Consultation Document: Regulatory Stocktake of the Prudential Requirements Applying to Registered Banks

The Reserve Bank invites submissions on this consultation document by 5pm on 16 September 2015

Submissions and enquiries should be addressed to:

Ashley Tomlinson, Jeremy Richardson and Rachel Fleet
Prudential Supervision Department
Reserve Bank of New Zealand
PO Box 2498
Wellington 6140
Email: stocktake@rbnz.govt.nz

Please note that a summary of the submissions may be published. If you consider that any part of your submissions 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

Introduction

1. There have been significant changes to the regulation of New Zealand banks over the last 10 years. These changes include the introduction of minimum liquidity and corporate governance requirements, the implementation of the Basel II and III capital adequacy frameworks, and the development of the Open Bank Resolution policy. At the same time, Non-bank Deposit Takers (NBDTs) have also become subject to prudential regulation.

2. It is possible for inefficiencies or inconsistencies to emerge in the overall regulatory framework when such a diverse range of changes are made. In turn, this can impose unnecessary costs or restrictions on regulated entities, hindering the efficient operation of the market and the scope for innovation. For this reason, the Reserve Bank considers that it is an appropriate time to pause and undertake a stocktake of the current regulatory environment for banks and NBDTs.

3. Our primary objective in conducting the stocktake is to enhance the efficiency, clarity and consistency of the specific prudential requirements applying to banks and NBDTs. By reducing any unnecessary costs or restrictions arising out of the current framework, we aim to help facilitate innovation and the efficient allocation of resources in the market, while still achieving our core financial stability objectives.

4. Within the scope of this stocktake are the contents of the current banking supervision handbook (which includes conditions of registration, guidance material, and the Orders in Council that set out the prescribed frequency and contents of the disclosure statements that are published by banks), and the specific prudential requirements for NBDTs (capital, liquidity, etc.). Outside of the scope of the stocktake are the contents of Part 5 of the Reserve Bank of New Zealand Act 1989, and other parts of the Non-bank Deposit Takers Act 2013 (for example, the provisions governing licensing, supervision, and investigations/enforcement).

5. The secondary objective of the stocktake is to consider whether there are areas where we can further improve the quality and effectiveness of current policy development process across our prudential and macro-prudential functions. A particular focus of this objective is considering the transparency of our policy development processes and our engagement with stakeholders.

6. The consultation document that follows sets out our analysis to date in relation to the prudential requirements for banks, and proposes a number of possible changes, or options for changes, that we are seeking submitters' feedback on. We note that the issues that have been considered in relation to NBDTs are not included in this consultation document, and instead are part of a separate "Industry Update" document that we have published.[1]

7. Our analysis to date in relation to banks has also been informed by a series of workshops with banking industry representatives and discussions with a private panel of experts we have established to test our thinking with. We would like to take this opportunity to thank workshop attendees and expert panel members for their input into the project thus far.

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[1] See http://www.rbnz.govt.nz/regulation_and_supervision/non-bank_deposit_takers/nbdt-industry-update-regulatory-stocktake.pdf

The structure of this consultation document

8. This consultation document is divided into six parts, covering the different work streams that have been considered as part of the stocktake. Specifically:

- Part 1: Data reporting and disclosure requirements for banks;
- Part 2: Format and structure of the Banking Supervision Handbook;
- Part 3: Capital requirements;
- Part 4: The RBNZ's policy making approach across regimes;
- Part 5: Differentiated regulatory approaches in the banking prudential regime; and
- Part 6: Miscellaneous changes to Bank policies and regulations.

9. Each of these parts of the consultation document are discussed in turn below

Part 1: Data reporting and disclosure requirements

10. The Reserve Bank's current approach to disclosure is heavily influenced by our broader approach to regulation, which is based upon the three pillars of:

- Regulatory discipline (i.e. the requirements imposed on a regulated firm by the prudential regime);
- Self-discipline (i.e. a firm's internal risk management and governance systems); and
- Market discipline (i.e. the incentives placed on firms by the fact that investors and other market participants are monitoring their risk profile, and financial performance and position).[2]

11. The prudential regime for banks is designed in part to buttress the operation of self-discipline and market discipline aspects of this approach. One of the most important ways that it aims to do this is through disclosure requirements that:

- Encourage market discipline through the quarterly publication of disclosure statements; and
- Encourage self-discipline through the due diligence that is required before the board will sign off on the content of these disclosure statements.

12. However, we remain conscious of the importance of ensuring that the disclosure regime remains fit for purpose and operates efficiently. To this end we carried out a review of the disclosure regime between 2009 and 2011 which made a number of important changes. These changes included:

- Removing the requirement to publish quarterly Key Information Summaries and make hard copies of them available in every bank branch;

[2] *The Evolution of Prudential Supervision in New Zealand*, p.5, Reserve Bank of New Zealand: *Bulletin*, Vol. 75, No. 1, March 2012.

- Removing the requirement to publish Supplemental Disclosure Statements (SDSs) containing information such as the full text of guarantee arrangements and netting agreements;

- Providing that the financial statements included in half year disclosure statements no longer had to be prepared on an IFRS full year basis, and could instead be prepared on an interim basis; and

- Reducing capital adequacy information in the off-quarter disclosure statement from a full update to a brief summary.

13. At the time, cost estimates from banks suggested that these changes would result in direct costs savings of between $99,000-$140,000 per year for larger banks, and $21,500 per year for smaller banks.

14. Notwithstanding these changes, whether it remains appropriate for banks to prepare off-quarter disclosure statements is an issue that has arisen again in the course of the stocktake. We have given careful consideration to whether further changes to this requirement would be appropriate. In considering this issue we have focused on the underlying question of whether the benefits of this requirement outweigh the costs, taking into account the effect of any changes on:

    - The market disciplines applying to banks;

    - The internal disciplines applying to banks;

    - The regulatory disciplines applying to banks;

    - The costs of preparing off-quarter disclosure statements;

    - The consequences of any changes for the treatment of banks under other regulatory regimes;

    - The overall impacts on financial stability; and

    - Consistency with international standards and the approach taken in other jurisdictions.

15. In light of this analysis we consider that there are four options for the treatment of off-quarter disclosures requirements. Specifically:

    - Option 1: The status quo;

    - Option 2: Scaling back off-quarter disclosure statements for larger locally incorporated banks to capital and asset quality disclosure, and removing the requirement for branches and locally incorporated banks with retail deposits below $200 million to prepare off-quarter disclosure statements;

    - Option 3: Removing the requirement for banks to prepare off-quarter disclosure statements and replacing it with some kind of continuous disclosure regime to ensure that material adverse changes are disclosed when they occur between full and half year disclosure statements being published; and

    - Option 4: Removing the requirement for banks to prepare off-quarter disclosure statements altogether.

16. Options 2, 3 and 4 would also require banks to provide additional private reporting to the Reserve Bank for supervisory purposes (and possibly also require banks to provide additional private reporting to rating agencies and/or the IRD).

17. We have considered the pros and cons of these options, but do not yet have a preference on which option to adopt. We stress that a key consideration in choosing whether to scale back or remove the requirement to prepare off-quarter disclosure statements is likely to be whether or not it would materially impact on the market and internal disciplines that banks are subject to. We encourage any submitters who support changes to the status quo to directly address this issue.

18. In addition to possible changes to the requirement to prepare off-quarter disclose statements, there are a number of other disclosure related issues we are considering.

19. Firstly, we are proposing a number of more minor and technical changes to the content of disclosure statements. These changes are outlined below in Table 1. Secondly, we are proposing that as part of banks' private statistical reporting they provide certain information drawn from their disclosure statements in templated form, which we consider would be a more efficient way of compiling this information for the Bank's statistical purposes.

Part 2: Format and structure of the Banking Supervision Handbook

20. The Banking Supervision Handbook (the Handbook) is the title given to a collection of documents that sets out a range of different matters relating to the Reserve Bank's regulatory requirements for banks. The Handbook has grown "organically" over time, in the sense that new documents have been added to it and numbered in chronological order, rather than being fitted into a more coherent structure. Formatting and layout also varies significantly across documents.

21. There are a number of problems that have been identified by the main users of the Handbook, namely registered banks and applicants for registration, and also by the Reserve Bank. Some of the key problems are:

    - The delineation between legally binding regulatory requirements, guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989, and general guidance material is not clear;

    - The handbook is unclearly drafted in places and contains unnecessary duplication, and the organisation of subsections and headings within some documents makes them hard to navigate (for example, BS1 is meant to set out the process for an entity seeking to apply for registration as a bank. However, it does not contain all the necessary information for applicants, and also contains a significant amount of information not directly relevant to them);

    - There are many defined terms within Handbook documents, and these definitions sometimes differ across documents; and

    - Some handbook documents and bank conditions of registration have to be regularly updated for purely technical reasons rather than to make substantive policy changes (for example, due to cross referencing between documents).

22. The Reserve Bank proposes to reorganise the Handbook in a number of ways to address these problems. Specifically:

- A standard organising principle will be applied to each document, to make it clear what the status of the material in the document is, and to facilitate navigation within the document;

- The electronic versions of documents will be modernised to allow better search and navigation features, while printable versions of individual documents will still be available;

- A clear distinction will be made between requirements that apply to registered banks at all times, process requirements that are triggered by particular changes/events, and material that is relevant only for new applicants;

- A single document will provide all the material needed by applicants for registration. This will draw on several existing documents, and will be designed so that banks will not need to refer to it once they have been registered;

- A number of continuing requirements for registered banks that are currently discussed in BS1 will be made more transparent by moving them into one or more separate documents that will clearly label them as continuing requirements;

- The documents setting out capital adequacy requirements and other related documents will be broken up into a number of smaller "modules", to deal with the length and complexity of these documents and the duplication between them;

- A single glossary will be created to contain all terms that are defined in Handbook documents, and where feasible, any inconsistencies within the Handbook and with other external standards will be removed;

- Material that provides guidance rather than defining or imposing binding requirements on banks will be clearly, separately marked as such. The Handbook will no longer include guidelines issued by the Reserve Bank under s78(3) of the Act: existing guidelines of this nature will be re-presented as guidance to clarify how a bank can meet a particular condition of registration; and

- The Reserve Bank proposes to make superseded, older-dated versions of handbook documents available on its website, along with redlined versions and summaries of what has changed. Documents that are cross-referred to in other documents will in future be referred to as "the version applying in the registered bank's conditions of registration", rather than being the version at a specific date. This will remove the need to replace whole documents and associated conditions of registration just to update date references.

23. The format and layout for Orders in Council which impose disclosure requirements on registered banks will be outside the scope of the above reorganisation. (Possible changes to their content are discussed in Part 1). Substantial improvements were made in their layout in 2008 and again in 2011, and they are a special case, as they are legal instruments published in the New Zealand Gazette.

24. The proposed reorganisation represents a substantial exercise, which will result in material benefits for banks and other users by significantly improving the clarity and accessibility of prudential requirements. The Reserve Bank proposes to implement the changes in a four-stage project running from September 2015 to end-2016.

Part 3: Capital requirements

25. Although the substance of the Reserve Bank's capital requirements is outside the scope of the regulatory stocktake, the Reserve Bank is keen to clarify these requirements in order to improve accessibility.

26. The structure of the Banking Handbook, including its capital adequacy components, is dealt with in Part 2 of this consultation paper.

27. There are also two other capital related matters that have been raised in the context of the stocktake. Firstly, the current version of the capital adequacy requirements (i.e. BS2A and BS2B) contains sections that may no longer be relevant and have never been used by the Reserve Bank (for example, the Foundation IRB approach, which was originally intended as a half-way measure between full IRB accreditation and being on the standardised approach, and the Qualifying Revolving Retail Exposure class). We have recently consulted on the possible removal of these sections (a link to the consultation, which has now closed, is provided in Part 3 below).

28. Secondly, a number of stakeholders have suggested that we review the current restrictions on banks' insurance business or the broader role of holding companies and treatment of groups that also carry on non-banking business. While it appears to be a relatively simply issue at first, it raises a number of other issues, specifically regarding disclosure requirements and the reporting requirements of locally incorporated banks and insurance companies as well as branches. We will be considering this issue in due course, but are not proposing to make changes to the policy at the current time.

29. While it is not formally part of the stocktake, we also note that, as announced in the May 2015 Financial Stability Report, the Reserve Bank is conducting its own review of its capital adequacy requirements, which will take account of any changes recommended by the Basel Committee as part of its current work on reviewing the standardised and IRB approaches to bank capital requirements. The Reserve Bank will consult separately on this work in due course.

Part 4: The RBNZ's policy making approach across regimes

30. The Reserve Bank's approach to policy making is firmly anchored in its governing legislation (the Reserve Bank of New Zealand Act 1989) and seeks to follow the "Best Practice Regulation" model developed by the New Zealand Treasury wherever possible. This includes the preparation of regulatory impact statements for proposals that will result in legislation, and consultation with stakeholders on relevant proposals. More broadly, the Bank assesses and reports on the expected regulatory impacts of all of its policies when decisions are made to implement those policies. The Bank also reviews its significant policies at intervals appropriate to the nature of the policy being assessed. The Bank publishes reports on these assessments and reviews on its website, and also publishes three accountability documents: an annual Statement of Intent, an Annual Report, and a (semi-annual) Financial Stability Report (FSR).

31. Our stakeholders have indicated an interest in greater transparency regarding the Bank's policy making processes, as well as enhanced engagement with industry regarding new policies or policy changes.

32. The Bank is proposing to take a number of steps to address these issues, including:

- Publishing a new document that describes our approach to policy-making and indicative timeframes for consultations (the outline for a possible draft of this document is included in Appendix F of this paper);

- Revising the content of the website to make it more user-friendly (this will build to some extent on the changes to the structure and presentation of the Banking Supervision Handbook);

- Providing a more dynamic “Consultations and Policy Initiatives” section on our website by updating it on an at least quarterly basis to include current initiatives of the various departments within the Bank working on matters relating to bank regulation and supervision;

- Developing an “Industry Update” newsletter for banks (based on the current “Insurance Industry Update”) to keep them informed about our work;

- Exploring ways of more proactively using the Banking Forum[3] to promote coordination among regulators regarding timelines for consultations; and

- Streamlining the process for amending regulations by eliminating some of the current need for changes (for example as a result of cross referencing between documents), and making the change process more transparent by providing a “change register” that shows amendments to prudential requirements that have been made over time.

Part 5: Differentiated regulatory approaches in the banking prudential regime

33. There are a number of ways in which the Reserve Bank differentiates the regulatory requirements that apply across different classes of bank. Some stocktake contributors questioned the rationale for certain of the cut-off points for different requirements imposed on banks. In response to this, as part of the stocktake we have taken the opportunity to review the nature of the differentiation between different classes of banks under the prudential regime.

34. We believe that a differentiated approach has value in delivering the objectives of prudential supervision in a more effective and efficient way than applying a “one size fits all” approach. Our aim in reviewing the nature of the current differentiation is therefore to identify changes that could be made to further improve the efficiency or effectiveness of our overall approach.

35. Our analysis of this issue has highlighted a number of points. Most importantly, that:

- The Reserve Bank uses regulatory tools that reduce either the likelihood of a bank failing, or the impact of that failure if it occurs (some tools target both);

[3] The Banking Forum is a subcommittee of the Council of Financial Regulators (CoFR), which is a venue for government departments and agencies with responsibility for, or an interest in, the financial sector. The members of CoFR are the Reserve Bank, Treasury, Ministry of Business, Innovation and Employment, and Financial Markets Authority. These four organisations are also full members of the Banking Forum. The Inland Revenue Department and Ministry of Justice are associate members of the Banking Forum.

- Most regulatory tools have at most limited effectiveness when applied to an overseas-incorporated bank with a branch in New Zealand (although one possible exception is short-term liquidity requirements);

- There remains a strong case for imposing a maximum size limit on overseas branches; and

- A number of regulatory tools work most effectively in combination with other tools.

36. As a result of our analysis we:

- Propose to reduce disclosure requirements applying to branches, both in line with the options for changes to the disclosure regime discussed above, and in some areas of more specific detail;

- Plan to consider whether the application thresholds for the outsourcing and OBR requirements should be made the same (as part of the separate review of our outsourcing policy for banks that is currently under way); and

- Will assess whether to extend a form of one week liquidity mismatch ratio to branches (as part of planned work to consider whether the Reserve Bank should modify its liquidity policy in light of the new Basel III requirements).

Part 6: Miscellaneous changes to Bank policies and regulations

37. During the stocktake, our analysis has also raised a number of more minor or technical matters that could usefully be addressed as part of the project. These matters are fairly diverse, but we consider that overall they can be expected to improve how efficiently the regime operates and achieves it objectives.

38. The first of these matters is refining the existing suitability assessment process for the directors and senior managers of banks. We consider that there are three issues with the current approach, specifically:

- The definition of senior manager can sometimes cover persons who do not have, or are unlikely to have, significant influence over a bank’s financial soundness (e.g. a bank’s Head of Change Management or a bank CEO’s Chief of Staff);

- There is a lack of any requirement to ensure the ongoing suitability of directors or senior managers after they have been appointed; and

- The existing framework may raise a number of broader risks or inefficiencies. For example:

    - It may raise moral hazard issues by creating a perception that appointments were being approved by the Bank (a particular concern here is that stressing that the process provides a form of negative assurance may be insufficient to change this perception); and

    - It may create unnecessary duplication and inefficiency by not being more integrated with the internal processes used by banks to assess suitability.

39. We have canvassed a number of options for potential changes to the definition of senior manager, and our preference at this stage to adopt a more focused definition that just covers certain key office holders (the Chief Executive Officer, the Chief

Financial Officer, the Chief Operating Officer and the Chief Risk Officer, or persons with equivalent responsibilities).

40. We also consider that it may be appropriate to provide for an ongoing requirement to ensure the continued suitability of directors and senior officers who have already been appointed. Again, we have canvassed a variety of options for how this could be done. Our preference at this stage is to require directors to attest in disclosure statements that they have effective systems and processes in place for ensuring the ongoing suitability of directors and senior managers, and that those systems and processes are being correctly applied (we note that this attestation could be included in full and half year disclosure statements, but may not need to be included in off-quarter disclosure statements if they are retained);

41. We do not propose at this stage to make any changes as a result of the broader risks that have been identified with the current model (moral hazard, etc.).

42. The stocktake has also identified two specific issues with the current arrangement for disclosing and reporting breaches. Firstly, while the Bank is privately notified of any breaches that might occur, there is no formal legal obligation for banks to report breaches to us under existing legislation. In response to this issue, we are proposing an approach whereby we use our existing information gathering powers under the Reserve Bank of New Zealand Act 1989 to require a bank to report actual or potential breaches privately to the Reserve Bank as soon as practicable after the bank becomes aware of these actual or potential breaches

43. Secondly, some banks have suggested that the need to disclose breaches in disclosure statements can be disproportionate where these breaches are of a very minor or trivial nature. We do not propose to change the requirement to disclose all breaches at this time, but will consider how conditions of registration are drafted in future to reduce the risk that genuinely trivial matters could result in technical breaches of conditions of registration.

44. Finally, the stocktake has highlighted again that some of the material in the Banking Supervision Handbook (specifically BS5) that refers to Anti-Money Laundering requirements is out of date. We propose to update the contents of BS5 separately, well before the end of this year.

Introduction

Why carry out a "Regulatory Stocktake"?

45. There have been significant changes to the regulation of New Zealand banks over the last 10 years including the introduction of minimum liquidity and corporate governance requirements, the implementation of the Basel II capital adequacy framework, and the development of the Open Bank Resolution policy. At the same time NBDTs have also become subject to prudential regulation.

46. It is possible for inefficiencies or inconsistencies to emerge in the overall regulatory framework when such a diverse range of changes are made. In turn, this can impose unnecessary costs or restrictions on regulated entities, hindering the efficient operation of the market and the scope for innovation. For this reason, the Reserve Bank considers that it is an appropriate time to pause and undertake a stocktake of the current regulatory environment for banks and NBDTs.

47. Our primary objective in conducting the stocktake is to enhance the efficiency, clarity and consistency of the specific prudential requirements applying to banks and NBDTs.

Scope of the Regulatory Stocktake

48. We are not looking to alter the fundamental shape of the prudential regime for banks and NBDTs (e.g. requiring adequate capital and liquidity, effective governance and risk management). Instead, our primary objective in conducting the stocktake is to ensure the efficiency, clarity and consistency of the specific prudential requirements to which banks and NBDTs are subject. By reducing any unnecessary costs or restrictions arising out of the current framework, we aim to help facilitate innovation and the efficient allocation of resources in the market, while still achieving our core financial stability objectives.

