

THE BANKING
REGULATION
REVIEW

ELEVENTH EDITION

Editor
Jan Putnis

THE LAWREVIEWS

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REGULATION
REVIEW

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PREFACE

Writing this preface in the depths of the crisis sweeping the world with the spread of covid-19, it is tempting to wonder whether banking regulation will fall down the agenda of priorities for governments when matters of life and death loom. The wave of corporate and individual insolvencies that the crisis has caused means, however, that the way that banks respond to economic crisis has never been as important as it is now, and the law and regulation that controls that response has never before affected the lives of so many people so directly.

The way that governments and regulators handle this crisis in the coming months is likely to make the difference between the success and failure of millions of businesses, and the well-being of hundreds of millions of people. Banking regulation will have a critically important role to play in determining how and when banks can and must help their customers get through this difficult time, and financial regulators must play their part to help facilitate this.

Like much else in the financial world, banking regulation will never be the same again and this crisis is likely to lead to new regulatory initiatives to help banks to support stricken economies and businesses. Regulatory lawyers will also have their part to play in helping banks navigate the immediate crisis and any subsequent reforms.

While operational resilience was already at the heart of many financial regulators' agendas before the crisis, it will now surely feature even more urgently. It is important that reforms and still greater expectations in this area are developed in a joined-up way, recognising the critical need for market participants to work together closely to maximise resilience rather than running their own operational resilience projects in isolation.

Looking forward with hope to a time when the crisis eases, other pressing issues will move back up the agenda for banks, such as their continuing efforts to harness the benefits and avoid the pitfalls of emerging technologies, and the role of the financial sector in helping to address climate change and its consequences. Whatever the outcome of the crisis, it seems certain that there will be many lessons to learn, both for banks and regulators. It is to be hoped that as the crisis evolves, cross-border regulatory cooperation and, where necessary, regulatory deference, will operate effectively and not be inhibited by irrational political considerations.

This edition covers 37 countries and territories in addition to our usual chapters on international initiatives and the European Union. Very special thanks are due to all of the authors who have devoted time to the book this year despite, in many countries, working from home, often in difficult and unexpected conditions amid 'lockdown' arrangements on account of covid-19, without any reliable indication of when those arrangements will come to an end.

Thank you also to the partners and staff of Slaughter and May in London and Hong Kong for continuing to support and contribute to this book, and in particular to Nick Bonsall,

Ben Kingsley, Peter Lake, Emily Bradley, Selmin Hakki, Jiayi Li, Jennyfer Moreau, Loye Oyedotun, Tolek Petch, Tamara Raoufi and David Shone.

Finally, the team at Law Business Research, in many cases also working in difficult circumstances, deserve great thanks for their understanding, flexibility and true professionalism in seeing this edition through to publication in the midst of so much disruption and inconvenience. This has been a truly heroic effort on their part. Thank you in particular to Tommy Lawson and Katie Hodgetts.

I wondered in the Preface to the 10th edition whether by the time of the 11th edition the position on Brexit would be clearer. That is, of course, only partially true, but no one imagined a year ago that Brexit would be comprehensively overshadowed by a crisis such as that caused by covid-19.

It is to be hoped that the crisis will be under control by the time of the next edition, and that banks and their regulators will have played a leading and positive role in helping economies begin to recover from the shock they are now experiencing.

Jan Putnis

Slaughter and May

London

April 2020

NEW ZEALAND

*Guy Lethbridge and Debbie Booth*¹

I INTRODUCTION

The New Zealand banking environment is characterised by a high level of ownership by foreign banks. Of the 26 banks currently registered in New Zealand, 11 operate as branches of overseas-incorporated banks. Of the 15 New Zealand-incorporated banks, 10 are foreign-owned. Australian ownership is dominant, with the four major retail banks having the greatest market share (that is, the assets of each bank as a proportion of the total assets of the banking system) being ANZ Bank New Zealand Limited, ASB Bank Limited, Bank of New Zealand and Westpac New Zealand Limited, all operated as New Zealand subsidiaries of Australian banks.

II THE REGULATORY REGIME APPLICABLE TO BANKS

New Zealand has a twin peaks approach to the regulation of the financial system. The Reserve Bank of New Zealand has responsibility for prudential regulation of financial institutions (including banks). The Financial Markets Authority (FMA) has responsibility for the regulation of financial products (including securities and derivatives issued by financial institutions regulated by the Reserve Bank). NZX Limited operates the principal securities exchange in New Zealand, and regulates issuers and securities listed on its markets.

In New Zealand, banks are regulated in the following ways:

- a* if an entity wishes to use the words 'bank', 'banker' or 'banking' in its name, title or (in some situations) advertisements, the entity must be registered by the Reserve Bank under the Reserve Bank of New Zealand Act 1989 (the RBNZ Act) and will be subject to ongoing prudential supervision by the Reserve Bank. Importantly, an entity is not required to be registered solely because it carries on banking activities; and
- b* a bank will be regulated in relation to the activities that it undertakes and the services that it provides. The provision of particular services may be subject to specific regulation, particularly where services are provided to consumers. For example, issuing financial products (including securities and derivatives), providing financial adviser services to retail investors and providing credit to consumers are all subject to prescriptive regulatory regimes. The activities carried on by banks also make them subject to more general laws, such as anti-money laundering laws and laws countering the financing of terrorism, privacy laws and general fair trading laws.

