Geoff Bascand: The effect of daylight - disclosure and market discipline

Speech by Mr Geoff Bascand, Deputy Governor and Head of Operations of the Reserve Bank of New Zealand, to members of the NZ Bankers' Association, Auckland, 28 February 2018.

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Introduction[1]

Thank you for coming today and giving me the opportunity to share the Reserve Bank's views on disclosure. I'm going to cover how we use a disclosure regime to support a sound and efficient financial system and the beneficial impact of more informed stakeholders.

The Reserve Bank's prudential framework emphasises the importance of disclosure of information from the entities we have responsibility for regulating and supervising – registered banks, licensed insurers and licensed non-bank deposit takers (NBDTs). It's a key part of market discipline, one of the three pillars of our prudential framework. It reflects the influence investors and other stakeholders can have on an institution's behaviour and risk profile.[2] By potentially influencing the business' behaviour, stakeholders can contribute to its long term viability, and the health of our financial system more generally.

One of the Reserve Bank's key statutory purposes is a sound and efficient financial system. So our interests are well aligned with stakeholders who want information on a financial institution's performance, strength, and risk profile. Indeed the demand for meaningful market information is broad, ranging from depositors, policyholders, shareholders, creditors, through to rating agencies, credit and market analysts, and the financial media.

The Reserve Bank as the prudential regulator is also a 'user' of such information – it informs our policy settings (e.g. capital ratios) and information may inform a range of specific supervisory actions to address any concerns about an entity we might have (e.g. to assess solvency and associated risks).

I should note, however, the information set we have includes the same information that is provided to the public, as well as other 'private' information that institutions report to us, sometimes under compulsion of statutory powers. This latter set might be more granular, detailed or proprietary. Information may also be kept confidential to the Reserve Bank to avoid market disruption or because it may have a detrimental impact on an individual financial institution's competitive position. In addition, there are constraints on public disclosure contained in our governing legislation[3] which prevent public disclosure of that information except in prescribed circumstances. Those provisions allow regulated entities and the Bank to discuss sensitive commercial information in candour, which is a necessary element for prudential supervision.

There are some limits to what is sensible to disclose and when; such judgements can be quite contentious. Moreover, we recognise that disclosure is not without cost. While mindful of these considerations, the Reserve Bank is disposed towards openness and enhancing disclosures.

I'm going to touch on attributes that make information relevant and useful for external stakeholders including that it is reliable, accessible and comparable. I'll also highlight some key initiatives to improve our disclosure regime including the *Bank Financial Strength Dashboard*, follow-ups to the bank director attestation review, and related initiatives in the insurance sector.

Why is disclosure important?

In general terms the disclosure of information is a response to the inherent issues when two economic agents enter into a transaction. Typically one party has greater information than the other – a situation termed ‘asymmetric information’.

Disclosure helps resolve a number of potential conflicts. These can be internal – for example between an institution’s senior management and directors who are monitoring performance on behalf of owners. And external – between the institution and a range of other stakeholders.

In short, managers have better firm-specific information than directors, shareholders and other stakeholders, and don’t necessarily have an incentive to fully report information that may be detrimental to their self-interests, or the interests of the institution as a whole.

Therefore both board directors and external stakeholders demand information from a firm’s managers so they can carry out their respective monitoring roles. There is a well-established literature on corporate governance that focusses on the various mechanisms designed to address the internal informational advantage between management and the Board. Hence, disclosure also supports an entity’s internal monitoring or ‘self-discipline’ – a second pillar of our prudential framework. I’ll return to the topic of corporate governance when I cover the Reserve Bank’s bank director attestation review.

Public disclosure can be challenging. There may be weak incentives for a financial institution to produce and share information. While market participants may demand information, what’s produced may not meet their needs, be ad hoc and/or not based on generally accepted and comparable accounting standards, for example. And there may be few ways of being sure the information being provided is reliable and gives a fair picture of the institution’s financial position – something that otherwise may only emerge once an institution comes under stress or evidence of fraud is made public.