49. Within the scope of the stocktake are the contents of the current Banking Supervision Handbook (which includes conditions of registration, guidance material, and the Orders in Council that set out the prescribed frequency and contents of the disclosure statements that are published by banks), and the specific prudential requirements for NBDTs (capital, liquidity, etc.) . Outside of the scope of the stocktake are the contents of Part 5 of the Reserve Bank of New Zealand Act 1989, and other parts of the Non-bank Deposit Takers Act 2013 (for example, the provisions governing licensing, supervision, and investigations/enforcement).

50. The secondary objective of the stocktake is to consider whether there are areas where we can further improve the quality and effectiveness of current policy development process across our prudential and macro-prudential functions. A particular focus of this objective is considering the transparency of our policy development processes and our engagement with stakeholders.

51. The consultation document that follows sets out our analysis to date in relation to the prudential requirements for banks, and proposes a number of possible changes, or options for changes, that we are seeking submitters' feedback on. We note that the issues that have been considered in relation to NBDTs are not included in this

consultation document, and instead are part of a separate "Industry Update" document that we have published.[4]

52. Our analysis to date in relation to banks has also been informed by a series of workshops with banking industry representatives and discussions with a private panel of experts we have established to test our thinking with. We would like to take this opportunity to thank workshop attendees and expert panel members for their input into the project thus far.

The structure of this consultation document

53. This consultation document is divided into six parts, covering the different work streams that are being undertaken as part of the stocktake. Specifically:

- Part 1: Data reporting and disclosure requirements for banks: In particular, whether the preparation of disclosure statements on a quarterly basis is still appropriate for some or all banks, and whether the content of disclosure statements remains appropriate and useful for users;

- Part 2: Format and structure of the Banking Supervision Handbook: In particular, how the presentation and layout of the handbook can be changed to improve the clarity and accessibility of existing requirements;

- Part 3: Capital requirements: In particular, how the clarity and presentation of the existing capital requirements can be improved, and a number of smaller discrete technical issues that have been, or will be, consulted on separately;

- Part 4: The RBNZ's policy making approach*:* In particular, how to improve transparency around our policy making approach, and our engagement with stakeholders;

- Part 5: Differentiated regulatory approaches used in prudential regimes for banks: In particular, clarifying where we adopt a differentiated approach between different classes of banks, and the reasons for this differentiation; and

- Part 6: Miscellaneous changes to Bank policies and regulations: In particular, proposals to improve the process for assessing the suitability of bank directors and senior managers, and make some technical changes around the private reporting of breaches to the Reserve Bank.

54. In each of these parts of the consultation document, we have provided our initial assessment of the costs and benefits of the proposed changes, or options for changes. However, we would be particularly interested in submitters' views on the likely costs and benefits, and encourage submitters to quantify and monetise these costs and benefits where possible.

[4] See http://www.rbnz.govt.nz/regulation_and_supervision/non-bank_deposit_takers/nbdt-industry-update-regulatory-stocktake.pdf

Part 1: Data reporting and disclosure requirements for banks

Introduction

Current public disclosure and statistical reporting requirements for registered banks

55. The disclosure regime applying to registered banks requires them to prepare disclosure statements on a quarterly basis. The required content of these disclosure statements varies depending upon whether they are full year, half-year or off-quarter disclosure statements, and whether a bank is locally incorporated or a branch of an overseas institution.

56. Disclosure statements must be signed by all of the directors (in the case of locally incorporated banks) and all of the directors or their appointed agents, and the New Zealand chief executive officer (in the case of branches).

57. Registered banks are also required to publish their disclosure statements on their website and make copies of their disclosure statements available on request.

58. It is an offence for a registered bank to fail to comply with any of these requirements. The individuals who sign a disclosure statement that contains false or misleading information also commit an offence.[5]

59. Financial statements make up a major part of disclosure statements, and in many cases accounting standards do not prescribe exactly how the information in financial statements must be presented. In addition, the format and presentation of other parts of disclosure statements are generally not prescribed. For these reasons, the approach taken to presenting information in disclosure statements often differs between registered banks. This can detract from the accessibility of disclosure statements and make comparisons across banks more difficult.

60. Alongside the disclosure regime, registered banks also provide monthly statistical returns to the Reserve Bank. These returns form the basis of aggregated statistical data which the Reserve Bank publishes on a regular basis. Information is also gathered from registered banks through other channels purely for the purposes of prudential supervision. The extent of this reporting (and the costs to banks of producing it) has increased over time: the balance sheet survey redevelopment[6] being undertaken this year is intended to rationalise some of the existing collections.

Role of disclosure in the prudential regime

61. Our current approach to disclosure is heavily influenced by our broader approach to regulation, which is based upon the three pillars of:

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[5] In addition, section 90 of the Reserve Bank of New Zealand Act 1989 provides a statutory right of action for any person to bring a civil claim for compensation against a registered bank and/or persons who signed the disclosure statement, if they have suffered loss as a result of relying on false or misleading information in the disclosure statement. However, to the best of our knowledge this provision has never been used.

[6] The Reserve Bank is in the process of reviewing and redeveloping the current registered bank balance sheet collection (Standard Statistical Return) which provides comprehensive information on a bank's funding and claims. The intention is to redevelop the survey in a manner that enables both the Reserve Bank's prudential data needs and the broader need for banking system statistics to be met. Five existing surveys have been identified that may be integrated (partly or fully) into the new balance sheet collection. Collection of external stakeholders' requirements and development of a survey template is under way, with the intention of sharing this template with banks in early August 2015.

- Regulatory discipline (i.e. the requirements imposed on a regulated firm by the prudential regime);
- Self-discipline (i.e. a firm's internal risk management and governance systems); and
- Market discipline (i.e. the incentives placed on firms by the fact that investors and other market participants are monitoring their risk profile, and financial performance and position).[7]

62. The regulatory regime is designed in part to buttress the operation of self-discipline and market discipline aspects of this model, which allows us to adopt a less intensive supervisory approach (for example, we do not carry out on-site inspections in the normal course of supervision). The most important way that that the regulatory regime aims to buttress market and self discipline is through disclosure requirements that:

- Encourage market discipline through the public disclosure of information; and
- Encourage self-discipline through the due diligence that is required before the board will sign off on these disclosures.

63. While it is true that the relative importance of disclosure under the regime has changed over time,[8] it continues to play an important role for these reasons.

Recent changes to the disclosure statement regime

64. The Reserve Bank completed a major review of its disclosure requirements over 2009-2011, prompted by the increasing volumes of disclosure arising from the new Basel Committee Pillar 3 capital adequacy disclosure, and the implementation of IFRS accounting standards. The review also recognised that banking supervisors were no longer placing sole reliance on disclosure statements to obtain the financial information they need to assess banks' soundness.

65. A key focus of the review was to cut back disclosure to the minimum necessary in order to give public users of disclosure statements the information they need to make regular assessments of banks' performance and soundness.

66. Changes made as a result of this review included:

- Removing the requirement to publish quarterly Key Information Summaries and make hard copies of them available in every bank branch;
- Removing the requirement to publish Supplemental Disclosure Statements (SDSs) containing information such as the full text of guarantee arrangements and netting agreements;
- Providing that the financial statements included in half year disclosure statements no longer had to be prepared on an IFRS full year basis, and could instead be prepared on an interim basis; and

[7] *The Evolution of Prudential Supervision in New Zealand*, p.5, Reserve Bank of New Zealand: *Bulletin*, Vol. 75, No. 1, March 2012.
[8] The regulatory regime was originally focused primarily on disclosure, and now places equal or greater weight on other regulatory requirements (e.g. minimum capital and liquidity), and on supervisory oversight using financial data reported privately to the Reserve Bank.

- Reducing capital adequacy information in the off-quarter disclosure statement from a full update to a brief summary.

67. At the time we estimated that these changes would result in direct costs savings of between $99,000-$140,000 per year for larger banks, and $21,500 per year for smaller banks.

68. The net effect of these changes on the volume of required disclosure has also been substantial. Some banks' SDSs were over 200 pages long, and needed to be reviewed for publication every quarter even though they rarely changed. Half-year disclosure statements of the major banks were typically well over 100 pages long before the review, and are now usually between 30 and 40 pages long. Off-quarter disclosure statements have reduced in length by around a third and are now often barely 20 pages long. Full-year disclosure statements of locally-incorporated banks are still close on 100 pages long, being driven by full-year IFRS and Basel Pillar 3 disclosure, although even they have reduced in size somewhat. The imminent removal of the requirement to include solo (legal entity) accounts as well as group accounts is expected to further shorten the full year disclosure statements of a number of banks.

Issues that have been identified with existing public disclosure requirements and statistical reporting obligations

69. The important place of disclosure under the prudential regime for banks means that we do not see any scope for fundamental changes to the disclosure statement regime. However, we do think that there are a number of areas where further potential efficiencies could be sought or improvements made. The first of these areas relates to the current requirement to prepare off-quarter disclosure statements, the second relates to the current content and presentation of disclosure statements, and the third relates to how statistical data is complied from disclosure statements.

(A) Requirement to prepare off-quarter disclosure statements

Problem definition

70. Anecdotal evidence received in recent times, as well as from the review carried out between 2009-2011, indicates that the preparation of disclosure statements is costly, both in direct financial terms and in terms of opportunity costs (e.g. staff and director time and resource that might otherwise be used for other purposes). The review carried out between 2009-2011 nonetheless concluded that the benefits of preparing off-quarter disclosure statements outweighed the costs. However, whether the requirement to prepare off-quarter disclosure statements should be retained has been raised as an issue as part of the stocktake, and the Bank considers that it is appropriate to consider this issue again. We note that whether the costs of this requirement outweigh the benefits is a complex question, which involves a number of different issues.

Analysis of issues influencing possible changes to the requirement to prepare off-quarter disclosure statements

71. We think that the issues which may influence the question of whether the benefits of preparing off-quarter disclosure statements are outweighed by the costs can be grouped into a number of categories. These are discussed in turn below.

i. Market discipline

72. Because of the presence of information asymmetries, some form of disclosure regime is necessary for the purposes of ensuring that banks are subject to effective market discipline. Assuming that relevant and accessible information is being disclosed, market discipline is likely to be improved by requiring disclosures on a more frequent basis. However, this needs to be balanced against the costs.

73. To date we have struck this balance by requiring disclosures to be made on a quarterly basis. In doing so, we have accepted that the information being disclosed will be historical in nature (rather than being disclosed on a real time basis). We are also not aware of any evidence indicating that disclosure statements are read by depositors to a significant extent. The market discipline provided by disclosure statements is therefore largely provided by secondary audiences (analysts, advisers, and commentators) who use the historical information for their own purposes or process it for a wider group or the public at large. This market discipline is difficult to measure, but we would be cautious about underestimating its value. The experience of KPMG's Financial Institutions Performance Survey (FIPS) may indicate that there are a significant number of groups that use information that is ultimately drawn from off-quarter disclosure statements, especially during stressed or crisis conditions.

74. We also understand that rating agencies may sometimes make use of disclosure statements, and find public regulatory disclosures useful because of their extra credibility. However, we also understand that rating agencies are likely to be in a similar position to the Bank, in that if the information they require is not publically available they are able to require it to be privately reported to them instead (from the institutions that they rate).

Q1. To what extent does private sector analysis and other published research on the financial system make use of off-quarter disclosure statements?

Q2. How important is the role of off-quarter disclosure statements in imposing market disciplines on banks?

ii. Internal discipline

75. As noted earlier, the disclosure statement regime aims to support the internal governance and risk management of banks by incentivising them to have the systems in place to produce key information about their affairs, and to consider this information at the management and board level (due to the requirement for it to be signed off by directors). The fact that this regime is designed to create these kinds of internal disciplines is part of the reason why we adopt what, by international standards, is a relatively less intensive approach to supervision (which involves extensive interactions with banks, but no onsite inspections). In saying this, our supervisory approach has become more intensive in recent years, which may compensate for any loss of internal disciplines resulting from scaling back or removing the requirement to prepare off-quarter disclosure statements.

76. It should also be stressed that it is difficult to assess the extent to which the disclosure statement regime produces valuable internal disciplines that would not otherwise exist (to date we have received extremely mixed feedback on this issue). We would be particularly interested in submitters' views on the extent to which the requirement to prepare off-quarter disclosure statements helps to create these disciplines.

Q3. Do you consider that the requirement to prepare off-quarter disclosure statements materially improves banks' internal governance and risk management? If so, do you consider that there may be more efficient ways of achieving these benefits?

iii. Regulatory discipline

77. Prior to our supervisory activity increasing in the last 10 years, we made considerable use of disclosure statements for supervisory purposes. However, since that time we have shifted to a model where we receive more timely private reporting from banks for prudential and statistical purposes. Today we continue to check disclosure statements for compliance purposes, but our use of disclosure statements for supervisory purposes is considerably less, and is declining over time. To the extent that the reduction or removal of the requirement to prepare off-quarter disclosure statements resulted in our needing additional information for supervisory purposes, we would be comfortable seeking this information through additional private reporting.

iv. Relationships with other regulation (FMC Act and tax law)

78. Changes to the requirement to prepare off-quarter disclosure statements also have the potential to impact on other regulatory regimes and other regulators. This is a particularly acute issue from a tax perspective. The IRD currently use off-quarter disclosure statements for general monitoring of banks, and in particular for quarterly checking of banks' compliance with thin capitalisation rules (which only apply to the New Zealand subsidiaries or branches of overseas banks). IRD advise that they would prefer to see, at a minimum, banks continue to prepare off-quarter public disclosures that would include:

- An income statement and the underlying specific notes;
- A statement of comprehensive income;
- A statement of changes in equity and the underlying specific notes;
- A balance sheet; and
- Financial statements note that details the accounting policies.

79. In the absence of this information being publically disclosed in off-quarters, the IRD are likely to request that banks provide similar information privately to the IRD.

80. Changes in the requirement to prepare off-quarter disclosure statements also have the potential to impact on the underlying rationale for the various exemptions that banks have from the disclosure obligations in the Financial Markets Conduct Act 2013 (FMC Act). In substance, these exemptions provide that banks are not required to prepare a product disclosure statement or register entries for offers of basic banking products (transactional accounts and term deposits) to retail investors. The reason for this is partly that banks are seen as being of a lower risk of failure as a result of their being prudentially regulated and partly that they are subject to the requirement to prepare disclosure statements on a quarterly basis under the prudential regime.

Q4. How much cost saving for banks would result if the requirement to prepare off-quarter financial statements was removed but the additional financial information referred to in paragraph 78 was privately reported to the IRD for off-quarters?

v. Other financial stability issues

81. The current requirement to prepare disclosure statements on a quarterly basis has the benefit of helping to provide transparency to the market about the soundness of the financial system in stressed market conditions or in a crisis situation. However, we are also conscious of the fact that the information in disclosure statements is historical by the time that it is published (i.e. it describes the position of the bank as it was several months before). In addition, in a fast changing situation it is possible that we would seek more frequent private reporting from banks on relevant issues. These factors may detract from the value or importance of off-quarter disclosure statements in a crisis situation.

82. Furthermore, we understand that scaling back or removing the requirement to prepare off-quarter disclosure statements may have beneficial consequences from a financial stability perspective. Specifically, we understand that the requirement to prepare off-quarter disclosure statements currently acts to restrict the windows available to banks to raise funds in foreign markets (effectively because they are unable to go to market between the end of the off-quarter and the time that the off-quarter disclosure statement is published). Removing the requirement to prepare off-quarter disclosure statements would therefore increase the windows during which New Zealand banks could seek overseas funding. Amongst other things, this may make it easier for banks to access funding in stressed market conditions and, on occasion, provide greater flexibility to access funding at more favourable terms.

> Q5. Do you agree with our assessment of how effective the disclosure statement regime is at providing information about the soundness of banks in a crisis situation or stressed market situation?
>
> Q6. Would removing the requirement to prepare off-quarter disclosure statements (or scaling it back to disclosure of a narrower range of matters) create larger windows for New Zealand banks to raise offshore funds? If so, please explain the reasons for this.

vi. International standards and the approach taken in Australia

83. The Reserve Bank partially implemented the original Basel Pillar 3 disclosure requirements in its disclosure regime in 2008. However, certain aspects of Pillar 3 were not adopted at that time. For example, there are areas of disclosure which are not relevant or not material for New Zealand banks, such as securitisation exposures and market risk exposures based on internal models. In January this year Basel released its revised Pillar 3, which member countries are expected to implement by end-2016. While Pillar 3 is aimed at internationally active banks, it also provides a good benchmark for the level of disclosure that might be internationally expected of the large banks in New Zealand. The primary changes from the previous version of Pillar 3, in areas that are relevant for New Zealand banks, are:

- The previous organisation of the disclosure into a number of tables, each containing some qualitative and some quantitative information, has been replaced by a combination of tables in flexible format, and templates in fixed format;[9] and

[9] The required off-quarter disclosure consists of four of these templates, covering: 1) an overview of RWA (total and 24 key components); and 2) RWA flow statement for modelling banks, reconciling changes in RWAs over the quarter, with one template for credit risk, one template for counterparty credit risk, and one template for market risk (all of which are quite short).

- A fairly detailed reconciliation, along with descriptive material, of the differences between regulatory data required for Pillar 3 and accounting line items has been added.

84. In January, APRA released a revised version of APS-330 setting out public disclosure requirements for authorised deposit-taking institutions (ADIs). In summary, this requires that:

- Information on the composition of capital and a reconciliation with financial statements must be published six monthly;
- Information on the main features of capital instruments must be published continuously;
- Information on capital adequacy, credit and other risks must be published quarterly;
- For ADIs with IRB and AMA approval, additional information on capital adequacy, credit and other risks must be published six monthly; and
- Information on remuneration must be published annually.

85. The approaches adopted by Basel and in Australia are relevant considerations here in that they provide an indication of the level of disclosure that might be typically be expected in prudential regimes overseas. Some consistency with the approach taken in Australia also allows Australian-owned New Zealand banks to adopt consistent systems and processes for preparing disclosures in each country[10].

Q7. Are there other issues that we should be considering with regard to off-quarter disclosure requirements for banks?

Options for changes to the frequency of disclosures

86. In light of the preceding analysis we see four possible options for the treatment of off-quarter disclosure statements. These are:

- Option 1: The status quo;
- Option 2: Scaling back off-quarter disclosure statements for large locally incorporated banks to capital and asset quality disclosure, and removing the requirement for branches and locally incorporated banks with retail deposits of under $200 million to prepare off-quarter disclosure statements;
- Option 3: Removing the requirement for all banks to prepare off-quarter disclosure statements and replacing it with some kind of continuous disclosure regime to ensure that material adverse changes are disclosed when they occur between full and half year disclosure statements being published; and

[10] In comparing our approach to APRA's it should also be noted that APRA also conduct on-site supervision, whereas the Reserve Bank does not. The major Australian banks are also listed on the Australian Stock exchange (ASX) and subject to additional disclosure responsibilities as ASX listed companies.

- Option 4: Removing the requirement for all banks to prepare off-quarter disclosure statements altogether.

87. These options, and the costs and benefits associated with them, are discussed in turn below. We note that if options 2, 3 or 4 are adopted, they would not be implemented until any additional private reporting that the Reserve Bank might require was in place. We also note that in Part 6 of this consultation document we discuss establishing a formal requirement for banks to report breaches to the Reserve Bank when they occur – our preference at this stage is to adopt that requirement irrespective of which option for off-quarter disclosure requirements is adopted.

Q8. Do you agree with the options we have identified for the treatment of off-quarter disclosure statements? Are there other options we should be considering?

i. Status quo

88. As noted above, the current disclosure statement regime requires banks to prepare disclosure statements on a quarterly basis, and have their directors attest to the accuracy of the disclosures that they contain.

89. We consider that the potential benefits of this option are:

- It does not reduce the type or frequency of information disclosed to the market, and the market disciplines applying to banks;

- It does not risk there being any reduction in the internal disciplines applying to banks;

- It supports the rationale for banks' exemptions under the FMC Act; and

- It avoids the need to supply additional private reporting to the Reserve Bank, and possibly the IRD and rating agencies.

90. We consider that the potential costs of this option are:

- It may result in banks incurring disproportionate costs as a result of having to prepare off-quarter disclosure statements;

- It may continue to narrow the windows available to New Zealand banks to raise funds offshore; and

- It may create significant opportunity costs for banks and bank boards as a result of the time it takes to prepare and review off-quarter disclosure statements.

Q9. Do you agree with our assessment of the costs and benefits of option 1? To what extent can these costs and benefits be quantified? Are there other costs and benefits we should be considering?

ii. Scaling back off-quarter disclosure statements for large locally incorporated banks to capital and asset quality disclosure, and removing the requirement for branches and locally incorporated banks with retail deposits of under $200 million to prepare off-quarter disclosure statements

91. This option would involve:

- Removing the requirement for branches, and locally incorporated banks with retail deposits of under $200 million, to prepare off-quarter disclosure statements; and

- Scaling back the content of off-quarter disclosure statements for locally incorporated banks to capital and asset quality disclosure.

