

Treasury Report: Treasury and Reserve Bank Comment on Closer Integration of Trans-Tasman Banking Regulation

Date:	16 August 2004	Treasury Priority:	High
Security Level:	IN-CONFIDENCE	Report No:	T2004/1486

Action Sought

	Action Sought	Deadline
Minister of Finance	<p>Note the contents of this report</p> <p>Agree to the next steps proposed for this process</p> <p>Submit the attached Cabinet memorandum for consideration by POL on 25 August 2004.</p> <p>Advise the RBNZ and the Treasury of your proposed communication strategy</p>	10am, 19 August 2004
Associate Minister of Finance (Hon Trevor Mallard)	Note the contents of this report	None
Associate Minister of Finance (Hon David Cunliffe)	Note the contents of this report	None

Contact for Telephone Discussion (if required)

[.....]

Enclosure: No

Treasury Report: Treasury and Reserve Bank Comment on Closer Integration of Trans-Tasman Banking Regulation

Executive Summary

- On 6 July 2004, you received a report entitled 'Development of a Framework for Closer Integration of Trans-Tasman Banking Regulation', jointly prepared by Australian and New Zealand officials. This report provides advice on officials' views on the models for closer integration discussed in that joint report, and proposed next steps in this process. Attached is a Cabinet memorandum for you to submit on this issue.
- Of the two models presented in the report, the Reserve Bank (RBNZ) and the Treasury strongly prefer enhanced home-host supervision. This model aims to harmonise regulation where appropriate and emphasises better coordination and information sharing between the Australian and New Zealand authorities. It would represent a material step forward with significant benefits for Australia and New Zealand, including on the key issue of coordination in a crisis or failure situation involving a cross-border bank.
- We do not support the model of APRA-as-supervisor, which would see Australian Prudential Regulatory Authority (APRA) undertaking the supervision of Australian banks operating in New Zealand. Our view is that the potential efficiency gains from this model would be small relative to the wider economic and financial stability issues for New Zealand that the model would raise. New Zealand would be relinquishing decision-making rights over prudential regulation and failure management for all our systemically important banks and APRA's accountability to the New Zealand authorities would be limited. Extension of the Australian depositor preference arrangements to New Zealand depositors at these banks would not adequately protect New Zealand interests in a crisis, and could add to competitive neutrality concerns.
- Regulatory integration beyond the enhanced home-host model could take many forms other than the APRA-as-supervisor model – including more mutual arrangements that would see New Zealand playing a larger and more active role in supervision and crisis management than under the APRA-as-supervisor model. However, these models would also raise significant issues and challenges, some of which are much broader than the banking system. Before proceeding down this route, we believe that more work needs to be done on the regulation of New Zealand's banking and insurance sectors and the contribution that these institutions make to growth and economic development. The associated institutional, legal, tax and crisis management implications of greater regulatory integration will also need to be considered.
 - We suggest:
 - developing the enhanced home-host model under current law;
 - initiating a review to identify how the issues in the joint report could be managed to achieve greater integration of financial markets and their regulation where that is beneficial to New Zealand; and
 - providing a progress report to you on this review process prior to your scheduled meeting with Mr Costello on single market issues in February 2005, giving a clear steer on the desirability of greater integration and the likely benefits for the provision of financial services in New Zealand.

Recommended Action

We recommend that you:

- (a) **read** this report in conjunction with the joint report that you received on 6 July 2004 entitled 'A Framework for Closer Integration of Trans-Tasman Banking Regulation.'
- (b) **note** that our preferred model for integration in trans-Tasman banking regulation is the enhanced home-host model. As well as offering potentially significant improvements in crisis management, it is a robust foundation for greater regulatory integration in the future, if this is to be pursued.
- (c) **note** that we do not consider that the APRA-as-supervisor model would adequately protect New Zealand's interests.
- (d) **note** that integration beyond enhanced home-host could take forms other than the APRA-as-supervisor model, including more mutual arrangements that would provide New Zealand with a more active role. However, these alternatives also raise some key issues for New Zealand that would need to be addressed before having further discussions with the Australian authorities.
- (e) **submit** the Cabinet memorandum attached to this report to Cabinet office by 19 August 2004.
- (f) **agree** that the RBNZ should develop the enhanced home-host model for supervision.
- (g) **direct** the Treasury to form a working group with the RBNZ and the Ministry of Economic Development (MED) to initiate a review of the regulation of New Zealand's banking and insurance sectors and the contribution that these institutions make to growth and economic development. The aim of this review would be to develop recommendations for how the issues identified in the early-July joint report could be addressed, and which forms of closer integration of financial system regulation best enhance the contribution of the financial system to New Zealand's growth.
- (h) **agree** to the terms of reference proposed for this report that is appended to the Cabinet memorandum.
- (i) **direct** the working group to report back to you on progress made on this review prior to your scheduled meeting with Mr Costello on single economic market issues in February 2005
- (j) **advise** the Treasury and the RBNZ on the approach you intend to take with regards to any public statements on the joint report on trans-Tasman banking integration and next steps in this process.

TREASURY REPORT:TREASURY AND RESERVE BANK COMMENT ON CLOSER INTEGRATION OF TRANS-TASMAN BANKING REGULATION

Purpose of Report

1. On 30 January 2004, you and the Australian Treasurer announced the formation of a working group of officials from Australia and New Zealand to consider options for mutual recognition and harmonisation in prudential regulation of the Australian and New Zealand banking systems. The terms of reference for the joint report required consideration of options including:
 - separate regulatory frameworks but greater coordination in crisis and failure management;
 - mutual recognition of regulation and supervision and coordinated crisis and failure management; and
 - harmonised rules for regulation and supervision for respective authorities and coordinated crisis and failure management.
2. On 2 July 2004, you received a report entitled 'Development of a Framework for Closer Integration of Trans-Tasman Banking Regulation' that outlined the current state of play in the trans-Tasman banking market, two possible models for closer integration and a broad assessment of these options. The working party that compiled that report comprised officials from the Australian and New Zealand Treasuries, the Reserve Banks of Australia and New Zealand and the Australian Prudential Regulatory Authority (APRA).
3. As per the terms of reference, this report provides you with New Zealand officials' assessment of the models proposed in the joint paper. We also propose steps to be taken before you next meet with the Australian Treasurer on single economic market (SEM) issues in February 2005. Attached to this report is a Cabinet memorandum for you to submit that outlines the process followed to date and the key issues that have emerged. This memorandum also makes recommendations for further work. It is due to be considered by Cabinet on 25 August 2004.

Analysis

A Context and background

4. Banking supervision was a natural issue for early consideration in the context of the SEM given the already high degree of integration of the Australian and New Zealand banking systems. However, in some ways the existing level of integration has made achieving even further integration more, rather than less, difficult. It means that the potential for further efficiency gains is probably limited while, at the same time, issues of national interest become more acute.
5. The trans-Tasman joint report is a carefully negotiated document that was completed against a backdrop of a number of competing pressures, all of which influenced the final report:

- A New Zealand working group that is investigating opportunities for advancing the SEM model with Australia.
- The RBNZ reinvigorating its approach to the supervision and regulation of banks in New Zealand, with particular focus on its financial crisis management capabilities, in line with the recommendations of the Financial Sector Assessment Programme (FSAP) undertaken by the IMF.
- The purchase by the ANZ Bank NZ Ltd of the National Bank of New Zealand Ltd, which added to the Australian geographic and industry concentration of the New Zealand banking sector.
- The negotiations with Westpac Bank for it to comply with the RBNZ's local incorporation policy.
- A new international standard for measuring risk to determine banks' capital requirements (Basel II)
- The objectives of banking regulation in both countries, which, although they overlap to a large extent, differ with regards to the explicit protection of depositors.

The New Zealand market is well integrated internationally and efficient.