There is a clear role for professional bodies and regulatory authorities to set minimum requirements attached to publicly disclosed information in order to help ensure its integrity, and to make it ultimately useful for stakeholders. These include auditors, accounting standards boards, stock market exchanges, financial market conduct authorities and prudential authorities.

There are a number of local and international examples that illustrate the importance of public disclosure – or more to the point, the failings of poor disclosure:

- In the United States a number of financial and accounting scandals in the early 2000s associated with Enron and WorldCom, prompted a major overhaul of regulation which included a focus on increased financial disclosure. These scandals also highlighted another aspect of public disclosure tied to the necessary independence of auditors and their role in attesting to the veracity of financial reporting. Serious conflict of interest issues can arise in the relationship between a financial institution and the auditors/accounting firms it hires.
- Here in New Zealand, the finance company sector experienced a wave of failures prior to the Reserve Bank assuming responsibility for the regulation of ‘non-bank deposit takers’ in 2008. The failures featured inadequate risk management, including over-exposure to certain sectors and related-party lending. The poor quality of information disclosed to ‘mum and dad’ investors was another key failing.TV advertisements with well-known New Zealand personalities painted a misleading picture of the risk-reward profile for their potential investments. Compounding the problem was the advice potential investors were receiving from financial advisers during this period.
- Internationally the demand for public disclosure and transparency has increased since the global financial crisis (GFC). The crisis highlighted the difficulty of evaluating complex financial products and deficiencies in public disclosure across a number of jurisdictions. The complexities served to heighten uncertainties about the financial strength of some individual banks, and undermined confidence in the banking system as a whole.

Good public disclosure

It is clear that there are real benefits from public disclosure of information – provided that information is trustworthy. It helps to:

- Build stakeholder confidence that the institution is presenting an accurate and reliable picture of its financial position, and complying with all relevant laws, regulations and rules. It helps avoid both the perception and/or realisation of financial malfeasance on the part of the institution. The old adage that 'sunlight is the best disinfectant' is relevant here.
- Enable diverse private sector stakeholders to monitor the institution and make appropriate and well-informed decisions on whether to invest in the institution as a potential shareholder, bondholder or depositor, or to enter into an insurance contract in the case of insurers.
- Create a well-informed market, which is a precondition for improving the efficiency of the financial system by helping to better allocate society's scarce resources. Welfare is enhanced when funds flow freely between more and less risky investment opportunities, provided those risks can be discerned and priced adequately. This applies to investments in financial institutions as much as it does to the businesses and financial products that they lend to or invest in. For example, riskier financial institutions should face commensurately higher funding costs.

There is some evidence, mostly from the United States and Europe, that market information affects the pricing, risk and behaviour of financial institutions. The Reserve Bank has recently undertaken some analytical work that finds similar, albeit tentative, results for New Zealand.[4] This analysis also suggests that the more visibility disclosures get, the more impact they have. This work is informing our evolving approach to disclosures, set out below.

The disclosure of information, by itself, will not achieve the benefits described above. Too much information, and the wrong sort, can obfuscate, confuse and detract from market participants' ability to monitor and exert discipline over financial institutions. Too much information may also, paradoxically, be used to hide evidence of poor practice or wrong-doing. Most importantly, the information itself needs to be trustworthy and meet a number of attributes to be effective.