92. The rationale for removing the requirement for branches to prepare off-quarter disclosure statements under this option is that capital and asset quality information for a branch (rather than the legal entity itself) does not provide much meaningful information about the branch's financial soundness. The rationale for removing the requirement for a locally incorporated bank with retail deposits under $200 million to prepare off-quarter disclosure statements is that the small size of these banks' retail business reduces the need for the extra public accountability provided by publishing off-quarter disclosure statements.

93. If this is the preferred option, we will develop for further consultation the detail of the required off-quarter capital and asset quality disclosure for banks that will still be required to prepare off-quarter disclosure statements. However, a good starting point for what this disclosure might amount to is the content required by Schedules 8, 10 and 12 of the current local Order[11]. The asset quality disclosure set out in Schedule 8 would need the addition of figures for the total risk exposure numbers, and we also think that it would be useful and not unduly burdensome to require corresponding figures from the previous period DS to be shown for comparison. With those changes, the net effect would be broadly similar to the off-quarter disclosure requirements applying in Australia.[12]

94. We note that under this option it may also be possible to shorten the deadline for how soon after the end of off-quarters the off-quarter disclosure statement needs to be published if it only contains information on capital and asset quality.

95. We consider that the potential benefits of this option are:

- Significant cost and time savings for banks from no longer being required to prepare off-quarter disclosure statements (although this has to be balanced against needing to make additional private disclosures to the Reserve Bank, and potentially IRD and rating agencies);

- Broadening the windows available to New Zealand banks to raise funds offshore, if this option results in off-quarter disclosure statements being published more quickly after the end of each off-quarter; and

- Maintaining the additional market and internal disciplines that come from preparing off-quarter disclosure statements for locally incorporated banks with sizeable retail business.

[11] Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014
[12] Compared to APRA, we would continue to also require a breakdown of mortgage lending by LVR, and a figure for Pillar 2 "capital for other material risks", but would continue not to require separate disclosure of securitisation risks, and interest rate risk in the banking bank.

96. We consider that the potential costs or risks of this option are:

- Some reduction in the nature and frequency of information disclosed to the market, with potentially adverse consequences for the market disciplines applying to banks;

- Some reduction in the internal disciplines applying to banks, as a result of no longer being required to prepare off-quarter disclosure statements (although this reduction may be minimal given the underlying work associated with preparing capital and asset quality disclosures); and

- The risk of questioning some of the rationale for banks' exemptions under the FMC Act.

> Q10. Do you agree with our assessment of the costs and benefits of option 2? To what extent can these costs and benefits be quantified? Are there other costs and benefits we should be considering? Are there ways of mitigating the costs or risks of this option?
>
> Q11. How would banks' internal risk management and governance be influenced by this option?

iii. Adopting a form of continuous disclosure requirement that ensures that material information is disclosed on a continuous basis between the publication of full and half year disclosure statements

97. This option would remove the requirement for banks to prepare off-quarter disclosure statements for all banks and replace it with either:

- A requirement to update the most recent full or half year disclosure statement to reflect any material adverse change which has occurred; or

- A requirement to publically notify any material (i.e. price sensitive) information that arises.

98. We note that this option would probably require amendments to the Reserve Bank of New Zealand Act 1989 in order to be implemented, and raises a number of more detailed design issues, including how soon disclosure statements would have to be updated to reflect a materially adverse change (especially if this update needed to be subject to a director attestation process), and how material information should be publically notified.

99. We consider that the potential benefits of this option are:

- Significant cost and time savings for banks from no longer being required to prepare off-quarter disclosure statements (although this has to be balanced against needing to make additional private disclosures to the IRD, rating agencies, and the Reserve Bank, and the costs associated with making updates to disclosure statements to reflect material adverse changes);

- More timely notification of material adverse changes to the market; and

- Broadening the windows available to New Zealand banks to raise funds offshore.

100. We consider that the potential costs of this option are:

- The possibility of some reduction in the nature and frequency of information disclosed to the market, with potentially adverse consequences for the market disciplines applying to banks;
- The possibility of some reduction in the internal disciplines applying to banks, as a result of no longer being required to prepare off-quarter disclosure statements;
- Some risk of questioning some of the rationale for banks' exemptions under the FMC Act;
- Some risk of confusion or additional cost associated by establishing a "continuous disclosure" type regime involving concepts that are not consistent with stock exchange continuous disclosure or the disclosure requirements in the FMC Act;
- Risk of notification of material adverse changes having adverse flow-on effects on confidence in a crisis situation.

> Q12. Do you agree with our assessment of the costs and benefits of option 3? To what extent can these costs and benefits be quantified? Are there other costs and benefits we should be considering? Are there ways of mitigating the costs or risks of this option?
>
> Q13. How would banks' internal risk management and governance be influenced by this option?

iv. Remove the requirement to prepare off quarter disclosure statements

101. This option would involve removing the requirement for all banks to prepare off-quarter disclosure statements altogether, with this not being replaced by any new disclosure obligations.

102. We consider that the potential benefits of this option are:

- Significant cost and time savings for banks from no longer being required to prepare off-quarter disclosure statements (although this has to be balanced against needing to make additional private disclosures to the Reserve Bank, and possibly rating agencies and the IRD); and
- Broadening the windows available to New Zealand banks to raise funds offshore.

103. We consider that the potential costs of this option are:

- Some reduction in the nature and frequency of information disclosed to the market, and the market disciplines applying to banks;
- Some reduction in the internal disciplines applying to banks, as a result of no longer being required to prepare off-quarter disclosure statements;
- Some inconsistency with international approaches suggesting that some disclosures should be made on a quarterly basis; and
- Questioning some of the rationale for banks' exemptions under the FMC Act.

> Q14. Do you agree with our assessment of the costs and benefits of option 4? To what extent can these costs and benefits be quantified? Are there other costs and benefits we should be considering? Are there ways of mitigating the costs or risks of this option?
>
> Q15. How would banks' internal risk management and governance be influenced by this option?

Conclusion on options for changes to the requirement to prepare off-quarter disclosure statements

104. We currently have no firm preference about which of the four options canvassed in this consultation document should be adopted. However, we note that some scaling back of the requirement to prepare off-quarter disclosure statements may be appropriate so long as it does not significantly impact market and internal disciplines applying to banks, and so long as it results in a material reduction in compliance costs given the additional financial information banks would have to privately report to the IRD and rating agencies (and possibly the Reserve Bank) if one of these options were adopted.

> Q16. Of the four options presented above, which do you prefer and why? Please provide detailed reasons, and thoughts on how the costs and risks of your preferred option could be managed.

(B) Content of disclosure statements

105. Our internal analysis has raised a number of minor or technical changes that could be made to the current content of disclosure statements. These changes are set out in the table below.

Table 1: Possible changes to the content of disclosure statements

	Possible reductions
All banks	We could consider some reduction in public disclosure of concentrated credit exposures. We are now giving consideration to putting in place regular private reporting on large exposures. Arguably, this would provide an adequate replacement for the internal discipline currently provided by the public disclosure. Also, a branch's large exposures are disclosed in relation to the whole bank's capital, so are particularly uninformative.
All banks	We could consider changing the approach to disclosure of Conditions of Registration so that conditions that apply to all banks do not need to be disclosed.
Local banks	We could review how informative the disclosure of credit risk mitigation is, and consider ways to improve it if necessary.
Branches	We could review how useful supplementary information on asset quality for the New Zealand financial reporting group is and whether it could be cut (as opposed to asset quality for the overseas banking group as a whole – which is required anyway).
All banks	Reconciliation of residential mortgage-related amounts (required six-monthly) was added into disclosure statements because of the diversity of figures that banks publish relating to residential mortgage lending. We could review how useful this disclosure has been.
All banks	Once all banks have adopted NZ IFRS 9 (which may not be until 2018), we can remove all NZ IAS 39 references. At that point we may be able to cut some of our disclosure requirements, as more of the detail will be required in any case by the expanded NZ IFRS 7 requirements.
	Possible tidy-ups

Local banks (IRB)	We could change from banks disclosing credit risk capital requirements using their own PD ranges, to our specifying the PD ranges. This would both improve comparability, and align with the recent Basel Pillar 3 revisions.
Branches	We could tidy up disclosure of the overseas banking group's P&L and balance sheet.
Branches	Dual-registered branches have a complex directors' sign-off requirement, covering management of risks in entities that are in the branch's financial reporting group but not in the locally-incorporated bank's group. This could be simplified or cut.
All banks	We could review the nature of what must be covered in the auditor's report/review opinion (full year and half year): (1) detail could be cut from what the Orders specify, to allow more reliance on audit standards; and (2) the current multi-part opinion on the different disclosure components is complex and potentially could be simplified.
Local banks	We could clarify disclosure of Credit Valuation Adjustments.
All banks	We can clarify whether the disclosed credit rating is meant to be as at signing date or as at balance date.
Branches	We could tidy up the wording of the requirement for a branch's DS to be easy to find on the bank's NZ website.
All banks	The word "examine" to refer to auditors' limited scope reviews is not the right technical term, and should be corrected.
All banks	Disclosure of risk management policies. References to Foundation IRB approach could be cut if the approach itself is cut (local banks), and more reliance placed on new expanded NZ IFRS 7 disclosure.
	Possible additions
Local banks	A reconciliation of regulatory capital versus accounting capital could be added (this is a Basel III requirement).
Local banks	We could consider whether additional dedicated disclosure is needed for a bank's covered bond issuance.

106. We would be interested in any views submitters may have on these changes, and any additional suggestions on information that could usefully be added to, or removed from, the content of disclosure statements to make them more useful and accessible.

> Q17. Do you have any comments on the proposed changes to the content of disclosure statements? Are there other matters we should consider removing from, or adding to, the contents of disclosure statements?

(C) Private reporting of quantitative content of disclosure statements

107. The Bank is currently seeking to rationalise some of its existing private data collections and reduce the regular reporting burden on banks. Related to this work, we are generally seeking to improve the quality of the private and public data we collect and publish. In the case of Disclosure Statements, we currently take data from .pdf files (published on banks' websites) and manually input it into our systems. We use some of this data for internal purposes (though that use is declining over time) and also for the external summary tables we publish on the RBNZ website.

108. The Bank is currently looking to develop a private reporting template for the quantitative component of disclosure statements. More specifically, our aim would be to require each bank to enter specified figures from its disclosure statement into an excel template, similar to those currently used for other types of private reporting. This would be supplemental and separate from the public Disclosure Statement published

on the bank's website. From the Reserve Bank's perspective, this would save significant time and resources and minimise the opportunity for errors in the data collection process. We are currently working to develop a model of this template and would consult with banks to minimise the burden this may create, while still ensuring the accuracy of the data and efficiency of its collection.

109. For the moment, we consider this should remain a separate and supplemental private report to the Reserve Bank and not be incorporated in disclosure statements.

Q18. What would be the costs associated with this supplemental private reporting of the quantitative components of disclosure statements?

Part 2: Format and structure of the Banking Supervision Handbook

Background

110. The Banking Supervision Handbook (the Handbook) is the title given to a collection of documents that sets out a range of different matters relating to the Reserve Bank's regulatory requirements for banks. A table of the contents of the Handbook is at Appendix B, including the date of issue of the most recent version of each document, with a hyperlink to the document. In the following discussion, all current Handbook documents are referred to by their reference number (BS1, BS2A etc.).

Status quo

Handbook documents other than Orders in Council

111. Under the status quo, policy amendments may be made by the Reserve Bank updating the text of any of these documents after appropriate consultation. The Reserve Bank generally tries to fit new or revised text into a document using the formatting and numbering approach of the existing document. If the document is one that is referred to in some banks' conditions of registration ('CoRs'), the policy only takes effect for those banks when revised CoRs are formally imposed on them, referring to a new version of the Handbook document containing the revised text: the new version is distinguished from the previous version by being given a new date.

112. The status of Handbook documents varies significantly. As well as those that are referred to in a CoR and provide the details of definitions and calculations required by the CoR, some provide explanation of requirements that are imposed directly on banks by the Act, rather than via CoRs; some describe processes that banks must go through to achieve certain outcomes; and some provide explanatory guidance on how specific requirements should be met.

113. Any new policy that is sufficiently different from existing requirements will generally lead to the preparation of a new Handbook document. Regardless of the legal powers under which this is issued, it will be given the next available number in the BS series.

114. This is the approach under which the Handbook has grown "organically" over time. The style and formatting of individual documents varies considerably, often reflecting the period in which it was prepared. The Handbook has expanded rapidly in recent years, from BS11 (Outsourcing Policy) in January 2006 up to BS19 (Framework for LVR restrictions) in October 2013. Also in 2008, the former BS2 (Capital Adequacy Framework) was replaced by the much longer and more complex documents BS2A

and BS2B, which were needed to implement the new Basel II capital requirements in New Zealand, for standardised banks and modelling banks respectively.

115. If we maintain the status quo, this organic approach to extending the Handbook will continue. Although the Reserve Bank does not expect to issue nearly as much new material in the next ten years as it has in the last ten years, we would still be stuck with the results of the organic growth to date. The documents would continue to be made available as individual PDFs on our website, with limited internal navigation features. The various problems inherent in this current set-up are discussed in the next section, Problem Definition.

Orders in Council

116. Requirements on banks to publish disclosure statements are imposed under a separate framework. The Governor-General makes Orders in Council that set out the information required to be published in disclosure statements, on the advice of the Minister of Finance given in accordance with a recommendation of the Reserve Bank. These Orders are therefore regulations that bind banks directly, and are subject to the disciplines of the associated order-making process, and the formatting requirements for publication in the New Zealand Gazette.

117. The formal version of these requirements is the online version of the principal Orders and any subsequent amending Orders, as published in the Gazette. The exact layout of these is outside the Reserve Bank's control. However, for users' convenience, we do make available so-called "working copies" of the Orders, that consolidate all amendments. These are the versions that are included as part of the Handbook.

Other related material

118. The Reserve Bank publishes on its website a document called "Bank registration information" which is intended to provide information for potential applicants to be registered as a bank. This is not presented as part of the Handbook, but is supplementary to Handbook documents that also specify requirements for registration.

119. There is also material on separate pages of the Reserve Bank website that provides a high-level overview of our regulatory requirements and our supervisory approach.

Problem definition

120. We regard registered banks as the key interested parties in the way that prudential requirements are structured and presented in the Handbook: the Handbook imposes requirements on, and expresses the Reserve Bank's expectations for registered banks. It should therefore be as clear as possible to banks what those requirements and expectations are.

121. The problem definition therefore draws on a number of issues that banks have told us they find problematic with the current Handbook layout. It also adds some other areas in which the Reserve Bank can see potential improvements in the accessibility of the Handbook. The specific problems that have been identified are:

- The delineation between hard regulatory requirements, guidelines, and guidance is not clear. It is not always clear when a given statement is legally binding and when it is simply a statement of the Reserve Bank's expectations;

- The drafting of the handbook is unclear in places and contains some unnecessary duplication, and the organisation of subsections and headings can be hard to follow;

- There are many defined terms within Handbook documents, and these are not always consistent across documents. Definitions are also not always aligned with definitions and other wording used in relevant external standards, e.g. IFRSs or those issued by APRA. This imposes a cost on banks from having to understand and apply different concepts under different regulatory regimes;

- The accessibility and navigability of the handbook would be improved, among other things, by providing a schematic representation of the handbook showing how the different handbook documents fit together, and by providing an index and/or glossary for the handbook;

- BS1 is not well organised. This could be improved by scaling it back to the principles that the Bank is required to publish under section 75 of the Act, and merging parts of BS1 with other BS documents and/or splitting out parts of it into separate standards or guidance documents;

- The process for registering new banks is not clear. It would be preferable to set out the rules around bank registration in a separate document;

- There is no single clear and comprehensive statement of the Reserve Bank's supervisory approach and expectations;

- The current approach leads to some handbook documents and bank conditions of registration having to be regularly updated for purely technical reasons rather than to make changes of substance; and

- It would be desirable to have a "change register", to enable users to keep track of superseded versions of documents and the reasons for changes.

Q19. Have you found any other problems with the current format and structure of the Handbook that are not covered by this list?

Objectives

122. As stated in the Terms of Reference for the Stocktake, one of the two key outcomes of the project will be changes (if needed) in the prudential regulation framework which:

- Cut or simplify requirements where this can be done without compromising financial stability objectives;

- Change requirements to make them more efficient (ie delivering similar benefits at lower cost); and

- Present requirements in a different way to improve their user-friendliness and/or clarify their scope and nature.

123. The project is intended to focus both on the detail of individual prudential standards, their presentation, and the way they interact as a whole.

124. The objectives of the work on the Handbook restructuring are to contribute to these outcomes by addressing the problems identified above. That drives the details of the core option discussed below. As noted later, the proposed restructuring of the Handbook is such a large piece of work that it will be delivered by a separate project that will start after this consultation has closed, and run for some time.

Options

125. One option is to maintain the status quo, with the implications discussed above.

126. This section sets out the details of our alternative, preferred option, which has a number of different elements to it, covered under each of the following headings.

<u>Overview</u>

127. To address the problems identified, we think the main goals of restructuring the Handbook should be the following:

- Deliver a user-centred approach, i.e. present the Handbook as far as possible to meet the needs of, mainly, registered banks;
- Organise material better by type of content rather than by date of development;
- Clearly separate rules from guidance;
- Distinguish between requirements applying to registered banks at all times, material for applicants for registration, and process requirements triggered by particular changes/events;
- Make navigation easier within and between documents, thanks to improved and common standards for internal layout of documents, such as section headings and paragraph numbering; and
- Make better use of on-line navigation tools, but also ensure that printer-friendly documents are available.

<u>Carving up BS1 and creating new registration document</u>

128. Section 75 of the Act requires the Reserve Bank to:

“publish the principles on which it acts, or proposes to Act,

(a) in determining applications for registration; and

(b) in imposing, varying, removing, or adding to conditions of registration.”

129. BS1 is intended to set out both of these sets of principles, which it broadly does. But it also includes a lot of other material. While that does not cause a legal problem, we think that all this extra material in BS1 dilutes the focus on the two key obligations it is required to meet (under s75(a) and s75(b) of the Act). Among the types of content currently included in BS1 are:

- Information for entities wishing to apply for registration as a bank in New Zealand, including a point-by-point consideration of all the matters that the Reserve Bank must take into account in determining such an application;

- A description and discussion of some of the continuing requirements that are imposed on registered banks via conditions of registration;

- A statement of some continuing requirements on registered banks that currently are not formally imposed on banks under any of the powers in the Act;

- Sets of the standard conditions of registration normally applying to different classes of bank;

- The principles for the approval of rating agencies under s80 of the Act; and

- A considerable amount of other descriptive material, eg describing some of the Reserve Bank's supervisory approach, and paraphrasing the crisis management sections in the Act.

130. At the same time, BS1 does not provide all the information that applicants for registration need to have. This is currently spread across BS1 and two other documents: BS3 (bank registration information requirements), and the stand-alone "Bank Registration Information", which is published on the Reserve Bank website separately from the Handbook.

131. The proposal is to have the following main new documents:

- A document dealing with applications for registration. Registration is about the information the Reserve Bank needs in coming to a decision: the Reserve Bank has to consider all the matters listed in s73, s73A, 73B and s78 of the Act, so this document should list the Bank's information needs under each of these matters. This document cannot in itself impose any hard rules, but it should cross-refer (briefly) to continuing rules that apply to banks from the date of registration. The intention is to create a single document covering all requirements and processes for registration: it will not be the principal source for any material that is applicable after registration, so existing registered banks should never need to refer to it;

- A brief document to meet the s75 remit. We believe that the part of this document covering the principles for registration does not have to include a blow-by-blow discussion of each separate matter that the Reserve Bank has to consider (which will be in the separate registration document);

- Banks have requested a more comprehensive statement of our approach to supervision and regulation. We think this is a useful idea, and propose to put together such a document. It will pull together some of the existing discussion in BS1, and also material elsewhere on our website. It will also include the principles of policy-making discussed in Part 4 below; and

- A single document on credit rating matters, relating to s80 of the Act. This would discuss both the standard notice issued to banks requiring a credit rating, and the rating agency approval regime.

132. We also believe that a number of other continuing requirements on banks that are stated in BS1 would be made clearer by being gathered into a single new document that would describe and give a brief rationale for each of these requirements. Each of these is, or if not should be, given legal force by conditions in each bank's CoRs. These requirements are:

- $15bn limit on branch size;

- 1% limit on banking group insurance business;
- Dual-registered branch not to take retail deposits;
- Limit of 10% of total assets on covered bond issuance; and
- Reserve Bank approval needed for establishment of overseas branch, subsidiary or representative office.