6. The New Zealand banking sector is one of the most open in the world. It is made up of 17 registered banks, with 15 of these foreign owned. Just four Australian-owned banks comprise approximately 85 percent of banking assets in New Zealand. This level of foreign ownership is greater than that found in other common markets such as the European Union.
7. In terms of efficiency, the major New Zealand banks are among the most profitable in the world with returns around, or in excess of, twice their cost of capital (the amount they need to make to justify their investment). This strong profitability has been, in part, related to rapidly declining cost-to-income ratios, as banks in New Zealand have rationalised branch networks, centralised functions and taken over smaller banks. The cost-to-income ratios of foreign-owned New Zealand banks are generally below Australian levels. However, much of these benefits have so far been retained by banks rather than passed through to customers.
8. While the potential for efficiency gains from further integration is likely to be limited, the development of truly seamless provision of banking services to trans-Tasman customers is still some way off. Factors such as separate legal systems, tax systems, and currencies are likely to make a seamless market difficult to achieve in the near term. New Zealand's banking regulation by itself is unlikely to be a significant impediment.

This raises some unique regulatory challenges.

9. With such a large proportion of the New Zealand banking system made up of foreign-owned banks, New Zealand is largely a host-country regulator. Australia and New Zealand work within an internationally-agreed framework for home-host supervision of multinational banks by national authorities.
10. The concentration of Australian ownership of New Zealand banks has increased the risk for the New Zealand banking system as it is heavily exposed to Australian shocks. While an Australian-owned bank in New Zealand may be systemically important to the New Zealand financial system, it may only be a small portion of the assets of the Australian bank. In a crisis, the different administrations' priorities may therefore mean that regulatory actions in Australia adversely impact on the New Zealand bank and financial system.

11. Trans-Tasman banking integration has been facilitated by the high degree of dovetailing between the Australian and New Zealand regulatory approaches – an important factor in the design of the New Zealand supervisory regime. For example, foreign-owned banks in New Zealand are generally able to use parent bank policies, consistent with the foreign regulator’s requirements, as long as the New Zealand board of the bank is prepared to attest that these requirements are sensible, implemented and monitored in New Zealand on an ongoing basis.
12. A key element of the RBNZ’s regulatory regime, which makes it stand out from other higher compliance-cost regulators, has been the RBNZ’s emphasis on market and self discipline on banks. That is, consumers, credit-rating agencies, other banks, commentators and the general public are provided with appropriate information to assess the overall risk management of a bank operating in New Zealand. This emphasis on disclosure is further supported by significant local governance commitments via director attestation and responsibilities.
13. Results over recent years suggest that this approach has generally been both effective and appropriate for the New Zealand situation. The 2004 FSAP report also endorsed the appropriateness, both for our circumstances and against international standards, of the way New Zealand’s supervision regime dovetails with foreign regulators’ supervisory regimes.

The New Zealand banking market is sound, but crises are possible.

14. New Zealand’s banking system remains sound. The various indicators of financial robustness, such as capital adequacy, credit ratings, and asset quality, suggest few concerns as to the current stability of the banking sector exist.
15. Nonetheless, system-wide financial stress can arise very rapidly, due, for example to mismanagement or economic shocks. Such events are more frequent than usually perceived. Resolving banking sector crises can also be very costly, with recent domestic and international experience measuring the cost of bank failure resolution anywhere between two to 20 percent of annual GDP.
16. Furthermore, the jurisdictional separation of shareholder interests (largely foreign) from consumer and taxpayer interests (largely domestic) means that national interests may diverge in the event of a failure. For example, a New Zealand taxpayer-funded bank bailout could largely benefit foreign shareholders. Foreign regulators would also be legally obliged to act in their own countries’ best interests.
17. Mindful of these considerations, the RBNZ has increasingly focussed on its financial crisis management capabilities, and on reinvigorating the current regulatory regime – an approach that has been endorsed by the recent FSAP report. These efforts should improve the New Zealand financial sector’s efficiency, as well as the RBNZ’s legal and operational capabilities when managing a bank failure. Recent policy enhancements include:
 - improved governance arrangements;
 - clear legal boundaries with respect to New Zealand assets, liabilities and capital (through local incorporation);
 - greater capability to manage crises involving New Zealand banks (through local incorporation and outsourcing policies);
 - bank failure management options, including a proposed bank creditor recapitalisation (BCR) scheme; and
 - increased cooperation and coordination with other regulators (especially APRA and the Reserve Bank of Australia).

