather than by the standard liquidation procedures of the Companies Act. Statutory management is declared by government regulation, made on the advice of the Treasurer, given in accordance with a recommendation from the RBNZ. The main features of statutory management are discussed in detail in Annex 6.

8. CONTACT WITH OTHER DOMESTIC AND OVERSEAS SUPERVISORY AUTHORITIES

(a) Powers to share information with other supervisors

The RBNZ Act imposes strict duties of confidentiality on the RBNZ in respect of information provided privately to the RBNZ in connection with the RBNZ's supervisory functions. The Act generally prohibits the RBNZ from releasing such information to any parties, except in limited circumstances. One of those circumstances is where the RBNZ releases information to authorities with supervisory functions similar to those conferred on the RBNZ. In releasing protected information to such authorities, the RBNZ is required by the Act to satisfy itself that the authority to whom the information is to be provided has adequate safeguards in place to protect the confidentiality of the information in question. Therefore, the RBNZ is generally able to release information to foreign and local supervisory authorities, on the basis that such information will be treated in strict confidence by those authorities.

Information obtained from banks' public disclosure statements may be shared by the RBNZ freely or obtained directly from the bank in question.

The type of information able to be shared is relatively broad in nature and includes:

(i) comprehensive financial information on individual banks, such as balance sheets, income statements, cash flow statements, asset quality and provisioning information and information on various risk positions;

(ii) information on the New Zealand banking system as a whole;

(iii) information relating to the business operations of individual banks, including information of a non-numerical nature (e.g. relating to a bank's risk management systems, board of directors, management and strategic direction);

(iv) information on the structure of the New Zealand financial system, including the ownership structures of banks, the operation of the payments system and aspects of banking law.

(b) Contacts with other supervisors

The RBNZ maintains a close working relationship with other New Zealand bodies with regulatory responsibilities in relation to of the financial sector. To facilitate this a Financial Regulators' Co-ordination Group consisting of representatives from the Reserve Bank, the New Zealand Securities Commission, the Government Actuary and the Registrar of Companies has been established. This Group provides a forum for sharing information and views about regulatory issues, financial system developments and other matters of mutual interest, co-ordinating and harmonising policies where appropriate, and dealing with situations where there is an overlap in members' responsibilities. The Group generally meets once per quarter or more frequently when the need arises.

The RBNZ also consults and exchanges information with other authorities in New Zealand as appropriate, including the New Zealand Police, the Serious Fraud Office and the Ministry of Economic Development.

The RBNZ maintains a productive working relationship with the parent supervisory authorities of those banks which have an important presence in New Zealand. These relationships involve liaison over bank-specific and policy issues and the exchange of information, as appropriate.

(c) Confidentiality of information received from other countries

Any information received by the RBNZ from overseas which is received in connection with the RBNZ's role as banking supervisor is protected under the RBNZ Act. The information so received may not be released by the RBNZ to any party without the consent of the supplier, unless it is released:

(i) for the purposes of, or in connection with, the exercise of the RBNZ's supervisory powers; or

(ii) in connection with any proceedings for an offence against the RBNZ Act; or

(iii) to a central bank or other authority with functions similar to those conferred on the RBNZ as banking supervisor; or

(iv) to any person which the RBNZ considers has a proper interest in receiving the information.

Information provided to the RBNZ in connection with the RBNZ's banking supervision functions cannot be obtained under New Zealand's Official Information Act or generally by government officials. However, there is provision in legislation relating to taxation and fraud matters under which officials can obtain such information from the RBNZ. In obtaining that information, the officials in question are only able to use that information for the purposes for which it was obtained.

The courts in New Zealand are not able to direct the RBNZ to release information protected by the confidentiality provisions of the RBNZ Act. The only exception to this is the ability of the courts to direct the RBNZ to release protected information to the taxation authorities and the Serious Fraud Office, in line with the legislative provisions referred to above.

Under existing law, Parliament (including parliamentary select committees) is not empowered to require the RBNZ to release protected information.

(d) Restriction on passing information by banks

Common law relating to the banker's duty of client confidentiality, and (in respect of bank clients who are natural persons, as opposed to corporate clients) the Privacy Act, could potentially inhibit a bank's ability, in the absence of explicit consent, to pass information on its customers to some other parties, such as parent banks and home supervisors. There are no

obstacles to the passing of such information from the New Zealand branch of a bank to the overseas head office of that bank, given that they are both part of the same legal entity.

(e) Ability of home supervisors to conduct on-site examinations

There are no legal obstacles preventing home supervisors of banks with operations in New Zealand from conducting on-site examinations of the New Zealand operations. However, as noted above, the bankers' common law duty of confidentiality and the Privacy Act could restrict the supervisor's access to customer specific information.

There is no law in New Zealand which requires a bank registered in New Zealand to cooperate with an overseas supervisor. However, if the head office or parent bank of the bank in New Zealand has directed its New Zealand operation to cooperate with the overseas authority, there would seem to be no legal obstacle to the conducting of an on-site examination of that bank in New Zealand.

Depending on the circumstances, the RBNZ would generally be willing to make available to an overseas authority information held by the RBNZ on the New Zealand operations of a bank headquartered in the overseas authority's country of jurisdiction, including reports prepared by the RBNZ on that bank. However, the RBNZ would need to satisfy itself that the authority in question had functions similar to the RBNZ's supervisory functions or otherwise had a proper interest in the information. The RBNZ would also need to satisfy itself that the information would be treated with appropriate confidentiality.

