

Terms of reference for development of a framework for closer integration of trans-Tasman banking regulation

The Australian and New Zealand banking markets are highly integrated and interdependent. This integration has helped to build stronger and more efficient institutions, with corresponding benefits for customers and the economies in general.

While banking markets have become more integrated, prudential regulation and failure management regimes have remained separate.

The increasing interdependency between the Australian and New Zealand banking systems raises the question as to the extent to which regulatory frameworks between the two countries should be more closely integrated. As a core principle, the respective regulatory frameworks should aim to allow integration of the two markets to the greatest extent possible, while maintaining the safety, stability and efficiency of both financial systems.

The development of a framework for closer integration in prudential regulation, supervision, crisis management and failure management for the two countries will involve evaluating the benefits, costs and risks for both countries, including in the context of the wider Trans-Tasman relationship. These are complex issues that touch on a range of issues broader than just prudential regulation and will require careful consideration.

To this end, officials from the Australian Treasury, and the New Zealand Treasury and Reserve Bank of New Zealand will jointly report to their respective Ministers by 30 June 2004 on a framework for closer integration of prudential regulation and failure management regimes, and the policy, institutional, and implementation issues to be addressed.

A working party of the Australian and New Zealand Treasuries and the relevant financial sector supervisory agencies, including the Reserve Bank of New Zealand, the Reserve Bank of Australia and the Australian Prudential Regulation Authority, will be formed to develop policy options for closer integration.

Options to be considered include:

- separate regulatory frameworks but greater coordination in crisis and failure management;
- mutual recognition of regulation and supervision, and co-ordinated crisis and failure management; and
- harmonised rules for regulation and supervision for respective authorities, and coordinated crisis and failure management.

The key stages of the project are:

- **Policy objectives and supervisory approach.** The prime objective of Australian and New Zealand prudential regulation is to encourage a safe and efficient financial system. To achieve this objective, New Zealand has emphasised self-discipline and market discipline via governance and disclosure requirements. Australia, in addition to encouraging self-discipline and market discipline, has layers of prudential regulation that address systemic stability and depositor preference, including close oversight by the regulator. Decisions on the extent to which policy objectives and supervisory approaches can be aligned will be needed at an early stage, in order to underpin subsequent consideration of options for greater coordination of prudential regulation regimes;
- **Crisis and failure management responsibilities.** Any regime would have to allow for the possibility (however remote) of the failure of a systemically important bank or other financial system crisis. This would require the design of robust processes for decision making and intervention, clarity about authority and responsibilities to respond in the event of a crisis;
- **Governance and accountability.** The alignment of supervisory rules and practices and close coordination of failure management regimes would involve complex issues of governance and accountability for both countries. Consideration will need to be given to the appropriate institutional arrangements to give effect to decisions regarding prudential regulation and failure management;

In considering the possible approaches officials will need to take into account:

- safety, stability and efficiency of both financial systems;
- business law coordination: Banking regulation in both countries rests on important foundations in company law, financial reporting, accounting standards, and insolvency regimes. There may be areas of business law that need to be reformed to support a more harmonised approach to bank regulation;
- interaction between tax and regulatory regimes: The interaction of respective tax systems can generate inefficiencies in financial markets. Care needs to be taken that regulatory regimes do not exacerbate these pressures, nor undermine respective national tax bases; and
- other international obligations (for example, trade agreements).

Australian and New Zealand Treasury officials will also report to their respective Ministers with their assessment of the costs, benefits, and risks of the options for developing a framework for closer integration in terms of the soundness and efficiency of the financial system in each country, plus any wider benefits from closer integration under each option.

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