Any proposals for greater regulatory integration need to be considered in the context of single economic market objectives.

18. Any proposals in relation to banking will need to be considered in the context of the Government's SEM objectives. On 29 June 2004, you were provided with a report (TR2004/1136) that contained a stocktake of the current trans-Tasman work programme. In addition to banking, this report covered other priority areas such as competition policy, accounting standards and business law coordination.
19. The objective of the SEM is to enable businesses to operate seamlessly in both Australia and New Zealand. This involves removing unnecessary regulatory impediments i.e., minimising obstructions rather than adopting identical laws. It also requires encouraging greater connectedness between the two countries through, for example, greater collaboration and stronger people-to-people links. In determining how best to move towards a single economic market, and the appropriate weight to be attributed to banking in this context, consideration should be given not only to the importance of maintaining the momentum of the current process, but also to how well the programme of initiatives progresses New Zealand's interests.

B *Officials' Assessment on Options for Greater Integration*

The New Zealand and Australian authorities have scoped two models for closer integration in banking regulation.

20. The New Zealand and Australian authorities scoped two models for greater integration of banking supervision in their joint report.
 - enhanced home-host supervision; and
 - APRA as supervisor of Australian-owned banks operating in New Zealand.
21. In broad terms, the main areas of disagreement between the New Zealand and Australian authorities are:
 - the potential size of any efficiency gains from greater integration;
 - the necessary level of decision making over prudential regulation and crisis resolution that each country would need to protect its interests;
 - the weight to attribute to moral hazard concerns (i.e., the potential for banks to undertake riskier activities if depositors are fully protected from risks);
 - the costs and benefits of more prescriptive regulation and supervision of the banking sector; and
 - the likelihood that New Zealand's interests would not be protected in a crisis or failure situation by extension of Australian depositor preference, pooling of the Australian and New Zealand assets of a trans-Tasman bank, and New Zealand banks being unable to operate on a stand-alone basis.
22. Both countries agree that effective crisis management is a key issue. Cross-border spillovers in a crisis situation are likely to be high, with the financial distress of a parent/subsidiary spilling over into market confidence in the financial health of the subsidiary/parent. When regulators act in an uncoordinated manner, the actions of one regulator can impact on the success of the actions of the other. Not resolving these issues would give rise to concerns about the stability of the financial system over the longer term.

Our preferred model emphasises better information sharing and coordination, ...

23. The enhanced home-host model is our preferred model. This model aims to harmonise regulation where appropriate, and to remove any unnecessary duplication of activity. In addition, the model emphasises arrangements for better information sharing and coordination to improve the crisis and failure management capacities of the relevant Australian and New Zealand authorities. Reflecting this, the key elements of this model are:

- reciprocal undertakings in relation to information sharing;
- adopting a consultative approach to the development of new regulations;
- aligning New Zealand policy with Australian policy where relevant; and
- forming arrangements and understandings for responding to crisis events.

These elements would strengthen the traditional home-host model most countries operate under, including New Zealand at present. Under this model, failure and crisis management would continue to be undertaken on a national basis. The policies associated with these responsibilities would remain e.g., local incorporation policy, outsourcing restrictions, and Australian depositor preference. Separate asset pools would be available in a crisis situation for Australian and New Zealand depositors.

... which are important for maintaining stability in New Zealand's banking system

24. In our view, this model would minimise compliance costs by eliminating any unnecessary duplication in the regulatory regimes. Given the less intrusive approach of the RBNZ, and APRA supervising Australian banks on a consolidated basis, few, if any areas of misalignment between the current sets of regulatory rules exists. Enhanced home-host supervision would also address stability concerns by facilitating coordination between regulators to address cross-border spillover effects in the event of a crisis. In sum, implementing this model would ensure that the regulatory burden on banks was minimised while maintaining sufficient input for New Zealand in a crisis situation.