9. SUPERVISION OF FINANCIAL CONGLOMERATES

Banking supervision in New Zealand is conducted primarily in respect of a registered bank's banking group. The banking group generally comprises the bank and all of its subsidiaries and in-substance subsidiaries. The group is determined by the RBNZ, in consultation with the bank in question. Subsidiaries or in-substance subsidiaries would generally be excluded only where the subsidiaries in question do not conduct banking or banking related business (broadly defined), and are sufficiently large relative to the group as a whole that their inclusion would render the disclosures of the group's affairs misleading. Banking groups can include subsidiaries that provide insurance or funds management business. GAAP requires insurance assets and liabilities to be included in the subsidiary's balance sheet. With funds management generally only the assets and liabilities relating to the management of these services would be included in the balance sheet of the subsidiary - the actual funds under management are generally not included.

New Zealand has a universal banking system, such that banks can conduct banking and securities trading business in the same legal entity or within a single banking group. Banking groups supervised by the RBNZ therefore tend to include securities trading business.

The RBNZ does not have supervisory responsibility for funds management, insurance or securities trading activities as such. As noted below, these types of activity are subject to supervision arrangements overseen by other regulatory entities.

The minimum capital requirements and the limit on lending to connected parties are applied to the banking group as a whole, rather than to the bank on a solo basis. However, banks are not required to hold capital against funds management or related activities, provided that there is adequate separation between those activities and the bank itself. The disclosure requirements also apply mainly in respect of a bank's banking group, although some disclosure on a solo basis is required. The RBNZ's powers to respond to financial distress apply in respect of both the banking group and bank itself.

The RBNZ does not generally supervise individual entities within the banking group (other than the bank itself), rather the focus is on the consolidated group as a whole. In general, the RBNZ does not receive information relating to individual subsidiaries within a banking group.

Insurance, funds management and securities trading business conducted by banks are subject to supervision by other authorities, to some extent (see sections 2(b) and 3(c)). The New Zealand Securities Commission also has jurisdiction over the offer of securities (including life insurance and managed funds) to the public by any issuer, including banks. That jurisdiction principally takes the form of the administration of disclosure and advertising requirements. Trust deed requirements apply to the issuance of some forms of security to the public, including unit trusts (managed funds).

Consolidated supervision is conducted using a combination of quantitative and qualitative requirements, including the following:

(i) Banks are required to comply with the Basel minimum capital requirements on a consolidated group basis.

(ii) The limit on credit exposures to connected parties is applied to the banking group on a consolidated basis.

(iii) Banks are required to make public quarterly disclosures both for the consolidated group and for the bank itself. The RBNZ principally monitors banks on the basis of their consolidated group disclosures.

(iv) The RBNZ's powers to respond to bank distress or failure are able to be applied both to the bank itself and its banking group.

There is no concept of "lead regulator", in any formal sense, in New Zealand. However, the RBNZ and other authorities liase as appropriate on matters of mutual interest, including to ensure, to the extent practicable, that regulatory requirements imposed by the respective authorities are not in conflict.

In the event of a bank failure or financial distress in a banking group, the RBNZ would generally take principal responsibility for the management of that situation where the banking group is of importance to the financial system.

10. SUPERVISION OF ELECTRONIC MONEY AND ELECTRONIC BANKING

There has been a significant expansion in electronic methods for making payments in New Zealand over recent years. This has been prompted by customer demand as well as by banks themselves in order to reduce transaction processing costs. Conducting business without using cash is currently possible through a number of electronic mechanisms including telephone banking, EFTPOS, (Electronic Funds Transfer at Point of Sale) credit cards, automatic payments, direct crediting and debiting. In addition, there is also growing interest in developing reliable methods of payment for use on the internet. All of the major retail banks are now offering Internet banking services.

New Zealand does not license the business of banking. Registered banks are the only financial institutions that can use the word “bank” in their name or title but anyone can conduct banking and financial activities. Similarly, there are no restrictions on non-registered offshore banks offering financial services through the internet, unless the institution concerned uses “bank” in this name and carries on business in New Zealand, or has an office in New Zealand.

New Zealand does not have any specifically focused legislation or rules to control electronic money or internet banking. In practice, the RBNZ has been relaxed about seeing most of the "money" in the economy taking the form of commercial bank liabilities rather than central bank liabilities; and has been relaxed about the banks (and others) developing payment methods (e.g. cheques, travellers cheques, debit cards and credit cards) which are close substitutes for the use of currency. Stored value cards and the like are seen as another innovation in this context, and as such do not raise any new issues of principle.

It may be desirable that substantial electronic "issuers" (or issuers offering the ability to store "high" monetary values) should be subject to a disclosure regime, so that holders of their obligations can be made more aware of the financial condition of the issuers, and the potential risks they may face. It is likely that many actual or potential card issuers will be subject to disclosure requirements under the Securities Act or the RBNZ Act in any case, but there may be a need to fill any significant gaps in coverage which emerge.

