

Submission

to the

Reserve Bank of New Zealand

on the

Review of the Connected
Exposures Policy (BS8) –
Consultation Document

31 March 2022

About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.
2. The following seventeen registered banks in New Zealand are members of NZBA:
 - ANZ Bank New Zealand Limited
 - ASB Bank Limited
 - Bank of China (NZ) Limited
 - Bank of New Zealand
 - China Construction Bank
 - Citibank N.A.
 - The Co-operative Bank Limited
 - Heartland Bank Limited
 - The Hongkong and Shanghai Banking Corporation Limited
 - Industrial and Commercial Bank of China (New Zealand) Limited
 - JPMorgan Chase Bank N.A.
 - Kiwibank Limited
 - MUFG Bank Ltd
 - Rabobank New Zealand Limited
 - SBS Bank
 - TSB Bank Limited
 - Westpac New Zealand Limited

Introduction

NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand (**RBNZ**) on the Review of the Connected Exposures Policy (BS8) Consultation Document (**Consultation Document**). NZBA commends the work that has gone into developing the Consultation Document.

Contact details

3. If you would like to discuss any aspect of this submission, please contact:

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Submission

NZBA broadly supports the changes that are being proposed to the Connected Exposures Policy (**BS8**). Please see our responses below to the Consultation Document questions.

As a general comment, we seek clarification as to how these proposals will fit with the Deposit Takers Act (**DTA**). For example, it would be helpful to understand how the RBNZ proposes to align any new conduct requirements under BS8 with those proposed under the DTA, as there is potential overlap. The DTA as currently drafted, will introduce a 'Directors' Due Diligence Duty' under section 88, and this applies in relation to "prudential obligations". We've assumed that the current BS8 policy will eventually be a Standard under the DTA, to which this duty (and its corresponding penalties) would apply. We would welcome further engagement on this topic.

#	Question	NZBA Response
1	The Reserve Bank welcomes views on our proposed overall approach.	<p>NZBA broadly supports the RBNZ's proposed overall approach.</p> <p>We agree that removing the current aggregate gross exposure limit is a good step. We favour aligning the definition of connected persons as much as possible to the accounting standards definition of related party.</p>
2	The Reserve Bank welcomes views regarding interbank exposures.	<p>We seek further clarity on the RBNZ's intention and rationale for capturing intra-day interbank exposures. Our understanding is that an intra-day exposure would clear during the day, meaning that it would not exist at the close of business. If these exposures are not cleared intra-day, then they would become inter-day exposures (unless there was a default, in which case they would be included as part of the exposure in the default). It is therefore unclear how the inclusion of intra-day interbank exposures would work in practice.</p> <p>We support the BS8 being updated to clarify that all exposures with connected persons, including those that are themselves banks (i.e. interbank exposures), are included.</p>
3	The Reserve Bank welcomes views on our proposed expansion of the definition of a connected person.	<p>In our view, a better approach is to align the definition of connected person to the accounting standard definition of related party in NZ IAS 24 <i>Related Party Disclosures</i>, as opposed to having a separate definition. This alignment:</p> <ul style="list-style-type: none"> • is closer to the Basel Core Principles definition of connected persons highlighted in the consultation document • will assist with efficiency and allow for a single definition to be applied consistently for financial and regulatory reporting and ease of application in systems and processes • will provide a closer relationship between related party disclosures required under NZ IAS 24 and the Exposures to Connected Persons information required by Schedule 14 of the Registered Bank Disclosure Statements

		<p>(New Zealand Incorporated Registered Banks) Order 2014 (the Order).</p> <p>If the Reserve Bank does not want to fully align and expand the definition of connected persons as suggested above, we ask that the definition proposed be amended to include “directors and their controlled entities” so that this aligns with the accounting standard definition and will avoid confusion from having two different definitions in relation to directors.</p> <p>If the current definition remains, we seek clarification of the definition of “connected person” in the policy, specifically the application of 4(e)(ii) which refers to “an entity in which an owner has a substantial interest” as a connected person. We request clarity as to whether this is intended to capture entities an owner has an investment interest in, rather than an operational one. Our view is that entities that the owner has an investment interest in, for example private equity funds, should not be captured. These entities would have little ready insight into the underlying portfolios of these entities.</p> <p>We also seek clarity as to whether 4(e)(iv) under the proposed expanded definition is intended to capture family trusts, where the director is a trustee or beneficiary.</p>
4	The Reserve Bank welcomes views on our proposed options to respond to the IMF’s recommendation. The Reserve Bank also welcomes your feedback as to what the compliance costs impacts would be under Option 2.	<p>Conflict of interest when providing loans to connected persons is managed through existing risk frameworks and policies that are approved by the Board. We do not see the need for explicit board approval of loans to connected persons and the writing-off of such loans.</p> <p>We recommend maintaining the current processes, as we consider Option 2 may have some unintended consequences. For example, Board approval would likely be required for use of a credit card with a small limit by a director.</p>
5	The Reserve Bank welcomes views regarding the gross exposure limit. Do you consider a gross exposure limit is still required? What would be the consequences of abolishing it?	We support the removal of this limit.
6	To the extent possible, please submit an estimate of your aggregate net credit exposures reflecting the changes proposed in this consultation paper.	Our members will provide this information individually.
7	The Reserve Bank welcomes views on changes to the surveys. Please indicate if there are any practical concerns or challenges in relation to the additional information collection.	<p>We support consistency with the RBNZ Large Exposure Survey.</p> <p>We are concerned about providing identifiable personal loan balance information for individuals and their related parties. We consider that balances/data should be aggregated by nature of party and type of exposure,</p>