¹ Guy Lethbridge is a partner and Debbie Booth is a special counsel at Russell McVeagh.

The Reserve Bank does not register and supervise banks for the purpose of depositor protection. The registration and prudential supervision powers are conferred on the Reserve Bank under the RBNZ Act for the purposes of promoting the maintenance of a sound and efficient financial system and avoiding significant damage to the financial system that could result from the failure of a registered bank. Accordingly, when considering an application for registration, the Reserve Bank is concerned that only financial institutions of appropriate standing and repute, and that will be able to comply with the prudential requirements imposed on them, are able to become registered banks. In particular, the RBNZ Act requires the Reserve Bank to have regard to:

- a* the incorporation and ownership structure of the applicant;
- b* the size and nature of the applicant's business or proposed business, or any part of the applicant's business or proposed business;
- c* the ability of the applicant to carry on its business or proposed business in a prudent manner;
- d* the standing of the applicant in the financial markets;
- e* the suitability of the directors and senior managers of the applicant for their respective positions;
- f* the standing of the owner of the applicant in the financial markets; and
- g* any other matters that may be prescribed in regulations.

If the application is by an overseas person or a subsidiary of an overseas person, the RBNZ Act also requires the Reserve Bank to have regard to:

- a* the law and regulatory requirements of the applicant's home jurisdiction that relate to:
 - the disclosure by the applicant of financial and other information of the kind that a registered bank must disclose under the RBNZ Act;
 - the accounting and auditing standards applicable to the applicant;
 - the duties and powers of the directors of the applicant;
 - the licensing, registration, authorisation and supervision of the applicant; and
 - in the case of an application from an overseas person only, the recognition and priorities of claims of creditors or classes of creditors in the event of the insolvency of the applicant; and
- b* the nature and extent of the financial and other information disclosed to the public by the applicant.

Registered banks currently operate in New Zealand as New Zealand-incorporated companies (often as subsidiaries of non-New Zealand banks or, in the case of The Co-operative Bank Limited, as a New Zealand-incorporated cooperative company) and as branches of non-New Zealand banks. Although the Reserve Bank must have regard to the ownership and incorporation structure of an applicant for registration, the Reserve Bank does not ordinarily prescribe the legal form that the bank must take. Rather, the Reserve Bank is concerned with ensuring that the owners are incentivised to monitor the bank's activities closely, and to influence its behaviour in a way that will maintain or improve the bank's soundness, but that still retains sufficient separation between the board and its owners to ensure that, where the interests of the bank and its owners diverge, the directors of the bank act in the best interests of the bank.

In certain circumstances, however, the Reserve Bank will require a bank to operate through a New Zealand-incorporated company rather than a branch of an overseas bank.

Those circumstances are where a bank is systemically important to New Zealand's economy, where the bank is proposing to take retail deposits in New Zealand and there is depositor protection in the bank's home jurisdiction, or where the Reserve Bank considers that the disclosure or supervisory requirements in the bank's home jurisdiction are inadequate.

The Reserve Bank itself is a statutory corporation, and it performs a number of roles in the New Zealand financial system in addition to the registration and prudential supervision of banks. The Reserve Bank:

- a* formulates and implements monetary policy (this is its primary statutory purpose);
- b* operates as the central bank of New Zealand and issues New Zealand currency;
- c* has oversight of certain payment and settlement systems;
- d* is the prudential regulator of non-bank deposit takers under the Non-Bank Deposit Takers Act 2013, including responsibility for granting licences to non-bank deposit takers;
- e* is the prudential regulator of licensed insurers under the Insurance (Prudential Supervision) Act 2010;
- f* is responsible for supervising banks, life insurers and non-bank deposit takers under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009; and
- g* operates high-value payment and settlement and clearing systems.

As part of its prudential function, the Reserve Bank has a number of macro-prudential tools at its disposal to manage the system-wide risks that can develop during boom–bust financial cycles. These tools include the ability to require banks to hold additional buffer regulatory capital and to limit high loan-to-value residential (LVR) mortgage lending. Various restrictions on high LVR lending have been imposed since 2013. LVR restrictions were relaxed in 2018, and further relaxed from 1 January 2019.

The Reserve Bank maintains relationships with other banking and financial system regulators, particularly in Australia. The Trans-Tasman Council on Banking Supervision (TTC), comprising representatives of the Australian and New Zealand Treasuries, the Reserve Banks of Australia and New Zealand and the Australian Prudential Regulation Authority (APRA), supports the development of a single trans-Tasman economic market in banking services. In particular, the TTC is mandated to develop and promote measures that enhance trans-Tasman policy harmonisation, mutual recognition, information sharing and cooperation. The TTC's work resulted in legislation in New Zealand and Australia requiring the Reserve Bank and APRA, when exercising their prudential regulation powers, to support each other in meeting their statutory responsibilities relating to prudential regulation and financial system stability and, where reasonably practicable, to avoid actions likely to have a detrimental effect on the financial system stability of the other country. The TTC members are signatories to a memorandum of cooperation setting out high-level principles that they will have regard to when dealing with trans-Tasman banking groups facing financial distress.

