

Submission

to the

Reserve Bank of New Zealand

on the

Exposure Draft of the Connected Exposures Policy (BS8)

8 March 2023



About NZBA

1. The New Zealand Banking Association – Te Rangapū Pēke (**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 eighteen registered banks in New Zealand are members of NZBA:
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3. If you would like to discuss any aspect of this submission, please contact:

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Introduction

NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand (RBNZ) on the Exposure Draft of the Connect Exposures Policy (**Exposure Draft**). NZBA commends the work that has gone into developing the Exposure Draft.

Our primary concern is that the definition of connected person is too wide, which will lead to workability issues and a huge compliance burden on banks. We have provided detailed feedback below, as well as a marked up version of the policy attached to reflect our suggestions.

We would welcome clarity on whether, if/when BS8 is revised and reissued, the RBNZ would expect to make any changes to related Conditions of Registration.

Definition of connected person

The RBNZ's response to submissions states that

“The perimeter in this definition is much closer to that of the related party defined in the NZ IAS 24 than what we had originally proposed in the consultation on the connected exposure policy”.

We disagree with this statement. While the originally proposed definition was narrower than that of a related party in NZ IAS 24, the new proposed definition is significantly wider. This wide definition will result in a number of workability issues and a significant compliance burden for banks that is in our view disproportionate to any policy benefit.

The burden created by the current definition is disproportionate to the policy benefit

We understand the policy is intended to capture parties that have a degree of influence or control over the bank, with the 2021 consultation noting:

“A New Zealand bank could be severely affected by a failure of a connected person. The connected exposure policy exists to put a limit on the maximum loss that a New Zealand bank could face in the event of a sudden failure of one or more connected persons. This ultimately helps support financial stability.”

In our view, the RBNZ can achieve this policy intention with a much narrower definition of 'connected person'. The current, wide, definition will result in a significant compliance burden for banks, as well as a number of workability issues. We encourage the RBNZ to narrow the definition to resolve these issues, while still achieving the intention behind the policy.

The proposed definition goes further than the last definition in extending to directors and senior managers (and their relatives) of every associated person of the registered bank. This definition would require banks to identify every director and “senior manager” of each subsidiary globally, then ask them to provide details of any transactions/accounts they or their relatives have with the banking group and validating that against bank records. This



could be hundreds of people, and potentially thousands once you include relatives. In some instances, banks would not have access to records that would enable them to capture this information for entities outside New Zealand, and would have no way to require people to provide this information. There is a significant likelihood that the information would be incomplete, and would take significant amounts of time to collate where the risk is relatively low.

Further, the definition of 'senior manager' appears likely to capture some people who we do not think should be captured. BS10 refers to an 'executive' who reports directly to the Chief Executive. The proposed definition here uses 'manager' instead of 'executive', which could capture roles such as the CEO's Chief of Staff, even though they're not at executive level or considered a senior manager for any other purpose. It would also catch arrangements such as temporary reports to the CEO.

This issue could become even more problematic if senior managers of associated entities remain caught. Some smaller subsidiaries may not have someone with the title "Chief Executive" making it hard to apply. Also, for some managers reporting directly to the CEO may not be senior staff in the context of the parent group.

Workability issues and inconsistencies also become apparent when considering this definition in conjunction with the existing reporting of large exposures. In our view, there is no policy benefit from a bank considering (for example) a credit card or mortgage owned by the sibling of the spouse of a director of another subsidiary of the global group of companies of which the registered bank is part, to be a connected person – when that exposure would not be included in the registered bank's large exposures.

The definition does not appear in the Deposit Takers Act

The RBNZ notes that the revised definition of 'connected person' is based on the definition of 'related party' in the Exposure Draft of the Deposit Takers Act (**Exposure Draft DTA**). The definition of related party in the Exposure Draft DTA includes use of the term 'relative' which is also defined in the Exposure Draft DTA and is used for the purposes of the connected persons definition (among other things). The definition of related party was, however, removed before the Deposit Takers Bill was introduced to Parliament in September 2022. The definition of related party will instead now be dealt with by way of the standards (yet to be released). The definition of relative remains in the current Deposit Takers Bill. It's unclear to us why the definition of related party was removed yet is the basis for the definition of connected person in the draft Connected Exposures Policy.

We note that NZBA expressed concern at the proposed definition of 'connected person' in the Exposure Draft DTA, noting in our February 2021 submission that we would prefer alignment with accounting standards. The submission expressed concern at the Exposure Draft DTA's inclusion of parents and siblings of directors and senior managers without also considering the likelihood of any influence those relatives may have (whereas NZIAS 24 definition is tailored to family members with influence).



