ADDRESS BY THE GOVERNOR

This article is taken from an address by the Governor, Mr Spencer Russell, to the Trustee Banks' Annual Conference on 22 February 1985.

The Governor outlines the historical development of trustee banks and discusses the challenges they face in the new financial environment. He suggests that:
- *the removal of remaining constraints on their activities might mean the elimination of the government guarantee of their deposits; and*
- *'. . . in a freer and more competitive environment there may be a strong impetus to further merging of existing banks.'*

"The past decade has been a period of significant and at times rapid change in the financial sector. With the exception of the period from 1982 until mid 1984, it has seen a gradual removal of controls and a greater reliance on competitive forces.

It has been a time of important developments for trustee banks including much reduced and finally abolished ratio requirements, abolition of interest rate controls, new forms of lending and generally a greater degree of independence in day to day operations.

These have also been years of rapid technological change with customers demanding greater sophistication both in types and the extent of the services provided. For trustee banks this has involved substantial expenditure in electronic equipment and staff training, at the same time remaining conscious of the need to retain personal customer contacts.

In this new environment of 1985 it is perhaps appropriate to raise the question of whether the current structure of trustee banks is appropriate to meet the challenges currently being faced, or likely to be faced in the future. The removal of regulation and control on the financial sector means that an institution's profitability and its ability to grow, or even to survive, will stem from its efficiency rather than, as in the past, from the protection of a regulated environment.

In considering this question I think it is of interest to look back briefly at the history of trustee banks as this may provide some perception of what the future may hold.

The concept of trustee savings banks was imported from England where they had evolved, along with commercial insurance associations and friendly and provident societies, as part of the late eighteenth, early nineteenth century self-help mechanism for assisting the accumulation of savings.

In exchange for a state guarantee on their deposits and the underwriting of an approved interest rate on deposits of trustee savings banks, funds had to be invested in government stock. It is interesting to note that the directors of the banks — the Trustees — were restricted to gaining intangible rewards appropriate to 'benevolence'.

The English framework was transferred with some modifications to New Zealand where the concept of mobilising small savings worked well in an environment hungry for funds to develop the growing economy.

A legislative council ordinance of 1847 created the legal authority to establish trustee savings banks. This provided among other requirements that trustees were precluded from being depositors, no individual depositor could have a balance in excess of £100, one-third of a bank's deposits could be lent against mortgages on land within 20 miles of the bank's head office and, surprisingly perhaps, the banks could buy bills of exchange with a maturity of less than three months.

In 1858 the ordinance was replaced by the Savings Bank Act. That Act, with some amendment over the next decade, provided the legislative basis within which trustee banks were constrained to operate for the following 90 years.

In the Act the small savings bias of the banks was retained. The colonial government guaranteed interest on deposits as well. An amendment to the Act in 1860 barred the trustee banks from all bills of exchange purchases and the direction was firmly pointed towards mortgage lending.

By the mid 1860s trustee savings banks had become established in all main population centres but the development of new banks was abruptly terminated by the passage of the Post Office Savings Bank Act in 1865. No new trustee banks were established during the next 90 years and four of the nine already in existence closed during the 30 years to 1900.

The Post Office Savings Bank had considerable advantages over the trustee banks, including a maximum deposit limit of £500 compared with £100 for the trustee banks. As a result, by 1874 the Post Office Savings Bank was four times the size of the combined trustee banks.

It was not until 1948 that a new Act was introduced. For the first time it was unequivocally stated that all deposits were covered by a government guarantee. Trustee banks became incorporated bodies able to conduct business in their own names rather than through those of their trustees and the trustees' personal responsibility for deposits was removed. Perhaps as a quid pro quo the tenure of appointed trustees was changed from life to 5 years.

The findings of the 1955/56 Royal Commission on the monetary banking and credit system recommended the opening of new outlets to encourage all forms of small savings. As a consequence, in 1957 the amendment to the 1948 Act authorised the establishment of new banks and by the mid 1960s a complete regional network existed.