International standards identify a number of characteristics of public information that can enhance the benefits of disclosure and market discipline:[5]

- **Decision-useful and accessible**: That means presented in a way that is appropriate for the information and distributed in ways market participants can easily access.
- **Timely**: Information should be of sufficient frequency and timeliness to be useful.
- **Comprehensive and meaningful**: Information should be sufficiently comprehensive so market participants can form a well-rounded view, including the risks faced. It should be sufficiently aggregated to provide a proper overall picture, and sufficiently disaggregated so distinct material items can be clearly identified.
- **Reliable**: Information should accurately reflect what it purports to describe. Note, there is some potential trade-off between reliability (getting the numbers 100 percent right) and timeliness.
- **Comparable**: The methods and assumptions used in the preparation of information (particularly for financial reporting based on accounting standards which allow a degree of flexibility) should be transparent.. More explicit standardisation of reporting requirements (both financial and other information) would enhance comparability and the identification of how banks differ by financial performance, business activities, various prudential metrics, risk profile and risk management processes/practices.
- **Consistent over time:** Disclosure should enable trends to be identified in the institution's balance sheet position, performance and risk profile over time.

Taken together, these criteria provide a useful framework for benchmarking disclosure requirements and outcomes across different financial sectors.

Global efforts to enhance and improve financial institution disclosure

Following the GFC there has been a global and ongoing effort to improve public disclosure and consequently market discipline. For example, the international standards for supervision of banks produced by the Basel Committee were revised in 2012. They now include two new core principles on *Financial reporting and external audit* (BCP 27) and *Disclosure and transparency* (BCP 28) which replaced a single core principle on *Accounting and disclosure* from the earlier 2006 standards.

The Basel standards are used by the IMF in their Financial Sector Assessment Programme (FSAP) which evaluates a member country's approach to banking supervision. The IMF recently conducted an FSAP for New Zealand and I'll touch on the results of their assessment shortly.[6] While the Reserve Bank's mandate is prudential (i.e. financial soundness), disclosure is also very important from a market conduct and consumer and investor protection perspective. These latter objectives generally sit with other entities, but equally demand high quality disclosure of information. Regulation has also evolved significantly in the conduct dimension, in New Zealand through the Financial Markets Conduct Act (2013) and the establishment of the Financial Markets Authority in 2011.

For the insurance sector, the International Association of Insurance Supervisors (IAIS) is the global standard setter, with core principles first issued in 2011. The IAIS' principles are also used by the IMF for FSAP purposes. ICP 20 is on *Public disclosure* and requires the supervisor to set requirements for insurers to disclose relevant, comprehensive and adequate information. It needs to be timely and give policyholders and market participants a clear view of their business activities, performance and financial position.

The Reserve Bank's approach to registered bank disclosure

Public disclosure has been a cornerstone of the Reserve Bank's approach to prudential regulation and supervision, particularly since 1996 when the disclosure regime for registered banks was introduced. The Reserve Bank has periodically reviewed the disclosure regime and made changes that underscore the Reserve Bank's commitment to effective disclosure. It's an ongoing process and there are further improvements we are making.

A brief overview of the bank disclosure regime

Currently all registered banks are required to produce disclosure statements on a quarterly basis. The required content varies depending on whether it is a full year, half year or 'off-quarter' disclosure statement, and whether the bank is locally incorporated or a branch of an overseas incorporated bank.[7] The disclosure statements include financial reporting and other supplementary information, such as a bank's capital adequacy position and asset quality.

The Reserve Bank's disclosure requirements for banks are overlaid on top of financial reporting obligations in the Financial Markets Conduct (FMC) Act 2013 and Financial Reporting Act 2013, which are enforced by the Financial Markets Authority (FMA). Under those Acts banks must prepare annual financial statements in accordance with generally accepted accounting practices. The Act also requires that the annual financial statements are audited by a qualified auditor.[8] Banks are exempt from many of the product disclosure requirements of the FMC Act by virtue of the separate disclosure regime imposed under the RBNZ Act.

RBNZ disclosure statements must be signed by bank directors, attesting to the veracity of the information provided (for branches, the NZ CEO also signs). Banks must publish their quarterly disclosure statements on their websites and make hard copies available on request. The attestation links a bank's internal governance processes and practices (thereby aligning the interests of senior management and the Board) to the supply of public information.