Any arrangements for making monetary payments require satisfactory legal underpinnings. It is important that all of the parties to a payment - the payer, the recipient, and any other parties such as banks or clearing systems who may be involved as intermediaries - clearly understand their rights and obligations, and any risks they may face. The rules need to specify clearly who carries risks at the various stages that a transaction may pass through, and what happens when things go wrong.

In practice, the overall rules which apply in a payment arrangement generally reflect a combination of statute law, common law, contractual arrangements and industry codes of practice. In the case of new electronic payments arrangements, it is likely that all of these will have some role to play. It may be possible to use current legal bases to create much, or even all, of the legal underpinning that is required. However, the distinctive characteristics of the new technologies may require some new thinking, and some new rules. In particular, where payments arrangements have significant cross-border elements (as some of them will), it may become very difficult to establish clearly the rights and obligations of the various parties that are

involved in a transaction, the forms of redress available when things go wrong, and the jurisdiction which applies.

Draft legislation is before Parliament to facilitate the use of electronic technology. The Electronic Transactions Bill aims to:

- Reduce compliance and transactions costs of business and the general public;
- Remove legislative impediments to dealing with Government electronically;
- Promote consistency between New Zealand law and that of our major trading partners, particularly Australia; and
- Promote the development of electronic commerce.

The Bill closely follows both the Model Law on Electronic Commerce prepared by UNCITRAL in 1996 and the Australian Electronic Transactions Act 1999. When enacted later this year, the provisions will reduce the uncertainty regarding the legal effect of electronic information, and the time and place of dispatch and receipt of electronic communications. They will also allow certain paper-based legal requirements, such as a requirement for writing, a signature, or the retention of documents, to be met by using electronic technology that is functionally equivalent to those paper-based legal requirements. The provisions are facilitative only. No one will be required to use electronic technology by virtue of the Bill.

In summary, the RBNZ does not have any substantial concerns about the development of electronic banking and new retail payment methods at this stage. More widespread uses of these new methods will be financial innovations which are not radical from a conceptual viewpoint, and they do not raise any new issues of principle. However, they may raise a number of significant issues of practice, including risk management and legal issues. The Bank's approach will be to watch developments, with a view to ensuring that the integrity of the financial system is maintained.

11. DEPOSIT PROTECTION

New Zealand does not have an explicit deposit protection scheme in any shape or form. There are no statutory or regulatory provisions in New Zealand that impede the ability of creditors outside New Zealand from having an equal claim on the assets of a bank incorporated in New Zealand, in the event of that bank's failure.

12. CONTROL OF MONEY-LAUNDERING ACTIVITIES

New Zealand has the following laws in place to help detect and combat money laundering:

(i) Proceeds of Crime Act 1991

This Act provides for the restraining of assets derived from serious crime and their eventual forfeiture to the Crown following conviction.

(ii) Mutual Assistance in Criminal Matters Act 1992

This Act implements New Zealand's international obligations to facilitate requests for assistance in criminal investigations and prosecutions.

(iii) The Crimes Act 1961

This Act creates an offence of money laundering. The money laundering offence refers to proceeds from all serious crimes (i.e. those punishable by a minimum sentence of five years imprisonment).

(iv) The Financial Transactions Reporting Act 1996

This Act imposes obligations on banks and other broadly defined financial institutions to:

- verify the identity of customers when new bank accounts are opened, when certain transactions are conducted (including cash transactions which exceed $9,999.99), or where money laundering transactions are suspected;
- retain records of transactions and customer verification details;
- report suspicious transactions;
- report certain movements of currency across New Zealand's border.

The Crown agencies with prime responsibility for controlling money laundering activities in New Zealand are the New Zealand Police, New Zealand Customs Department and the Serious Fraud Office.

New Zealand fully endorses the objectives of the Financial Action Task Force (FATF). With the passing of the Financial Transactions Reporting Act 1996 and other recent minor legislative amendments, New Zealand considers it now complies with FATF's 40 recommendations to prevent money laundering occurring in financial institutions.

The RBNZ is a member of New Zealand's inter-departmental FATF working group that is involved in providing advice to Government and, in liaison with various international agencies,

ensuring that New Zealand continues to comply with FATF's 40 recommendations. The working group represents New Zealand at FATF Plenary meetings and meetings of the Asia/Pacific Group on Money Laundering, and contributes to initiatives to encourage adoption of, and compliance with, FATF's 40 recommendations by other countries in the Asia Pacific region.

The RBNZ's role and interest in money laundering stems from its statutory responsibility for prudential supervision of the banking system and its aim to ensure that the legislative, accounting and institutional infrastructure is conducive to the overall soundness and efficiency of the financial system. With a focus on ensuring the continued integrity of the New Zealand financial system, the RBNZ has also been concerned to ensure processes put in place to combat money laundering do not compromise system efficiency unduly (e.g. through the imposition of high compliance costs).

The approach that has been taken to combating money laundering is consistent with the broader approach to financial sector regulation in New Zealand, i.e. to seek to ensure that incentive structures within the financial sector are conducive to minimising the incidence of money laundering.