25. The model is consistent with global best practice, and an advance on what many other countries have in place. It would also address some of the IMF's concerns highlighted in the recent FSAP process regarding the challenges that the RBNZ would face in the event of a trans-Tasman bank encountering financial difficulties.

26. The enhanced home-host model would not be costly to implement as it builds on current arrangements, and provides a foundation for further integration in prudential regulation and supervision in the future if that is to be pursued. Moreover, the steps required to make this model operational would be considerably less complex and therefore quicker to execute than those required to implement the proposals for more far-reaching integration, including the APRA-as-supervisor model discussed below.

Australia's proposed model would see New Zealand relinquish the ability to set prudential policy and respond to a banking crisis...

27. The Australian model (referred to as 'APRA-as-supervisor') would see APRA undertaking the supervision of Australian banks operating in New Zealand. The Australian authorities would determine the appropriate response to problems with any bank that it supervised in Australia and New Zealand, both during business-as-usual times and in a crisis or failure situation.

28. With a view to protecting New Zealand's interests, Australian officials have offered to:

- extend the depositor preference provisions of the Australian Banking Act to include New Zealand depositors of banks regulated by APRA;

- include New Zealand representation on the Australian Council of Financial Regulators; and
 - require APRA to report to relevant parliamentary committees in New Zealand.
29. The APRA-as-supervisor option raises a number of concerns for New Zealand. These include:
- New Zealand foregoing decision rights over policy affecting our largest banking institutions and the management of these institutions in a crisis or failure situation;
 - the lack of accountability APRA would have to the New Zealand authorities;
 - the potential for such a system to create a non-level playing field for the smaller non-Australian banks and potential entrants;
 - potential risks to the New Zealand tax base;
 - issues around the ‘hollowing-out’ of decision-making capacity and technical expertise in the New Zealand financial system; and
 - the ability of this model to adjust to changes in the New Zealand financial system, such as the entry of a non-Australian foreign bank.

... posing potential risks to stability.

30. We consider that this option is unlikely to adequately protect New Zealand’s interests in a crisis situation. Depositor preference would take effect in the limited circumstance of a bank being liquidated, which is an unlikely response for systemically important banks considered ‘too important to close’. Furthermore, the international (wholesale) market for funds is particularly important for both countries’ banking systems. A depositor preference provision could discourage foreign investors from lending in a crisis situation as they would be subordinated by such a provision. In addition, while requiring APRA to report to the relevant parliamentary committees in New Zealand would bolster transparency, there would be little real accountability. Under this model, the Australian authorities do not envisage the New Zealand Minister of Finance having the same powers of direction over APRA as the Australian Treasurer.
31. Moreover, the APRA-as-supervisor model may not adequately protect New Zealand’s interests during business-as-usual times. Regulatory discipline – or the threat of regulatory discipline – may on occasion need to be exercised over banks e.g., when the bank comes close to a crisis situation or is otherwise behaving in a manner that is unfavourable to its New Zealand customers. Implementing, the APRA-as-supervisor model would remove New Zealand’s ability to apply leverage over our banks.

The efficiency implications of greater integration are mixed.

32. In our view, the potential efficiency gains from the APRA-as-supervisor model that are in addition to those that could be achieved through enhanced home-host supervision are not sufficiently compelling to compensate for the potential risks that this model poses to stability. Some of the efficiency considerations are outlined below.
33. **Compliance Costs** - Given the heavier-handed regulatory approach of the Australian authorities, under the APRA-as-supervisor model, New Zealand banks would be required to comply with more prudential rules than currently. However, a modest reduction in compliance costs is possible through removing the current restrictions on local incorporation and outsourcing. The size and nature of these costs would vary on a bank-by-bank basis. The RBNZ is adopting a non-prescriptive approach to implementing its outsourcing policy, placing the onus on banks to meet the general requirements of its policy in a manner that best fits their individual business strategies. Moreover, given the high profits banks are making, even if some savings can be made,

these would likely accrue to Australian shareholders rather than the customers of New Zealand banks.