Reserve Bank additional requirements include the preparation of off-quarter and half year disclosure statements based on interim financial reporting standards, a requirement for the full year disclosure statement to include the auditor's report, including an opinion on the supplementary information that is provided, and penalties for false or misleading director attestation. Reserve Bank supervisors also meet annually with the audit firms of registered banks.

IMF FSAP evaluation of the Reserve Bank's approach to bank disclosure

The IMF assessed the Reserve Bank's disclosure framework for registered banks against the core principles developed by the Basel Committee. For BCP 27 *Financial reporting and external audit* the New Zealand regime was assessed as 'largely compliant' – effectively a pass mark. The New Zealand legal framework provides for financial statements to be prepared in accordance with New Zealand equivalents to internationally recognised accounting standards, and to be audited by a qualified external auditor in accordance with equivalent standards to international auditing standards.

One specific area where New Zealand was marked down was because the Reserve Bank does not determine or verify that banks use valuation practices consistent with New Zealand accounting standards, relying instead on the existing auditing process and director attestation. The IMF recommended that the Reserve Bank engage in a more focussed way with external auditors to discuss valuation practices of banks in their financial reporting. We will add this to the list of issues that we explore in our engagement with auditors.

For BCP 28 *Disclosure and transparency,* the Reserve Bank received the highest grade, being assessed as 'compliant'. The IMF noted that the Reserve Bank is committed to achieving high-quality disclosure by banks in line with international standards. There were no specific recommendations; however we were encouraged to extend disclosure to include information on bank staff remuneration. We don't currently require that and see remuneration frameworks as the responsibility of directors.

The Bank Financial Strength Dashboard – improving the accessibility and comparability of bank information

The Reserve Bank regularly reviews the specific requirements it imposes on banks to ensure the disclosure regime remains fit for purpose. A major review over 2009–11 streamlined requirements, resulting in cost savings for banks without weakening market information. More recently the Reserve Bank undertook a Regulatory Stocktake over 2014–15. The objective was to enhance the efficiency, clarity and consistency of the prudential requirements for banks and non-bank deposit takers. Reviewing bank disclosure requirements was a key part of the Stocktake and in particular whether off-quarter disclosure requirements continued to deliver clear benefits, relative to the costs imposed on banks to prepare.

The Stocktake concluded that there was little merit in continuing to impose off-quarter disclosure requirements on branches, but some form of continued disclosure for locally incorporated banks was warranted.

The Stocktake also highlighted issues with accessing and comparing disclosure statements. Differences in how information is presented reduce the ability of non-expert users to review and understand disclosure information. It also imposes costs on more experienced users in their efforts to compare across registered banks.

Currently the Reserve Bank provides a summary table on its website of individual bank data. This is based on the non-templated bank disclosure statement data (i.e. non-standardised) and therefore suffers from the same issues noted above. In addition, the summary table does not hold a prominent place on the website, nor is the data particularly timely.

As a consequence the Reserve Bank has developed and consulted on a *Bank Financial Strength Dashboard* concept that will be a big step forward in reporting of bank information. The Dashboard will be a user-friendly interactive online tool that will provide a central repository of key information about the prudential and financial condition of New Zealand incorporated banks. The underlying data will be updated quarterly and hosted on the Reserve Bank's website. The information will be drawn from data that banks provide to the Reserve Bank and presented in an accessible and user-friendly format. Importantly, the new Dashboard will allow users to make side-by-side comparisons of banks in an `apples-with-apples' scenario on key subject areas. They are likely to include: credit ratings, capital adequacy, asset quality, profitability, the balance sheet, and liquidity.

The main benefits of the Dashboard are the material enhancement to market discipline by improving the **accessibility** and **comparability** of information available to market participants. This will significantly reduce the costs for existing users of disclosure statements to digest and analyse bank-specific information and conduct comparative analysis. In addition, the Reserve Bank expects that the Dashboard will widen the range of stakeholders who will use publicly disclosed bank information, extending the points of influence and avenues of market discipline. Ordinary depositors are one group who arguably only exert a fairly weak level of influence over banks at the moment. While retaining the Reserve Bank's prudential focus, the Dashboard will also contribute to the wider public policy objectives for informed investor/consumer decision-making.