III PRUDENTIAL REGULATION

i Relationship with the prudential regulator

The Reserve Bank's approach to bank supervision is based on three pillars: self-discipline, market discipline and regulatory discipline.²

The self-discipline pillar involves the Reserve Bank creating incentives for banks to maintain the systems and capacity to identify, measure, monitor and control their risks and maintain prudent operations. This is achieved by:

- a requiring high-quality, regular and timely financial public disclosure by banks in the form of disclosure statements;
- b requiring directors to sign attestations in their bank's public disclosure statements;
- c not creating an impression that the Reserve Bank (rather than the banks themselves) has primary responsibility for the prudent management of banking risks; and
- d the Reserve Bank avoiding explicit or implicit government support for banks.

The market discipline pillar attempts to use market forces to reinforce the incentives for the prudent management of banks. This second pillar is based on the premise that an efficient and well-informed market will reward well-run banks, for example, through lower funding costs and better access to funding. This is principally achieved by the Reserve Bank maintaining a contestable and competitive banking system, and ensuring the market is well informed about a bank's financial performance and condition.

The regulatory discipline pillar involves the Reserve Bank using regulatory and supervisory tools to reinforce incentives for banks to manage their risks prudently. The Reserve Bank has deliberately sought to keep its regulatory interventions to a minimum.

The Reserve Bank monitors all banks on an ongoing basis. Monitoring occurs principally through banks' twice-yearly disclosure statements. The RBNZ Act provides the Reserve Bank with extensive powers to obtain additional information, to have that information audited if required and to have a bank's affairs investigated.

The Reserve Bank meets with the boards of directors of the larger banks on a regular basis. The Reserve Bank does not conduct on-site examinations of banks in its capacity as the prudential regulator of banks.

ii Management of banks

When considering an application for registration as a bank, the Reserve Bank will consider the suitability for their positions of the directors and senior managers of the bank. This policy applies in the case of locally incorporated applicants, to existing or proposed directors, the existing or proposed chief executive officer (CEO) and existing or proposed executives who report directly to the CEO; and, in the case of overseas-incorporated applicants, to existing directors and the existing or proposed chief executive of the New Zealand operations.

If a proposed director or senior manager has already passed a foreign banking regulator's suitability assessment, the Reserve Bank will usually accept that assessment as evidence of suitability.

2 Geof Mortlock, 'New Zealand's financial sector regulation' (2003), *Reserve Bank of New Zealand Bulletin*, 66(4), p. 5.

A locally incorporated bank will be required to maintain adequate separation between the bank and its owners. This will require:

- a* putting in place policies to monitor and limit exposures to related parties;
- b* the company having a constitution that does not permit the directors to act in the interests of its holding company;
- c* the size and composition of the board being such that it does not give rise to concerns about the bank's ability to pursue its own interests when those interests conflict with those of its shareholders; and
- d* the bank having an audit committee (or other committee whose mandate includes audit matters) comprising non-executive and otherwise independent directors.

The Reserve Bank generally will require a locally incorporated bank to have at least five directors. The majority of the directors must be non-executive, and at least half are required to be independent. At least half of the independent directors must be ordinarily resident in New Zealand. The chairperson must also be independent. The Reserve Bank's criteria for a director to be independent are set out in the Reserve Bank's Corporate Governance (BS14) document.

The Reserve Bank must be supplied with a copy of the curriculum vitae of any potential director, CEO or executive who reports to the CEO of a locally incorporated bank, and the appointment of such a director, CEO or executive can only be made if the Reserve Bank has advised that it has no objection to the appointment.

Directors of banks (and the New Zealand CEO of an overseas bank) are required to sign bank disclosure statements (published twice yearly), which include certain attestations by the directors. Attestations include that the directors believe, after due enquiry by them, that:

- a* the bank has systems in place to monitor and adequately control the banking group's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks, and that those systems are being properly applied;
- b* exposures to connected persons have not been contrary to the interests of the banking group (this applies to locally incorporated banks only); and
- c* the bank has been complying with its conditions of registration.

In the full-year disclosure statement, a bank must also disclose the following (and address any changes to the composition of the bank's board in the half-year disclosure statement):

- a* details of each director (including name, occupation, technical or professional qualifications, whether he or she is executive or independent, other directorships and any details of transactions that could materially influence a director in carrying out his or her duties); this information must also be disclosed in respect of the New Zealand CEO of an overseas bank;
- b* whether there is a board audit committee (locally incorporated banks are required to have an audit committee or other committee that considers audit matters), and certain details of that committee; and
- c* the board's policy for avoiding or handling conflicts of interest that may arise from directors' personal, professional or business interests.

In addition to the disclosure statements that are published twice-yearly by banks, the Reserve Bank publishes selected financial information for New Zealand banks side by side on what is known as the Dashboard. The Dashboard is updated quarterly with financial information

that banks privately report to the Reserve Bank. The Dashboard approach aims to enhance market discipline by aggregating financial information in an accessible format that facilitates side-by-side comparison of banks based on key metrics.