34. **Competition** - The APRA-as-supervisor model could create a non-level playing field for non-Australian incumbent banks and potential entrants, thereby undermining the contestability and competitive neutrality of the New Zealand banking system. Under this model, two regulatory regimes would be operating in the New Zealand market – one regime for the systemically-important Australian banks and another for the other, currently smaller, banks. A stronger presumption that the systemically-important Australian banks would be bailed out in the event of distress, coupled with the extension of depositor preference to cover the New Zealand depositors of these banks, would place stakeholders in the smaller banks at a comparative disadvantage. More generally, in considering more far-reaching models of integration, attention would need to be given to the Australian Government's policies on bank ownership, which imply a strong preference for the four major banks to remain under Australian control. This policy may not be in New Zealand's best interests e.g., if it discouraged entry to New Zealand by third-country banks.
35. **Location and Tax Issues** - To the extent that models of supervision beyond the enhanced home-host allow banks to organise their functionality without constraints, risks exist for the provision of financial services in New Zealand and our tax base. At least some of the efficiency gains made by the New Zealand banking sector over the last ten years are likely to be related to the centralisation of banking system functionality as the degree of foreign ownership has increased. However, further movement offshore of management and decision-making capability as well as technical expertise could start to have an adverse impact on the provision of financial services in New Zealand. In addition, the relocation of functionality, and hence income, to Australia could have implications for the New Zealand tax base.
36. **Future Evolution of New Zealand's Financial System** - Although Australian-owned banks account for the majority of the New Zealand banking system's assets today and, due to the similarities between the two economies, Australia is likely to remain a key presence for some time, this presence may not always be so pronounced. Moreover, the structure of New Zealand's financial system may change over time. For example, conglomerates (financial institutions involved in several lines of business such as banking, insurance, funds management etc) have yet to play much of a role in New Zealand relative to other countries, including Australia. It is unclear whether the APRA-as-supervisor model would be sufficiently flexible to deal with non-Australian ownership of systemically-important banks.
37. **Wider Financial System Regulation** - The non-bank financial sector in New Zealand comprises around 25% of total financial system assets. Australia has a strong presence in areas such as life and general insurance, and the managed funds industry, with that presence often connected to the banking groups. The question of whether New Zealand should supervise or monitor certain non-bank financial institutions using an umbrella regulator approach similar to that in Australia might be raised. The pros and cons of that approach for New Zealand are, as yet, unclear.
38. **Other Barriers to the Seamless Provision of Financial Services** - Most arguments in favour of more far-reaching models for regulatory integration are centred on potential efficiency gains and therefore the scope for an improvement in the provision of financial services. However, given the high degree of integration already present in the trans-Tasman banking system, and the significant scale economies achieved along the way, this impact is likely to be reasonably modest. The similarities between Australia and New Zealand provide a solid foundation for a single market for the provision of financial services. Nonetheless, the ability to provide financial services in a seamless manner

across the trans-Tasman market is likely to be hampered by factors such as different tax regimes and currencies, as well as separate legal and payment systems.

C Next Steps

Enhanced home-host supervision is a good starting point for closer integration.

39. Developing the enhanced home-host supervision model under current law would be a good starting point for closer integration in trans-Tasman banking supervision. The enhanced home-host model would facilitate work to address one of the key risks to stability in the trans-Tasman banking system – crisis management coordination – without compromising New Zealand’s ability to protect its national interests. Moreover, the model holds benefits for both New Zealand and Australia that should be relatively straight forward to secure.
40. The key steps in implementing this model would be for the RBNZ to:
 - consider where common specifications of prudential rules can be achieved (probably based on Australian specifications) to keep compliance costs to a minimum;
 - consider how to make better use of APRA bank inspections in New Zealand to maximise the effectiveness of supervision;
 - seek further development of coordinated crisis management procedures; and
 - seek stronger protocols with APRA on information exchange and supervisory cooperation.