The Dashboard information will be aim to be **comprehensive** with a high-level summary of key metrics, and the ability to drill down to more detailed information. Simple text will accompany the data to help explain it to users. Additional content is expected to be added over time as experience with the Dashboard builds and we receive feedback from users. The quarterly standardised and comparable data will enable users to readily identify trends in data, and hence be **consistent over time**.

It is expected that the publication lag will also be somewhat shorter as data would be updated on the Reserve Bank's website within two months compared to four months at present –therefore improving the **timeliness** of the data.

While the Dashboard information will not be subject to the same formal director attestation requirements, the **reliability** of the information provided by banks will be ensured by the due diligence that the Reserve Bank expects banks to add to their internal processes tied to private reporting. Banks will have the opportunity to review their own Dashboard data prior to publication, as well as providing commentary. The Reserve Bank will process all corrections to private reporting before publication of the Dashboard. In addition, banks will be able to correct their Dashboard data after publication has occurred. These revisions will be made transparent in order to support market discipline.

We are finalising web page development for the Dashboard and release is currently planned for late May using banks' data for Q1 2018. There will be an awareness campaign to promote the Dashboard as a user-friendly, authoritative and reliable source of information.

All banks, including branches will still be subject to half and full year disclosure requirements and the associated director attestation process. The Reserve Bank will be making technical amendments to the half and full year disclosure requirements so they align with the quarterly information provided in the Dashboard.

Improving bank reporting of regulatory capital

Current disclosure requirements include information on regulatory capital. Banks must provide information on their capital ratio which includes a risk-adjusted measure of banks' assets (risk-weighted assets). New Zealand banks use either a standardised approach to risk-weights (prescribed by the Reserve Bank), or an approach based on internal modelling and various regulatory formula (currently used by the big-4 banks). The calculations are crucial to understanding banks' exposures and financial strength but can be difficult to evaluate.

The standardised approach for the calculation of risk-weights is inherently more transparent to the public than the customisation of internal models. Even for the Reserve Bank, which has access to banks' modelling documentation and regularly meets with the big-4 banks' modelling teams, it is sometimes unclear how risk-weights have been arrived at.

The Reserve Bank is currently reviewing capital requirements for locally incorporated banks, including the disclosure of risk-weighted asset data. It is our view that improvements to their transparency can be made, and we are consulting on this and any associated costs that may arise.

In the December 2017 consultation document (PDF 1MB), and broadly consistent with recent Basel guidance, the Reserve Bank is proposing an option that would require the big-4 banks to disclose capital ratios under both the internal models and standardised approaches – so-called 'dual reporting'. The Reserve Bank hopes that as a result of dual reporting internal models banks will provide more public explanation of the reason for any marked variation between their internal models measure and the standardised calculation, as well as their modelling assumptions and methods in general.

Bank director attestation review

As I discussed earlier, the bank disclosure regime is supported by a requirement for bank directors to attest to (i.e. sign-off on) the accuracy of information contained in the disclosure statements. This is a crucial aspect of New Zealand's regulatory regime. Directors are responsible and accountable for the integrity of bank reporting. Due diligence helps support the internal governance processes of the bank, driving responsibilities, systems and processes to generate and scrutinise management information.

The question arises as to how confident users can be in the robustness of attestation statements. Directors and users of disclosure statements are aided by the reporting of external auditors, but to what extent should the Reserve Bank review the information directors have relied on, or independently test and challenge their assurances?

Currently, the Reserve Bank evaluates the reliability of directors' attestations and compliance with RBNZ guidelines through reviews of documentation such as risk appetite statements, financial information, reports submitted to bank management, and meetings with bank management and directors.