133. With this re-organisation, we think it becomes possible and will be helpful to distinguish between: initial registration; ongoing requirements that apply at all times post-registration to all banks or to classes of bank; requirements and processes that are only triggered upon certain events/changes (e.g. new capital issues, new director appointment); and those documents that are only for information and guidance (note that documents imposing requirements will also include guidance material wherever helpful for explaining requirements: as discussed below, this will also be clearly marked as such).

134. The proposed destination of the material currently in BS1 is summarised in the following table. The nature of the new material is indicated by the following colour coding:

green	Pure guidance
blue	Trigger event/notification requirements
red	Continuing rules
no shading	Deleted

Table 2: Possible destinations of BS1 material

Source (current BS1 sections)	**Destination: new material**
Sections A (Intro) and B (purposes of registration and supervision)	New short document setting out s75 principles at a high level.
Section C (bank registration)	New one-stop registration document (BS1 material significantly re-worked: remove general justification and discussion, move elsewhere minimum business requirements that apply after registration, add cross-references to relevant sections of Act and to ongoing requirements, and add information and process needs).
Parts of Section C (bank registration) referring to eg branch size cap, limits on retail deposits	Move to a separate document summarising and explaining such rules.
Section D (supervision)	Significantly re-worked and updated, to go into a separate guidance document on the RB's approach to supervision. (Other material in BS1 which summarises sections of the Act could be covered in this document, mainly by using brief cross-references.)
Section E (Conditions of Registration) (includes discussion of all the standard CoRs we apply)	Cut the majority of this. A brief summary of how we use CoRs would be part of S75 principles document. Any discussion of a given condition is kept only in the document covering that area of rules.
Sections F and G (Variation and Removal, and Breaches, of Conditions of Registration)	Also to be replaced by a brief section in the S75 principles document.
Section H (Breaches of minimum Capital	Move to the relevant capital module (see below).

Source (current BS1 sections)	Destination: new material
Adequacy Ratio Requirements)	
Section I (Disclosure Requirements)	Cut. This simply describes the disclosure requirements. Any necessary guidance is given by BS7A (and its successor in the new structure).
Section J (Credit Rating requirement)	Move to a separate document on credit ratings. This describes a continuing rule, derived from notices issued under s80 of the RB Act.
Sections K and L (responsibilities for, respectively, NZ CEOs of overseas bank branches and for directors)	Cut. This is guidance, relates almost entirely to disclosure, and is already covered in BS7A. There is one general statement of directors' other responsibilities, which is already covered in BS14.
Section M (changes of ownership). This repeats S77A of the RB Act, which requires a person acquiring significant influence over a bank to obtain RB consent, states the matters we will have regard to, and refers to document BS9	Move (along with the current BS9 material) to a single document which summarises what happens when a person wants to acquire or increase significant influence over a registered bank.
Section N (states that a locally-incorporated bank must seek RB approval before establishing an overseas branch, subsidiary or rep office)	If this statement is to be backed up, it needs to be in the form of a standard CoR. Move to a separate document that summarises any factors that the RB will take into account and any associated information needs.
Section O (Crisis Management) (subsections I to VI)	Cut. This simply reproduces sections of the RB Act. (General discussion of crisis management could be in the "approach to supervision" guidance.)
Section O (VII) Loss absorbency of capital	Move to the relevant capital module.
Section O (VIII) OBR	Cut. This summarises what is already in BS17. (The new Handbook structure should make it clear that a newly-registered bank over the size threshold will be subject to OBR conditions from its date of registration.)
Section P (foreign supervisor access to information held by registered banks)	Cut. This simply reproduces sections of the Act.
Section Q (UN Sanctions), which notes that the RB will have to have regard to UN Sanctions in considering applications for registration, changes of ownership, and establishment of overseas branch or subsidiary	Move. Each of the documents relating to these application/approval processes should briefly note this point.
Appendix One: Standard Conditions of Registration	Cut or move. Each "rule" or "trigger event" document will include any associated conditions of registration. One option is to have an additional document that lists all standard conditions, sections of the Act, etc. that impose requirements on banks.
Appendix Two: Credit Rating – standard S80 notice.	Move to the separate credit rating document.
Appendix Three: Approval of Credit Rating Agencies	Move to the separate credit rating document.

Q20. What do you see as the costs or risks arising from this proposed restructuring? Do you have any alternative suggestions for making it easier for new applicants to know what is expected of them, and for registered banks to be clear about the continuing requirements applying to them?

Modular approach to capital adequacy framework

135. BS2A and BS2B are such long documents that they are hard to navigate. There are also significant overlaps between them: the sections on the calculation of capital requirements for credit risk and operational risk are distinct, but the rest of each document is mainly the same, including the definition of capital and the calculation of market risk.

136. There is also other material in the Handbook directly related to capital adequacy. There are sections of BS1 that discuss the processes for dealing with a breach of a capital adequacy ratio, and triggers for write-down or conversion of capital instruments. BS16 sets out the processes for the Reserve Bank to give non-objection to new capital instrument issues and approval for repayment of capital instruments. BS12 gives guidelines on how a bank should manage its own assessment of the level of capital it needs.

137. We propose to deal with this by breaking BS2A and BS2B up and bringing together the other material to form a set of capital modules. The proposed structure of this is shown in Appendix C.

138. Most of the modules will contain details of the calculation of various components of the overall capital ratios. A single "overview" document will contain the definitions of capital ratios and pull all the threads of the calculations together, cross-referring to the other documents for the definitions of the components. These other documents will all relate to continuing requirements that are binding on locally-incorporated banks. The documents are equally applicable to standardised and modelling banks, except where the title indicates otherwise.

139. One module will fall into the "event-driven" category. This will be a document that pulls together in one place all the process requirements relating to capital. These are currently set out in BS16 and in various sections of BS1. One of the modules will be purely guidance, taken from the current BS6 that gives guidance on how to carry out the required calculations for market risk. The status of BS12 needs to be considered further (see the discussion below on guidelines issued under s78(3) of the Act).

140. At the same time, we aim to keep the advantages of material being in one searchable file, so that users can find references to given material across the whole capital framework.

141. Even broken up this way, the module on credit risk for IRB banks will remain a lengthy and complex document. Better layout and numbering as discussed in the next section should be able to improve the navigation of this section considerably. However if reasonable options for cutting this document up into smaller segments emerge during the detailed drafting phase, we may include them as further options. The detail will be the subject of further consultation as discussed below in the section on the handbook migration plan.

Q21. Do you have any comments on the proposed restructuring of the documents in the capital adequacy framework?

Clearer document structure and numbering and online navigation

142. We propose to create a standard structure for all documents in the Handbook (apart from the disclosure requirements, as discussed below). The main features will be the following:

- The cover page will include the full title and short-form reference number, and should make it clear whether a document deals with a continuous requirement for banks, an event-driven requirement or process, or (in a few cases) is entirely guidance;

- We plan to introduce new naming and numbering conventions to align better with the purposes of the documents. Our initial thinking is that "Banking Prudential Requirements" is a more suitable description than "Banking Supervision Handbook": its contents relate to prudential regulation, not just supervision, of banks, and the term "handbook" suggests a "how to do it" manual rather than a set of requirements. The documents have a number of different purposes, as noted above, so the term "requirements" is intended to be more general than, for instance, "rules" or "standards". Document reference numbers would be of the form "BPRnnn", where the numbering would group related documents together, rather than being chronological: for instance the capital-related documents might all have short titles of the form BPR1nn;

- Inside the front page there will be a brief statement of the purpose of the document, including any relevant information on what other Handbook documents it relates to, and which classes of banks it is relevant to;

- This will be followed by a "legal powers" section, to explain what power(s) in the Act this document relates to, or otherwise that the document is purely guidance;

- The substance of the document will start with a contents page (unless it is very short), and will be divided into sections and paragraphs numbered in a standard way (as discussed further below);

- Any material within a document that provides explanatory guidance rather than being related to specific compliance or process requirements will be clearly marked as such. We propose that each section of guidance will be shown using a box with grey backing and marked "guidance" at the top; and

- At the end of the document there will be a "document version history" table, with the dates of all previous versions of the document, and a brief summary of why changes were made.

143. We believe that improvements and standardisation in the approach to numbering paragraphs and sections can make a substantial difference to how easy it is to understand how different part of a document relate to each other, and hence to overall understanding of its content. This is particularly true of some long sections of the current Handbook where there is no consistency of approach, even within the document.

144. Appendix E sets out two alternative samples of new numbering schemes that could be applied, using the opening few sections of Subpart 4C of BS2B. This sets out system requirements for banks using the IRB approach to credit risk, and is proposed to be a separate module in the new capital framework structure. For comparison, the original text as it is currently laid out in BS2B is included at the start of Appendix E.

145. The key change needed to improve navigability is to make it clear what the hierarchy of headings is: in this example, the hierarchy is nested four deep. We believe that both alternative approaches achieve this to a reasonable level. The main differences between the two numbering approaches used in the two samples are discussed below, along with the pros and cons of each.

146. In Sample 1, the sub-numbering of the headings goes all the way down to the fourth layer in the hierarchy. This gives maximum clarity of what level each heading is at.

147. However, we think this makes it unrealistic to link the number of each paragraph to the nearest heading above it, as this would require paragraphs to be sub-numbered to the fifth level: this would be very cumbersome. The paragraph numbering therefore just runs consecutively through the document. This has the advantage of being simple, but the drawback is that it is not immediately obvious where a paragraph belongs in the overall structure.

148. In Sample 2, headings are only numbered to a depth of two: below that, readers would have to rely on different formatting of the headings (font size etc.) to see what the hierarchy is. On the other hand, this means that paragraph numbering can hang off the most recent numbered heading above, as illustrated in the sample: the paragraph numbering is nested to a maximum depth of three, which we believe is manageable.

149. Compared to Sample 1, this means that paragraph numbering is not quite as simple, and that it may not be as clear where a heading fits into the hierarchy. But on balance we think this a better option, as it is easier to see immediately how a paragraph fits into the overall structure.

150. One further problem with the paragraph numbering in Subpart 4C is that there are currently several paragraphs which are not numbered: in effect, each of these is material which “belongs to” the nearest paragraph number above. This does not seem desirable in terms of being able to refer precisely to the content of a given paragraph. In such cases, the options are to merge the current unnumbered paragraphs, or to number them: we propose to use both approaches, depending on how linked the respective material is.

151. We propose one exception to this general approach, in the situation where a paragraph contains some numbered subparagraphs, and there is related introductory text above, followed by related additional commentary below. In this case, the additional commentary would be unnumbered, as illustrated in the following example:

> “2.1.3 There are two exceptions to this general rule:
>
> (a) In order to take into account country transfer risk, different obligor grades may be assigned according to whether a facility is denominated in local or foreign currency; and
>
> (b) A facility’s associated guarantees may be reflected by an adjustment to the obligor grade.
>
> In the case of either exception, separate exposures to a given obligor may be assigned different obligor grades.”

152. We have taken on board the point that the handbook needs to be more workable online as well as in print form. Clear hierarchy numbering like this should make it feasible to use something like the Adobe indexing approach that is available in PDFs (using ‘+’ and ‘-‘ markers).

Q22. Do you have any other suggestions for how a standard handbook document should be structured? Of the proposed numbering structures in Sample 1 and Sample 2, which do you prefer? Can you give suggest any alternative numbering approaches that you believe would work better? Do you have any other suggestions for renaming the Handbook itself and replacing the BS numbering convention?

Presentation of guidance and role of guidelines issued under s78(3) of the Act

153. As noted above, some documents will contain guidance. This will be material intended to explain or give background information relating to stated requirements. It will be clearly distinguished as guidance using grey boxes.

154. Section 78(3) of the Act gives the Reserve Bank the power to issue guidelines for the purpose of interpreting any of the matters listed in s78(1) that the Bank is permitted to consider in determining that a bank has not carried on its business in a prudent manner. (These matters include capital, risk management systems and controls, etc.) If the Reserve Bank determines that a bank has not carried on its business in a prudent manner, certain powers in the Act can be exercised, leading for example to cancellation of the bank's registration, or the bank being put into statutory management.

155. Currently, there are four places in the Handbook where the Reserve Bank has invoked section 78(3) in issuing guidelines:

- Guidelines on anti-money laundering and countering the financing of terrorism (BS5);
- Guidelines on a bank's internal capital adequacy assessment process (ICAAP) (BS12);
- Guidelines for a bank's liquidity risk management (part of BS13, Liquidity Policy); and
- Guidelines on the overall quality and competence of a bank's Board (part of BS14, Corporate Governance).

156. The Reserve Bank has reconsidered how effective these sets of guidelines have been in promoting the expectations they set out, and also the way that each of them is presented and (in two of the four cases) is linked to conditions of registration. We note that the thinking behind using s78(3) guidelines rather than alternative mechanisms in these cases was that the more subjective, judgement-based nature of the requirements would make it problematic to impose them via conditions of registration (CoRs). Conversely, we assumed that linking them to the s78 powers would give them more legal force than issuing them purely as guidance.

157. However, considering how effective these varying uses of s78 guidelines have been and comparing them with other more judgement-based policies that we already impose by CoR[13], we have come to the view that it is both practical, and more effective, to impose requirements on more subjective matters such as risk management by specifying a few key requirements in CoRs themselves. Additional

[13] Examples of these are the CoR imposed on IRB banks that they have to meet all the requirements for internal rating frameworks set out in Subpart 4C of BS2B, and outcomes-based CoRs imposing the Outsourcing Policy (BS11).

material in the associated Handbook document then provides guidance and explanation of the key CoR requirements, rather than being the primary source for the requirements. In our view, a good existing example of how the balance between CoRs and guidance should be pitched is provided by the minimum requirements for liquidity risk management, which are imposed quite specifically in a standard CoR, with the supporting material given in BS13.

158. Using this mechanism means that guidance is given weight by the CoR that it relates to: the CoR specifies a few key requirements around, say, some aspect of risk management, while the guidance set out in a Handbook document expands on what the CoR means and provides greater clarity on how a bank can comply with it. The corollary is that the guidance does not need to be additionally supported by issuing it formally as guidelines under s78(3): on the contrary, that may unnecessarily restrict the purposes for which those guidelines can be used.

159. A key benefit of this change of approach in the reorganised Handbook is that there will be no need to try and provide a general explanation of the difference between guidelines issued formally under 78(3) and other guidance. We doubt this has been well understood in the past, and believe that even with extensive explanation would likely be a source of confusion in future. As far as possible, all guidance will have the same status, and be labelled as such in grey boxes (as described above).

160. We believe this proposed shift in emphasis recognises the limited resources the Reserve Bank has available for supervisory monitoring. Even if some requirements are more subjective in nature (for instance, in risk management areas generally) it is important to frame them with as much precision and legal effectiveness as possible at the high level. This should incentivise the right behaviour by banks when a new policy is issued, even if supervisory follow-up may not be possible for some time after the effective date of the policy. When the Reserve Bank does carry out a cross-bank thematic review, the material should give us something concrete on which to pin recommendations for improvement, and provide a background for peer analysis.

161. The implications of the above for the Handbook are that we propose to remove the references to s78(3) in BS12, BS13 and BS14. We will consult on a revised version of the CoR that imposes the ICAAP requirement, to give it more content and revise the way that it links to guidance in BS12. The current guidelines in BS14 will become guidance associated with a new CoR, the details of which we will consult on. We propose to leave the liquidity risk management CoR and the guidance in BS13 broadly unchanged.

162. However, we propose that BS5 should continue to be framed as s78(3) guidelines. We view it differently from the other three cases, because while each of them provides the main regulatory tool we have to impose requirements in their respective areas under Part 5 of the Reserve Bank Act, it is the Anti-Money Laundering and Countering the Financing of Terrorism Act 2009 (the AML Act) that gives the Reserve Bank the main powers to supervise, monitor and enforce banks' AML/CFT obligations. BS5 can be regarded as an adjunct to the AML regime, giving us a power to take action against banks in extreme cases of AML failure, rather than as a central part of our prudential supervision of banks. We will consider whether to underline the separate status of BS5 by making it available as part of the Reserve Bank's AML material rather than as part of the Handbook.

163. These changes to BS5, BS12, BS13 and BS14 will be made at the same time as changes in their naming, formatting and layout, in line with the Handbook restructuring work programme discussed below. However, we also plan in the shorter term to update BS5 in its current form, as discussed in Part 6 below.

Q23. Do you have any concerns about the proposal to remove from the Handbook guidelines issued under s78(3) of the Act? Do you have any other suggestion for how the Reserve Bank could most effectively require improvements by banks in more subjective areas such as risk management?

Keeping track of different document versions and cross-referring to them

164. Currently, there are several places where one document in the Handbook cross-refers to another Handbook document to define terms, and the cross-reference is usually (but not always) dated, to provide certainty about which version is being referred to. This means for instance that whenever there is an update to BS2B, we have to update BS19 (LVR restrictions) at the same time, so that it refers to the new version of BS2B.

165. This creates a lot of empty process both for the Reserve Bank and the banks, because although (in this example) the BS2B change only affects the four IRB banks, conditions of registration (CoRs) have to be changed for all 24 banks that are currently subject to BS19. This requires one letter to each bank proposing the change to their CoRs and to BS19, and another letter confirming that the change is coming into effect, and enclosing the revised BS19. Any CoR change has to signed off at senior levels both within the Reserve Bank and at affected banks, and banks also then have to disclose the CoR update in their next disclosure statement.

166. As part of the Handbook restructuring, we propose a new approach to deal with this problem, which would otherwise carry across to the new structure, and in fact be exacerbated by it. The new approach will mean that when there is a change of substance in one Handbook document, the only matters needing updating would be that document itself, and any bank's CoRs that refer specifically to that document.

167. The documents we are concerned with are those that are in effect incorporated by reference in banks' conditions of registration. (Not all Handbook documents are, or will be, of this type.) For instance, a CoR imposing a minimum capital ratio includes the whole of the calculation and definitions underlying that ratio, but for convenience, the detailed specifications are in a separate document, rather than being spelt out in each bank's CoRs. What this means is that these documents are given legal effect only by being referred to in a bank's CoRs.

168. This in turn means that unlike primary legislation, or other legal instruments like our bank disclosure Orders in Council, any given version of such a Handbook document does not have a single clearly defined commencement date. For example, it is possible on a given day for one bank's CoRs to refer to BS8 dated August 2012 and another bank's CoRs to refer to BS8 dated September 2013. In this case, there would be two versions of BS8 in force at the same time, although each bank would have certainty about the version that applies to itself.

169. Our proposed solution to reduce this process burden has four main components:

- We will continue to differentiate between different document versions by labelling the version with the month of issue;

- In a bank's CoRs, every document that is referred to will continue to be referred to by date, so that the bank has certainty about which version of a document applies to it;

- Any cross-reference from one document to another document that is incorporated in a bank's CoRs should refer to "the version of that document that currently applies to the bank via its CoRs", instead of referring to a dated version of that document; and

- If a document that is referred to in a bank's CoRs cross-refers to another document (e.g. for defining a term), the second document will also need to be explicitly referred to in the bank's CoRs (this is necessary to ensure that the mechanism given in the previous bullet works).

170. Cross-references between documents would therefore be drafted something along the following lines, although the exact wording will depend on the purpose of the cross-reference in each case:

- "Defined term X" [has the same meaning as in] / [is calculated in accordance with] the Reserve Bank document "Document Y", in the version applying to the bank in its conditions of registration.

171. To meet the principle in paragraph 169 fourth bullet above, some documents which are not currently referred to directly in a bank's CoRs, but on which the bank depends for the definition of terms, will need to be incorporated into the bank's CoRs. For example, most overseas bank branches are currently subject to a CoR imposing the "speed limit" on high-LVR housing lending, under the BS19 framework. BS19 includes housing-related terms which are defined by reference to BS2A, but branch CoRs do not refer directly to BS2A, because branches are not subject to separate capital adequacy requirements in New Zealand. The standard wording of the branch LVR conditions will need to be expanded as shown in the following extract:

> In conditions of registration 8 to 12:
>
> - "loan-to-valuation ratio", "loan value", "property value", "qualifying new mortgage lending amount" and "residential mortgage loan" have the same meaning as in the Reserve Bank of New Zealand document entitled "Framework for Restrictions on High-LVR Residential Mortgage Lending" (BS19) dated [October 2014], where the version of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) referred to in BS19 for the purpose of defining these terms is that dated [July 2014]:

172. A similar issue will arise with the proposed capital module approach discussed above (see Appendix 3). For example, the calculation of "Tier 1 capital ratio" will be set out in the Overview document, and so would be defined in a bank's CoRs by reference to that document. However, one component of the ratio will be total risk-weighted credit risk exposures, the calculation of which will be in the Credit Risk Overview document. That in turn will refer to the IRB Credit Risk and Standardised Credit Risk documents. Under the proposed approach, banks' CoRs will include a list of references to all documents on which the capital ratio calculations depend, all of which will be dated. The text of the definitions part of a bank's capital CoR would be expanded along the following lines:

1. That:

(a) the Total capital ratio of the banking group is not less than 8%;

….

