



**RESERVE  
BANK**

O F N E W Z E A L A N D  
T E P Ū T E A M A T U A

**July 2015**

**Feedback Statement:**

**Proposed removal of solo annual financial statements from bank disclosure requirements**

**1 Consultation**

- 1 We issued the consultation paper “Registered bank disclosure requirements: Proposal to remove requirements for solo annual financial statements” on 23 February 2015 and asked for comments by 23 March 2015. We received 15 responses in total, from ten registered banks, three government departments, and two finance academics. This paper summarises the responses we received and confirms our policy decisions in light of the consultation.
- 2 Reserve Bank disclosure requirements require registered banks, in their full-year disclosure statements, to publish financial statements on a full GAAP basis for both the banking group and the “parent” (ie stand-alone, or solo) entity<sup>1</sup>.
- 3 However, following recent changes, the general financial reporting legislation no longer requires entities to prepare solo accounts if they also prepare group accounts. The consultation therefore sought views on whether the requirement for annual full solo financial statements should also be removed from Reserve Bank disclosure requirements, either entirely, or to be replaced by an annual short summary table of the bank’s solo financial position.
- 4 The paper noted that if it was decided to remove the requirement for full solo financial statements, the Reserve Bank would need additional private reporting on a solo basis from relevant banks, to obtain the information it needs for its prudential supervision of those banks. The consultation therefore asked for views on three possible options, with the combinations of public disclosure and private reporting under each option summarised as follows:

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<sup>1</sup> More precisely, the requirement is for New Zealand-incorporated banks to include financial statements for the stand-alone registered bank if they are different from those of the banking group, and for overseas-incorporated banks to include financial statements for the New Zealand branch on a stand-alone basis if they are different from those of the bank’s New Zealand financial reporting group.

	Changes in disclosure requirements	Changes in private reporting
<b>Option A (preferred option)</b>	<u>Remove</u> solo annual financial statements.	Develop additional solo reporting from selected banks.
<b>Option B (reduced public solo information)</b>	<u>Replace</u> solo annual financial statements with short summary table.	Develop additional solo reporting from selected banks.
<b>Option C (status quo)</b>	<u>Keep</u> full solo annual financial statements.	No change.

- 5 Other related changes to the full-year disclosure requirements were also proposed under Options A and B, namely the removal of certain solo financial information that is supplemental to that required in the solo financial statements. In both the local and branch Orders, this includes the solo versions of some of the miscellaneous financial items specified in Schedule 4, and the solo versions of all of the supplemental information on asset quality required by Schedule 7.
- 6 Under all three options, we proposed that banks would continue to have to disclose the following few items of solo financial information:
- (a) for every branch, in every quarter, total branch liabilities (net of any related party funding), and (where applicable) total retail deposits in New Zealand. We argued that these should be kept because both amounts are subject to a limit imposed in the branch's conditions of registration.
  - (b) for every locally-incorporated bank, in their full year and half-year disclosure statements, solo capital ratios (total, Tier 1, and Common Equity Tier 1 ratios). These so-called solo capital ratios are in fact required to be calculated on a "solo-consolidated" basis, under which certain subsidiaries which are wholly-funded as well as wholly-owned by the registered bank are included in the scope of the ratio calculation. We argued that this requirement provides a useful public confirmation that a bank is maintaining sufficient capital within the solo-consolidation "ring-fence" to address risks taken on within that ring-fence, and is not down-streaming excessive capital to subsidiaries where third parties have a claim on it.

## **2 Views on relevance of solo financial information**

- 7 The consultation paper ran through some of the theoretical reasons why solo financial information about a bank may be useful to those interested in the financial position of banks, whether banks in general or certain classes of bank. It also asked for responses from any readers of bank disclosure statements who find the annual solo financial information useful in practice. The specific questions we asked were the following:

*Question 1: Do you make any use of the solo financial information in banks' annual disclosure statements? Do you think that public disclosure of this information adds to the market discipline benefits of disclosure statements generally?*

*Question 2: If you take an interest in the solo financial information, do you think that it has more value in relation to some classes of bank than others? Is there any subset of banks for which you think that it is important to keep the current level of solo financial information disclosure?*

- 8 Only two respondents indicated any interest in the solo financial statements:
- (a) one bank preferred Option A of the available options, but felt that locally-incorporated banks' solo financial statements can provide important insights for peer review by investors. They were in favour of another option in which the solo financial statement requirement would only be removed from branches of overseas banks.
  - (b) Inland Revenue (IRD) said that they make considerable use of the information in banks' full year DSs in carrying out their functions, including information on the solo position of the bank, where that differs from group.
- 9 A number of respondents gave other reasons why they feel that financial statements are not of value for the market in general, in addition to their own lack of use of them:
- (a) a common theme was that solo financial statements do not reflect the economic reality of how a group is managed (this was the main reason that the requirement was removed from the financial reporting legislation);
  - (b) respondents noted various limitations with solo financial statements, including that internal securitisation arrangements materially gross up the balance sheet, investments in subsidiaries are measured at cost, and the solo balance sheet has to include securitised assets, which are set aside for investors' benefit (and hence are unavailable to general creditors of the bank);
  - (c) disclosure of how risk is managed on a solo basis does not necessarily reflect how the banking group actually manages its risk, and can be essentially just a compliance exercise;
  - (d) apparent differences in risk profile between banks, based on a comparison of their solo financial statements, may not reflect actual differences in risk profile, as the solo picture is not comparable from bank to bank: it is highly dependent on a bank's particular group structure and its application of accounting standards;
  - (e) the solo information that is included in a bank's full-year DS makes it longer and more cluttered, and hence makes it harder to understand the content that is of real value; and