The IMF (in its 2017 FSAP report), while not contesting the attestation regime, urged the Reserve Bank to more rigorously test attestations through specific reviews, especially for locally-owned banks. For example, they expressed a concern that the Reserve Bank did not undertake much independent verification of banks' internal risk management practices or Board effectiveness.

Last year, and partly in response to the IMF's FSAP, the Reserve Bank undertook a thematic review of the attestation process across 15 locally-incorporated banks. The review was carried out by Deloitte on behalf of the Reserve Bank. Deloitte determined the attestation regime as 'largely effective' based on a weighted average of scores using their methodology, with some variation across individual banks. Deloitte noted a number of a general issues that potentially limit the effectiveness of the regime:

- A reliance on high-quality directors to make the regime work. The number of directorships held by directors, length of tenure, lack of banking experience, risk of capture by management and lack of diverse skills on the Board all potentially affect the effectiveness of the regime.
- There is a correlation between the effectiveness of the attestation regime and an open and honest culture within the bank. Sign-off from directors is only appropriate if they believe that staff at all levels will communicate ‘bad news’ upwards.
- In the absence of Reserve Bank guidance, banks could be applying different processes to verify attestations; applying different materiality thresholds, and; applying some policies differently. There may be a role for the Reserve Bank to provide more specific guidance on specific policies, and to independently verify an individual bank’s attestation process.

The Reserve Bank has begun considering both the findings from the IMF FSAP (which were released in April last year), and those from the more recent attestation review.

In relation to FSAP, the Reserve Bank is closely examining the recommendations that, taken together, may further enhance the three pillar approach to regulation and supervision.

Particularly key are the recommendations about independent verification by the Reserve Bank of banks’ internal policies and processes, and the provision of more explicit guidance to help provide a better benchmark to support bank director attestation. Our view is that rather than a fundamental shift to a more intrusive supervisory regime such as checking an individual institution’s reporting via on-site inspections, our verification is likely to be undertaken through greater use of thematic reviews (i.e. reviewing policies and practices across the banking sector). We continue to see directors and auditors owning the primary verification role.

The Reserve Bank will be considering the findings of the attestation review in the context of how it might better support banks’ internal governance processes (i.e. self-discipline). No final policy decisions have been made, but some elements of this enhanced approach may include:

- More frequent engagement with bank Board of directors. This will provide a greater opportunity for the Reserve Bank to communicate any concerns with directors, and help to address the information asymmetry between senior management and directors described earlier. The Reserve Bank will also gain a potentially better insight into the effectiveness of the Board and how it is discharging its oversight duties.
- The Reserve Bank will also consider how to support directors in understanding their duties, via induction sessions for new independent directors.
- The development of guidance on the Reserve Bank’s expectations around risk management. This will help provide a clearer and more consistent benchmark for bank directors to attest whether they believe their institution is adequately managing risks.
- Formally embedding a ‘positive assurance’ process for attestation sign-off. The review highlighted that most banks adopt a limited or ‘negative’ assurance process whereby management states to directors that they are not aware of any compliance or risk appetite breaches. The Reserve Bank would prefer to see senior management actively demonstrating or providing evidence of compliance to directors.
- Reviewing requirements in the Reserve Bank’s corporate governance policy (BS14) related to, for example, tenure limits for independent directors, limits on directorships and requirements on banking experience.
- Reviewing BS10 to require banks to undertake on-going suitability assessments of their directors and senior managers. The Reserve Bank will also be providing greater clarity on the definition of ‘senior manager’ for the purposes of the current non-objection process.

Insurer disclosure

Overview of disclosure regime

Public disclosure of information also forms an important part of the market discipline pillar for the insurance sector – a sector the Reserve Bank assumed responsibility for in 2010 under the Insurance (Prudential) Supervision Act (IPSA). Section 4(e) of IPSA defines disclosure in the public interest: "the desirability of providing to the public adequate information to enable the public to make [their own] decisions".