Measures in place to encourage banks and other financial institutions to comply with their legislative and regulatory obligations as pertaining to money laundering include:

(i) New Zealand company law prevents persons convicted of crimes of dishonesty (including money laundering) from managing companies. The supervision of banks and various regulations governing non-bank financial institutions have the effect of placing character and criminal history restrictions on persons who can manage or direct financial institutions, or persons who may act in a professional capacity with respect to soliciting funds. In the non-bank financial institution sector, these constraints are reinforced by the supervision of governmental authorities, such as the Registrar of Friendly Societies and Credit Unions;

(ii) New Zealand company law places strong obligations on company directors generally and imposes personal liability on them in circumstances such as money laundering. As a result, directors may require regular and intensive systems and compliance audits of companies they govern. Many New Zealand institutions already subject themselves to audit scrutiny of their systems for complying with legislative requirements.

(iii) A bank's "standing" is an important consideration for registration in New Zealand. This means that there is an expectation that banks should be of good reputation and high integrity. A bank involved in money laundering could lose its bank registration.

(iv) For banks, the incentives to comply with money laundering requirements are bolstered by the market-oriented banking supervision arrangements introduced in January 1996. Among other things, these proposals place an increased focus on directors' responsibilities by way of a requirement for public attestations by directors regarding the adequacy of internal control systems which banks have in place to monitor and control business risks.

(v) Fines and prison sentences associated with New Zealand's financial transaction reporting requirements and the money laundering offence, provide very strong incentives for all financial institutions to comply with the Financial Transactions Reporting Act and related legislation.

In addition to having these incentive structures in place, the RBNZ has, since 1989, required all banks to observe the Bank of International Settlements "Statement of Principles on Prevention of the Criminal Use of the Banking System for the Purpose of Money Laundering". Moreover, the New Zealand Bankers' Association has developed its own guidelines, based on the United Kingdom model (Procedures and Guidance Notes for Banks on Money Laundering). Banks in New Zealand have followed these guidelines since 1991.

The RBNZ also conducts annual prudential consultations with all registered banks. Compliance with money laundering requirements is discussed at these meetings. The RBNZ does not conduct on-site inspections of banks, nor does it undertake or require specific external compliance monitoring with respect to the money laundering regime.

In this environment, the RBNZ has not considered it necessary to promote or implement additional specific compliance monitoring arrangements to reinforce the money laundering regime.

Reserve Bank of New Zealand
March 2001 (Revised)

Annex 1

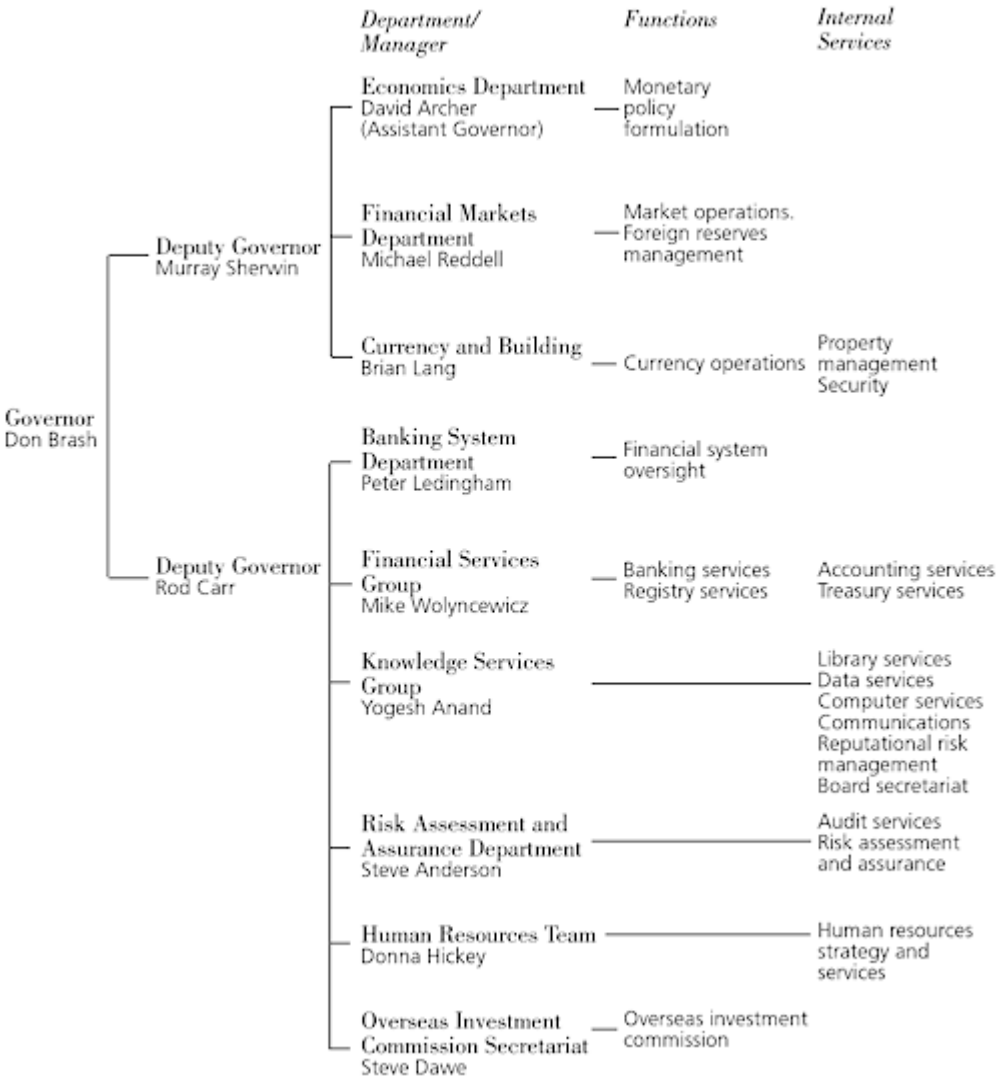
Registered Banks as at beginning of March 2001

