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Financial Sector Legislation Amendment (Trans-Tasman Banking Supervision) Bill 2006

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Financial Sector Legislation Amendment (Trans-Tasman Banking Supervision) Bill 2006

Date introduced: 14 September 2006

House: Senate

Portfolio: Treasury

Commencement: on Royal Assent

Purpose

To facilitate trans-Tasman cooperation in the prudential regulation of financial institutions.

Background

Early in 2004 a working party of Australian and New Zealand officials began discussions to look at options for integrating the banking and finance regulatory regimes in both countries. The New Zealand Government published a Report entitled *Review of the regulation and performance of New Zealand's major financial institutions* (the Review) in early 2005.[1] The main recommendation of that Review was that the New Zealand Treasurer discuss with the Australian Treasurer, Peter Costello, the benefits of enhanced co-ordination and cooperation in the regulation of financial institutions. Subsequent negotiations between the Australian Treasurer and New Zealand Treasurer have led to this Bill. They have also led to changes being proposed to relevant legislation in New Zealand.

The issue of trans-Tasman financial supervision has received little attention in Australia. However, the issue is quite important in New Zealand. In announcing the Bill, the press release by the Parliamentary Secretary, Chris Pearce, refers to the high level of commercial integration between the Australian and New Zealand banking markets.[2] The press release goes on to suggest 'key benefits in moving towards seamless regulation of banks on both sides of the Tasman, including minimising compliance costs and promoting efficiency.' In fact the 'integration' comes about because of the domination of the Australian banks and insurance companies on both sides of the Tasman.

The Australian big four banks (ANZ, Commonwealth, National Australia and Westpac) control 89 per cent of the assets of the New Zealand banking system.[3] By contrast, an inspection of APRA's statistics reveals no Australian presence of any identifiable New Zealand bank.[4] At 89 per cent of the New Zealand banking system, the big four Australian banks control more of the New Zealand market than the Australian market where they account for around two thirds of the Australian banking industry (as measured by share of assets). There would be some New Zealand held equity in the Australian banks, but apart from that the dominance of the trans-Tasman financial system is almost completely one way. Hence regulation of the New Zealand banking system in practice means little more than regulating the subsidiaries and branches of the big four Australian banks.

Foreign ownership remains an issue in New Zealand. While the above discussion suggests the New Zealand banking industry is 89 per cent owned by the Australian big four, the Review reports that New Zealand banking is 98 per cent foreign owned.[5] Therefore, if a bank is not owned by Australian interests it is **probably** owned by other foreign interests. Prior to deregulation of the New Zealand banking industry, foreign ownership was lower at 60 per cent.

The Review also discusses the impact on New Zealand of decision-making dominated in Australia as well as the disappearance of head office and back office functions from New Zealand. The Review expressed concern about the outsourcing of banking functions to Australia. It found that the New Zealand banking system is potentially subject to risks emanating from technological failure in Australian activities. On the positive side, outsourcing may result in efficiency gains and so benefit banks themselves as well as bank customers.

The Review also considered non-bank financial institutions such as insurance and managed investment funds. Essentially the same reasoning applies in the case of non-bank financial institutions. The non-bank sectors are not as important in New Zealand as they are in Australia in terms of their significance in the financial system as a whole. The non-bank sector is 26 per cent of the New Zealand financial system compared with 51 per cent in Australia. Moreover, the *Review* notes that while insurance companies are also a concern, the 'risk of an insurance failure causing harm to the rest of the economy…is less likely in New Zealand than for a bank.'[6] For these reasons banks have been the main focus of attention.

Financial implications

In principle there should be some savings for APRA through a more cooperative arrangement with the Reserve Bank of New Zealand (RBNZ). Yet no savings are identified because APRA is self-funding, relying on the levies that it imposes on the institutions it regulates. It sets the levies to recover its costs, so, to that extent there would be no impact on the budget bottom-line as a result of any efficiencies. There would, however, be an impact on total budget revenue and total expenses and those could have been quantified.

Main provisions

The present Bill tries to progress a seamless trans-Tasman regulatory scheme by amending the relevant Australian legislation. The Bill does not create a co-operative arrangement as such but implements the agreement by inserting the appropriate concerns into the Australian legislation. It should be pointed out that the Bill applies to all institutions, banks, building societies, super funds, insurance companies, and all other institutions now subject to the *Australian Prudential Regulation Authority Act 1998.*

Schedule 1 of the Bill makes various changes to the *Australian Prudential Regulation Authority Act 1998*, the *Banking Act 1959* and the *Financial Sector (Transfers of Business) Act 1999*.