The insurer public disclosure regime is based on accounting and audit standards (enforced by the FMA as is the case for registered banks). For example, the Financial Reporting Act requires all insurers to produce audited financial statements within four months of the financial year-end. These financial statements are available from the Companies Office website, while some insurers also publish them on their own website.

Licensed insurers are also subject to additional disclosure requirements imposed by IPSA and Reserve Bank standards and guidelines.

- Under IPSA most licensed insurers must have, and disclose on its website, a financial strength rating prepared by an approved rating agency to policyholders before issuing and renewing insurance policies. The Reserve Bank also publishes these financial strength ratings on its website. Overseas insurers must disclose the existence of any overseas policyholder preference if one exists.
- Licensed Insurers must also disclose their financial strength ratings to policyholders before entering into or renewing a contract of insurance.
- As part of Reserve Bank solvency standards, insurers are required to disclose solvency positions and regulatory capital information in their financial statements and on their website.
- IPSA requires that actuarial information contained in financial statements is reviewed by the licensed insurer's appointed actuary and subject to a separate report which is included in the financial statements.
- Guidance material on governance creates an additional expectation on insurers tied to the disclosure of governance arrangements to shareholders, policyholders and other stakeholders.

IMF FSAP evaluation of insurer disclosure regime

As I noted earlier, the IMF evaluates the effectiveness of insurance supervision by benchmarking a jurisdiction against the 26 core principles developed by the IAIS. With respect to ICP 20 on *Public disclosure,* the New Zealand regime was assessed as 'partly observed' –reflecting that some gaps exist. The IMF argued that **comparison** across insurers is made difficult by accounting standards that allow some management discretion on details to be disclosed, and because branches are allowed to present solvency information using home-jurisdiction methodologies.

They also noted that disclosure requirements were lacking in areas such as asset-liability management, descriptions of risk concentration and the interaction between capital adequacy and risk exposures – in other words were not **comprehensive**.

The IMF recommended improving insurer disclosure in a number of areas, including ways to improve solvency information to make it easier to compare across insurers and between subsidiaries and branches. This is particularly key as branches account for a much larger share of the insurance market compared to the role branches play in the banking sector.

The Reserve Bank is currently undertaking a review of IPSA. A number of the IMF's recommendations will be considered during the legislative review.

Reserve Bank thematic review of disclosure requirements

The Reserve Bank has conducted its own review of insurers' compliance with existing disclosure requirements in a thematic review completed in June last year. The Reserve Bank sampled 36 insurers and was generally disappointed with the overall level of compliance with the requirements. The most common issues were:

- Insurers not meeting requirements to disclose financial strength ratings in writing prior to policyholders entering into and/or renewing a contract of insurance. For some overseas insurers this included failure to correctly disclose the existence of an overseas policyholder preference.
- Solvency disclosure in financial statements being incomplete or incorrect.
- Website disclosures being incomplete, incorrect or not updated.

The Reserve Bank has shared the general findings with all insurers and other interested parties in order to improve compliance across the industry as a whole. In addition, the Reserve Bank has followed up with individual insurers whose compliance levels were assessed as low or poor – 19 of the 36 insurers sampled.

These insurers were provided with specific feedback and required to provide a written response on the findings, actions taken and timeframes. Insurers generally responded positively to this feedback and have taken steps to improve compliance with the requirements, giving greater comfort on the internal assurance processes tied to the disclosure requirements. It is our intention to undertake a further review of compliance in 2018; however, the exact timing and detail has yet to be finalised.

Statistical reporting is a key component of a disclosure regime. To date, statistical reporting on the insurance sector has been impeded by the newness of the regulatory regime, lack of historical information and inconsistent or poor quality of information. A new regular statistical publication on the insurance sector, which we believe will help incentivise the industry to provide better quality information over time, was released for the first time yesterday. The Reserve Bank is considering measures to enhance the integrity of insurers' statistical returns, including the option of audited statements.

