RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

Registered bank disclosure requirements

Proposal to remove requirement for solo annual financial statements

The Reserve Bank invites submissions on this consultation paper by 23 March 2015.

Submissions and enquiries about the consultation should be addressed to:

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Please note that a summary of submissions may be published. If you think any part of your submission should properly be withheld on the grounds of commercial sensitivity, or for any other reason, you should indicate this clearly.

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Executive Summary

1. 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.

2. However, following recent changes, the general financial reporting legislation no longer requires entities to prepare solo accounts if they also prepare group accounts. This consultation therefore seeks 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.

3. The attached paper runs through some of the theoretical reasons why solo financial information about banks may be of interest. **However, the Reserve Bank is keen to hear from any readers of bank disclosure statements who find the annual solo financial information useful in practice, whether from registered banks in general, or from particular groups of banks (for example, overseas bank branches).**

4. If it is 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 combinations of public disclosure and private reporting under the different proposed options are summarised in the following table.

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

5. Final decisions will be based on an assessment of the benefit currently derived from the publication of solo financial statements, compared to the benefit of additional private reporting, and the possible cost-savings for banks under the different options. **The Reserve Bank therefore seeks as much detailed information as possible from registered banks on the costs and cost-savings under the options described.**

6. The aim is that any changes to the public disclosure requirements decided on in the consultation should be made in time for end-June 2015 disclosure statements. **To meet this target date, we need to receive any feedback on this consultation by 23 March 2015.** Additional private prudential reporting to the Reserve Bank would be developed over a longer time frame.

Background

1. The Financial Reporting Act 2013 ("FR Act 2013") came into force on 1 April 2014. Shortly thereafter, the Reserve Bank consulted on the necessary follow-on amendments to the disclosure requirements set out in two Orders in Council made under section 81 of the Reserve Bank of New Zealand Act 1989. These are the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 ("local Order") and the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 ("branch Order").

2. These Orders referred in a number of places to either the Financial Reporting Act 1993 as a whole, or to specific sections of it. These needed to be updated to refer to the equivalent sections of the FR Act 2013 or the Financial Markets Conduct Act 2013 as required.

3. For the most part, the switch to the FR Act 2013 did not result in material change from the status quo for registered banks. However, one significant change was the removal of the requirement for "parent" entity (ie stand-alone or solo) financial statement reporting. That is, under the FR Act 2013, only group financial statement reporting is needed, unless the solo entity is not part of a group.

4. By contrast, the Reserve Bank's disclosure requirements require New Zealand incorporated banks to include the audited financial statements of the registered bank (solo) in full year disclosure statements, as well as the banking group financial statements that are required by the FR Act 2013 in any case. The corresponding requirement for branches is to include, in the full-year disclosure statements, the audited financial statements for the business of the stand-alone branch, as well as the accounts of the branch's New Zealand financial reporting group (which covers all of the New Zealand business of the overseas banking group).

5. Due to the limited time available for consultation on the changes arising from the FR Act 2013, the Reserve Bank decided to maintain the status quo rather than eliminating the solo financial statement requirement. However, the Reserve Bank undertook to consult further on the advantages and disadvantages of maintaining the current solo financial statement requirement, and on whether there were alternative approaches that could give the Reserve Bank as supervisor, and any interested external users, the information they need. That is the purpose of this consultation.

Reserve Bank starting assumptions

6. The Reserve Bank has certain assumptions based on its own supervisory practices and feedback on earlier consultations. These are –

    a. External readers of disclosure statements have no interest in seeing financial information on registered banks on a solo basis in addition to group financial information.

    b. The costs to banks of publishing annual solo financial statements (audited as required) are significant, and banks would strongly prefer to provide private prudential reporting of key solo financial information to the Reserve Bank, even if that was on a more frequent basis, eg quarterly.

c. The Reserve Bank's prudential supervisors have an interest in obtaining solo as well as group information, for banks where the differences between the two are material.

7. Based on these assumptions, the Reserve Bank's central proposal is to remove the requirement for solo financial statements from banks' published disclosure statements, and to replace that with standard private solo reporting from selected banks. However, this consultation seeks views on whether those assumptions are correct, and includes alternative options that may be preferred if they are not.