For the purposes of this condition of registration:

"Total capital ratio" … has the same meaning as in the Reserve Bank of New Zealand document "Capital adequacy framework (overview)" (Doc NN) dated April 2016;

….

the versions of the capital adequacy framework documents on which these calculations depend are those dated as follows:

Document Title	***Version date***
Risk-weighted credit exposures overview	April 2016
IRB credit risk RWAs	April 2016
Standardised credit risk RWAs [needed in case the bank calculates any RWAs this way]	April 2016
AMA operational risk	April 2016
Market Risk	April 2016
Insurance, securitisation, funds management	April 2016

173. We believe that this provides a solution that should be straightforward from the point of view of the "end-users", namely the banks. Each bank will have dated versions of all relevant documents that are referred to in its CoRs, so it will be clear which version of each document applies to each bank at any point in time. Cross-references between documents will refer to the versions of other documents that also currently apply to the bank. And changes of substance to one document will only need the version of that document to be changed, along with any bank CoRs that refer to that document.

174. In addition, we are planning in future to make superseded versions of all Handbook documents available on our website, and also to add redlined versions to show how each document has changed with each update. This is partly a matter of good practice to allow readers to track policy developments over time, but it will also be helpful under the proposed approach described above, since that approach gives the flexibility to leave some banks temporarily subject to a superseded version of a policy document.

175. The creation of a single glossary for the Handbook may allow further simplification of the approach to cross-references between documents, but that will become clearer as the glossary is developed.

Q24. Can you see any drawbacks with this proposed approach to handling different versions of a given document?

Destination of other documents

176. A number of other Handbook documents will be retained with their substance largely unchanged, apart from being re-named and re-formatted into the new standard style.

Disclosure Orders in Council

177. As noted above, the disclosure Orders in Council are a special case. They were substantially improved in 2008, both in terms of their legal drafting style and their layout. The Disclosure Review led to further improvements in their layout in 2011, with two Orders (one for locally-incorporated banks, one for branches) replacing the previous four, and greater clarity around which material is required in which period. Given the constraints of publication in the Gazette, we propose to leave the Orders outside the reformatting of the rest of the Handbook discussed above. In our view, they are already reasonably well laid out.

178. The previous section on possible disclosure amendments notes a few areas in which specific disclosure requirements could be clarified. Also, in the work to produce a single Glossary for the Handbook we will take account of the defined terms in the disclosure Orders.

Q25. Are there any ways in which you think the current layout of the disclosure Orders in Council, as presented on the Reserve Bank's website, could be improved?

Proposed work programme to deliver the above changes

179. The Reserve Bank assesses that it will be a major exercise to restructure the current Handbook as proposed under this option. Banks for their part have also expressed concern at the prospect of having to analyse a consultation on a complete revised new Handbook all in one go.

180. We therefore propose that if this option is agreed on, the implementation work will be broken up into stages. A proposed plan for the staged migration of current Handbook material into the new layout is attached as Appendix D. The plan breaks the migration work down into four stages, with the aim that this is enough to make each stage manageable, while not fragmenting the work too much. The groupings are driven by the logic of the linkages between the documents at each stage. For instance, all the capital-related material forms one stage: that will probably need more than one quarter of the overall work, but would be hard to carry out in more than one stage.

181. The proposed order of the stages is based on completing the hardest / biggest impact ones first. So Stage 1 covers capital: it will also need to be carefully co-ordinated with existing policy updates under way, separate from the restructuring. Stage 2 does not deal with many existing documents, but does involve the creation of three new documents and the proposed formalisation of some existing policy "requirements" into new conditions of registration. Stage 3 includes the new one-stop registration document and the document setting out our supervisory approach, which will involve significant drafting work on our part, but which we think is less crucial for existing registered banks. Stage 4 involves formatting and layout changes to existing documents, so will be mainly cosmetic.

182. The timings shown are designed to ensure that there are no overlaps between the public consultation periods for each of the stages, to meet the banks' primary concern about consultation overload. The draft timetable shows the work starting in September 2015 when the consultation period on this Consultation Document ends and running until December 2016.

183. We believe it is important to allow enough time to avoid any errors or unintentional consequences arising from the Handbook restructuring. As a general principle, we

aim to ensure that the documents and revised CoRs at each stage are fully updated and checked before they are rolled out: this is a more important consideration than the speed with which the changes are completed.

184. For the purpose of consultation, during the implementation phase only, each draft new document would have at the back a list of the related source material in the existing Handbook, and how that material has been updated. Experience to date has shown that some areas in the existing material need some minor corrections and clarifications, and we want to avoid making inadvertent changes to actual policy requirements in the process of tidying up the Handbook. This section of each new document will ensure that we consult transparently on any areas where text is changing.

Q26. Could you please give us any comments on the proposed grouping of the work in the different stages of the migration plan, and on their respective timings?

Part 3: Capital requirements

185. Although the substance of the Reserve Bank's capital requirements is outside the scope of the regulatory stocktake, the Reserve Bank is keen to clarify its capital adequacy requirements to improve accessibility.

186. The structure of the Banking Supervision Handbook, including its capital adequacy components, is dealt with in Part 2 of this consultation paper. The current version of the capital adequacy requirements (i.e. BS2A and BS2B) contains sections that are no longer relevant and have never been used by the Reserve Bank.

187. Basel II represented a fundamental shift in capital adequacy requirements across the world. Whereas capital adequacy calculations had previously followed reasonably simple rules, Basel II led to greater risk differentiation and the introduction of much more complex calculations, particularly for banks that were approved to be on the internal ratings-based approach (IRB). The rules around the IRB approach in particular were novel and untested. The Reserve Bank adopted most of the Basel II recommendations, bar a few amendments to reflect New Zealand circumstances and its approach to IRB modelling.

188. Some of the features of the Reserve Bank's current IRB requirements have never been put into practice and with the experience gained in the interim seven years are unlikely to ever be used. Examples are the Foundation IRB approach, which was originally intended as a half-way measure between full IRB accreditation and being on the standardised approach, and the Qualifying Revolving Retail Exposure class. The latter was intended to be used for revolving retail credit exposures such as credit cards but the Reserve Bank has not been convinced that the Basel prescribed calibration would be correct for New Zealand. We have recently consulted on the removal of both of these features within the IRB approach, although we have not yet made a final decision on the outcome.[14]

189. The Reserve Bank will continue to update its capital adequacy requirements when appropriate and notes that the Basel Committee on Banking Supervision (BCBS) is currently carrying out a review of the standardised approach and the IRB approach. As announced in the May 2015 Financial Stability Report, the Reserve Bank is

[14] See http://www.rbnz.govt.nz/regulation_and_supervision/banks/Consultation-paper-asset-class-treatment-of-loans-to-residential-property-investors_1.pdf

conducting its own review of its capital adequacy requirements, which will take account of any changes to the Basel recommendations resulting from the BCBS work. The Reserve Bank will consult separately on this work in due course.

190. Detail on the proposed capital work is also available on the Banks: Consultations and Policy Initiatives section of the Reserve Bank's website.[15]

191. One other suggestion that was raised by industry was to review the restrictions on banks' insurance business or the broader role of holding companies and treatment of groups that also carry on non-banking business. While this appears to be a small matter, it raises a number of other issues, specifically regarding disclosure requirements and the reporting requirements of locally incorporated banks and insurance companies as well as branches. This is an issue that the Bank is reviewing for both banks and insurance companies, and will continue to examine in the coming months. The Bank will be considering this issue in due course, but is not proposing to make changes to the policy at the current time.

192. A final capital related issue that was raised was the perceived lack of clarity regarding the Reserve Bank's policy related to banks' internal capital adequacy assessment processes (ICAAPs). The Reserve Bank carried out a recent review of banks' ICAAPs, and further work will be undertaken in this area outside of the stocktake project.

Part 4: The RBNZ's policy making approach

193. The Reserve Bank's approach to policy making is firmly anchored in its governing legislation (the Reserve Bank of New Zealand Act 1989) and seeks to follow the "Best Practice Regulation" model developed by the New Zealand Treasury wherever possible[16]. More broadly, the Bank assesses and reports on the expected regulatory impacts of all of its policies when decisions are made to implement those policies.[17] The Bank also reviews its significant policies at intervals appropriate to the nature of the policy being assessed. The Bank publishes reports on these assessments and reviews on its website.

194. The Bank also produces three accountability documents: A Statement of Intent, an Annual Report, and a Financial Stability Report, as required by Section 162AA of the Act. The Bank uses these documents to allow assessments to be made of the effectiveness of its powers to achieve its statutory prudential purposes. The Financial Stability Report, which is produced twice a year (currently May and November), reports on the soundness and efficiency of the financial system and other matters associated with the Bank's statutory prudential purposes. All of these documents are publicly available on the Bank's website.

195. In developing its policies, the Bank seeks to structure its analysis by working through the following topics: problem definition, objectives, options and impact analysis, consultation, implementation, monitoring, evaluation and review. The Banks seeks to follow Treasury's guidance in its approach to drafting Regulatory Impact Statements (RISs), in its public consultation process and its use of cost-benefit analysis. It uses its

[15] See http://www.rbnz.govt.nz/regulation_and_supervision/banks/4506949.html under "Future Policy Work."
[16] See http://www.treasury.govt.nz/economy/regulation/bestpractice
[17] Except those that are of a minor or technical nature (see section 162AB(2), Reserve Bank of New Zealand Act 1989).

website and the semi-annual Financial Stability Report to communicate its analyses and policies to the public.

196. Additional detail on the Bank's overall approach to regulatory policy-making, and its approach to engagement with industry, is described in Appendix F to this document. While the document itself is new, the content is not; it summarises the principles and practices that are currently in place.

Problem definition

197. Across the bank and NBDT sectors there is an interest in greater transparency regarding the Banks' policy making processes, as well as enhanced engagement with industry regarding new policies or policy changes.

198. More specific industry feedback from banks has indicated a desire to see better communication of the Reserve Bank's forward plan, including clearer information to industry and better coordination within the Bank and with other regulators. Banks have suggested that a published statement of current and forthcoming work, and future timetables for consultation on specific projects, would help industry plan ahead. They also noted a strong desire to get a better sense of the potential scale of any future work.

199. Banks also expressed a strong preference to be involved at an early stage in policy development, and sufficient time for consultation and ultimate implementation. Banks have also indicated an interest in seeing greater accountability from the Reserve Bank regarding timelines as well as an increase in the Bank's use of post-implementation reviews.

Proposed changes

200. The Reserve Bank's efforts in this space are subject to a number of different constraints. The Bank's policy-related work plans must remain dynamic in nature, responding to changes in the market or in international standards. The Bank is, and must continue to be, cautious about indicating firm timelines, as this could create a false sense of accuracy, given the flexible nature of the plans. Emerging issues sometimes need to be addressed extremely quickly. In addition, the Bank is unable to signal some aspects of its workplan because doing so might create market distortions.

201. However, within these constraints the Bank believes it can make significant strides towards addressing the issues which have been identified. Below is a list of objectives the Bank is seeking to achieve, as well as specific proposals for addressing each objective.

Policy Making Objective 1: Improve "Forward Planning:" Provide clearer information to industry and better coordinate within RBNZ and with other regulators regarding timelines and consultations.

202. The Bank has identified a number of separate initiatives to better achieve this objective:

Clearer information to industry via the Bank's website

203. As discussed in Part 2 of this consultation document, we are proposing to make a number of changes to the Banking Supervision Handbook, including overall navigation and its placement on the Bank's website. Building on these changes, we aim to make

the overall website more user-focused, rather than Reserve Bank department or function-focused as it is currently organised. Whereas information regarding data collection for banks, for example, or information regarding new prudential statistics initiatives is currently housed on another section of our website, going forward these will be integrated into the general "regulation and supervision- banks" section. We propose to adapt a similar (though not identical) approach to our websites for other regimes.

204. We also propose to commit to keep the website content more dynamic, updating it at least quarterly to reflect upcoming consultations and policy initiatives. This material is currently provided on our website.[18] The format for these website updates will be broadly similar to the current approach, but with slightly more detail on the timing of initiatives (e.g. 1H, 2H Year) and s effort to identify the scale of the initiative. In response to industry feedback, we have also recently begun providing the date of the last update, to provide industry with clarity as to when changes have been made, and to create accountability for our "at least quarterly" commitment.

205. Additionally, we would also propose to better populate the "Future Policy Work" section, to the extent possible. Work that the Reserve Bank has formally committed to, but has not yet begun, could be reported in this section. As with the website overall, our aim here will be to include initiatives of all Reserve Bank departments related to regulation and supervision for each industry (including prudential data collection and macro-financial policy).

Creation of an Industry Newsletter

206. During the insurance industry licensing process, the Bank created a quarterly newsletter to keep industry up to date on the many changes taking place within the sector. Because of the positive reception that the newsletter has received, the Bank continues to produce this newsletter, even though the licensing process has been completed. The Bank proposes to introduce a similar newsletter for the banking industry, broadly based on the content of the insurance newsletter. The newsletter would contain information on the current and planned work of the various Reserve Bank departments (supervisory, policy and statistics/reporting). The Table of Contents would be based broadly on the standard content of the Insurance Industry Update, which contains the following headings: general update, policy initiatives, data collection and other miscellaneous issues.

207. The banking industry newsletter would also provide additional detail that would not be provided on the policy and consultation section of the website. It will be structured as a separate, stand-alone document, which could be forwarded and shared easily within organisations. A goal of this report would be to allow regulatory affairs contacts within banks to more easily share prudential regulation related information within their organisations. Whereas the website content would be on a "pull" basis, this would be structured as a "push" publication. The target audience for this newsletter would be registered banks. We propose to distribute the newsletter to the full industry mailing list, but also make it available to members of the public on our website.

208. While we would propose to update the website quarterly, at a minimum, we would only publish the banking industry newsletter on a semi-annual basis. We would need to consider the precise timing of the publication, which would be structured to complement the publication of the Bank's Financial Stability Report, which also contains information on upcoming regulatory initiatives.

[18] See the webpage at http://www.rbnz.govt.nz/regulation_and_supervision/banks/4506949.html

Enhanced coordination with other regulators

209. The Bank engages regularly with other regulators through a number of different mechanisms. Details on this engagement are provided in the attached Statement of Approach to Policy-Making in Appendix F. We proposed to continue our efforts in these areas.

- For the banking industry, we propose to maintain all of these existing structures, but propose to improve our coordination through the newly established Banking Forum, which the Reserve Bank chairs; and

- We are currently exploring the details of this with the other members of the Forum and would propose to follow-up on this bilaterally with the New Zealand Banker's Association (NZBA). We are currently looking to develop an external communications strategy for the Banking Forum, in order to keep industry informed of the group's activities, particularly as they relate to forward planning. The Bank is also considering ways to incorporate the work of the Banking Forum into its proposed industry newsletter for banks.

Better use of existing supervisory communication channels

210. We are considering a number of ways to better communicate information about the Reserve Bank's broader regulatory agenda as well as the timing of various policy and other regulatory initiatives. In particular:

- "Expected regulatory engagement" is a standing agenda item for bank meetings with Supervisors and we propose to work to ensure that sufficient time and priority is allocated to this point; and

- As was done for the first time in 2015, we propose to include policy-making (macro and micro prudential) and relevant prudential-related statistics initiatives in the annual supervisory letter to banks.

Policy Making Objective 2: More clearly communicate the basic principles of our policy-making approach, including our target time frames for consultations.

211. In an effort to address this issue, the Bank is developing a new document that describes its approach to policy-making. A preliminary outline of this document is provided as Appendix F. While the approach described in the document is not new, we had not previously documented it and shared it publicly with industry. In our view, once formalised, this document would help to clarify the principles behind our approach. It would also make us more clearly accountable to industry.

212. We are proposing to include this document as part of the new "Approach to Regulation and Supervision" document that is proposed to be included in the restructured Banking Supervision Handbook/ Banking Prudential Requirements. The current proposal is that this document would become part of the new documentation describing our regulatory approach. By publishing these as part of the new Banking Prudential Requirements, the Bank would make an express commitment to stand by these principles.

213. We note that the document does not consider specific commitments to time-frames regarding post-implementation review. We believe that committing ourselves to rigid time-frames would be inefficient, as it might force us to conduct reviews, even in times when they are not necessary. Our current practice is to review policies as appropriate

and we are proposing to continue with this approach, except where otherwise required by primary legislation.

214. We also note that, in several places, the document indicates that the Bank will seek to do things “wherever possible.” As discussed above, in some cases, the Bank is simply not able to consult industry or signal projects to the extent industry would like. In these instances, we would seek to clearly communicate our reasons for any deviation from the stated goals.

215. Regarding the commitment to the target time-frames for consultation, the Bank proposes to include a standard statement, in each consultation paper, regarding the length of the consultation period, including the reasons, if any, for deviation from the standard four to eight week period.

Policy Making Objective 3: Streamline process for amending regulations

216. Industry has indicated that changes to the regulations, however minor, are time consuming to analyse and process. Staff time is often consumed by monitoring changes that are technical and minor, and distracting from more substantive issues. Minor issues can create a perception of high regulatory burden. In order to address this, we propose to:

- Minimise the number of updates to regulatory documents by bundling minor changes. For the banking industry, where the majority of the changes take place, we would seek to make changes on a quarterly basis, to be published or at least signalled on a quarterly basis, if practical;

- More consistently make available tracked changes versions of revised documents, in order to make the extent of changes clearer to all current and future users of the documents. For minor changes, this would confirm the minor and technical nature of the changes. For the banking industry, we typically send tracked changes versions of the documents to currently registered banks via e-mail, when informing them of the changes. Going forward, we propose to make these documents available on our website. We propose to make available the immediately prior (“Expired”) versions of all documents, as well as any other versions that have been active within the prior year;

- For the various documents that are “incorporated by reference” in the disclosure regulations, we recently have made versions available dating back five years. This period matches the period for which banks are required to make available historical disclosure statements on their website. The documents “incorporated by reference” govern some of the disclosure requirements, therefore the period for which they are made available should match the period for which disclosure statements must be available; and

- Going forward, reduce the need to update documents because of changes to referenced document. In all new regulatory documents, we would seek to make reference to “versions of documents in place at the time,” to eliminate the need to change guidelines merely because of changes to referenced documents (see Part 2 above for more detail on handbook changes). For the banking industry, this would streamline policy updates and reduce the burden on banks associated with minor and technical changes.

Q27. Do you agree that these are the correct proposals to consider? If not, why not?

Q28. If possible, please quantify the benefit of the specific options presented above. Which of the specific proposals do you see as the most effective?

Q29. Are there other options we should consider to solve the problem (either as we have identified it in the document, or as you identify it)?

Part 5: Differentiated regulatory approaches in the banking prudential regime

217. There are a number of ways in which the Reserve Bank differentiates the regulatory requirements that apply across different classes of bank. A differentiated approach should be able to deliver the objectives of prudential supervision in a more effective and efficient way than applying a "one size fits all" approach. The stocktake provides an opportunity to review the nature of the differentiation that currently exists, and consider whether it might need to be varied to deliver similar outcomes more efficiently. Our current policy documents may not always have spelt out clearly the reasons for the different classifications of banks and the differences in regulations applying to each class.

218. The objectives of our prudential oversight, set by s68 of the Act, are (a) to promote the maintenance of a sound and efficient financial system and (b) to avoid significant damage to the financial system that could arise from the failure of a registered bank. We increase the likelihood of achieving (b) both by reducing the probability of such failures, and by reducing the impact of such failures if they occur. We note first that in our supervision of banks, we deploy supervisory resources in line with an internal framework that assesses both the probability and impact of a bank's failure. Directing supervisory effort to the biggest risks to the s68 objectives improves efficiency, for any given set of regulatory requirements: we take this framework for supervision as a given for the purpose of the Stocktake, which is only considering the regulations themselves.

219. The regulatory tools that we employ (or could employ) can be categorised into those that are designed to reduce the probability of a bank failure, and those that are designed to reduce the impact of failure (and in some cases both). The challenge for identifying any improvements to the current differentiated approach is to identify which tools deliver the best returns for which classes of banks, in terms of how cost-effectively they reduce probability or impact of failure.

220. In our view, the key basis for differentiation is between overseas-incorporated banks that are registered to operate as a branch in New Zealand, and New Zealand-incorporated banks. The main reasons are that there is much less the Reserve Bank, as host supervisor, can do to affect the probability or impact of failure in the case of an overseas bank. We are heavily dependent on the prudential regime and the resolution framework applying to the bank in its home country.