Multi-purpose banks	**Banking group**	**Foreign ownership (%)**
ANZ Banking Group (New Zealand) Limited	Australia and New Zealand Banking Group Limited	100
Bank of New Zealand	National Australia Bank Limited	100
The National Bank of New Zealand Limited	Lloyds TSB Group Plc	100
Westpac Banking Corporation (B)	Westpac Banking Corporation	100
Wholesale banks		
ABN AMRO Bank N.V. (B)	ABN AMRO Bank N.V.	100
BNZ Finance Limited	National Australia Bank Limited	100
Citibank N.A. (B)	Citibank N.A.	100
Commonwealth Bank of Australia (B)	Commonwealth Bank of Australia	75
The Hongkong and Shanghai Banking Corporation Limited (B)	The Hongkong and Shanghai Banking Corporation Limited	100
Bank of Tokyo-Mitsubishi (Australia) Ltd (B)	Bank of Tokyo-Mitsubishi	100
Rabobank Nederland (B)	Rabobank Group	100
BNP Paribas (B)	BNP Paribas	100
Deutsche Bank AG (B)	Deutsche Bank AG	100
Kookmin Bank (B)	Kookmin Bank	100
Mainly retail banks		
ASB Bank Limited	Commonwealth Bank of Australia	100
AMP Bank Limited (B)	AMP Bank Limited	100
Rabobank New Zealand Limited	Rabobank Group	100
TSB Bank Limited	TSB Bank Limited	0

(B) Banks registered in New Zealand as branches of overseas incorporated banks

Annex 2

Organisation Structure as at March 2001



Annex 3

Registration Requirements

When determining an application for registration as a registered bank, the RBNZ is required to have regard to the following matters:

Incorporation and ownership structure

The RBNZ 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.

In addition, sufficient separation is required 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.

Ownership structures are assessed in the light of these factors. In addition, the RBNZ takes into account the standing of the owners, since this is likely to have a significant impact on the standing of the applicant.

Where an applicant wishes to register as a branch of an overseas incorporated entity, that entity needs to have bank status in its home jurisdiction. Furthermore, the RBNZ needs to satisfy itself as to the adequacy of supervisory or disclosure requirements, or the effectiveness of market disciplines, in the country of incorporation. Where the RBNZ is not satisfied on these points it may require the applicant to incorporate locally. In particular, it is likely that an applicant which is incorporated in a country which does not apply the BIS capital adequacy framework (or a satisfactory equivalent) would be required to operate via a locally incorporated entity rather than via a branch. There are no de facto capital or net asset requirements for branches of foreign incorporated banks.

Planned changes to policy on bank organisational form due to be introduced in 2001 will mean that applicants falling into the following categories will, in future, be required to incorporate locally:

- Systemically important banks (those whose liabilities net of those due to related parties exceed $10 billion);

- Banks that take retail deposits where either:

    - Disclosure in the home jurisdiction is inadequate; or

- Legislation in the home jurisdiction gives depositors or creditors in that country a preferential claim in a winding up.

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.

Standing

Where an applicant is owned by a major international bank of standing and repute, the RBNZ is likely to accept this as evidence that the applicant has an appropriate level of standing for a registered bank. Other applicants need to satisfy the RBNZ that they have a degree of standing which is appropriate for a registered bank. In such cases, the RBNZ also takes into consideration any impediments to the raising of further capital which arise as a result of the applicant's ownership structure.

Where the applicant is a subsidiary or branch of an overseas bank, the RBNZ seeks the views of the parent supervisor before determining the application for registration.

While the RBNZ does not rule out the possibility of entities with other forms of ownership (e.g. partnerships) becoming registered banks, such entities need to satisfy the RBNZ 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.

There is no restriction on the number of companies within a group which may be registered.

Ability of the applicant to carry on business in a prudent manner

Capital in relation to size

The RBNZ has regard to the applicant's ability to meet minimum capital adequacy ratio requirements imposed by way of condition of registration, on an ongoing basis.

In the case of a bank incorporated locally, this requires the applicant to demonstrate that it will be able to comply with the minimum capital adequacy ratio of 8% and the tier one capital ratio requirement of 4%, in respect of the banking group. It also requires the applicant's capital policy to take into account the need to maintain sufficient capital to carry on business in a prudent manner at all times. In some cases this requires that the policy takes into account any constraints on access to further capital, should it be needed either to cater for an increase in business or to cover unexpected losses. All applicants are expected to have a capital policy which takes into account the need to hold capital against risks which are not captured by the BIS capital adequacy framework.

In the case of branches of banks incorporated overseas, the RBNZ requires the applicant to demonstrate that the global bank complies with the internationally-agreed BIS capital standards and/or the standards imposed by the home supervisor.

All applicants are required to show that they have the ability to disclose information on capital adequacy, including, where applicable, the BIS capital adequacy ratios of the parent or global bank.

