

## REGULATORY DEVELOPMENTS IN NEW ZEALAND

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Last year, there were two significant developments in the New Zealand banking industry that specifically affected the way banks are organised in New Zealand and how they deal with their customers.

The first was a proposal by the Reserve Bank of New Zealand that foreign banks would operate through locally-incorporated subsidiaries rather than branches; and the second was the New Zealand Bankers' Association statement of principles on how banks should deal with small, medium-sized and farming customers.

### **Proposed Changes to Bank Registration Rules**

As New Zealand's central bank, the Reserve Bank registers banks and undertakes prudential supervision of registered banks. Unless registered, a person cannot do business in New Zealand under a name or title that includes the words 'bank', 'banker' or 'banking'.

Before allowing registration, the Reserve Bank must be satisfied that the applicant's business will consist substantially of the borrowing and lending of money, and/or the provision of other financial services. The Reserve Bank must take into account factors such as the ownership structure of the applicant and the ability of the applicant to carry on its business in a prudent manner.

The principles that the Reserve Bank applies when considering applications for registration differ depending on whether the applicant plans to register as a branch of an overseas-incorporated entity, or as a locally-incorporated entity.

Under the Reserve Bank Act, banks must disclose (on a quarterly basis) information on financial performance and risk positions, and their directors must attest to certain key matters. The intention is to strengthen market disciplines. As well, the Reserve Bank has various powers in the event of a bank distress or if a potential failure threatened.

In September 1999, the Reserve Bank said that it was considering altering its policy which allows foreign banks operating in New Zealand to choose between operating as a branch or via a separate New Zealand subsidiary. The new policy, if implemented, would require certain foreign banks to operate only through a subsidiary incorporated in New Zealand.

It is not entirely clear exactly which foreign banks would be affected. The Reserve Bank's statement indicated that if the new rules were implemented, the banks affected would be those which:

- €# have New Zealand activities of sufficient size that their soundness is important to the New Zealand financial system as a whole; or

## have a significant level of retail deposits in New Zealand, and are branches of banks that are incorporated in countries where the banks either are allowed to operate with low levels of public financial disclosure or give priority to depositors in the country of incorporation in an insolvency situation.

No doubt the position will be clarified before any new policy takes effect. But it does seem the Reserve Bank will have some discretion as to which banks ultimately are affected.

The Reserve Bank's overall intention is to create as much certainty as possible in identifying the New Zealand assets of the foreign bank. This would ensure a closer connection between those assets and the figures that are contained in the bank's published disclosure statements. It would also make the legal position clearer under an insolvency.

There are a number of Australian, European, American and Asian banks registered in New Zealand which currently operate as branches, rather than via a local subsidiary. The Reserve Bank is consulting with those and other banks in relation to the proposed changes, and it is not yet known whether the proposed changes will be made, or indeed when.

### **The Code of Banking Practice**

The New Zealand Bankers' Association is a voluntary organisation whose members include what used to be called the trading banks in New Zealand.

From time to time, the NZBA publishes codes of practice and statements of principles which lay down standards of good banking practice. These represent standards that its members have agreed to observe when dealing with their customers in New Zealand.

Until recently, the existing Code of Banking Practice only applied at a retail level.

The Code does not apply to all banks, and it is not legally enforceable unless expressly incorporated into the contract between the bank and the customer. However, a court is likely to treat the Code's standards as evidence of acceptable banking practice.

The NZBA on 1 June, 1999, released a Statement of Principles governing the relationships between member banks and their small and medium-sized business and farming customers.

The aim of the stated principles was to make industry best practice abundantly clear to customers, and to show them what they can expect from their bank. In return, it also highlighted what they could do to develop their relationship with their bank.

### **Thirteen principles**

## The Code of Banking Practice, which normally applies only to the relationship between banks and their personal customers, is stated to apply (with minor exceptions) to business customers as well.

## The terms of banking arrangements and facilities will be confirmed in writing, in easy to understand language.

- ## Customers will be reminded to seek independent professional advice (eg: accountants, auditors, solicitors and farm advisers).
- ## Banks will co-operate with customers' advisers in order to clarify the terms of the bank/customer relationship.
- ## The bank's reporting requirements will be agreed at the outset to enable the bank to monitor the customer's continuing financial position.
- ## Banks agree to alert the customer in writing when they have concerns about the customer's business or the relationship between them, and to explain the reasons for those concerns.
- ## In the case of difficulties or disagreements, the bank may ask for additional financial information and/or seek an independent review of the customer's business.
- ## If an independent review is sought, the bank's requirements will be explained, and the bank will discuss the terms of reference, the identity of the person who will conduct the review and the nature of the costs the customer is likely to incur.
- ## When an independent review has been obtained, where possible the bank will seek to discuss the review with the customer and the customer's advisers before taking any further action.
- ## The bank will "add its support to a recovery proposition which it believes will succeed".
- ## The bank will not normally undertake enforcement action when the customer is being totally co-operative, and will make it clear what the customer needs to do to avoid such action.
- ## The bank will act fairly and reasonably in order to resolve problems, complaints and disagreements.
- ## The customer can appeal to the banking ombudsman if the customer feels the bank has not acted in accordance with its published procedures.

It can be seen that the principles are heavily weighted towards a situation where the customer might be in financial difficulties or in default. They were published when banks generally were being criticised for taking enforcement action too early or unreasonably.

It remains to be seen whether the publication of these principles will have any significant impact on dealings between banks and their business and farming customers - or indeed on the public perception of banks in cases where "things go wrong".

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