Banks whose New Zealand liabilities, net of amounts due to related parties, exceed NZ\$10 billion will also be subject to outsourcing conditions of registration.

- a* The bank must comply with the Reserve Bank's Outsourcing Policy (BS11). The Outsourcing Policy requires the bank to have the legal and practical ability to control and execute outsourced functions. The policy is intended to minimise the impact of the failure of a large bank, or a service provider to a large bank, on the wider economy, and to preserve the available options if there is a large bank failure. The current version of the policy was issued in 2017, and affected banks have a transition period of five years to be fully compliant with the Outsourcing Policy.
- b* The bank must ensure that:
 - the business and affairs of the bank are managed by, or are under the direction or supervision of, the board of the bank;
 - the employment contract of the CEO or person in an equivalent position with the bank and the terms and conditions of the employment contract are determined by the board of the bank, and any decisions relating to the employment or termination of employment of that person are made by the board of the bank; and
 - all staff employed by the bank have their remuneration determined by the board or the CEO of the bank, and are accountable (directly or indirectly) to the CEO of the bank.

No restrictions have been imposed by the Reserve Bank on bonus payments to management and employees of banks.

iii Regulatory capital and liquidity

A bank's capital requirements must be calculated under one of two approaches available under the Reserve Bank's capital adequacy framework. The first is the standardised approach and is set out in the Reserve Bank's Capital Adequacy Framework (Standardised Approach) (BS2A). This approach uses external credit assessments produced by approved credit rating agencies and is the default approach. The second permits a bank that has been accredited by the Reserve Bank to use its internal models to measure the risks of the bank's business and is set out in Capital Adequacy Framework (Internal Models Approach) (BS2B). The Reserve Bank's capital adequacy framework aligns with the Basel III global standards in almost all areas, but some departures were made to reflect New Zealand's circumstances; for example, the Reserve Bank did not support the introduction of a leverage ratio for New Zealand banks, relying instead on its liquidity policy (which is discussed below).

A bank must have a capital policy. The capital policy must take into account any constraints on the bank's access to further capital, for instance if required in relation to an increase in business or an unexpected loss. In addition, a bank must satisfy the Reserve Bank that it has the capacity to implement and manage an internal capital adequacy assessment process that meets the Reserve Bank's Guidelines on a Bank's Internal Capital Adequacy Assessment Process (BS12).

A branch of a bank incorporated overseas will have to demonstrate to the Reserve Bank that the global bank complies with adequate capital standards that are at least broadly comparable with those in New Zealand, and that it is subject to adequate supervision by the bank's home supervisor.

Minimum levels of capital must be held on both a solo and group basis. Capital is divided into Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital, consistent with Basel III. Currently, locally incorporated banks generally need to comply with the following capital requirements:

- a* the total capital ratio of the banking group is at least 8 per cent;
- b* the Tier 1 capital ratio of the banking group is at least 6 per cent;
- c* the Common Equity Tier 1 capital ratio is at least 4.5 per cent; and
- d* the capital of the banking group is at least NZ\$30 million.

Since 1 January 2014, most locally incorporated banks have been required to maintain a conservation buffer of 2.5 per cent above the minimum ratios or face restrictions on distributions. The Reserve Bank has the discretion to apply a countercyclical buffer of common equity of between zero and 2.5 per cent, although there is no formal upper limit. The purpose of the buffer is to protect the financial system during the downturns that follow periods of excessive credit growth. If a bank does not maintain its capital ratios above the buffer, the bank's ability to make distributions will be restricted.

Capital ratios are calculated by reference to risk-weighted on-balance and off-balance sheet credit exposures, a capital charge for market risk exposures and a capital requirement for operational risk. Locally incorporated banks must obtain a notice of non-objection before treating a capital instrument as regulatory capital and must receive approval for certain repayments of instruments.

The Reserve Bank has undertaken a review of the capital requirements for locally incorporated banks. The review was commenced in 2017, and in December 2019, the Reserve Bank announced its final decisions on this review. As expected, the total amount of capital required to be held by banks is increasing. By the end of the seven-year transition period, which is due to commence on 1 July 2021, banks will be required to hold total regulatory capital of at least 16 per cent of the bank's risk-weighted assets (or at least 18 per cent in the case of systemically important banks). Of that regulatory capital, only 2 per cent can be in the form of Tier 2 capital, and only 2.5 per cent can be in the form of Additional Tier 1 capital.

The proposed removal of contingent capital instruments (that is, instruments that achieve loss absorption via conversion or write-off) has been confirmed. The concept of Additional Tier 1 capital has been retained but only in the form of redeemable non-cumulative perpetual preference shares. Tier 2 capital means long-term subordinated debt.

The proposals to more closely align the risk-weighted asset outcomes for banks operating under the Standardised Approach (BS2A) and those operating the Internal Models Approach (BS2B) have also been confirmed, by the inclusion of an 85 per cent output floor and increasing the scalar from 1.06 to 1.2 for BS2B banks.