Loan concentration and risk exposures

Applicants for registration are 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.

Separation from other interests of the owners

Owners 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. Where there is inadequate separation between a bank's board and its principal shareholders, these incentives and disciplines may be undermined.

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. Where a bank is fully, unconditionally and irrevocably guaranteed by an overseas parent bank, the arrangement is, in some respects, similar in substance to a branch operation because the creditors have a claim on the assets of the overseas bank, rather than just on the assets of the local entity. Neither branches nor guaranteed subsidiaries are required to comply with the separation arrangements applied to locally incorporated banks.

Where the applicant is a locally incorporated company, applicants are required to satisfy the RBNZ that there will be sufficient separation between the bank and its owners. Generally this requires:

- that the proposed bank has in place policies to monitor and limit exposures to related parties;

- that the company does not have a constitution which permits the directors to act in the interests of the holding company when this would conflict with the interests of the bank in New Zealand, to the detriment of creditors;

- 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.

At least two of the applicant's directors are required to be independent (i.e. not employees of the applicant in New Zealand and not directors or employees of any holding company of the applicant or of any other entity able to control or significantly influence the applicant in New Zealand). The chairperson cannot be an employee of the applicant. This policy is intended to ensure that there is 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.

Locally incorporated applicants also need to satisfy the RBNZ that they will be in a position to comply with a condition of registration which limits aggregate exposures to connected parties (excluding risk layoffs to a parent bank) to 75 % of tier one capital and, within this limit, aggregate exposure to non-bank connected parties to 15 % 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.

Internal controls and accounting systems

Applicants are required to satisfy the RBNZ that they have, or will have, internal controls and accounting systems which 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, it is likely that this would be accepted as evidence that this requirement can be met. Similarly, a financial institution which has been operating successfully for some time may also be in a position to satisfy the RBNZ of its ability to meet this requirement.

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 needs to satisfy the RBNZ 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 are required to attest to the adequacy of systems to monitor and control material business risks in disclosure statements.

Other

As from 1 April 2001 the Bank will also be required to take into account the following matters when assessing an application for registration as a registered bank:

- For overseas applicants, the law and regulatory requirements of the home jurisdiction relating to the recognition, and priorities, of claims of creditors or classes of creditors in an insolvency.

- For overseas applicants, the law and regulatory requirements of the home jurisdiction relating to the disclosure of financial and other information.

- For overseas applicants, the nature and extent of the financial and other information actually disclosed in the home jurisdiction.

- The size and nature of any part of the applicant's business or proposed business.

Annex 4

Accounting Standards Framework in New Zealand

The accounting standards framework in New Zealand is governed by the Financial Reporting Act 1993. This Act requires all reporting entities (i.e. most companies and all public issuers of securities) to prepare financial statements and group financial statements annually.

The financial statements must comprise

- a balance sheet;
- a profit and loss statement;
- a statement of cash flows (where required by an accounting standard);
- any notes to the financial statements.

The financial statements, in turn, are required to comply with generally accepted accounting practice ("GAAP"). GAAP is determined by the Accounting Standards Review Board ("ASRB"), a public body whose members are appointed by the Government. The role of the ASRB includes:

(i) approving financial reporting standards submitted to it by the New Zealand Society of Accountants (NZSA) or any other party; and

(ii) determining those matters which have authoritative support within the New Zealand accounting profession.

GAAP comprises "applicable financial reporting standards", that is, financial reporting standards that have been approved by the ASRB. Where, in respect of a certain matter, no applicable financial reporting standard applies and the matter is not subject to any applicable rule of law, GAAP includes accounting policies that:

(i) are appropriate to the circumstances of the reporting entity;

(ii) have authoritative support within the accounting profession, as determined by the ASRB.

If, in complying with GAAP, financial statements do not give a true and fair view of the affairs of the reporting entity, the directors of the entity must add further information, such that a true and fair view is given.

GAAP under the Financial Reporting Act is "black letter law" - that is, it is legally binding on reporting entities and directors. Failure to comply with GAAP and to prepare financial statements giving a true and fair view of the reporting entity's affairs can result in severe criminal penalties for the reporting entity in question and its directors.