221. The only two areas where the Reserve Bank can have some influence over the probability of a branch failing are:

- At the point of registration, we take a view on the strength of the bank, the importance of governance-based supervision and, to a lesser degree the nature of the Reserve Bank's relationship with the home country supervisor, and our findings can lead us to insist on local incorporation, rather than registering an overseas bank as a branch; and

- The failure of a branch to meet a payment when it is due could in principal push the whole bank into insolvency, even though the whole bank is adequately capitalised. This could arise in the case of wider market disruption that creates temporary problems for head office to provide the necessary liquidity to the branch. The Reserve Bank could reduce the probability of this happening by imposing regulatory requirements for a minimal stock of liquid assets held in New Zealand, and minimum standards for the branch's liquidity risk management.

222. On the impact side, key tools such as the OBR and outsourcing policies that are designed to improve resolution outcomes for locally-incorporated banks cannot realistically be imposed on branches. If an overseas bank with a branch fails, the outcome in terms of the overall resolution cost will be heavily dependent on how the parent bank resolution turns out. So as there is little we can do to reduce this cost for a branch of a given size, our current policy is to put a maximum value on that potential cost, by limiting branch size: branches generally can have no more than $15bn in non-related party liabilities. We continue to believe that this rationale for a cap on branch size makes sense.

223. Within locally-incorporated banks, the main points of differentiation are currently in policies targeted mainly at the impact of failure: the OBR policy only applies to banks with more than $1bn in retail funding, and the outsourcing policy only applies to banks with more than $10bn in total funding that is not from related parties. We believe it makes sense to have some size cut-off for both of these policies, given the limited benefit of applying them to small banks compared to the cost: the s68 objective in any case has a materiality aspect, as it talks about avoiding "significant" damage to the financial system. However, an important general consideration in applying regulatory tools is how they work in combination. In this particular case, it is notable that the requirements of the outsourcing policy are partly designed to avoid problems arising when a statutory manager initiates an OBR, which is leading us to consider whether all banks subject to the OBR requirements should also meet the outsourcing requirements.

224. There is little differentiation in the way we apply regulatory tools that affect the probability of failure of locally-incorporated banks. As noted above, the main differentiation at present is in the intensity of supervisory effort applied to the banks. As most of our regulatory requirements are imposed by individual bank conditions of registration, it would always be possible to tighten any of those requirements on a bank that gave serious cause for concern. In the one area of disclosure requirements, we are considering some options that would mean reduced disclosure for banks with few or no retail deposits (see Part 1 above).

225. From the above discussion, we note the following action points that we either propose to take forward as part of the stocktake, or that will be considered as part of other initiatives:

- The options for changes in disclosure requirements set out in Part 1 all include the removal of the requirement for off-quarter disclosure statements for branches;

- We also propose to remove some other supplemental disclosure requirements for branches in relation to the branch's balance sheet, including concentrated individual credit exposures and sectoral loan concentrations;

- We consulted on extending some variant on our liquidity policy (BS13) to branches in Q1 2012. The proposals were to impose a one-week mismatch ratio on branches. Competing priorities have meant that that work has never been completed, but we still regard it as important. Our earlier proposals, and the feedback we received on them, will be looked again as part of the planned project to consider whether to implement Basel III liquidity requirements in New Zealand;

- As noted above, we are considering the question of whether the application thresholds for the OBR and outsourcing policies should be aligned. This falls within a separate project to review the outsourcing policy, which is currently in hand. We are planning to issue a consultation paper on that shortly;

- We propose to include a clearer articulation of the reasons for the different categories of banks, and the requirements applying to each category, in the new documents setting out our regulatory and supervisory approach; and

- We plan within the next two years to develop a more comprehensive model for determining the right level for the branch size cap, with a view to reconsidering the current level of $15bn and agreeing on an approach to updating it over time.

Q30. Do you have any comments on this analysis of the points of differentiation in the Reserve Bank's regulations for banks? Are there other action points that you think the analysis points to?

Part 6: Miscellaneous changes to Bank policies and regulations

226. During the stocktake, our analysis has also raised a number of more minor or technical issues that could usefully be addressed as part of the project. These matters are fairly diverse, but we consider that overall they can be expected to improve how efficiently the regime operates and achieves it objectives.

Refinements to the existing suitability assessment process for the directors and senior managers of banks

Status quo

227. The Bank's three pillar approach to regulation and supervision places heavy weight on effective governance and risk management as key aspects of self-discipline for banks. In this context, arguably the most important things the regime does to promote good governance within banks is to require a significant degree of independence on boards, and assess the suitability of directors and senior officers.

228. BS10 sets out how we approach reviewing the suitability of directors and senior officers. Specifically:

- In the case of locally incorporated banks, the current or proposed directors, the chief executive, and executives who report directly to the chief executive; and

- In the case of New Zealand branches, the directors (at the time the bank is registered), and the current or proposed chief executive of the New Zealand operations.

229. The standard considerations for suitability are integrity, skills and experience. These considerations are set out in BS10. We typically make an assessment of these factors by reviewing:

- The individual's curriculum vitae;

- The individual's criminal record information (if any); and
- Assessments of the individual from other supervisors and regulators (where appropriate).

230. The assessment includes checks on whether there is any information that suggests that the nominated office holders are not suitable for their positions. It is important to note that this assessment provides a negative assurance. It is not a positive assurance of suitability. The primary responsibility for ensuring that office holders have the necessary skills, experience, and integrity to carry out their tasks lies with shareholders (for director appointments), and the board (for senior officer appointments), not the Bank.

231. We also assess the suitability of the skills and experience of the board of directors as a whole. Boards are expected to have members with a range of relevant skills and experience for being directors of a bank, and to avoid having an undue concentration of skills and experience among directors.

Problem definition

232. Our analysis suggests that there are a number of actual or potential problems with the current suitability assessment process.

233. The first of these problems is the scope of the definition of senior manager. The current definition is "the existing or proposed chief executive officer and any existing or proposed executive who reports directly to the chief executive officer". This definition can sometimes cover persons who do not have, or are unlikely to have, significant influence over a bank's financial soundness (for example, a bank's Head of Change Management, or a bank CEO's Chief of Staff). From a prudential perspective, there seems to be little purpose associated with requiring that a person be subject to a suitability assessment unless they may have this influence.

234. The second problem is the lack of any requirement to ensure the ongoing suitability of directors or senior managers after they have been appointed. This is a potential gap in the regime which could undermine its effectiveness (for example, by meaning that a director or senior manager who was subject to court proceedings for allegedly dishonest behaviour could continue to act in their role[19]).

235. The third problem is that the existing framework may raise a number of more general risks or inefficiencies. Specifically:

- It may raise moral hazard issues by creating a perception that appointments are being approved by the Bank. A particular concern here is that stressing that the process provides a form of negative assurance may be insufficient to change this perception;
- It may divert a disproportionate amount of the Bank's supervisory resources to suitability assessments, when some of this resource could potentially be used for other supervisory activities that make a larger contribution to promoting the maintenance of a sound and efficient financial system; and

[19] Unless removed by the bank itself or under the RBNZ's power to issue directions or remove directors under sections 113 and 113B of the Reserve Bank of New Zealand Act 1989.

- It may create unnecessary duplication and inefficiency by not being more integrated with the internal processes used by banks to assess suitability.

Q31. Do you agree with the problems we have identified with the suitability assessment process of a bank's directors and senior managers? Are there other issues with this process that we should be considering?

Options

236. In light of the problems that have been identified, we consider that consideration should be given to revising the definition of senior manager.

237. We see three options that could be adopted to the definition of senior manager:

- Option 1: Retain the status quo;

- Option 2: Define senior manager as certain key office holders (the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer and the Chief Risk Officer, or persons with equivalent responsibilities); or

- Option 3: Define senior officer as a person occupying a position that allows the person to exercise significant influence over the management or administration of the bank (for example, a chief executive or a chief financial officer).

238. For the reasons noted earlier, we do not prefer option 1. We are also concerned that option 3 may be difficult to apply in practice without the need to provide further guidance. Our preference at this stage is option 2, as we think that this is the best targeted definition for identifying those persons who are most likely to have a significant influence over a bank's financial soundness.

Q32. Do you agree with our preferred option for changes to the definition of senior manager? If not, which option do you prefer?

239. We also consider that it may be appropriate to provide for an ongoing requirement to ensure the continued suitability of directors and senior officer who have already been appointed. We consider that there are three possible approaches that could be taken to this issue:

- Option 1: Retain the status quo;

- Option 2: Require directors to attest in disclosure statements that they have effective systems and processes in place for ensuring the ongoing suitability of directors and senior managers, and that those systems and processes are being correctly applied (we note that this attestation could just be included in full and half year disclosure statements if some or all banks cease being required to prepare off-quarter disclosure statements, as a result of the possible changes discussed in Part 1 of this consultation document); or

- Option 3: Require banks to notify the Reserve Bank when any director or senior manager is subject to criminal, civil or disciplinary proceedings, or has been involved in the management of a failed institution.

240. For the reasons given above we do not support option 1. While option 3 should be relatively easy to apply, we are also concerned that it may not address all of the

potential matters influencing a person's suitability. As a result, our preference is for option 2. We consider that this option is likely to have the intended effect of ensuring that there is some ongoing checking of directors and senior officers' suitability, while at the same time avoiding the risk that the process may miss certain matters that could influence a person's suitability.

> Q33. Do you agree that there should be an ongoing assessment of directors and senior managers' suitability? If so, do you agree with our preferred option for how this should work, or would other options be more appropriate?

241. We do not propose at this stage to make any changes as a result of the broader risks that have been identified with the current model (moral hazard, etc.). However, we note that over the medium term the Bank may carry out further work on whether it would be appropriate to adopt a more consistent approach to suitability assessments across the regimes that we administer, and whether an approach similar to that used under the Insurance (Prudential Supervision) Act 2010 or in Australia might also be appropriate here.[20]

Disclosure and reporting of breaches

Problem definition

242. We have identified two actual or potential issues around the reporting and disclosure of breaches of conditions of registration. Firstly, while in practice the Bank is privately notified of any breaches that might occur, there is no formal legal obligation for banks to report breaches to us under existing legislation. Secondly, while banks must publically disclose breaches in disclosure statements, it has been suggested that in some cases this can require disclosure of genuinely trivial matters, and that disclosure should not be required in those cases.

> Q34. Do you agree with the potential problems we have identified around the disclosure and reporting of breaches of conditions of registration?

Options

243. In respect of the lack of a formal legal obligation for banks to privately report breaches to the Bank, we have identified two options. Specifically:

- Option 1: The status quo; and
- Option 2: Issuing a standing notice to all banks under section 93 of the Reserve Bank of New Zealand Act 1989 requiring them to report any actual or potential breaches of conditions of registration to the Bank as soon as practicable after it occurs.

244. For the reasons given above we do not prefer option 1, and propose to adopt option 2. We note that option 2 has a number of advantages:

- It formalises an important private reporting requirement;

[20] In summary, this approach involves the regulator setting requirements for how an entity should carry out assessments of their own directors and senior managers. The entity must then report on these assessments to the regulator, who retains a reserve power to remove directors or senior managers from office.

- It hooks into the existing liability regime that applies to reporting under section 93 (this makes it an offence to fail to provide information that is required under section 93, or to provide false or misleading information in response to an information request made under section 93);

- It may make it easier to scale back the existing requirement for directors to attest to a bank's compliance with conditions of registration in off-quarter disclosure statements (thereby supporting some of the possible changes to the disclosure statement regime discussed in Part 1 of this consultation document); and

- The terms of the requirement to report breaches could be aligned with the requirement to report breaches to the Financial Markets Authority that some banks will be subject to as a result of their being licensed under the FMC Act for certain purposes.[21]

Q35. Do you agree with our proposal to create a standing obligation to disclose any actual or potential breaches privately to the Reserve Bank as soon as they occur? What are the potential costs and benefits of this option?

245. In respect of the requirement to disclose very minor or trivial breaches, we see two possible options. Specifically:

- Option 1: The status quo; and

- Option 2: Ensuring that the drafting of conditions of registration minimises the scope for any genuinely trivial matters to result in breaches of binding requirements.

246. Our preference at this stage is for Option 2. We do not propose to change the requirement for banks to disclose all breaches, as we see this as an important discipline.

Q36. Do you agree that it would be better to ensure that the drafting of conditions of registration minimises the scope for genuinely trivial matters to result in breaches, rather than providing some form of exception to the requirement that all breaches must be disclosed?

Updating the contents of BS5 (guidelines on anti-money laundering and countering the financing of terrorism)

247. During the stocktake a number of submitters have questioned whether there is still a need to retain BS5 given that the AML Act is now in force. We have considered this issue and concluded that BS5 should be retained, as the 'policies, systems and procedures … to detect and deter money laundering and the financing of terrorism' are one of the matters that the Reserve Bank can consider in determining whether a bank has been carrying on business in a prudent manner. BS5 helps to clarify the threshold for when we might determine that a bank has not been carrying on business in a prudent manner, and hence when the powers to issue a direction to a bank or deregister a bank for AML-related reasons would be exercisable. This is important because Financial Action Taskforce guidelines require AML regulators to have the power to revoke an entity's licence, authorisation or registration, and this power is not provided for in the AML Act itself.

[21] See in particular the reporting requirement in section 412 of the Financial Markets Conduct Act 2013.

248. However, the current text of BS5 is outdated in certain ways (for example, it does not take into account the AML Act coming into force and refers to a number of guidelines that have since been updated or replaced). Accordingly, we propose to revise BS5 separately in the near future, to bring it up to date while leaving its current format unchanged. We propose to make further changes to BS5 over the medium term, as part of the restructuring of the Banking Supervision Handbook, as discussed in Part 2 of this discussion document.

Conclusion

249. As noted at the beginning of this consultation document, the Bank considers that it is an appropriate time to review the prudential requirements applying to banks given the major changes to these requirements over the last 10 years. At the same time we are not looking to alter the fundamental shape of the prudential regime that applies to banks (e.g. adequate capital and liquidity, effective governance and risk management).

250. The contents of this consultation document reflect our discussions with stakeholders and our analysis to date. It sets out a variety of potential changes which could improve the efficiency, clarity and consistency of the prudential requirements applying to banks, in particular, the possible changes to the disclosure statement regime and reorganisation of the Banking Supervision Handbook.

251. We also consider that the proposals in this consultation document relating to the Bank's policy making processes will also further improve the quality and effectiveness of our current policy development process across our prudential and macro-prudential functions.

252. We encourage submitters to provide free and frank responses to the various questions in the consultation document, and are happy to meet to discuss the impacts of these proposals where that would be helpful. We also stress that wherever possible it would be helpful for submitters to quantify the costs and benefits of the proposed changes, or options for changes, that are canvassed in the consultation document.

253. Subject to responses received from submitters, we expect to publish our conclusions on the matters canvassed in this consultation document in October or November of this year. At the same time we will also set out what the likely process and timeframes will be for implementing any changes.

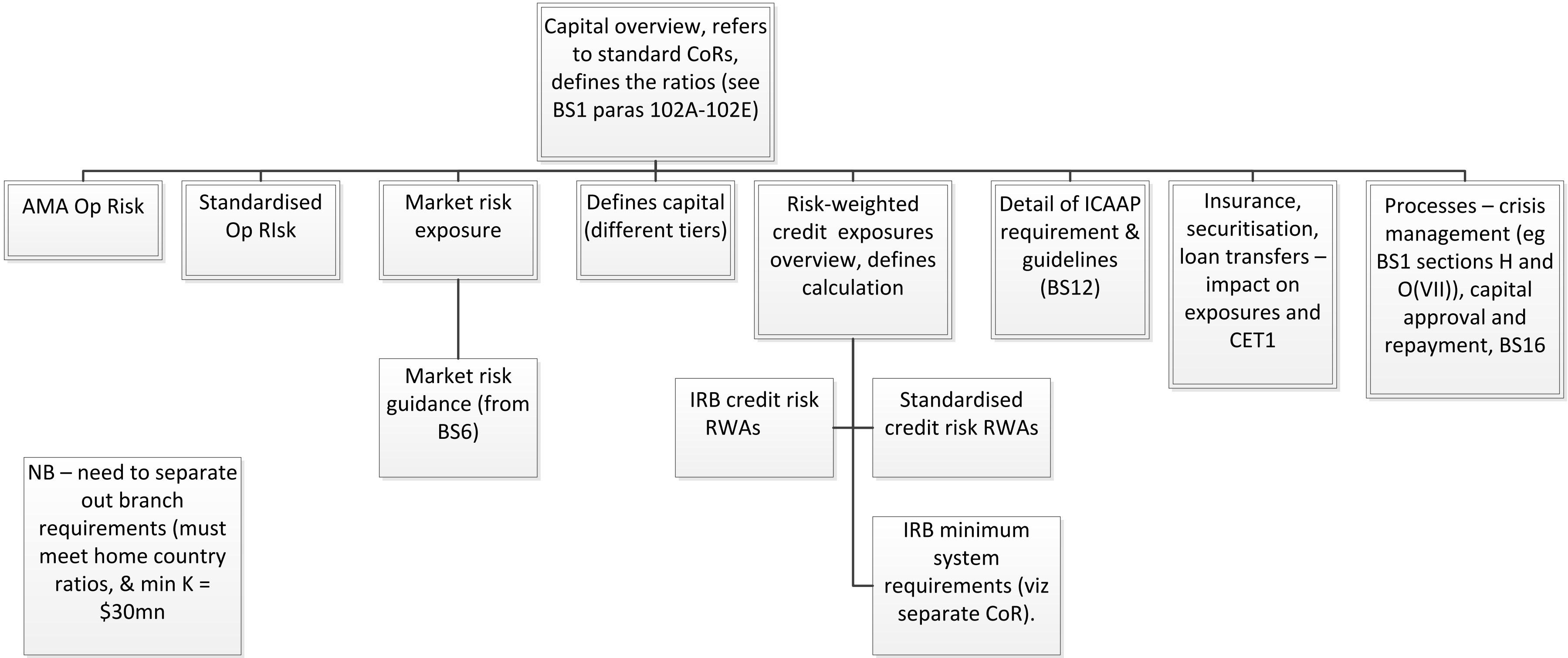
Appendix A: Stocktake Register of Issues to be Addressed

Category	Issues to be Addressed	Status as of 01.07.15
1. Data and Disclosure for banks	A: Consider removing requirement for parent company (solo) financial statements	In process
	B: Review the role of off-quarter Disclosure Statements	In process
	C: Improve use of technology in the Disclosure Statement regime	In process
	D: Review disclosure requirements more generally	In process
	E. Fix other minor issues previously identified (eg. IFRS 9, minor Basel III related clarifications and other potential simplifications)	In process
2. Format & structure of the Banking Supervision Handbook	A. Restructure Handbook, particularly BS1, making the distinction between binding requirements, guidance and guidelines clearer	In process
	B. Improve Handbook navigation	In process
	C. Improve consistency of presentation across the Handbook	In process
	D. Create glossary for Handbook, improving consistency with external definitions	In process
	E. Review AML matters covered in the Handbook	In process
	F. Reduce need to make such frequent Handbook and CoR updates for minor/technical matters	In process
3. Capital requirements for banks	A. Reorganize structure of capital documents	In process
	B. Improve layout of credit risk section of BS2B of the Banking Supervision Handbook	In process
	C. Consider removal of any unutilized provisions in BS2A/BS2B	In process
	D. Fix other minor issues previously identified (e.g. inconsistent wording and definitions, outdated references)	In process
	E. Review 1% Limit on insurance business	Follow-on initiative
	F. Review approach to internal models	Follow-on initiative
	G. Review purpose of ICAAPs (overlap with parallel initiative)	Follow-on initiative
4. Policy-making approach across regimes	A. Improve "Forward-Planning": Provide clearer information to industry and coordinate better within RBNZ and with other regulators regarding timelines for consultations	In process
	B. Establish target time frames to allow sufficient time for consultation (early stage) and implementation	In process
	C. Make greater use of post-implementation reviews	In process
	D. Streamline process for making changes to regulations	In process
5. Differentiated regulatory approach	A: Improve consistency across prudential regimes	In process
	B. Clarify key points of differentiation (ie size cut-offs for various policies) within the bank's regulatory approach.	In process
6. Miscellaneous changes to bank policies and regulations	A: Ensure the clarity of netting rules under connected exposure policies	Handbook and Follow-on Initiative
	B: Improve the clarity of the local incorporation and dual registration policies	Handbook and Follow-on Initiative
	C: Improve director/ manager non-objection policies	In process
	D: Improve tools for handling minor/ technical CoR breaches	In process