Scope of consultation

8. The full-year disclosure requirements include a significant amount of financial information that is supplemental to that required in the financial statements, and a certain amount of this information is required on a solo as well as on a group basis: in both the local and branch Orders, this is true of some of the miscellaneous financial items specified in Schedule 4, and all of the supplemental information on asset quality required by Schedule 7.

9. Generally, there is no required disclosure of solo financial information in half-year and off-quarter disclosure statements, although there are two minor exceptions:

a. Branches are required to disclose two items in every quarter relating to limits that are imposed on them by conditions of registration, namely total branch liabilities (net of any related party funding), and (where applicable) total retail deposits in New Zealand. We do not propose to reduce these required disclosures, given their link to conditions of registration.

b. Locally-incorporated banks are required to disclose solo capital ratios in their full year and half-year disclosure statements (total, Tier 1, and Common Equity Tier 1 ratios). These ratios are required alongside the group capital ratios and extensive other details of the group capital adequacy position. However, these so-called solo capital ratios are in fact required to be calculated on a "solo-consolidated" basis, which means that 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 believe that the publication of these solo capital ratios provides a useful 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 downstreaming excessive capital to subsidiaries where third parties have a claim on it. This disclosure is also not directly related to solo financial statements, so we do not propose to reduce or remove these disclosure requirements either.

10. We propose that whatever is decided about the requirement for full-year solo financial statements in this consultation should apply equally to the supplementary solo information in Schedules 4 and 7, except for the branch items noted in paragraph 9(a) above. Disclosure of solo capital ratios is also out of scope.

Relevance of solo financial information: complete removal (Option A) or status quo (Option C)

11. The general rationale for the removal of parent entity financial reporting in the FR Act changes was that group accounts reflect the economic reality of the way that a group of companies fully owned by a parent company is run. From the point of view of shareholders and others interested in the entity's performance, group assets and financial returns of the group are all under the control of, and all flow up through, the parent entity.

12. However there is no indication that the change was considered at the time specifically in relation to banks. No banks submitted on the FR Act 2013 while it was before select committee, and the response from the banking industry body (the NZBA) did not address the proposal to eliminate the solo reporting requirement. The Reserve Bank did not comment on the proposal at the time either, as questions of financial reporting for entities in general are beyond its remit, and in relation to registered banks it has the ability under s81 of the Reserve Bank Act to add whatever requirements it recommends to be necessary.

13. In this consultation the Reserve Bank is therefore keen to air further whether there are sufficient arguments that banks are a special case, to justify continuing with producing solo financial information when other entities no longer have to do so. For a start, banks are special to the extent of justifying prudential supervision and a registration regime; and the importance of disclosure in the Reserve Bank's supervisory approach is already taken to justify additional financial disclosure requirements beyond those applying to businesses generally. So we think that arguments for removing solo financial disclosure need to be reconsidered for registered banks, separately from the arguments made in the case of entities in general.

14. The question to consider is what value is provided by all or part of the information in solo financial statements and other required items of solo financial information, when extensive group information is already produced.

15. A key reason for interest in solo information is that the Reserve Bank's powers to carry out prudential supervision under Part 5 of the Act relate only to the registered bank as a stand-alone legal entity. So while the health of the banking group is vitally important to assessing the risk of failure of the solo bank, it is also important that supervisors have the information necessary to assess the bank's solo performance. For example, it could be the case that the registered bank itself was significantly underperforming relative to another entity within the group structure. In monitoring the longer-term viability of the bank, it may be important for the supervisor to have a good understanding of where group profitability is coming from. Having regular data on the position of the solo entity may also be important if crisis management powers ever need to be invoked.

16. But none of this justifies maintaining public disclosure of the information. We are therefore interested to hear views on whether other parties find any aspects of the solo information valuable in assessing the group's performance; and even if no-one is currently using such information, whether anyone believes that its publication exerts valuable market discipline.