The Bill inserts a **new Section 8A** 'Trans-Tasman cooperation' into the *Australian Prudential Regulation Authority Act 1998.* This section requires the Australian Prudential Regulation Authority (APRA) to support and consult with the New Zealand authorities in carrying out their duties and avoid actions that might have a detrimental effect on the New Zealand financial system stability (**item 8A)**.

In order to harmonise the Australian and New Zealand arrangements the Bill makes it clear that one of APRA's objectives is to 'promote financial system stability in Australia'. Many of the changes in the Bill involve adding words that specifically mention 'financial system stability'. For example, 'Financial system stability' is explicitly inserted into Section 8 of the *Australian Prudential Regulation Authority Act 1998* that sets out APRA's purpose (**item 5**).

Outsourcing was a big issue for New Zealand. Australian banks have the potential to undertake a lot of the back-room operations for New Zealand companies in Australia. That creates a potential risk to the stability of the New Zealand financial system in the event of some failure in the Australian operations. The Bill addresses those concerns by specifically mentioning 'actions that prevent or interfere with outsourcing arrangements' as an 'action that is likely to have a detrimental effect on financial system stability in New Zealand' and therefore a factor that APRA needs to take into account when making regulatory decisions (**item 1**).

Concluding comments

The main impact of this Bill is to reduce the duplication in Australia/New Zealand financial regulation and to harmonise the regulation in each country.

The Bill makes 'financial system stability' one of the APRA objectives. However, the Reserve Bank of Australia (RBA) has always had that role. The RBA notes that:

> Financial system stability is the absence of financial crises, such as distress in financial institutions or disturbances in financial markets, that are sufficiently severe to threaten the health of the economy. The Reserve Bank has a clear mandate to contribute to the maintenance of financial stability because financial crises are costly.[7]

The new legislation will provide for the two Australian regulatory bodies, the RBA and APRA, to have 'financial system stability' as one of their objectives. The second reading speech claims that the changes 'will assist in the implementation of reciprocal legislative amendments in New Zealand legislation.' It is not clear what that would mean in practice. For example, does this mean that APRA's general responsibilities have been expanded?

In New Zealand the functions of the RBNZ are similar to functions that were held by the RBA before APRA was hived off as a separate body. The RBNZ is responsible for banking supervision as the RBA was before the power was given to APRA. The RBNZ is also responsible for financial system stability precisely because its charter includes functions that in Australia remain with the RBA. In Australia the split of functions between the RBA and APRA has meant that APRA is concerned with the soundness of individual companies it regulates, but once the soundness of an entity threatens 'financial system stability' then responsibility passes to the RBA. The RBA can issue liquidity and that is the ultimate weapon to confront any financial instability. Ultimate authority on these issues has to reside with the RBA and some arrangement would have to be made between the two if these new arrangements proposed in the Bill are to work effectively. If it is the status quo then the insertion of the objective 'financial system stability' into APRA's legislation is redundant. However, if APRA is to have a real role then understandings about the respective roles need to be worked out with the RBA.

There is always a danger that the regulators fail to respond to a crisis because the lines of demarcation are not clear. If they are both responsible for financial system stability then there will need to be further thought as to how they might cooperate and share that responsibility.

Endnotes

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1. Joint Report by New Zealand Treasury, Reserve Banks of New Zealand and the Ministry of Economic Development, January 2005. available at: http://www.treasury.govt.nz/mfireview/rrpnzmfi-report.pdf.

2. Hon Chris Pearce, MP, Parliamentary Secretary to the Treasurer, 'Better co-operation in banking supervision with New Zealand', *Press Release No 034*, 14 September 2006 at: http://parlsec.treasurer.gov.au/cjp/content/pressreleases/2006/034.asp.

3. Figure calculated from Reserve Bank of New Zealand statistics obtained from its web site on 10 October 2006 at: http://www.rbnz.govt.nz/statistics/banksys/g1/data.html.
4. Statistics for individual banks operating in Australia can be obtained from APRA's site at: http://www.apra.gov.au/Statistics/Monthly-Banking-Statistics.cfm.
5. ibid., p. 7.
6. ibid., p. 9.
7. RBA, About Financial System Stability at: http://www.rba.gov.au/FinancialSystemStability/about_financial_stability.html accessed 5 October 2006.

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