Appendix B: Banking Supervision Handbook Table of Contents

Handbook Document	***Document Reference***	***Date of Issue***
Statement of principles – bank registration and supervision	BS1	July 2014
Capital adequacy framework (standardised approach)	BS2A	July 2014
Capital adequacy framework (internal models based approach)	BS2B	October 2014
Application for status as a registered bank: Material to be provided to the Reserve Bank	BS3	March 2011
Audit obligations	BS4	June 2014
Guidelines on Anti-Money Laundering and Countering Financing of Terrorism	BS5	February 2009
Market risk guidance notes	BS6	March 2011
Registered bank disclosure regime – overview of Orders in Council and related documents	BS7	March 2015
Registered bank disclosure regime – explanatory information on Orders in Council	BS7A	September 2014
Connected Exposures Policy	BS8	October 2014
Application for consent to acquire or increase significant influence over a registered bank: Material to be provided to the Reserve Bank	BS9	April 2013
Review of Suitability of Bank Directors and Senior Managers	BS10	March 2011
Outsourcing Policy	BS11	January 2006
Guidelines on a Bank's Internal Capital Adequacy Assessment Process ("ICAAP")	BS12	December 2007
Liquidity Policy	BS13	July 2014
Liquidity Policy Annex: Liquid Assets	BS13A	December 2011
Corporate Governance	BS14	July 2014
Significant Acquisitions Policy	BS15	December 2011
Application for capital recognition or repayment	BS16	September 2013
Open Bank Resolution (OBR) Pre-positioning Requirements Policy	BS17	September 2013
Registration of Covered Bonds: process and information requirements	BS18	December 2013
Framework for Restrictions on High-LVR Residential Mortgage Lending (BS19)	BS19	October 2014
Orders in Council (disclosure requirements)		
Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended)	Local OIC	March 2015
Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended)	Branch OIC	March 2015

Appendix C: Proposed new capital module structure



Appendix D: Draft Map and Timeline for Handbook Migration

Stage	Handbook documents involved	Destination of current material in new structure	Timing
Stage 1 – capital	BS1 (statement of principles) BS2A (capital adequacy standardised) BS2B (capital adequacy modelling) BS6 (guidance on market risk) BS8 (connected exposures) BS12 (Internal Capital Adequacy Assessment Process - ICAAP) BS16 (processes for capital issuance and repayment) BS19 (LVR restrictions)	• BS2A and BS2B are carved up into the new modular approach for capital requirements. • Depending on the outcome of the recent consultation, FIRB and QRRE (unused sections of BS2B) may be removed at this stage. • BS16 and parts of BS1 are moved into the new "capital processes" document. (The sections of BS1 are Section H on breaches of capital ratios, and Section O(VII) on the loss absorbency of capital). • BS6 would become a separate guidance document within the capital module (subject to consultation on whether it still serves any useful purpose). • BS12 would also become a separate document within the capital module. (The current review of banks' ICAAPs may lead to changes in the content of this policy, but that will be independent of this restructuring). • The new documents would be set up in the proposed new format and layout, seeking further detailed feedback on how well that works. (But BS1, BS8 and BS19 would not be re-formatted at this stage; some BS1 text would be cut). • NB, overall Handbook layout and presentation (eg on the website) may be a bit piecemeal after Stage 1 – there will be some new documents in the new format, but others will be unchanged. • The new Glossary is set up at this stage, to be added to at each subsequent stage.	Sept 2015 – Dec 2015: develop text. Jan 2016: finalise formatting in line with proposed new style, and issue drafts for consultation for 6 week period. April 2016: update bank CoRs to put new documents in place. Minor updates will also be needed to the disclosure Orders in Council, to amend the existing cross-references to BS2A and BS2B, to come into force on the first quarterly balance date after BS2A and BS2B are replaced.
Stage 2 – pulling requirements out of BS1	BS1 (statement of principles) BS9 (acquisition of significant influence)	• New document #1 will summarise and briefly explain several standard requirements imposed by CoR (the branch size cap, the limit on insurance business, etc). It will also add requirements that are stated in BS1 but are not currently imposed by CoR (e.g. dual-registered branches cannot take retail deposits). Consultation will focus on these newly formalised requirements. • Related parts of Section C of BS1 ("bank registration") will be cut and replaced by cross-references where necessary. • New document #2 will set out credit rating-related matters in one place (Section J and Appendices 2 and 3 of BS1 will be cut).	Jan – March 2016: develop text. Early April 2016: issue drafts for consultation. We propose an 8 week consultation period, given that changes are potentially ones of substance rather than layout. Finalise and impose via banks' CoRs: either do this for end-June 2016, or hold the Stage 2 CoR

Stage	Handbook documents involved	Destination of current material in new structure	Timing
		• We will expand BS9 to deal with the case where the would-be acquirer is a natural person rather than a corporate (using cross-reference to BS10, approval of individuals). Section M of BS1, which also covers this, will be deleted (any material that needs to be kept will be moved into BS9). • Consult on new document #3 to deal with the requirement for a bank to seek RBNZ approval before establishing an overseas branch, subsidiary or representative office: a standard CoR will be added, backed up by guidance on the factors that we may take into account before giving approval. (This will replace Section N of BS1).	changes until the documents in Stage 3 are ready. The latter also has benefits in terms of a single batch of changes to the website.
Stage 3 – registration requirements and s75 obligation	BS1 (statement of principles) BS3 (registration – material to be provided by applicant) "Bank registration information document" BS5 (AML guidelines) BS9 (acquisition of significant influence) BS10 (director and senior manager suitability) BS11 (outsourcing) BS14 (corporate governance)	• At this stage, the rest of BS1 is removed. • We will put together the new one-stop registration document, taken mainly from the current Section C of BS1, the Bank Registration Information document, and BS3. This will cross-refer to other documents for registration requirements that link to continuing post-registration requirements. It will also include the current AML questionnaire from BS3. • BS5 will be reformatted and possibly re-located, so that cross-references to it from the new registration document can be finalised at this stage. • A new single document will cover director/senior manager suitability (to remove duplication between BS3 and BS10). • We will put together a new document setting out our general approach to supervision (this will replace Section D of BS1, but also draw on other material). • A new document will set out the Principles required by s75 of the Act (unless these are covered in the previous document). This would include a high-level statement of our principles for granting registration (rather than a point-by-point consideration of the matters we must consider, which would be in the registration document); and a statement of how we use conditions of registration. (This will replace Sections E and F of BS1.) • BS9 is updated to refer to the new director/senior manager document. • BS14 is updated as needed, where it deals with the CoR imposing the director / senior manager non-objection requirement, and also take the current material from BS11 on the CoR that requires the business and affairs of the bank, the CEO's contract and so on to be the board's responsibility.	April – Jun 2016: develop text. Consult for 4 weeks from start of July 2016. BS11 and BS14 need CoR updates at this stage, to take effect at (say) end-Sept 2016, but these would be fairly minor. If Stage 2 CoR changes are held over to Stage 3, they would be implemented at the same time. Website updates would be at the same time as CoR updates.

Stage	Handbook documents involved	Destination of current material in new structure	Timing
		• The material noted above is cut from BS11. • Full reformatting of BS11 and BS14 is left for Stage 4.	
Stage 4 – the rest	BS4 (audit requirements) BS7 & BS7A (explanation of disclosure regime) BS8 (connected exposures) BS11 (outsourcing) BS13 & BS13A (liquidity policy) BS14 (corporate governance) BS15, BS17, BS18, BS19 (all of these appear to need minor updates at most, or re-branding)	• This should be a relatively mechanical stage. There are no major structural issues with these documents – they mostly need only re-formatting and re-labelling. • BS4 is pure guidance for auditors, who will be consulted to see if anyone still needs it. • The substance of BS7 is now replaced by the incorporation-by-reference page on the RBNZ website, so can be removed. • BS11 and BS13/13A are, or may be, subject to separate policy reviews, so the timing of changes may be affected by co-ordinating with those. • Completion of this stage allows the new web layout and Handbook navigation to be finalised.	July – August 2016: develop text. 4 week consultation during Sept 2016. Oct-Dec 2016, finalise these documents and also complete the whole website update and deal with any snagging from previous stages. Update CoRs to implement the final set of new documents from end-Dec 2016.

Appendix E: New Handbook standard formatting / layout:

(1) Existing text before re-formatting (extract from BS2B Subpart 4C)

Introduction

4.217 This sub-part sets out the minimum requirements for the IRB approach to measuring credit risk for the purposes of calculating capital requirements.

The minimum requirements are set out in the following sequence.

General requirements

Rating system design

Risk rating system operations

Corporate governance and oversight

Use of internal ratings

Risk quantification

Validation of internal estimates

Supervisory LGD and EAD estimates

Requirements for recognition of leasing

4.218 Unless noted otherwise:

(a) the requirements for assigning exposures to borrower or facility grades (and the related oversight, validation, and related matters) apply equally to the assignment of retail exposures to pools of homogeneous exposures; and

(b) the minimum requirements set out in this part apply to both the FIRB approach and the AIRB approach.

General requirements

Risk rating systems used for capital adequacy purposes must enable risk to be ranked and quantified in a consistent, reliable and valid fashion.

4.219 Rating and risk estimation systems and processes must provide for:

(a) meaningful assessments of obligor and transaction characteristics;

(b) meaningful differentiation of risk; and

(c) accurate and consistent quantitative estimates of risk.

Internal ratings and risk estimates from these systems and processes must play an essential role in the bank's risk management processes as well as for the purposes of calculating regulatory capital requirements. The systems and processes used must be based on data and analysis that are rigorous, well-established, and plausible. An appropriate degree of conservatism should be incorporated into estimates in response to limitations in the scope or quality of the information and data used. The data and analysis must be clearly documented and such documentation retained.

Rating system design

4.220 The term "rating system" means all of the methods, processes, controls, and data collection and systems that support the assessment of credit risk, the assignment of internal credit-risk ratings, and the quantification of associated default and loss estimates.

4.221 If multiple rating methodologies or systems are used within an exposure class, the rationale for assigning an obligor to a rating methodology or system must be documented and must be applied in a manner that best reflects the risk-level of the obligor.[22] Each of the systems used for IRB purposes must comply with the minimum requirements.

Rating dimensions for the corporate, sovereign, and bank IRB exposure classes

4.222 A qualifying IRB rating system must have two separate and distinct dimensions:

(i) the risk of obligor default (the "obligor rating"); and

(ii) transaction-specific factors (the "facility rating").

4.223 **The risk of obligor default (obligor rating grades)**

Separate exposures to a given obligor must be assigned to the same obligor rating grade, irrespective of any differences in the characteristics of the specific transactions.

There are two exceptions to this general rule:

(a) in order to take into account country transfer risk, different obligor grades may be assigned according to whether a facility is denominated in local or foreign currency.

(b) a facility's associated guarantees may be reflected by an adjustment to the obligor grade.

In the case of either exception, separate exposures to a given obligor may be assigned different obligor grades.

[22] Banks must not allocate borrowers inappropriately to rating systems with the aim of minimising regulatory capital requirements (i.e. cherry-picking by choice of rating system).

Credit policy must articulate the levels of risk implied by each obligor grade. The grades must be such that perceived and measured risk increase as credit quality declines from one grade to the next. In articulating the risk of each grade the policy must describe both the probability-of-default risk typical for obligors assigned that grade and the criteria used to distinguish that level of credit risk.

4.224 **Transaction-specific factors (facility ratings)**

Facility ratings must reflect LGD transaction-specific factors such as collateral, seniority, product type, etc.

If the FIRB approach is used, this requirement can be fulfilled by having a rating system with a facility dimension that reflects both obligor and transaction-specific factors. For example, a facility rating that reflects EL by incorporating both obligor strength (PD) and loss severity (LGD) considerations would qualify. Likewise a rating system that exclusively reflects LGD would qualify. Where a rating dimension reflects EL and does not separately quantify LGD, the supervisory estimates of LGD must be used.

If the AIRB approach is used, facility ratings must reflect only LGD and must take account of factors that influence LGD including, but not limited to, the type of collateral, product, industry and purpose. Obligor characteristics may be included as LGD rating criteria only to the extent they are predictive of LGD.

If the supervisory slotting criteria are used for the SL sub-class, the two dimensional requirement does not apply. Given the interdependence between obligor and transaction characteristics in SL, registered banks may use a single rating dimension that reflects EL by incorporating both obligor strength (PD) and loss severity (LGD) considerations.

Rating dimensions for the retail IRB exposure class

4.225 Rating systems for retail exposures must account for both obligor and transaction risk, and must capture all relevant obligor and transaction characteristics. Each exposure that meets the IRB definition of a retail exposure (see 4.7) must be assigned to a particular pool. This rating process must: provide for a meaningful differentiation of risk; group together sufficiently homogenous exposures; and allow for accurate and consistent estimation of PD, LGD and EAD at pool level.

4.226 PD, LGD, and EAD must be estimated for each pool. Different pools may share the same PD, LGD and EAD estimates.

At a minimum, the following risk drivers must be taken into account when exposures are assigned to a pool.

(a) Obligor-risk characteristics. Indicators of a borrower’s risk characteristics might include, for example, a measure of the borrower’s debt servicing burden and demographic information regarding factors such as age or occupation.

(b) Transaction-risk characteristics, including product and/or collateral types. Cross-collateral provisions must be explicitly addressed where present. Indicators of transaction risk characteristics might include, for example, loan to value measures, seasoning, guarantees, and seniority.

Rating structure for the corporate, sovereign, and bank IRB exposure classes

4.227 Specific rating definitions, processes and criteria must be used to assign exposures to grades within a rating system. The rating definitions and criteria must result in a meaningful differentiation of risk. All relevant and material information must be considered when borrower and facility ratings are assigned.[23] That information must be up to date. Where only limited information is available, assignments of exposures to borrower and facility grades or pools must be made on a conservative basis.

4.228 An obligor grade is defined as an assessment of obligor risk, based on a specified and distinct set of rating criteria, from which estimates of PD are derived. A grade definition must include a description of the degree of credit risk typical for obligors assigned to that grade and details of the criteria used to identify that level of credit risk.[24]

A registered bank must have a meaningful distribution of exposures across grades on both its borrower-rating and, where relevant, facility-rating scales. To meet the objective of having a meaningful distribution of exposures across obligor grades with no excessive concentrations, there must be a minimum of seven obligor grades for non-defaulted obligors and one grade for those that have defaulted.[25]

4.229 Where a loan portfolio is concentrated in a particular market segment and range of credit risk there must be enough grades within that range of credit risk to avoid undue concentrations of obligors in particular grades. Significant concentrations within a single grade or grades must be justifiable on the grounds of convincing empirical evidence that the grade or grades cover reasonably narrow PD bands and that the credit risk posed by each obligor in a grade falls within that band.

Registered banks using the supervisory slotting criteria for the SL exposure classes must have at least four grades for non-defaulted obligors, and one for defaulted obligors.

4.230 Where the AIRB approach is used there must be a sufficient number of facility grades to ensure that no single grade contains facilities with widely varying LGDs. The criteria used to define facility grades must be grounded in empirical evidence.

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23 An external rating can be the primary factor determining an internal rating assignment. However, the bank must ensure that it considers other relevant information.

24 "+" or "-" modifiers to alpha or numeric grades may only qualify as distinct grades if the registered bank employing the modifiers: has developed complete rating descriptions and criteria for their assignment; and separately quantifies PD estimates for the modified grades.

25 This is subject to the exception for banks using the supervisory slotting approach for any SL sub-class.

Rating structure for the retail IRB exposure class

4.231 For each pool of retail exposures identified, quantitative measures of loss characteristics (PD, LGD, and EAD) must be calculated. There must be a sufficient number of exposures in each pool to ensure meaningful quantification and validation of loss characteristics at the pool level.

No single pool may include an undue concentration of the total retail exposure.

Rating criteria

4.232 Rating-grade descriptions and criteria must enable obligors or facilities that pose similar risk to be consistently assigned to the same rating grade.[26]

etc …

[26] This consistency should exist across lines of business, departments and geographic locations within a bank.

New Handbook standard formatting / layout: sample 1

<u>(2) New Layout Sample 1</u>

Contents

1 General requirements

1. Risk rating systems used for capital adequacy purposes must enable risk to be ranked and quantified in a consistent, reliable and valid fashion.

2. Rating and risk estimation systems and processes must provide for:
   (a) meaningful assessments of obligor and transaction characteristics;
   (b) meaningful differentiation of risk; and
   (c) accurate and consistent quantitative estimates of risk.

3. Internal ratings and risk estimates from these systems and processes must play an essential role in the bank's risk management processes as well as for the purposes of calculating regulatory capital requirements. The systems and processes used must be based on data and analysis that are rigorous, well-established, and plausible. An appropriate degree of conservatism should be incorporated into estimates in response to limitations in the scope or quality of the information and data used. The data and analysis must be clearly documented and such documentation retained.

4. Unless noted otherwise:
   (a) the requirements for assigning exposures to borrower or facility grades (and the related oversight, validation, and related matters) apply equally to the assignment of retail exposures to pools of homogeneous exposures; and

(b) the minimum requirements set out in this part apply to both the FIRB approach and the AIRB approach.

2 Rating system design

5. The term "rating system" means all of the methods, processes, controls, and data collection and systems that support the assessment of credit risk, the assignment of internal credit-risk ratings, and the quantification of associated default and loss estimates.

6. If multiple rating methodologies or systems are used within an exposure class, the rationale for assigning an obligor to a rating methodology or system must be documented and must be applied in a manner that best reflects the risk-level of the obligor.[27] Each of the systems used for IRB purposes must comply with the minimum requirements.

2.1 Rating dimensions

2.1.1 Corporate, sovereign, and bank IRB exposure classes

7. A qualifying IRB rating system must have two separate and distinct dimensions:
   (a) the risk of obligor default (the "obligor rating"); and
   (b) transaction-specific factors (the "facility rating").

2.1.1.1 The risk of obligor default (obligor rating grades)

8. Separate exposures to a given obligor must be assigned to the same obligor rating grade, irrespective of any differences in the characteristics of the specific transactions.

9. There are two exceptions to this general rule:
   (a) in order to take into account country transfer risk, different obligor grades may be assigned according to whether a facility is denominated in local or foreign currency.
   (b) a facility's associated guarantees may be reflected by an adjustment to the obligor grade.

   In the case of either exception, separate exposures to a given obligor may be assigned different obligor grades.

10. Credit policy must articulate the levels of risk implied by each obligor grade. The grades must be such that perceived and measured risk increase as credit quality declines from one grade to the next. In articulating the risk of each grade the policy must describe both the probability-of-default risk typical for obligors assigned that grade and the criteria used to distinguish that level of credit risk.

[27] Banks must not allocate borrowers inappropriately to rating systems with the aim of minimising regulatory capital requirements (i.e. cherry-picking by choice of rating system).

2.1.1.2 Transaction-specific factors (facility ratings)

11. Facility ratings must reflect LGD transaction-specific factors such as collateral, seniority, product type, etc.

12. If the FIRB approach is used, this requirement can be fulfilled by having a rating system with a facility dimension that reflects both obligor and transaction-specific factors. For example, a facility rating that reflects EL by incorporating both obligor strength (PD) and loss severity (LGD) considerations would qualify. Likewise a rating system that exclusively reflects LGD would qualify. Where a rating dimension reflects EL and does not separately quantify LGD, the supervisory estimates of LGD must be used.

13. If the AIRB approach is used, facility ratings must reflect only LGD and must take account of factors that influence LGD including, but not limited to, the type of collateral, product, industry and purpose. Obligor characteristics may be included as LGD rating criteria only to the extent they are predictive of LGD.

14. If the supervisory slotting criteria are used for the SL sub-class, the two dimensional requirement does not apply. Given the interdependence between obligor and transaction characteristics in SL, registered banks may use a single rating dimension that reflects EL by incorporating both obligor strength (PD) and loss severity (LGD) considerations.

2.1.2 Rating dimensions for the retail IRB exposure class

15. Rating systems for retail exposures must account for both obligor and transaction risk, and must capture all relevant obligor and transaction characteristics. Each exposure that meets the IRB definition of a retail exposure (see 4.7) must be assigned to a particular pool. This rating process must: provide for a meaningful differentiation of risk; group together sufficiently homogenous exposures; and allow for accurate and consistent estimation of PD, LGD and EAD at pool level.

16. PD, LGD, and EAD must be estimated for each pool. Different pools may share the same PD, LGD and EAD estimates.

17. At a minimum, the following risk drivers must be taken into account when exposures are assigned to a pool.

    (a) Obligor-risk characteristics. Indicators of a borrower’s risk characteristics might include, for example, a measure of the borrower’s debt servicing burden and demographic information regarding factors such as age or occupation.
    (b) Transaction-risk characteristics, including product and/or collateral types. Cross-collateral provisions must be explicitly addressed where present. Indicators of transaction risk characteristics might include, for example, loan to value measures, seasoning, guarantees, and seniority.