Banks must also comply with the Reserve Bank's Liquidity Policy (BS13). The Liquidity Policy requires banks to meet a minimum core-funding ratio of 75 per cent, ensuring that a greater proportion of bank funding is met through retail deposits and term wholesale funding. This has led to increased competition among banks and non-bank deposit takers for retail deposits. Basel III proposes a leverage ratio, which the Reserve Bank considers very similar to the intent of BS13. The Reserve Bank considers, however, that certain aspects of the leverage

standards are not suitable for adoption in New Zealand; for example, the requirement that government securities comprise the bulk of high-quality liquid assets held by banks is not suitable because New Zealand does not have a sufficient volume of government debt on issue.

iv Recovery and resolution

The Reserve Bank's Open Bank Resolution (OBR) Pre-positioning Requirements Policy (BS17) applies to locally incorporated banks holding retail deposits in excess of NZ\$1 billion (although other registered banks may opt in). The OBR is a tool for responding to a bank failure, allowing the bank to be open for full-scale or limited business on the next business day after being placed under statutory management. It is intended to provide an immediate and practical tool for responding to a bank failure and to reduce the moral hazard associated with implicit government support of banks (those that are too big to fail).

The OBR policy places the cost of a failure in the first instance on shareholders, but also provides flexibility to assign losses to creditors without causing unnecessary disruption to the banking system and wider economy. If a statutory manager is appointed to a bank, the bank must close, and all accounts must be frozen to enable the bank's net asset deficiency to be determined. A haircut reflecting the bank's net asset deficiency plus a buffer is applied to all creditors' accounts, and funds equal to the amount of the haircut are frozen. The non-frozen funds are guaranteed by the government, and the bank is able to reopen for core transactions business. On the following day, haircuts are applied to other non-time sensitive liabilities to enable those liabilities also to be partially satisfied. If sufficient funds become available, the frozen funds can be released during the course of the statutory management.

Banks subject to the OBR policy must pre-position for OBR; this means having IT, payments, resource and process functionality in place ahead of a crisis so that, if a statutory manager is appointed, access channels can be closed, funds can be frozen and access channels can be reopened for business by no later than 9am the next business day.

IV CONDUCT OF BUSINESS

The rules governing New Zealand banks' conduct of business are found in a range of statutes. These include the following:

- a* the Financial Markets Conduct Act 2013: this Act regulates how financial products are created, promoted and sold, and the ongoing responsibilities of those who offer, deal and trade in them. The Financial Markets Conduct Act regulates registered banks in the following ways:
 - fair dealing: the Act sets out core standards of behaviour that those operating in the financial markets must comply with. It imposes fair dealing requirements on persons acting in trade in relation to financial products and financial services by prohibiting misleading or deceptive conduct, and prohibiting false, misleading or unsubstantiated representations about certain matters relating to financial products and financial services or in connection with dealings in, or the supply or promotion of, those products or services;
 - disclosure of offers of financial products: the Act replaced the previous requirement for issuers to prepare a prospectus and investment statement with a requirement to prepare a product disclosure statement and a register entry tailored to retail investors for regulated offers. There are a number of exclusions from offers being

- regulated offers that are available to registered banks, including for certain simple debt products. The disclosure regime also expressly applies to certain offers of derivatives;
- licensing of market services: the Act requires providers of certain market services to be licensed. Any person acting as a derivatives issuer in respect of a regulated offer of derivatives must apply for a licence from the FMA;
 - financial reporting: the Act sets out financial reporting requirements, including for registered banks, which include keeping proper accounting records and lodging audited financial statements on a public register; and
 - financial advisers: as discussed below in relation to the Financial Advisers Act, the regulation of financial advice and financial advisers will be brought under the Act when the Financial Services Legislation Amendment Act 2019 comes into full effect on or before 1 May 2021;
- b* the Credit Contracts and Consumer Finance Act 2003: this Act principally regulates the provision of credit products to consumers. It prescribes a disclosure regime and regulates specific aspects of consumer credit products, such as prohibiting the charging of unreasonable credit fees. It also requires lenders to comply with responsible lending principles in relation to their consumer lending;
- c* the Financial Advisers Act 2008: this Act regulates financial advisers and brokers. The existing regime requires registration and authorisation of financial advisers and brokers (there are different levels of authorisation depending on the types of products advised on and the types of services provided) and imposes disclosure and conduct obligations. However, the Financial Services Legislation Amendment Act 2019 will reform this regime when it comes into full effect on or before 1 May 2021. The Amendment Act will repeal the Financial Advisers Act and replace it with a new regulatory regime, incorporated into the Financial Markets Conduct Act 2013. Under the new regime, financial advice providers (being any person carrying on a business of giving financial advice) will be required to be licensed by the FMA to give advice to retail clients. Any person giving financial advice on behalf of a financial advice provider will need to be either engaged (employed or otherwise) by a financial advice provider or registered as a financial adviser under the Financial Services Providers (Registration Disputes Resolution) Act 2008. The Amendment Act also imposes conduct and competence requirements for all those giving advice (both firms and individuals);
- d* the Financial Service Providers (Registration and Dispute Resolution) Act 2008: this Act creates a register of entities that provide financial services. New Zealand banks are required to register as financial service providers and be members of an approved dispute resolution scheme in respect of services provided to retail customers. The Financial Services Legislation Amendment Act 2019 also amends this Act. The amendments to this Act are intended to prevent misuse of the register of financial service providers by offshore entities that have little or no connection to New Zealand;
- e* the Anti-Money Laundering and Countering Financing of Terrorism Act 2009: this Act places obligations on reporting entities (including financial institutions) to detect and deter money laundering and the financing of terrorism. The compliance of banks, life insurers and non-bank deposit takers under the regime is supervised by the Reserve