Public reporting of non-compliance and sanctions

A further aspect of disclosure that warrants discussion is the Reserve Bank's approach to reporting on bank and insurer non-compliance with regulatory requirements. As noted earlier, most institution-specific matters are required to be kept confidential by the Reserve Bank. For registered banks, regulations setting disclosure requirements require that compliance breaches will be reported in their disclosure statements. However, public notice or censure of a regulated institution by the Reserve Bank is also an available option, recognising that public understanding and attention is likely to sharpen the incentives for good behaviour in future. Recent preliminary work by the Bank provides some evidence of market discipline when public notices have been issued.[9]

The Reserve Bank assesses the merits of public warnings or censures on a case-by-case basis, balancing the public interest in transparency and the deterrence effect against the natural justice of protection of information if prosecution is being considered and the seriousness of the offence.

Alongside the Dashboard we also expect to begin reporting breaches on a separate page on our website. This is likely to provide greater transparency around non-compliance breaches than current reporting practices, due to information about breaches being published on a more frequent and accessible basis. In this context, we will also be considering whether requiring information to be published on very minor or inconsequential breaches may be disproportionate. We are aware that directors are concerned that undue focus is being given to immaterial matters.

Conclusion

Financial markets rely on information for their operation. While there are many participants in the information market contributing to its production, distribution and assurance, there are also some problems and biases that can lead to less than full or meaningful disclosure by financial institutions. The role of regulators in supporting fair and accurate reporting is an important one. The Reserve Bank places considerable store on public disclosure as a means for investors, customers and other stakeholders to hold banks and insurers to account.

The Reserve Bank is introducing a number of initiatives to strengthen the disclosure system in both banking and insurance. The *Bank Financial Strength Dashboard* will significantly improve the accessibility, comparability and timeliness of information about banks' financial positions. The integrity of bank reporting appropriately is vouched for by bank directors through their attestation statements. The Reserve Bank is actively considering steps to enhance the effectiveness of the attestation regime through expecting evidence of positive assurance, more thematic reviews, more explicit guidance on good banking practices, more frequent engagement with bank directors, and a review of the materiality of disclosures.

The insurance sector also has scope to improve its disclosure performance. Regulatory initiatives will be considered during the review of IPSA, but in the meantime, disclosure practice will be scrutinised closely through our engagement with insurers, and supported by new and expanded statistical reporting that commenced yesterday.

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1 I am very grateful to Chris Hunt for considerable help in the preparation of this speech, along with valuable comments from other Reserve Bank colleagues.

2 See Fiennes, T (2016)'*Regulation and the Importance of Market Discipline*', speech delivered to NZBA and Bank of New Zealand, 4 February.

3 Section 105 Reserve Bank of NZ Act 1989; section 135 IPSA; section 54 NBDT Act.

4 Haworth, C (2018) 'Measuring market discipline in New Zealand' RBNZ *Analytical Note* .

5 There is a strong parallel with the desirable properties of official statistics. In 1994, the United Nations adopted 'fundamental principles of official statistics' recognising that reliable and objective information through official statistics is crucial for decision making. Statistics New Zealand developed 'principles and protocols for producers of Tier 1 statistics' in a similar vein, encompassing principles of relevance, integrity, quality, coherence, accessibility, confidentiality, etc.

6 See the Reserve Bank's Financial Sector Assessment Programme page for information on the FSAP, including the IMF's main report and accompanying technical notes.

7 Off-quarter disclosure statements refer to the first and third quarters of a bank's annual financial reporting cycle.

8 The FMA is also required to perform regular reviews of auditing firms on their compliance with the New Zealand standards issued by the New Zealand External Reporting Board (XRB). The XRB is a body that implements all accounting and auditing standards issued by the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standard Board (IAASB) respectively, by issuing New Zealand equivalents.

9 Haworth (2018), *op cit*.