2.2 Rating structure

2.2.1 Corporate, sovereign, and bank IRB exposure classes

18. Specific rating definitions, processes and criteria must be used to assign exposures to grades within a rating system. The rating definitions and criteria must result in a meaningful differentiation of risk. All relevant and material information must be considered when borrower and facility ratings are assigned.[28] That information must be up to date. Where only limited information is available, assignments of exposures to borrower and facility grades or pools must be made on a conservative basis.

19. An obligor grade is defined as an assessment of obligor risk, based on a specified and distinct set of rating criteria, from which estimates of PD are derived. A grade definition must include a description of the degree of credit risk typical for obligors assigned to that grade and details of the criteria used to identify that level of credit risk.[29]

20. A registered bank must have a meaningful distribution of exposures across grades on both its borrower-rating and, where relevant, facility-rating scales. To meet the objective of having a meaningful distribution of exposures across obligor grades with no excessive concentrations, there must be a minimum of seven obligor grades for non-defaulted obligors and one grade for those that have defaulted.[30]

21. Where a loan portfolio is concentrated in a particular market segment and range of credit risk there must be enough grades within that range of credit risk to avoid undue concentrations of obligors in particular grades. Significant concentrations within a single grade or grades must be justifiable on the grounds of convincing empirical evidence that the grade or grades cover reasonably narrow PD bands and that the credit risk posed by each obligor in a grade falls within that band.

22. Registered banks using the supervisory slotting criteria for the SL exposure classes must have at least four grades for non-defaulted obligors, and one for defaulted obligors.

23. Where the AIRB approach is used there must be a sufficient number of facility grades to ensure that no single grade contains facilities with widely varying LGDs. The criteria used to define facility grades must be grounded in empirical evidence.

2.2.2 Retail IRB exposure class

24. For each pool of retail exposures identified, quantitative measures of loss characteristics (PD, LGD, and EAD) must be calculated. There must be a sufficient number of exposures in each pool to ensure meaningful quantification and validation of loss characteristics at the pool level.

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[28] An external rating can be the primary factor determining an internal rating assignment. However, the bank must ensure that it considers other relevant information.

[29] "+" or "-" modifiers to alpha or numeric grades may only qualify as distinct grades if the registered bank employing the modifiers: has developed complete rating descriptions and criteria for their assignment; and separately quantifies PD estimates for the modified grades.

[30] This is subject to the exception for banks using the supervisory slotting approach for any SL sub-class.

25. No single pool may include an undue concentration of the total retail exposure.

2.3 Rating criteria

26. Rating-grade descriptions and criteria must enable obligors or facilities that pose similar risk to be consistently assigned to the same rating grade.[31]

etc …

[31] This consistency should exist across lines of business, departments and geographic locations within a bank.

New Handbook standard formatting / layout: sample 2

(3) New Layout Sample 2

Contents

1 General requirements

1.1 Risk rating systems used for capital adequacy purposes must enable risk to be ranked and quantified in a consistent, reliable and valid fashion.

1.2 Rating and risk estimation systems and processes must provide for:

(a) meaningful assessments of obligor and transaction characteristics;
(b) meaningful differentiation of risk; and
(c) accurate and consistent quantitative estimates of risk.

1.3 Internal ratings and risk estimates from these systems and processes must play an essential role in the bank's risk management processes as well as for the purposes of calculating regulatory capital requirements. The systems and processes used must be based on data and analysis that are rigorous, well-established, and plausible. An appropriate degree of conservatism should be incorporated into estimates in response to limitations in the scope or quality of the information and data used. The data and analysis must be clearly documented and such documentation retained.

1.4 Unless noted otherwise:

(a) the requirements for assigning exposures to borrower or facility grades (and the related oversight, validation, and related matters) apply equally to the assignment of retail exposures to pools of homogeneous exposures; and
(b) the minimum requirements set out in this part apply to both the FIRB approach and the AIRB approach.

2 Rating system design

2.0.1 The term "rating system" means all of the methods, processes, controls, and data collection and systems that support the assessment of credit risk, the assignment of internal credit-risk ratings, and the quantification of associated default and loss estimates.

2.0.2 If multiple rating methodologies or systems are used within an exposure class, the rationale for assigning an obligor to a rating methodology or system must be documented and must be applied in a manner that best reflects the risk-level of the obligor.[32] Each of the systems used for IRB purposes must comply with the minimum requirements.

2.1 Rating dimensions

Corporate, sovereign, and bank IRB exposure classes

2.1.1 A qualifying IRB rating system must have two separate and distinct dimensions:
(a) the risk of obligor default (the "obligor rating"); and
(b) transaction-specific factors (the "facility rating").

The risk of obligor default (obligor rating grades)

2.1.2 Separate exposures to a given obligor must be assigned to the same obligor rating grade, irrespective of any differences in the characteristics of the specific transactions.

2.1.3 There are two exceptions to this general rule:
(a) in order to take into account country transfer risk, different obligor grades may be assigned according to whether a facility is denominated in local or foreign currency.
(b) a facility's associated guarantees may be reflected by an adjustment to the obligor grade.
In the case of either exception, separate exposures to a given obligor may be assigned different obligor grades.

2.1.4 Credit policy must articulate the levels of risk implied by each obligor grade. The grades must be such that perceived and measured risk increase as credit quality declines from one grade to the next. In articulating the risk of each grade the policy

[32] Banks must not allocate borrowers inappropriately to rating systems with the aim of minimising regulatory capital requirements (i.e. cherry-picking by choice of rating system).

must describe both the probability-of-default risk typical for obligors assigned that grade and the criteria used to distinguish that level of credit risk.

Transaction-specific factors (facility ratings)

2.1.5 Facility ratings must reflect LGD transaction-specific factors such as collateral, seniority, product type, etc.

2.1.6 If the FIRB approach is used, this requirement can be fulfilled by having a rating system with a facility dimension that reflects both obligor and transaction-specific factors. For example, a facility rating that reflects EL by incorporating both obligor strength (PD) and loss severity (LGD) considerations would qualify. Likewise a rating system that exclusively reflects LGD would qualify. Where a rating dimension reflects EL and does not separately quantify LGD, the supervisory estimates of LGD must be used.

2.1.7 If the AIRB approach is used, facility ratings must reflect only LGD and must take account of factors that influence LGD including, but not limited to, the type of collateral, product, industry and purpose. Obligor characteristics may be included as LGD rating criteria only to the extent they are predictive of LGD.

2.1.8 If the supervisory slotting criteria are used for the SL sub-class, the two dimensional requirement does not apply. Given the interdependence between obligor and transaction characteristics in SL, registered banks may use a single rating dimension that reflects EL by incorporating both obligor strength (PD) and loss severity (LGD) considerations.

Rating dimensions for the retail IRB exposure class

2.1.9 Rating systems for retail exposures must account for both obligor and transaction risk, and must capture all relevant obligor and transaction characteristics. Each exposure that meets the IRB definition of a retail exposure (see 4.7) must be assigned to a particular pool. This rating process must: provide for a meaningful differentiation of risk; group together sufficiently homogenous exposures; and allow for accurate and consistent estimation of PD, LGD and EAD at pool level.

2.1.10 PD, LGD, and EAD must be estimated for each pool. Different pools may share the same PD, LGD and EAD estimates.

2.1.11 At a minimum, the following risk drivers must be taken into account when exposures are assigned to a pool.

(a) Obligor-risk characteristics. Indicators of a borrower's risk characteristics might include, for example, a measure of the borrower's debt servicing burden and demographic information regarding factors such as age or occupation.

(b) Transaction-risk characteristics, including product and/or collateral types. Cross-collateral provisions must be explicitly addressed where present. Indicators of transaction risk characteristics might include, for example, loan to value measures, seasoning, guarantees, and seniority.

2.2 Rating structure

Corporate, sovereign, and bank IRB exposure classes

2.2.1 Specific rating definitions, processes and criteria must be used to assign exposures to grades within a rating system. The rating definitions and criteria must result in a meaningful differentiation of risk. All relevant and material information must be considered when borrower and facility ratings are assigned.[33] That information must be up to date. Where only limited information is available, assignments of exposures to borrower and facility grades or pools must be made on a conservative basis.

2.2.2 An obligor grade is defined as an assessment of obligor risk, based on a specified and distinct set of rating criteria, from which estimates of PD are derived. A grade definition must include a description of the degree of credit risk typical for obligors assigned to that grade and details of the criteria used to identify that level of credit risk.[34]

2.2.3 A registered bank must have a meaningful distribution of exposures across grades on both its borrower-rating and, where relevant, facility-rating scales. To meet the objective of having a meaningful distribution of exposures across obligor grades with no excessive concentrations, there must be a minimum of seven obligor grades for non-defaulted obligors and one grade for those that have defaulted.[35]

2.2.4 Where a loan portfolio is concentrated in a particular market segment and range of credit risk there must be enough grades within that range of credit risk to avoid undue concentrations of obligors in particular grades. Significant concentrations within a single grade or grades must be justifiable on the grounds of convincing empirical evidence that the grade or grades cover reasonably narrow PD bands and that the credit risk posed by each obligor in a grade falls within that band.

2.2.5 Registered banks using the supervisory slotting criteria for the SL exposure classes must have at least four grades for non-defaulted obligors, and one for defaulted obligors.

2.2.6 Where the AIRB approach is used there must be a sufficient number of facility grades to ensure that no single grade contains facilities with widely varying LGDs. The criteria used to define facility grades must be grounded in empirical evidence.

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33 An external rating can be the primary factor determining an internal rating assignment. However, the bank must ensure that it considers other relevant information.

34 "+" or "-" modifiers to alpha or numeric grades may only qualify as distinct grades if the registered bank employing the modifiers: has developed complete rating descriptions and criteria for their assignment; and separately quantifies PD estimates for the modified grades.

35 This is subject to the exception for banks using the supervisory slotting approach for any SL sub-class.

Retail IRB exposure class

2.2.7 For each pool of retail exposures identified, quantitative measures of loss characteristics (PD, LGD, and EAD) must be calculated. There must be a sufficient number of exposures in each pool to ensure meaningful quantification and validation of loss characteristics at the pool level.

2.2.8 No single pool may include an undue concentration of the total retail exposure.

2.3 Rating criteria

2.3.1 Rating-grade descriptions and criteria must enable obligors or facilities that pose similar risk to be consistently assigned to the same rating grade.[36]

etc …

[36] This consistency should exist across lines of business, departments and geographic locations within a bank.

Appendix F: Outline Draft Statement of the Reserve Bank's Policy Making Approach

Overall approach and framework

- The Reserve Bank's approach to policy making is firmly anchored in its governing legislation (the Reserve Bank of New Zealand Act 1989) and seeks to follow the "Best Practice Regulation" model developed by the New Zealand Treasury wherever possible.[37]
- The Reserve Bank carries out regulatory impact analyses on all of its regulatory policies.[38] This analysis generally takes the form of a Regulatory Impact Statement (RIS), which includes stakeholder consultation and is published on the Reserve Bank website.
- Policy papers and potential policy consultations, and all RISs, are discussed by an internal Reserve Bank committee, which is chaired by the Deputy-Governor, Financial Stability and attended by all governors. Analysis, policy options and subsequent feedback from stakeholders are reviewed by the committee. Decisions are ultimately made by the Governor.
- We also monitor and report on our work in the accountability documents we publish: our Statement of Intent, our Annual Report, and our semi-annual Financial Stability Report.

Approach to Regulatory Impact Assessment

- Assessments of regulatory impact generally cover the following: status quo and problem definition, objectives, options and impact analysis, consultation, implementation, monitoring, evaluation and review.
- Problem definitions are generally based on market failure arguments and/or bringing New Zealand standards into line with international practice where it is in New Zealand's interest to do so.
- Not every potential market failure warrants a regulatory solution. Regulatory costs can be significant and there is always a risk of regulatory failure. An analysis of policy options is undertaken against the status quo and/or the absence of regulation. Regulatory action is only proposed if a regulatory solution would improve on the market outcome.
- Some policy initiatives are also driven by efforts to increase the efficiency of existing regulatory regime.
- Problem definitions are supported by analysis of underlying data (whenever available) and other information, including international norms and best practices.
- Objectives may be linked to the Reserve Bank's legislative mandate as per the Reserve Bank Act with more specific objectives targeted at addressing the relevant policy objective.
- In its internal decision-making process, the Reserve Bank uses internal cost benefit frameworks to guide its analysis. Whenever possible, we quantify and seek to monetize costs and benefits.
- We also seek to reduce and minimize costs on affected parties if possible. This may include the use of exemptions or policy thresholds, and appropriately chosen timelines.

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[37] http://www.treasury.govt.nz/economy/regulation/bestpractice

[38] Except those that are of a minor or technical nature.

Approach to Consultation, Implementation and Post- Implementation Review

- Industry and broader public consultation provide crucial input for the Bank's analysis. Our aim is to consult over a four to eight week period depending on the significance of the proposal. There may be rare cases where circumstances mean we adopt a shorter consultation period. In these cases, the Bank will seek to be clear about why a longer period is not possible.
- Unless a proposal is of a minor and technical nature, or only affects a small number of entities and is a matter of limited public interest, we will release a consultation paper inviting stakeholder feedback, followed by a policy decision paper summarizing the feedback.
- In some cases, for more significant or complex initiatives, the Bank may also hold targeted workshops with industry to elaborate or solicit more detailed feedback on specific matters. If there is a need for further discussion or consultation on an issue, we adapt our time-frames and process accordingly.
- In all of its consultations, the Bank seeks to be transparent about its assumptions and its goals, stating clearly which options may or may not be feasible and why.
- The Bank welcomes full and frank feedback from its stakeholders and gives proper consideration to alternative viewpoints.
- Each consultation should address transitional arrangements and implementation timeframes. Industry will be consulted on potential implementation timeframes and the reasons behind them. Time requirements will vary significantly depending on the nature of the policy. Wherever possible, the Bank seeks to implement policy changes in reasonable time-frames.
- The Bank is committed to reviewing its existing policies to keep them up to date and, where appropriate, in line with international regulatory developments, and to address any issues that may arise.
- The Bank is committed to reviewing its existing policies on a regular basis, subject to available resources. In some cases, the Bank's governing legislation contains its own timelines for review.

Approach to Communication/Engagement with Industry

- To the extent possible, the Reserve Bank provides information about its upcoming consultations and policy initiatives via a dedicated section of its website.
- In some cases, the Bank is unable to signal some aspects of its workplan because doing so might create market distortions. In other cases, issues emerge suddenly and cannot be communicated with much advance notice. The Bank's policy-related work plans must remain somewhat dynamic in nature, responding to changes in the market or in international standards. The website is updated on an as-needed basis and at least quarterly for Banks and insurers. The NBDT section of the website is updated on an as-needed basis.
- The Bank currently produces a regular newsletter for the insurance sector, to keep industry up to date on its planned consultations and work program. The Bank is considering expanding this to include a newsletter for banks.
- Consultations are posted on the Bank's website and distributed to subscriber mailing lists.
- In some cases, depending on the nature of the consultation, the Reserve Bank's communications department also makes more public announcements or press releases in order to solicit broader public input.
- Where appropriate, supervisors also discuss policy issues as a standing agenda item in their supervisory meetings with the regulated entities. Feedback from these meetings is relayed back to the policy-making departments at the Bank.

- The Bank also has regular engagement with representatives of industry bodies in the various sectors it regulates.

Collaboration with Other Regulators and Government Agencies

- The Bank collaborates and consults with other regulators and government agencies in its policy-making work through the following mechanisms:
  - Quarterly meetings with the Financial Markets Authority
  - Membership of Council of Financial Regulators (CoFR)
  - Chairing the Banking Forum, a sub-committee of CoFR
  - Regular engagement with the Australian Prudential Regulatory Authority (APRA)
  - Membership of the Trans-Tasman Banking Council
- The Bank is also a member of a number of other international bodies and engages regularly with the international banking community in order to keep abreast of changing international standards and best practices.

Appendix G: List of Questions Asked Throughout the Document

Question	Content
1	To what extent does private sector analysis and other published research on the financial system make use of off-quarter disclosure statements?
2	How important is the role of off-quarter disclosure statements in imposing market disciplines on banks?
3	Do you consider that the requirement to prepare off-quarter disclosure statements materially improves banks' internal governance and risk management? If so, do you consider that there may be more efficient ways of achieving these benefits?
4	How much cost saving for banks would result if the requirement to prepare off-quarter financial statements was removed but the additional financial information referred to in paragraph 78 was privately reported to the IRD for off-quarters?
5	Do you agree with our assessment of how effective the disclosure statement regime is at providing information about the soundness of banks in a crisis situation or stressed market situation?
6	Would removing the requirement to prepare off-quarter disclosure statements (or scaling it back to disclosure of a narrower range of matters) create larger windows for New Zealand banks to raise offshore funds? If so, please explain the reasons for this.
7	Are there other issues that we should be considering with regard to off-quarter disclosure requirements for banks?
8	Do you agree with the options we have identified for the treatment of off-quarter disclosure statements? Are there other options we should be considering?
9	Do you agree with our assessment of the costs and benefits of option 1? To what extent can these costs and benefits be quantified? Are there other costs and benefits we should be considering?
10	Do you agree with our assessment of the costs and benefits of option 2? To what extent can these costs and benefits be quantified? Are there other costs and benefits we should be considering? Are there ways of mitigating the costs or risks of this option?
11	How would banks' internal risk management and governance be influenced by this option?
12	Do you agree with our assessment of the costs and benefits of option 3? To what extent can these costs and benefits be quantified? Are there other costs and benefits we should be considering? Are there ways of mitigating the costs or risks of this option?
13	How would banks' internal risk management and governance be influenced by this option?
14	Do you agree with our assessment of the costs and benefits of option 4? To what extent can these costs and benefits be quantified? Are there other costs and benefits we should be considering? Are there ways of mitigating the costs or risks of this option?
15	How would banks' internal risk management and governance be influenced by this option?
16	Of the four options presented above, which do you prefer and why? Please provide detailed reasons, and thoughts on how the costs and risks of your preferred option could be managed.
17	Do you have any comments on the proposed changes to the content of disclosure statements? Are there other matters we should consider removing from, or adding to, the contents of disclosure statements?
18	What would be the costs associated with this supplemental private reporting of the quantitative components of disclosure statements?
19	Have you found any other problems with the current format and structure of the Handbook that are not covered by this list?

Question	Content
20	What do you see as the costs or risks arising from this proposed restructuring? Do you have any alternative suggestions for making it easier for new applicants to know what is expected of them, and for registered banks to be clear about the continuing requirements applying to them?
21	Do you have any comments on the proposed restructuring of the documents in the capital adequacy framework?
22	Do you have any other suggestions for how a standard handbook document should be structured? Of the proposed numbering structures in Sample 1 and Sample 2, which do you prefer? Can you give suggest any alternative numbering approaches that you believe would work better? Do you have any other suggestions for renaming the Handbook itself and replacing the BS numbering convention?
23	Do you have any concerns about the proposal to remove from the Handbook guidelines issued under s78(3) of the Act? Do you have any other suggestion for how the Reserve Bank could most effectively require improvements by banks in more subjective areas such as risk management?
24	Can you see any drawbacks with this proposed approach to handling different versions of a given document?
25	Are there any ways in which you think the current layout of the disclosure Orders in Council, as presented on the Reserve Bank's website, could be improved?
26	Could you please give us any comments on the proposed grouping of the work in the different stages of the migration plan, and on their respective timings?
27	Do you agree that these are the correct proposals to consider? If not, why not?
28	If possible, please quantify the benefit of the specific options presented above. Which of the specific proposals do you see as the most effective?
29	Are there other options we should consider to solve the problem (either as we have identified it in the document, or as you identify it)?
30	Do you have any comments on this analysis of the points of differentiation in the Reserve Bank's regulations for banks? Are there other action points that you think the analysis points to?
31	Do you agree with the problems we have identified with the suitability assessment process of a bank's directors and senior managers? Are there other issues with this process that we should be considering?
32	Do you agree with our preferred option for changes to the definition of senior manager? If not, which option do you prefer?
33	Do you agree that there should be an ongoing assessment of directors and senior managers' suitability? If so, do you agree with our preferred option for how this should work, or would other options be more appropriate?
34	Do you agree with the potential problems we have identified around the disclosure and reporting of breaches of conditions of registration?
35	Do you agree with our proposal to create a standing obligation to disclose any actual or potential breaches privately to the Reserve Bank as soon as they occur? What are the potential costs and benefits of this option?
36	Do you agree that it would be better to ensure that the drafting of conditions of registration minimises the scope for genuinely trivial matters to result in breaches, rather than providing some form of exception to the requirement that all breaches must be disclosed?