Branch-specific considerations

17. The single-economic-entity argument for group rather than solo reporting does not hold so well where a registered bank is incorporated overseas. In this case the relevant single economic entity is in practice the overseas banking group as a whole. Financial reporting by the whole group is governed by home country financial reporting legislation and supervisory requirements, and is outside the scope of this consultation. The New Zealand “financial reporting group” is of some interest to prudential supervisors and possibly to external readers of disclosure statements, as it presents the performance of the overseas banking group from a New Zealand geography perspective. However it does not necessarily represent a single economic unit the way that a locally-incorporated group does, and the solo performance of the branch may in some cases be of equal importance.

18. The value of solo branch financial statements may be greater when a bank has dual registration to operate as both a locally incorporated bank and a branch of an overseas bank in New Zealand. In this case, the branch’s financial reporting group includes all the business of the locally incorporated bank’s group, so that there is typically a large difference in scale between the financial statements of the branch’s group and those of the stand-alone branch.

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?

Compromise (Option B): reduce rather than remove published solo bank financial information

19. If responses to the above questions show that there are readers of disclosure statements who do have some interest in solo information but do not require the comprehensive information provided by financial statements, then we think it will be worth considering an option under which we would replace the requirement for solo financial statements with disclosure of only certain key components of the financial reports. This option could significantly reduce the compliance burden for registered banks but would still have the advantage of making certain key information publicly available.

20. The Reserve Bank has prepared the following template of information on the solo bank that could be included in the full year disclosure statement. As the table shows, we propose that corresponding group figures (from the financial statements) are shown alongside the solo figures for ease of comparison. The Reserve Bank would be interested in views on whether this information is adequate or whether further items should be included (and if so, which).

Table 1: Supplementary solo bank financial information to be included in full year disclosure statements

Item		**Solo**	**Group**
Total interest income			
Total interest expense			
Total other income			
Total impaired asset expense			
Total operating expenses			
Net profit or loss before taxation			
Taxation			
Net profit or loss after taxation			
Total assets			
Comprising:			
	Cash and deposits		
	Debt securities		
	Loans		
	Shares and equity instruments		
	Other financial assets		
	Non-financial assets		
Memo items:	*Total lending to related parties*		
	Total investment in subsidiaries[1]		
	Total individually impaired assets		
Total liabilities			
Of which:			
	Total liabilities to related parties		
Head office account[2]			
Equity[1]			

1: Local Order only
2: Branch Order only

21. Under this option, we would also cut the existing solo supplemental disclosure that is within the scope of this consultation, as noted in the section on Scope above. If respondents feel that any of that supplemental information is particularly important, it could be retained but disclosed as part of the above table instead.

22. The six-monthly disclosure of solo capital ratios by locally-incorporated banks would not change, and we do not propose that the figures are included in the above table as well as being in the capital adequacy summary, because they are calculated on a different basis (“solo-consolidated”, as described above).

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?

Additional private reporting if public disclosure reduced

23. As noted above, the Reserve Bank has an interest in solo financial information for a number of its registered banks. Under the options for either cutting the requirement for published solo financial statements altogether, or replacing it with an annual short-form summary table, the Reserve Bank would want to ensure that the information needs of its banking supervisors were sufficiently covered by private reporting from selected solo entities. This section gives an indication of what that would entail.

24. One particular advantage of private reporting compared to public disclosure set by Orders in Council is the much greater flexibility. Elements to be included in private reporting could be amended as needed without modification of the Orders. Also, 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.

25. The Reserve Bank already has in place an income statement survey that is submitted monthly by all registered banks on a group basis, but is also submitted by a few overseas registered banks quarterly on a solo basis. We expect that additional private reporting from other banks where solo information was seen as important would be on a similar basis, namely quarterly submission of the income statement survey.

26. The Reserve Bank also collects the monthly Standard Statistical Return (SSR) from solo banks, although that is to measure monetary aggregates rather than for supervisory purposes. The Reserve Bank currently has plans to rationalise existing data collections, including redeveloping its current statistical balance sheet survey for registered banks, to add to 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 for which it matters. This could be on a quarterly basis to match the income statement survey.

27. The information that the Reserve Bank currently draws from published solo financial statements is subject to full scope external audit. By contrast, quarterly reporting to the Reserve Bank via private prudential returns is not currently subject to any form of independent quality assurance on a routine basis. So under this option, the Reserve Bank would consider some way of obtaining assurance on the data quality, for instance by periodically requiring a reporting bank to provide a report from an approved person on how the return has been prepared, under s95 of the Act. This might be carried out on a rolling basis across banks, at less than annual frequency.

