RESERVE BANK OF NEW ZEALAND
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MEMORANDUM FOR	Independent Expert Advisory Panel – Review of the RBNZ Act
COPIED TO	
FROM	Reserve Bank
DATE	9/03/2018
SUBJECT	The NZ-Australia home-host relationship – insights from the New Zealand Financial Sector Assessment Programme (FSAP) 2016
FOR YOUR	Information

1 Introduction

This paper provides an overview of the observations and recommendations on the 'home-host' relationship with Australia arising from the IMF's 2016 Financial Sector Assessment Programme (FSAP) for New Zealand.

Australian ownership of the New Zealand financial system is significant. Australian-owned banks account for around 87 percent of total banking system assets, while Australian-owned insurers make up two thirds of the New Zealand market.

The 2016 FSAP took place over two 'missions' in August and November respectively, with the findings and recommendations released in May 2017.

The August mission involved:

- A detailed (graded) assessment against the international standards for banking supervision (the Basel Committee's core principles).
- A detailed (graded) assessment against the international standards for insurance supervision (the IAIS' core principles).
- A non-graded assessment of New Zealand's crisis management and resolution framework for banks, insurers and non-bank deposit-takers.
- A non-graded assessment of the regulation and oversight of financial market infrastructure (FMIs).

The August mission began with some of the IMF team visiting Sydney and Melbourne to meet with Australia authorities, as well as with the parent banks of the four large Australian-owned banks operating in New Zealand. This pre-mission visit to Australia underscored the importance of the trans-Tasman context for the IMF's assessment of New Zealand financial system and regulatory frameworks.

The main focus of the November mission was on the role of the Financial Markets Authority (FMA) in regulating New Zealand's capital markets. The November missions also included:

- A non-graded assessment of the Reserve Bank's macro-prudential framework.

- The completion of a stress testing exercise directed at the large banks that had begun earlier in the year.

- A series of meetings on the topic of 'correspondent banking relationships, and the interface between New Zealand's anti-money laundering and countering the financing of terrorism (AML/CFT) regime and money remittances.

The IMF's summary report from the two missions – the *Financial System Stability Assessment* (FSSA) – noted the already well-developed relationship with Australian authorities, but recommended 'strengthen cooperation and collaboration arrangements with Australian authorities' (Table 1 of the key recommendations). The FSSA noted that Australia is both a source of strength for the New Zealand financial system, and a source of potential shocks, given the interdependence evident in both the banking and insurance sectors. The FSSA encouraged the Reserve Bank to be more active in APRA's on-site visits of the New Zealand banking subsidiaries and to continue work with Australian authorities in relation to crisis preparedness and resolution.

The main report's findings are based on more detailed observations in the underlying assessments of the banking and insurance regimes, and the crisis management framework.

2 Banking supervision assessment

There are 29 Basel core principles (BCPs) against which the assessment of the prudential framework for effective banking supervision is undertaken. The assessment is made on a five point scale: compliant, largely compliant, materially non-complaint, not compliant and not applicable.

New Zealand's banking regime received a 'pass mark' (compliant or largely compliant grade) for 16 of the 29 principles. We received a 'largely compliant' grade for BCP 13: *Home-host relationship*.

BCP 13 assesses the extent to which home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group, including during stress situations.

The IMF's assessment noted that the Reserve Bank is not a home supervisor for any bank with material foreign operations, but that as a host supervisor we have established an 'enhanced home-host relationship' with Australia. The assessment noted:

- the close working relationship between the Reserve Bank and APRA (informally and via supervisory colleges, and through joint stress tests);

- the reciprocal provisions in legislation (obligations to consult and to endeavour to avoid actions detrimental to the other jurisdiction); and

- the formal coordinating and collaborative trans-Tasman body established in 2005 (the Trans-Tasman Council on Banking Supervision).

Given the importance of the trans-Tasman relationship, the IMF assessors applied their principle of 'proportionality' in the grading of this BCP, despite recognising that the New Zealand-Australia home-host relationship is well-developed relative to other jurisdictions. As such, we received a 'largely compliant' grade rather than 'compliant'. [Note we did benefit from proportionality in the assessment of several other BCPs].