- (f) it was noted that the recently-introduced NZ IFRS 12 “Disclosure of interests in other entities” is designed to provide insight into the group structure of a bank and highlight any relevant risks to investors.
- 10 Two banks queried the retention of the disclosure of solo capital ratios. One of them made the point that their solo financial statements do include some other legal entities, namely securitisation trusts, since they take a substance-over-form approach, and that as a result, the scope of their solo capital ratio calculation is in fact the same as that of their solo financial statements. They argued therefore that the treatment of both should be considered together, although they also noted that while this is the case for some other locally-incorporated banks, it is not true for all of them. On the other hand the FMA support the disclosure of “critical prudential ratios” at the full year and half year, and one of the academics regards it as important to be able to see when capital has been down-streamed to subsidiaries, and hence sees value in the disclosure of solo capital ratios. Our response to this is to reiterate the reasons given in the consultation paper for keeping the solo capital ratios. We also note that if solo financial statements are removed, differences in scope between those and solo capital ratios will matter much less, while the importance of keeping public disclosure of at least one summary measure of financial strength on the appropriate solo basis will increase.
- 11 One bank also questioned the rationale for not removing the remaining two solo items in branches’ half-year and off-quarter DSs. Our response to this is that as long as market discipline remains a key part of our supervisory approach, we see value in the public disclosure of figures that relate to a condition of registration of a bank.

### **3 Views on retaining some summary solo information (Option B)**

- 12 The consultation paper included a proposed summary table as an alternative to full solo financial statements. The table set out a number of key balance sheet and P&L items (21 in total) that a bank would have to disclose in its full year DS on a solo basis, alongside a column of corresponding group figures to allow easy comparison.
- 13 The specific questions we asked on Option B were:

*Question 3: If full solo financial statements are cut from disclosure, would there be benefit in retaining some summary reporting on the solo bank in annual disclosure statements?*

*Question 4: If you support the idea of such a summary table, do you think the proposed table includes all of the main information that will be useful to readers? If not, what additional items do you think should be included, and why?*

- 14 There were no responses from any readers of disclosure statements saying that this would provide a helpful summary if the requirement for full solo financial statements was removed.

- 15 A number of the bank respondents raised issues with the proposed approach to providing some summary solo information. The main concern was that presenting balance sheet and income statement items in the exact manner specified would be at odds with the principles of financial statement preparation. Additional explanations and notes would be needed to ensure the information was complete, along with reconciliations with the group financial statement figures. This would add complexity and end up not reducing by much the solo financial information to be disclosed. Two respondents suggested that if we did decide to go down this route, it would be best to require an Income Statement, Statement of Changes in Equity, and Balance Sheet in line with accounting standards, to improve comparability for readers and facilitate reconciliation for preparers.

#### **4 Views on net cost impact of moving from public disclosure to private reporting**

- 16 As noted above, the Reserve Bank uses some of the solo information provided in some banks' full year disclosure statements, for prudential supervision purposes. However, the Reserve Bank has a power to request a registered bank to send it privately any financial information it needs for its supervisory purposes. So an important question for the consultation to determine was whether, if it turned out that there are no other users of the solo financial information, it would be more cost-effective for banks to continue to provide the Reserve Bank the information it needs by publishing annual solo financial statements, or by providing that information to the Reserve Bank via private data submission.
- 17 Although the Reserve Bank is not yet able to confirm in detail what such additional private reporting would amount to, the consultation paper set out the general direction of our thinking on that. We noted in particular the much greater flexibility of private reporting. For instance, solo private reporting for supervisory purposes would only be required from those registered banks for which the difference between the solo and group business is material. (We would need to set out precisely the materiality test and the arrangements for determining through time which banks are captured.)
- 18 We suggested that the existing income statement survey that is submitted on a group basis monthly by all registered banks, and on a solo basis quarterly by a few overseas registered banks, could be extended to other banks on a solo basis where that was seen as important, possibly quarterly. For balance sheet-related data, we noted that the Reserve Bank currently has plans to rationalise existing data collections, including redeveloping its current statistical balance sheet survey for registered banks, to complement the income statement survey. The stakeholder review that will be part of this exercise will factor in the needs of prudential supervisors to receive regular balance sheet-related information on a solo basis from those banks where the difference between solo and group is material. We suggested that this could be on a quarterly basis to match the income statement survey.
- 19 We also said that we would consider some way of obtaining assurance on the data quality of solo information provided via private returns to the Reserve Bank, to replace the current full scope audit applying to the solo financial statements. The approach we suggested was

to require a reporting bank to provide a report from an approved person on how the return has been prepared, under s95 of the Act, on a periodic (but less than annual) basis.