Bank. The key tools used by the Reserve Bank to monitor compliance are on-site inspections, desk-based reviews and thematic surveys. Under this regime, reporting entities (including registered banks) must:

- assess the money-laundering and terrorism-financing risks they may reasonably expect to face;
- implement a compliance programme to detect, manage and mitigate those risks;
- carry out appropriate customer due diligence;
- report suspicious activities; and
- maintain robust record-keeping;

f the Privacy Act 1993: this Act regulates the collection, retention, use and disclosure of personal information relating to individuals; and

g the Fair Trading Act 1986: this Act prohibits misleading or deceptive conduct in trade. Conduct in trade includes the marketing and sale of any financial products or services. This Act also contains provisions effectively prohibiting the inclusion of unfair contract terms in standard form contracts.

With the exception of the Privacy Act (which sets out a complaints procedure), each of these statutes includes a comprehensive enforcement regime. In most cases, if a bank is in breach of the relevant act, both the bank and its directors (and often others) are subject to both civil and criminal liability provisions. In addition to the statutory rules, registered banks are subject to certain common law rules, such as the banker's duty of confidentiality (which, unlike the Privacy Act, is not limited to individuals).

Registered banks have the opportunity for self-regulation through membership of the New Zealand Bankers' Association (NZBA). The NZBA is a forum for member banks to work together on a cooperative basis. One of the NZBA's key contributions to self-regulation of the New Zealand banking industry has been its development of the Code of Banking Practice, which sets out minimum standards of good banking practices for member banks. Membership is open to any New Zealand-registered bank. Currently, 17 banks are members of the NZBA.

Banks may also elect to participate in the Banking Ombudsman scheme, which is a free and independent dispute resolution service established to assist people in resolving complaints made against participating banks. The Banking Ombudsman is an approved dispute resolution scheme for the purposes of the Financial Service Providers Act.

The primary purpose of the Banking Ombudsman is to review and recommend ways to resolve disputes that remain unresolved after consideration by a participating bank's internal complaints procedures. Where appropriate, the Banking Ombudsman may also refer complaints to other organisations, such as the Insurance and Savings Ombudsman, the Privacy Commissioner or the Human Rights Commissioner.

V FUNDING

Banks typically fund their activities through retail term deposits and the offshore wholesale markets.

The RBNZ Act includes a formal regulatory framework to support the issuance of covered bonds by New Zealand banks. Under this regime, banks may only issue covered bonds under a covered bond programme that has been registered with the Reserve Bank. A programme can only be registered if it meets certain requirements, including that the

cover pool assets are held by a special purpose vehicle that meets the specified requirements; a cover pool monitor has been appointed to monitor the programme; and the programme documentation meets certain requirements (e.g., administrative requirements in relation to the cover pool assets and testing to ensure sufficient assets are held in the cover pool).

The RBNZ Act covered bond framework addresses previous legal uncertainty associated with the effect on the covered bond guarantor and the cover pool assets if a statutory manager is appointed to a bank. The framework also provides greater transparency of covered bond issuance and minimum standards of monitoring.

The Reserve Bank also limits the amount of covered bonds a bank may issue via the bank's conditions of registration. The Reserve Bank considers a limit to be necessary to balance the benefits of covered bond issuance against the potential adverse impact on unsecured creditors. The limit is currently set at 10 per cent of a bank's total assets.

The amount of funding that can be provided by Australian-owned parents of banks is restricted by APS 222. APS 222 is a prudential standard issued by the Australian banking regulator that aims to ensure that Australian banks are not exposed to excessive risk as a result of their associations and dealings with related entities, such as their New Zealand-incorporated subsidiaries. APS 222 requires each Australian bank to monitor contagion risk between itself and other members of its group to adhere to prudential limits on intra-group exposures.

In New Zealand, the Reserve Bank is consulting on a new residential mortgage obligations (RMO) framework. The implementation of a new RMO standard will standardise the use of mortgage bonds as collateral and is ultimately intended to replace the current residential mortgage-backed securities framework.

VI CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESS

i Control regime

The Reserve Bank does not seek to regulate the owners of registered banks other than, in the course of considering an application for registration, having regard to the ownership structure of the applicant and the standing of the applicant's owners in the financial markets.

As discussed in Section II, the Reserve Bank is concerned with ensuring that the ownership structure of an applicant incentivises the owners of the bank to monitor the bank's activities closely, and to influence its behaviour in a way that will maintain or improve the bank's soundness while retaining sufficient separation between the board and its owners to ensure that, where the interests of the bank and its owners diverge, the directors of the bank act in the best interests of the bank.