In terms of recommendations, the IMF has encouraged the Reserve Bank to:

> "identify areas where policy making and supervisory activities for the day to day supervisory assessment of risks would benefit further from active cooperation and collaborative work with APRA, to enhance the RBNZ's cost-effective approach to supervision pursuing its own statutory mandate. For example, the RBNZ could pursue a proactive approach on the assessment of group risk exposures, risk management, corporate governance and cross-border crisis management" (Table 3: Recommended actions, page 217, *BCP Assessment*).

In relation to crisis management, the BCP assessment notes the potential tension with Australian authorities in relation to the implementation of Open Bank Resolution (OBR). The IMF suggest the RBNZ could "pursue the possibility of including in the Trans-Tasman Memorandum of Cooperation specific provisions for the Australian authorities to improve the likelihood of continued provision of services to the New Zealand subsidiary by the parent bank or other group member as a supplement to some of the specific systems requirements proposed for separation arrangements" (page 109, *BCP Assessment*).

3 Crisis management and resolution

The assessment of the crisis management regime largely focussed on domestic arrangements.

In relation to the trans-Tasman context, the crisis management report (the 'Technical Note'), notes that trans-Tasman cooperative arrangements have been well-established in the form of the Trans-Tasman Council on Banking Supervision in 2005, the provisions in parallel legislation and the Trans-Tasman Memorandum of Cooperation signed in 2010.

The Technical Note recommends expanding the current Memorandum of Cooperation to explicitly include insurance and Financial Market Infrastructures (FMIs) – currently the focus is on the banking system. The IMF note that "the interdependencies between insurance branches and subsidiaries in New Zealand and their Australian parents parallel the issues that led to the original trans-Tasman focus on bank distress. Subsidiaries of banks in New Zealand are in many cases dependent on their Australian parents for access to key FMIs" (page 12, Crisis Management *Technical Note*).

The Technical Note identifies some issues that have proven quite challenging in the trans-Tasman space, including any *ex ante* agreement or consensus on single point of entry (SPE) or multiple point of entry (MPE) approaches to resolution.[1] The IMF puts this down to national mandates which have constrained the extent to which agreement on how to deal with a failing trans-Tasman bank in advance can be reached.

4 Insurance supervision assessment

The assessment of the regulatory framework for the insurance sector was undertaken against the standards developed by the International Association of Insurance Supervisors (IAIS). There are 26 core principles, two of which come under the broad responsibilities of the FMA

[1] SPE refers to the resolution actions through the parent bank of the banking group (e.g. recapitalisation through the parent where capital gets downstreamed to the subsidiary and the group remains intact), while MPE refers to separate actions directed at the subsidiary and parent parts (e.g., separate recapitalisation which may lead to separation).

(ICPs 18 and 19). There is a five point grading scale: observed, largely observed, partly observed, not observed, and not applicable.

For the 24 ICPs relevant for the prudential regime and the Reserve Bank's role, 13 received a pass mark (an observed, or largely observed grade).

There is no direct counterpart to home-host principle for the banking system, however, there are two ICPs of relevance.

ICP 25 Supervisory Cooperation and Coordination (largely observed). The assessment notes the well-established procedures to cooperate with Australia whose insurers account for two thirds of the New Zealand market. Note there is a much larger share of Australian insurers operating as branches in New Zealand relative to the banking system – 18 of the 19 Australian insurers operate as branches. The Reserve Bank has participated in APRA's on-site supervisory work of the larger Australian operations in New Zealand. The Reserve Bank has a MoU with APRA (signed in 2012) that covers cooperation in both banking and insurance.

Unlike the banking sector, some New Zealand-owned insurance groups have overseas operations, including in Australia, the South Pacific and Europe. The IMF recommended that we establish supervisory colleges for these domestically-owned cross-border insurance groups.

ICP 26 Cross-border Cooperation and Coordination on Crisis Management (partly observed). Again the assessment notes the well-developed relationship with Australia, given the presence of Australian-owned insurers in the New Zealand market. The IMF note, however, that specific crisis management arrangements for insurers is somewhat underdeveloped.

The IMF recommended that, due to the high level of cross-border activities, the RBNZ should prioritise its crisis management policy and procedures and consider how best to achieve the Insurance (Prudential Supervision) Act's (IPSA) principle of policyholder protection in a crisis. This recommendation was tied to concerns that policyholders of foreign branches may be vulnerable to possible overseas policyholder preference.