Summary of options

28. The following table summarises the changes that would be made to public disclosure, and to private reporting to the Reserve Bank, under each of the options discussed above. As an alternative to deciding on one of these options to apply to all registered banks, the Reserve Bank would also consider applying different options to different groups of banks.

Table 2: Summary of Options

	Changes in public disclosure requirements	**Changes in private reporting**
Option A (preferred option)	Remove solo annual financial statements and most other solo financial information.	Develop additional solo reporting from selected banks.
Option B (reduced public solo information)	Replace solo annual financial statements, and most other solo financial information, with short summary table.	Develop additional solo reporting from selected banks.
Option C (status quo)	Keep full solo annual financial statements, and all other solo financial information currently required.	No change.

Views on relative costs

29. The Reserve Bank would welcome views and as much specific information as possible from registered banks on the relative costs and cost savings for them under the different options. We have not provided much detail at this stage on the contents of the private reporting returns, but would appreciate feedback on how the continuing costs of providing such returns compares with the costs of public disclosure of the solo information.

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; 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).

Alignment with international standards

30. The Reserve Bank is not bound by banking supervision standards issued by the Basel Committee, but adopts them where they make sense for New Zealand, adapted as necessary. In this context, we note that the Basel Core Principles for Effective Banking Supervision (revised in 2012) discuss reporting on a solo and group basis in Principle 10 and Principle 28. Principle 10 relates to prudential reporting (that is, private reporting submitted directly to the supervisor) while Principle 28 relates to public disclosure (that is, information that banks are required to make available to the general public).

31. Principle 28 requires that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis. However, no guidance is provided on the circumstances in which solo reporting may be necessary or appropriate. We believe that this consultation provides a reasonable test of whether solo entity public disclosure

is appropriate, so if it proves not to be so, then removing any requirement for disclosure of solo information will not detract from compliance with Principle 28.

32. Principle 10 suggests that prudential reporting (as distinct from public disclosure) should be conducted on both a solo and a consolidated basis and these reports should be independently verified through either on-site examinations or use of external reports. As the Reserve Bank does not conduct on-site examinations, satisfying this principle depends on the use of external reports.

33. Under either the current solo financial statement requirement, or the option to publish an annual summary of the solo position, all the solo prudential reporting that the Reserve Bank is receiving from banks comes from published disclosure statements. In both cases the information is subject to external review: the standard “true and fair” audit opinion applying to financial statements in the first case, and in the second case, the auditor’s opinion on whether the information was fairly stated in accordance with the relevant Schedule of the Order. In this way, Principle 10 is satisfied in a fashion, although the information also happens to be published.

34. So if we do move to the private reporting-only option, then continued compliance with Principle 10 implies the need for some form of external report on that private data submission. This underlines the desirability of the suggestion in paragraph 27 above of instituting a rolling programme of independent reports on private reporting returns.

<u>Timing and next steps</u>

35. This consultation does not include proposals for the detailed drafting changes to the disclosure Orders in Council that will be needed if it is decided to change the current requirement for annual solo financial statements. If that is the outcome of this consultation, there will be a further short consultation on the changes to the Orders that are needed to implement the policy decisions made.

36. The aim is to get any agreed changes to the Orders in force by 30 June 2015, which is the earliest disclosure statement reporting date by which that is achievable. That end-date entails a timetable along the lines set out below.

Deadline for comments on this consultation paper	23 March
Consider feedback, draft amending Orders	23 March – 10 April
Short consultation on wording of revisions to Orders	10 – 22 April
Finalise drafting of amending Orders and covering papers to get Orders made	23 April – 6 May
Amending Orders gazetted	Around 28 May
Amending Orders come into force after 28-day notice period	By 30 June

37. Any compensating additions to private reporting would continue to be developed by the Reserve Bank's Statistics Unit within its overhaul of balance sheet reporting, over a longer timescale. In this case, until further standardised solo information becomes available via private reporting, individual supervisors may need to request ad hoc solo information from their bank during the period after the bank has published its last solo annual financial statements.

Summary of questions for consultation

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?

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