The Reserve Bank considers that the standing of the applicant's owner is likely to have a significant impact on the standing of the applicant itself. Accordingly, an applicant for registration must provide the Reserve Bank with an outline of the parent company's main activities and areas of expertise, including a list of the jurisdictions in which it is operating, a list of the major shareholders of the parent company and financial accounts for the parent company for the previous three years. The Reserve Bank will also seek the views of the regulator of the parent company in its home jurisdiction where relevant.

The prior written consent of the Reserve Bank is required if a person acquires or increases a significant influence in a registered bank other than a registered bank that is incorporated outside New Zealand or, if an unincorporated body, that has its head office or principal place of business outside New Zealand. A significant influence is:

- a* the ability to directly or indirectly appoint 25 per cent or more of the board of directors (or other persons exercising powers of management, however described) of the registered bank; or
- b* a direct or indirect qualifying interest in 10 per cent or more of the voting securities issued or allotted by the registered bank (the definition of qualifying interest is broad, and includes persons having legal or beneficial ownership of the voting securities, as well as lesser or indirect interests such as powers to exercise or control the exercise of voting rights attached to the security, or powers to acquire, dispose of or control the acquisition or disposal of the securities, in each case whether directly or by virtue of any trust, agreement, arrangement or understanding).

When considering an application for consent to an acquisition of or increase to a significant influence in a registered bank, the Reserve Bank will have regard to the same matters as when considering the ownership structure of an applicant and the standing of an applicant's owners in the financial markets in relation to an application for registration.

In addition, if the person acquiring or increasing the significant influence is an overseas person, the consent of the Overseas Investment Office (as delegated by the relevant ministers) may be required under the Overseas Investment Act 2005. To obtain consent under that Act, an applicant must demonstrate that he or she has relevant business experience and acumen, that he or she has a financial commitment to the registered bank, and that the persons controlling the applicant are of good character and are not persons of the kind who are not eligible for exemptions or permits under the Immigration Act 2009.

New Zealand's competition laws may also restrict changes of ownership of a registered bank.

In relation to New Zealand-incorporated banks, the Companies Act 1993 requires certain approvals to be obtained and procedures to be followed if a company (including a bank) provides financial assistance for the purpose of or in connection with the acquisition of shares issued by that company. If a bank provided credit support such as a guarantee or security in connection with acquisition finance obtained by a person acquiring or increasing a significant influence in that bank, that credit support would need to be approved as financial assistance.

ii Transfers of banking business

There are limited ways under New Zealand law in which a registered bank can transfer all or part of its business (including deposits and loan arrangements) to another entity without the consent of the affected customers.

The Companies Act 1993 allows the court, on the application of a company or any shareholder or creditor of a company, to order that a scheme of arrangement be binding on the company and other persons specified in an order (e.g., customers). However, prior to making the final order, the court may make orders requiring meetings of affected persons such as creditors (which would include depositors) to be held for the purpose of obtaining the

approval of those persons to the scheme of arrangement. Accordingly, while the consent of each customer may not be required, a certain level of approval of the affected persons would likely be required.

Although unlikely to occur frequently, legislation can be used to transfer or vest all or part of the business of an entity to or in another entity. This process was used in 2006 and 2011 to vest significant parts of the business of a registered bank operating in New Zealand as a branch of an offshore bank in a New Zealand-incorporated subsidiary of that bank. In both cases, the legislation was a private act of Parliament (that is, initiated by a person other than a member of Parliament).

The Reserve Bank has also identified that significant acquisitions, investments or business combinations by locally incorporated New Zealand banks have the potential to pose risks to the soundness of the financial system. Accordingly, in December 2011, the Reserve Bank imposed an additional condition of registration on locally incorporated banks relating to significant acquisitions. The condition applies to acquisitions or business combinations for which either the total consideration is equal to or greater than 15 per cent of the banking group's Tier 1 capital, or the value of the assets acquired is equal to or greater than 15 per cent of the total assets of the banking group. The condition requires banks to notify the Reserve Bank of an intended acquisition or business combination before giving effect to it and, depending on the size of the acquisition, either waiting for a period of 10 working days to elapse during which the Reserve Bank can object to the transaction or (in the case of larger transactions) obtaining a notice of non-objection to the transaction from the Reserve Bank.

The rationale for having a notice of non-objection as opposed to other alternatives outlined by the bank (i.e., prior approval or prior notification) is that the directors of the bank would retain responsibility for the decision on the acquisition, but that the Reserve Bank would have a tool to assess whether there are any risks to the soundness of the financial system that need to be considered.

VII THE YEAR IN REVIEW

According to its most recent Financial Stability Report, the Reserve Bank considers that New Zealand's financial system as a whole remains resilient to a broad range of economic risks.³ The banking sector maintains buffers of capital and liquidity over current requirements and has strong profitability. However, some parts of the life insurance and credit union sectors have less resilience and are facing current challenges.