		<p>rather than by individual counterparty, and categorised accordingly in the connected exposures survey, i.e.:</p> <p>1) Counterparty type: Parent company (and other subsidiaries of the group); Directors (and their related parties); other Key Management personnel (and their related parties); Associates; Other related parties</p> <p>2) Nature of balance: Loan, Securities, Derivatives (including cash collateral paid), other receivables (including nostros, etc).</p>
8	The Reserve Bank welcomes views on implementing the amended BS8 at the same time as or after the upcoming implementation of the Dual Reporting Requirements.	Our preference is for the Dual Reporting Requirements to be implemented before the BS8 amendments. Our members will require sufficient time for implementation following the release of final decisions, which we understand is expected to be released in Q2/3 2022. This timing would likely not provide a sufficient implementation period if implementation occurred at the same time as the Dual Reporting Requirements, scheduled for Q3 2022.
9	The Reserve Bank welcomes views on our proposed changes and any impacts that banks and the financial system may encounter with the proposed changes. We also seek any feedback about possible risks that might result from allowing more bilateral netting agreements to be eligible under the Connected Exposures Policy.	<p>We don't consider there to be any adverse impacts as a result of the proposed changes.</p> <p>We don't consider there to be any additional risks posed by expanding the range of eligible bilateral netting agreements.</p>
10	The Reserve Bank welcomes views on these general principles.	We recommend the general principles include an intention to keep this policy as simple as possible, in order to avoid any unintended consequences or administratively or operationally burdensome requirements.
11	The Reserve Bank welcomes views on the replacement of the terminology of "market related contracts" with "derivatives and securities financing transactions (SFTs)".	We support the proposed update to the terminology.
12	The Reserve Bank welcomes views on the proposal to allow IRB banks to use gross exposure values, if netting of any impairment allowances is operationally burdensome.	We note that only some of our members are IRB banks. Those members support allowing IRB banks to use gross exposure values.
13	The Reserve Bank welcomes views on our proposed application of a flat 100% CCF for off-balance sheet commitments to connected persons. Please quantify your feedback, particularly if you disagree with our proposed flat 100% CCF.	We seek clarification as to whether this proposal is specific to BS8, or whether this proposal extends to the Capital Adequacy Calculations. While we do support the proposal within the context of BS8, we do not support the 100% CCF being incorporated into the Capital Adequacy Calculations.

		We would also welcome consideration and guidance on the treatment of uncommitted facilities, i.e. where express approval is required before drawdown.
14	The Reserve Bank welcomes views on our proposed clarification of the measurement methodologies for financial instruments issued by a bank's connected persons or derivatives with underlying financial instruments issued by a bank's connected persons. Please quantify your feedback, particularly if you disagree with our proposed clarification.	Our preference is to use the on-balance sheet accounting values, in order to keep things simple and comparable to financial statement related party exposures as much as possible. We consider that referencing the capital standards will increase complexity.
15	The Reserve Bank welcomes views on (i) the proposal to apply in the connected exposure policy the same conditions and same treatment of CRMs as those in the standard approach in BPR132, and (ii) the proposal that banks would not be able to recognise unfunded contingent credit protection provided by a connected person (e.g., a guarantee, credit derivative and indemnity).	We support allowing netting of cash collateral in derivatives exposure calculations. We would also support clarification of the definition of "risk lay-offs" – e.g., the situation where guarantee of an exposure to a non-connected person is provided by a connected person. This is currently excluded as the principal exposure is not to a connected person, but the guarantee is.
16	The Reserve Bank welcomes views on the proposal to allow on-balance sheet netting subject to meeting the requirements set out in C1.2 of BPR132.	We support allowing on-balance sheet netting, noting the proposed consistency with BPR132. Some members have noted that while they don't currently have any on-balance sheet bilateral netting agreements in place with any connected party, it may be a consideration for the future. An alternative would be to allow netting to the extent that it meets the on-balance sheet netting requirements of NZ IAS 32 or the offsetting requirements of NZ IFRS 7.
17	The Reserve Bank welcomes views on the proposed treatment of maturity mismatches under the Connected Exposures Policy.	Some members have noted that introducing further complexity to the netting requirements will likely mean that, after considering implementation costs for what is a daily calculation, they may not apply all of the netting options available to reduce the risk of non-compliance.
18	The Reserve Bank welcomes views on the clarification of the capital measure for the purposes of calculating the connected exposures limit.	We do not support this proposed change. There is no need to introduce an adjusted measure of Tier 1 capital. This will create confusion for users of disclosure statements as it will be an exception/difference that may need to be explained. For consistency with the Order disclosure requirements, the regulatory capital base used for the calculation (i.e., Tier 1 capital) should be the amount that the bank is regulated against and not an alternative measure.