Other models of integration entail much wider issues, which we propose to assess through a review process.

41. Scope for integration beyond enhanced home-host supervision may exist but is likely to entail more genuinely mutual arrangements than proposed by the APRA-as-supervisor model, with New Zealand playing a larger and more active role in supervision and crisis management. However, before proceeding down this route, we believe that more work needs to be done on the regulation of New Zealand’s major financial institutions, in particular banking and insurance, and the contribution that these institutions make to growth and economic development.
42. It is logical that the investigation should extend to the prudential regulation of insurance companies. Insurance has some of the same characteristics that led us to consider trans-Tasman banking integration i.e., most of the major New Zealand insurance companies are Australian owned and, in their home country, regulated by APRA. The key difference is that currently prudential supervision of insurance companies in New Zealand is minimal. However, the Law Commission is reviewing the Life Insurance Act 1908, and the extent of regulation of New Zealand’s insurance markets more generally will come under scrutiny over the next few years, as we consider whether there is a case for moving closer to international and Australian norms.
43. Models for integration beyond enhanced home-host supervision would raise much wider issues for both governments. The Treasury proposes forming a working group with the RBNZ and MED to assess the costs and benefits of such an approach. This would be undertaken in parallel to implementing the enhanced home-host model for supervision. The ultimate aim of this review would be to form a view on how the issues identified in the joint report on trans-Tasman banking integration could be addressed or managed so as to achieve greater integration of financial markets and their regulation where that is beneficial to New Zealand. This review would include consideration of:

- all associated institutional, legal, tax, and sovereign crisis management implications; and,
 - whether including some non-bank financial institutions, and in particular insurance companies, into the regulatory structure would be beneficial for New Zealand.
44. While we propose that the main focus of this review would be the banking and insurance sectors, issues relating to other non-bank financial institutions and the wider financial system would also be explored where relevant. Ultimately, however, such issues may need to be dealt with in a different forum. Wherever possible, we would draw on existing work, including the FSAP review of New Zealand produced by the IMF and the Law Commission's Review of the Life Insurance Act 1908.
45. A key milestone for this process would be your meeting with Mr Costello on trans-Tasman issues scheduled for February 2005. We would make this work a high priority and provide you with at least an initial update on our progress prior to this meeting. Banking could then be considered alongside a number of other priorities in the SEM context, such as accounting standards, business law coordination and competition policy. We envisage that some of the banking work undertaken would have significant cross over with other issues being addressed in the context of the wider SEM agenda.
46. The purpose of that progress report would be to provide you with a clear steer on the desirability of integration beyond that envisaged by enhanced home-host supervision and the costs and benefits this may have for the provision of financial services in New Zealand. It would also provide you with a better idea of how, if at all, non-bank financial supervision fits into the trans-Tasman framework.
47. Attached to this report is a Cabinet memorandum, which outlines this process and is due to be considered on 25 August 2004. A draft version of this memorandum was provided to MED, the Inland Revenue Department, the Ministry of Foreign Affairs and Trade and the Department of Prime Minister and Cabinet and their comments have been incorporated. A draft terms of reference for the review process is also attached to the memorandum for your consideration.

D Communications

48. You and Mr Costello may wish to make a public statement regarding the joint report on trans-Tasman banking supervision that you received in early July and next steps in this process. We propose that this statement:
- acknowledges the contribution made by the joint report to highlighting the key policy issues that need to be considered in developing a framework for closer integration of trans-Tasman banking regulation;
 - indicates that there are some clear coordination issues to address and potential for improved coordination of some regulatory practices in the short term;
 - recognises that further integration would raise some significant policy issues that need to be considered on a sovereign basis e.g., legal and fiscal considerations; and
 - confirms that the New Zealand and Australian authorities will report back to their respective Ministers on these issues in due course.

E Consultation

49. This report has been jointly prepared by the RBNZ and the Treasury.