20 The following was the question we asked in the consultation paper about costs:

*Question 5: If you represent a bank that is currently required to publish separate annual solo financial statements, please provide: (1) as detailed a breakdown as possible of the costs of preparing and publishing them; (2) an estimate of the costs of publishing annual summary solo information in accordance with Table 1 [ie, the proposed summary table]; and (3) an indication of the costs of submitting quarterly income and balance sheet returns privately to the Reserve Bank, particularly relative to the costs referred to under (1) and (2).*

21 In response, banks mostly expected material cost savings from the removal of the solo financial statement requirement. Two of the big banks identified cost savings in the range of \$70-\$80,000 per annum, and another, savings of about 14 days' staff time, as well as some saving of senior management and board time for reviewing the information. One small bank expected a 20% reduction in the time taken to produce the annual DS, another expected a \$9,000 per annum saving, and a third expected a one week reduction in the time taken. Some banks also expected to benefit from some reduction in their audit fee. However, one of the big banks and one of the smaller banks did not expect material savings in their costs overall.

22 Not much information was given on the expected additional annual cost of preparing the summary table in Option B. One large bank gave a figure of \$9,000 and one smaller bank gave a figure of \$4,500. Another large bank did not expect much net cost saving under Option B, given the combined cost of preparing the proposed summary table and providing the additional private reporting.

23 The views that banks have on the costs of additional private reporting to the Reserve Banks varied somewhat, depending on their interpretation of what that might involve. It was generally the smaller banks who saw the most danger that the cost of the private reporting could outweigh the savings from the reduced disclosure. Some noted that the suggestion of requiring regular independent assurance of the numbers provided could more than offset the savings from no longer having to publish the numbers, although it appears that these respondents thought we would require this annually or even quarterly, which is not our intention. Some respondents also queried why would need quarterly private reporting to replace annual published information, and noted that that would make a significant difference to the cost offset.

24 As noted, the only user of the solo financial information identified in the consultation was the IRD. They have powers to request banks to provide them with the information they need, so, like the Reserve Bank, they would be able to substitute private reporting for the information they currently take from the published disclosure statements. Banks provided the above responses on costs without being aware of the possible additional cost of having to provide separate private information to IRD.

- 25 We therefore carried out a brief follow-up consultation with banks, to seek their revised views on the cost trade-off between public and private reporting. To inform this consultation we explained the IRD's possible data needs, and also provided the banks with some feed-back on concerns that they had raised in the initial consultation about the cost of the replacement private reporting to the Reserve Bank, as follows:
- (a) on the IRD's data needs, we pointed out that what is useful to the Reserve Bank as prudential supervisor will not be identical with the information that is useful to IRD for tax compliance purposes, and that although some of the solo information currently published in the DS will not be needed by either body, the IRD may need additional information that is neither currently in the DS, nor part of the Reserve Bank's future data needs for prudential purposes.
  - (b) on future private reporting to the Reserve Bank, we noted that the balance sheet aspects of solo reporting would tie in to the current project to rationalise balance sheet-related reporting, which should save costs in other ways. Details of the content and frequency of the returns would be consulted on fully, and we would aim to achieve a cost-effective outcome. We also explained that the suggestion of external review of the proposed returns was only an early indication of a possible approach, that would need to be consulted on fully in due course. Our thinking is that independent verification of prudential reporting is good practice in general, as enshrined in the Basel Core Principles, so we might implement this more broadly across our prudential returns. But this would be carried out on a rolling basis across returns, so for instance one return might be selected for review each year: it would certainly not be an annual requirement for every return, and the exact scope of such reviews would also need to be considered carefully.
- 26 Five out of six banks that responded to this follow-up confirmed that despite the expected need to provide additional information to IRD as well as to the Reserve Bank, they were still in favour of removing the public solo financial statement requirement.

## **6 Conclusions and next steps**

- 27 In the consultation we did not hear from any external readers of disclosure statements who pay attention to the information published in solo annual financial statements, and we were given a number of reasons why the information is not useful. We therefore see no loss of market discipline on registered banks from removing the requirement. In fact there could be some improvement in market discipline at the margin, as full year DSs would be a little shorter and easier to understand.
- 28 Banks have confirmed on balance that it would cost them less to provide the specific solo information that the Reserve Bank and the IRD need for their respective purposes, directly to those bodies on a private basis, than to publish full GAAP solo financial statements.
- 29 We have therefore concluded in light of the consultation that Option A is the strongly preferred option.

- 30 We are in the process of getting amending Orders in Council made to implement the changes to bank disclosure statements included in Option A. Subject to any uncertainties in the order-making process, we intend the changes to take effect on or before 30 September 2015, so that banks with a full-year reporting date of 30 September will not have to include solo financial statements in their DS for that date.
- 31 The Reserve Bank's Statistics Unit will continue to work over the coming months on its project to rationalise balance sheet data reporting. Work to develop proposals for additional private reporting on a solo basis will be co-ordinated with that project, and will also consider how far to extend the respondent coverage of the current income statement survey.