The Reserve Bank continues to identify high levels of indebtedness in the dairy sector and exposure to volatility in international funding markets as key risks facing the financial system. Vulnerabilities in the housing market (particularly in Auckland) have continued to improve as house prices and credit growth slowed over the past year. This has reduced perceived housing lending risk, and this sentiment is reflected in the further-relaxed LVR requirements from 1 January 2019. However, more recently, the financial system has become exposed to the significant uncertainties of the impacts of covid-19.

The Reserve Bank's review of capital requirements concluded in December 2019. The review, which began in May 2017, has considered the capital adequacy framework for locally incorporated banks, which financial instruments should qualify as bank capital, how

³ Reserve Bank of New Zealand, Financial Stability Report, November 2019, p. 2.

risk-weighted assets should be calculated and whether the current capital requirements are adequate. As discussed in Section III.iii, one of the key outcomes of that review will be the increased regulatory capital requirements.

The Reserve Bank expects to redraft the relevant sections of the Banking Handbook in consultation with key stakeholders in the first half of 2020. However, the implementation of the revised sections is now expected to come into effect on 1 July 2021.

The government's decisions on Phase 2 of the review of the RBNZ Act were also announced in December 2019. The objective of Phase 2 of this review was to comprehensively consider the Reserve Bank's financial policy activities and it has been decided that the RBNZ Act will be replaced with two separate Acts: an Institutional Act and a Deposit Takers Act. The Institutional Act will contain the governance and accountability arrangements for the Reserve Bank. The Deposit Takers Act will:

- a* integrate the regulation of banks and non-bank deposit takers under one deposit-taking regime;
- b* provide for standards to be set by the Reserve Bank as the primary tool for imposing regulatory requirements on deposit takers. Requirements that impact on the rights of individuals, however, will be provided for in primary legislation, rather than in standards; for example, fit and proper requirements for directors and senior executives;
- c* increase accountability requirements for directors of deposit takers established through broad positive duties, with civil penalties as the primary sanction for non-compliance;
- d* increase the Reserve Bank's supervision and enforcement tools; for example, to undertake on-site visits, powers to issue directions to a deposit taker and to delicense a deposit taker without ministerial involvement;
- e* reform the enforcement and penalty framework and introduce a broader range of potential sanctions; and
- f* establish the deposit insurance scheme, which will insure deposits up to a limit of NZ\$50,000 per depositor, per institution.

The Cabinet paper proposes to include a new resolution regime in the proposed Deposit Takers Act. That regime will provide the Reserve Bank with a greater range of bank resolution and crisis management options without relying on taxpayer funds. This will include providing the Reserve Bank with the ability to 'bail-in' (that is, write-down or convert to equity) certain unsecured liabilities as a new mechanism to recapitalise a failing bank. The Cabinet paper notes that bail-in may not be usable in all circumstances, such as for debt instruments issued by NZ banks under foreign law. It also notes that, in general, international experience shows that contractual clauses in debt instruments expressly permitting bail-in may be necessary. Safeguards protecting creditor property rights in a bank resolution will be introduced, reflecting the 'no creditor worse off' principle.

The government has also confirmed that, outside of the Phase 2 review process, work will continue on an executive accountability regime for banks and insurers.

In November 2018, the FMA and Reserve Bank completed their joint review into the conduct and culture of New Zealand's retail banking services. Although conduct and culture issues were not found to be widespread, the report concludes that the overall standard of banks' approaches to identifying, managing and dealing with conduct risk needs to improve markedly. Weaknesses in the governance of conduct risks and gaps in the measurement and reporting of customer outcomes leave New Zealand banks vulnerable to the misconduct issues experienced in other jurisdictions. Each of the 11 banks under review was required

to respond to the feedback and recommendations of the FMA and Reserve Bank by the end of March 2019. Those responses were required to include a plan for implementing the recommendations. The FMA and Reserve Bank reviewed those responses and are monitoring each bank's progress in implementing its plan on an ongoing basis.

VIII OUTLOOK AND CONCLUSIONS

With key policy decisions having been made in both the Reserve Bank's review of regulatory capital and the government's review of the RBNZ Act, further consultations will be undertaken in the course of 2020 to progress the implementation of those decisions.

In relation to the decisions on regulatory capital, the Reserve Bank plans to consult on changes to the relevant sections of the Banking Handbook with key stakeholders in the first half of 2020, with the revised sections to come into effect on 1 July 2020.

Before any legislative process is commenced to enact a Deposit Takers Act, the Treasury will undertake a further round of public consultation on the proposed Act and the deposit insurance scheme in the first quarter of 2020. The government plans to make final policy decisions and to progress legislation after that.

In addition, and separate from the Phase 2 review of the RBNZ Act, the government has agreed, in principle, to the development of an integrated prudential and conduct 'executive accountability regime' to cover both deposit takers and insurers. Such a move would bring New Zealand broadly in line with similar regimes in other jurisdictions such as Australia and the United Kingdom. However, before progressing this decision, the government has commissioned cross-agency advice. That advice will outline the possible time frames and resourcing requirements for progressing this work, and will discuss the appropriate prioritisation of this work with the relevant agencies taking into account other policy and legislative initiatives.

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