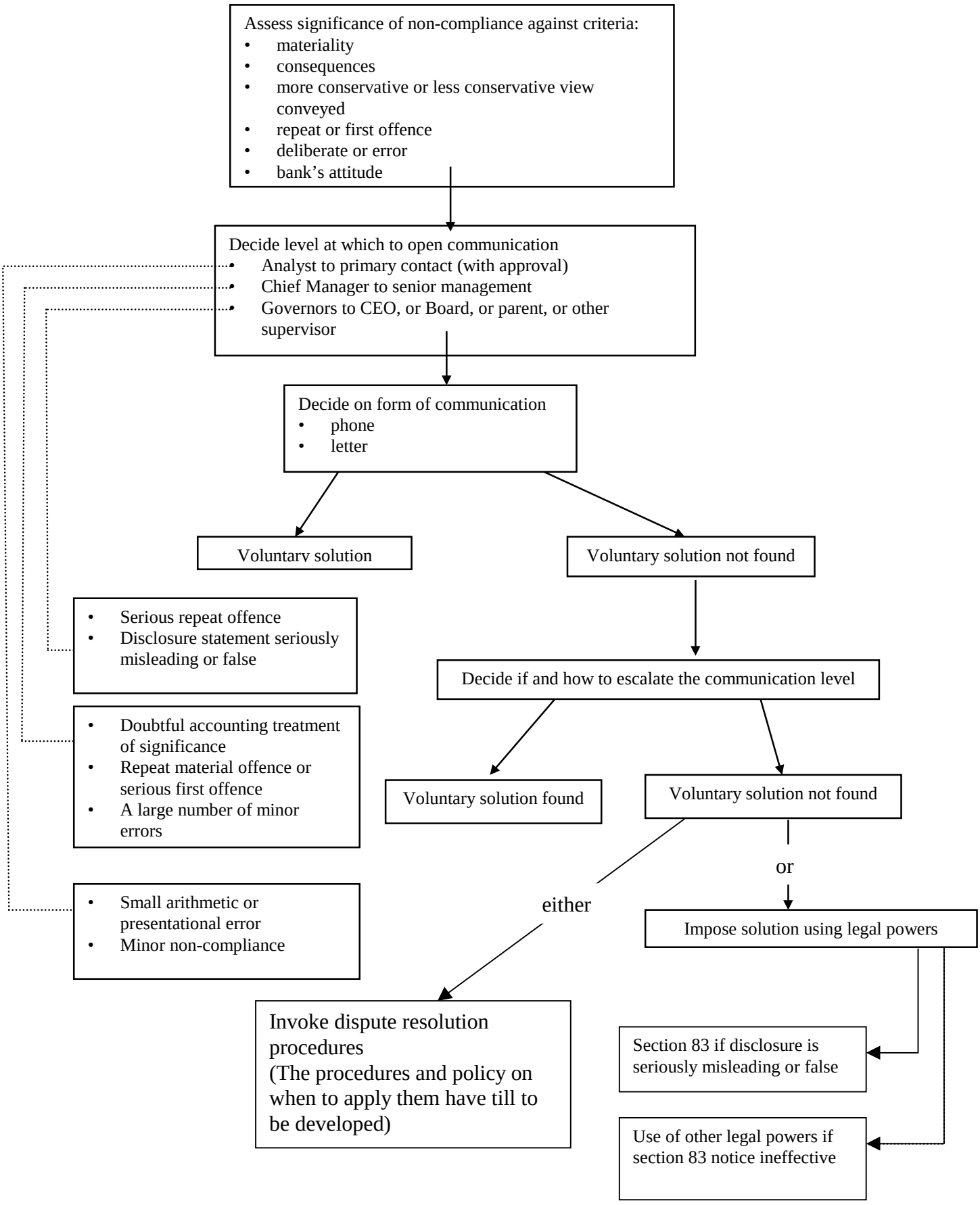
The Financial Reporting Act and company law require the financial statements of companies and issuers to be externally audited, in terms of audit report requirements set out in the Act.

Annex 5

Banks' Disclosure Statements - Hierarchy of Responses

Criteria for assessing type of response	Possible responses	Example of circumstances
• Materiality (capacity to influence users' interpretation and decision making). • Consequences for creditors, the Bank and the Government. • Does the error or omission portray a more conservative or less conservative view of the bank's affairs. • Is it a repeat or first offence (for the same type of error or non-compliance). • Is it deliberately misleading or an error. • The bank's attitude – cooperative or non-cooperative.	• The first step is to decide the level at which to start communications with the bank. • This depends on the Bank's assessment of the potential severity of the problem, and how high we need to go in the offending bank to get the problem fixed. • The possible levels of communication are: ⇒ Analyst to primary contact (with approval); ⇒ Chief Manager to senior management; ⇒ Governors to CEO or Board, parent bank, or foreign supervisor. • The type of communications at all levels includes phone calls and letters. • The primary objective of the initial communication is to reach agreement with the offending bank on how the problem is to be solved. • If the problem is not initially solved, the second step is to decide how much to escalate the level of communication. This depends on the severity of the problem. • If, after escalating the communication, the problem is still not solved, the imposition of a solution through enforcement actions needs to be considered if the issue is significant enough.	• Analyst to primary contact – initial communication: ⇒ Small arithmetic or presentational error. ⇒ Minor non-compliance. • Chief Manager to senior management – initial communication or subsequent escalation: ⇒ Where we have strong grounds for doubting the veracity of an accounting treatment, where the matter is material and the Bank's view is disputed by the offending bank. ⇒ Repeat offence of a material nature, or first offence of a serious nature. ⇒ There are a large number of minor problems in the same disclosure statement. • Governors to CEO or Board – initial communication or subsequent escalation: ⇒ Serious repeat disclosure breach. ⇒ Where the disclosure statement is seriously misleading or false such that investors' decisions could be influenced significantly. • Either use of enforcement actions: ⇒ Use of section 83, where the disclosure statement is seriously misleading or false, such that investors decisions could be influenced significantly or where there are major aspects of non-compliance. ⇒ Use of other legal powers where the bank has repeatedly failed to comply with a section 83 notice. • Or, invocation of dispute resolution procedures. (The procedures and policy on when to apply them have still to be developed.)

Dealing with disclosure non-compliance



Annex 6

Failure Management

The specific statutory powers available to the RBNZ include:

(i) the ability to require a bank to have its financial and accounting systems independently reviewed. Under this power, the RBNZ approves the appointment of the reviewer and the scope of the review.