NZBA's preferred definition

For consistency of definitions, we suggest applying some general principles to the definition:

- a) Treating a director or senior manager relationship as being equivalent to significant influence. However, those relationships are not as close as a relationship of control or joint control;
- b) For two parties to be connected, there must be an element of control.

Applying the above to the definition of connected person could be achieved with some relatively simple amendments. We suggest:

- a) changing A3.1(a) and A3.1(b) to replace "...of its associated persons" with "person who has control of the registered bank". The definition of control includes indirect control so directors and senior managers of all entities in the ownership chain of a group are still captured.
- b) changing A3.1(b) and A3.8 to replace "relative" with "close relative"; amending the definition of relative by changing A3.8(b) to read "any child under the age of 20 of the person or the person's spouse, civil union partner or de facto partner"; and removing A3.8(c).
- c) amending A3.1(h) to read "a director of the registered bank has control over A;"
- d) amending A3.1(i) to read "any other person who has control of the registered bank has either control of or significant influence over A;"
- e) replacing A3.1(j) with "any other person who has significant influence over the registered bank has control of A." This proposed change is consistent with NZ IAS 24: Paragraph 11: "In the context of this Standard, the following are not related parties: (a) two entities simply because they have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity."
- f) in A3.3(c). changing "a manager who reports directly..." to "an executive who reports or is accountable directly..." for consistency with bank conditions of registration, refer to [BS14, App1, clause 2](#).
- g) removing the definitions in A3.4 and A3.5 as these would be redundant, and amending the cross references in A3.11 (which would become A3.9).
- h) replacing the references to 'specified person' in A3.9 and A3.10 with 'other connected persons'. This change would make A3.11 redundant and it should be deleted. There is no practical way to establish this connection and it could only be limited by confirmation from connected persons that they were not controlling or significantly influencing a separate entity with a specified person.



For clarity and easier reading for users, move A3.13, A3.14 and A3.15 to immediately after A3.1. Currently, the definition of ‘controlled entity’ at clause A3.1 includes entities that would be within the banking group, in particular through paragraph (c) which covers subsidiaries of the registered bank and paragraph (f) that covers other controlled entities of the registered bank. We understand that the Reserve Bank may give notice to a registered bank that an entity that is a subsidiary of, or is otherwise controlled by, a registered bank is not part of the registered bank’s banking group (refer to clause 3 of the [Order](#)). As such we understand that these paragraphs of the definition need to be retained within clause A3.1. Moving these clauses will help users in reading the definition, by making it clearer that these clauses are part of the definition of ‘connected person’ and partially override the clause A3.1.

We have also provided a mark up of the policy to reflect the above.

B2 – Conduct

We suggest including some guidance to section B2.1 to clarify the treatment of terms of staff banking packages. This would be consistent with footnote 75 to the Basel Core Principles for Banking Supervision. This guidance could say “Guidance: Exposures under the terms of standard staff banking packages are not considered to be on more favourable terms than corresponding exposures to non-connected persons.”

B3 – Directors’ attestation, systems and controls

We suggest rewording section B3.1 for clarity, and consistency with BPR100 D2.13, to read: “The registered bank’s board of directors retains the ultimate responsibility for the registered bank’s compliance with the requirements set out in this Policy.”

Additionally, this subsection is titled “directors’ attestations, systems and controls”, but this does not appear to align with the content of the section which does not refer to directors’ attestations. We suggest renaming this section “Governance and Compliance Management” or similar.

C2 – Definition of exposure value

Section C2.1 uses the term “exposure value” in the definition of itself. It also refers to A1.3(2)(b) of BPR131, however the other BPRs do not provide any further definition of “value” – i.e. the starting point. Is it the full drawn amount of a loan, the face value of the instrument, are mark-to-market revaluations included? We suggest the wording be revisited, and note that there may be an issue that needs to be addressed with an amendment to other BPRs.

We suggest simplifying section C2.2 to read: “For the purpose of the connected exposures policy, off-balance sheet items will be converted into the credit equivalent amount (CEA) by using a credit conversion factor (CCF) of 100%.”

C5 – Exposure value for trading book positions

We query the reference to BPR140 at C5.2. BPR140 sets out the calculation of the market risk capital requirement, rather than the exposure. Our recommendation is that the policy requires banks to use the exposure in accordance with BPR131.

In relation to C5.3, we would welcome an explanation as to the purpose of calling out trading book positions and not allowing netting across those banking and trading books.