(ii) the power to obtain information and documents. Where the RBNZ believes that information provided to it may be false or misleading or where a bank has failed to provide required information, the RBNZ may appoint a person to enter and search a bank's premises in order to obtain the information required.

(iii) The power to have a bank investigated. This power can only be exercised in order to determine whether the RBNZ should exercise the types of crisis powers referred to below (particularly the power to recommend that a bank be placed into statutory management).

(iv) the ability to require a bank to consult the RBNZ and to give the bank assistance, including in respect of proposals to sell all or part of the bank's business undertaking. This power can only be exercised in limited circumstances, such as where:

- a bank is insolvent or likely to become so;
- a bank is about to suspend payment or is unable to meet its obligations as and when they fall due;
- the affairs of a bank are being conducted in a manner, or a bank's circumstances are such as to be, prejudicial to the soundness of the financial system;
- a bank's business is not being conducted in a prudent manner;
- a bank has failed to comply with a requirement imposed pursuant to the RBNZ Act or has been convicted of an offence against the Act;
- a bank has failed to comply with one or more of its conditions of registration.

(v) The ability to give directions to a bank, including directions to remove specified directors or management, to cease to conduct certain specified forms of business, or to take specified actions. This power can only be exercised in the type of circumstances referred to above, and only with the consent of the Treasurer.

(vi) The power to recommend to the government that a bank be placed into statutory management. The appointment of a statutory manager is made by the government by regulation, on the recommendation of the RBNZ. The statutory manager can be a staff member of the RBNZ or, more likely, a person appointed from outside the RBNZ.

Under statutory management, a bank is subject to the control of a statutory manager, who assumes all the powers of the shareholders in general meeting, and the powers of the bank's directors and management. Statutory management imposes a moratorium on claims against the bank and facilitates the suspending of the bank's obligations. Statutory management can only be declared in the type of circumstances referred to above.

(vii) The power to recommend to the Treasurer that a bank be deregistered. Deregistration is effected by regulation made by the government. Deregistration can only occur in limited circumstances, including where:

- a bank has suffered a material loss of standing;
- a bank has failed to comply with a condition of its registration;
- a bank has not carried on business in a prudent manner;
- a bank has failed to comply with an obligation imposed under the RBNZ Act;
- a bank is in receivership or liquidation.

Deregistration does not prevent the bank from taking in deposits or conducting other banking business, but does prevent the use of the word "bank" in the entity's corporate name.

(viii) The RBNZ is empowered to provide lender of last resort facilities where this is considered necessary for the purposes of stabilising the financial system.

The RBNZ has established a hierarchy of responses where a bank breaches the minimum capital adequacy requirements. These responses are as follows:

(i) Where a banking group's capital falls below the minimum requirements (8% total capital and 4% tier one capital), the bank is required to prepare a plan for the restoration of capital to the minimum levels and provide a copy of the plan to the RBNZ. The plan must be disclosed in the bank's next quarterly disclosure statement. The plan must contain statements that:

- no distributions will be made to holders of capital instruments until capital has been restored to minimum levels (unless a contractual obligation exists to make such distributions);

- there will be no increase in credit exposures to related parties while capital remains below minimum levels;

- where the banking group's tier one capital is below 3% of group credit exposures, there will be no increase in the level of gross credit exposures from the level which prevailed at the time of the first occurrence of the breach.

(ii) Where a bank fails to publish a plan complying with the above requirements, or where it fails to comply with the required provisions of the plan, the RBNZ would be likely to give directions to the bank in question to enforce compliance or use other crisis response powers, as appropriate.

The liquidation of an insolvent bank of importance to the financial system would generally be dealt with by statutory management, rather than by the standard liquidation procedures of the Companies Act.

The main features of statutory management are as follows:

(i) Statutory management is declared by government regulation, made on the advice of the Treasurer, given in accordance with a recommendation from the RBNZ.

(ii) Statutory management can only be declared where a bank is insolvent or is likely to become so, or where a bank has suspended or is about to suspend payment, or where its affairs are being conducted in a manner prejudicial to the soundness and efficiency of the financial system, or where it has failed to comply with a direction give to it by the RBNZ.

(iii) All subsidiaries of the bank are also placed into statutory management, unless specifically exempted. Associates of the bank are not automatically placed into statutory management when the bank itself and its subsidiaries are made subject to statutory management, but can be included as appropriate. (An associate company is an entity which is owned by the bank to the extent of between 25% and 50% of the entity's shares.)

(iv) A statutory manager assumes all the powers of the shareholders in general meeting and those of the directors and management of the bank.

(v) A statutory manager is required to comply with any directors given by the RBNZ.

(vi) Under statutory management a moratorium is immediately imposed on all claims on the bank and its subsidiaries. The bank's and subsidiaries' obligations are suspended.

(vii) In exercising statutory management powers, a statutory manager is required to have regard to certain statutory considerations. These require priority be given to promoting the soundness of the financial system and resolving expeditiously the affairs of the bank.

(viii) Statutory management facilitates the restructuring of a bank's liabilities, with the consent of creditors.

(ix) Where the bank in statutory management is a branch of an overseas bank, statutory management facilitates the transfer of all or part of the business undertaking of the branch to a specially incorporated entity.