The Government's desire to see a greater number of small savings institutions presented a possible threat to the trustee banks in that trading banks were enabled to establish savings banks subsidiaries. So, for the first time since the establishment of the Post Office Savings Bank in 1967, a new competitor emerged. I well recall the very keen debate which took place regarding the entering of the trading banks into the savings area and the strong opposition to that development by the trustee banks.

The picture I have outlined is one of a structure still very much based on that established 150 years ago and which has as its main cornerstone the government guarantee of deposits.

Despite the restrictions, ability to grow as measured by total assets indicates that, as a group, trustee banks have been most successful in collecting and reinvesting a growing proportion of savings over the past 100 years. They have generally out-performed their nearest rivals, the Post Office Savings Bank, building societies and the private savings banks as a stable yet increasingly important source of high quality savings instruments and of loan accommodation in the regions in which they are based.

However, given the new policy environment in which we now live, with the emphasis based on a free competitive financial sector, it is perhaps timely to consider whether fundamental changes in the structure and direction of trustee banks will be required to ensure their place in the future financial community.

The Minister of Finance has recently suggested that as an Association, trustee banks should give consideration to their future role and the structure which will be appropriate to perform that role.

The Minister has further suggested that, over the coming months, discussions should take place between the Association and the Reserve Bank to enable the Reserve Bank to be better informed on the place for trustee banks as we move towards the twenty-first century.

While I would not wish to anticipate the outcome of deliberations or the dialogue which will be taking place between the Association and the Reserve Bank, no doubt the trustee banks will be looking for the removal of remaining constraints on their activities even though that might mean the elimination, perhaps over a period, of the government guarantee of their deposits.

The rationale for the guarantee would have been to protect the interests of small personal depositors. If, for example, trustee banks were of a mind to move more into commercial banking, it would be debatable whether such business should also enjoy a similar protection.

I know from my own experience the costs of operating a branch banking network, especially when the core of business is in the higher cost personal sector. I am sure that you all watch closely the non-interest cost of deposits gained through branch networks. Representation, be it in a main city location, a more remote suburban area or indeed in a smaller town carries significant costs before allowing for interest paid on the deposits funds gained.

It may well be that in a freer and more competitive environment there may be a strong impetus to further merging of existing banks.

Some of the benefits of merger have already been achieved through the various moves trustee banks have made towards a nationwide banking system, such as co-operative advertising, common EDP processing facilities, product services, office formats and so on.

On this subject of amalgamation and co-operation, electronic funds transfer, more particularly at point of sale, has the potential to reduce transaction costs markedly. However, while the technology has been available for some time, we have a number of overseas examples where the potential has not been realised because there has been a lack of agreement among various parties on how to share the benefits and the substantial costs. It is our hope that in New Zealand those developing this system will be able to adopt a low cost option that will benefit both the participating financial institutions and the community as a whole.

The current co-operative schemes have undoubtedly assisted trustee banks in maintaining their share of the nationwide retail market and at the same time retaining local identity. However, in a freer and more competitive environment, cost structures will be of vital concern and you may wish to consider the economies which might be attained from larger regional operations.

With an origin founded on that which pertained to Britain it would be an interesting turn of history's wheel if, in fact, you decided at some future time on the structure now being adopted in Britain — namely a national trustee bank. It might also be that amalgamation could include other financial institutions, particularly where they serve a similar purpose and a similar region. However, all these questions are for the future. I am sure that the trustee banks will find a role and a future appropriate to their history and that it will enable them to continue serving the best interests of our people.

One thing is, I think, certain — the changes which are taking place in the financial sector are permanent. We have learnt well that control, regulation and attempts to segment the overall market into parts served by only one type of institution are both unnecessarily costly and inefficient.

We have also come to realise that regulations such as the different government stock ratios applied to various categories of financial institutions can produce penalties as well as subsidies and that the consumer, borrower and depositor is best served by a free competitive financial community.

We all face great changes. There is, I believe, a general realisation that if our country is to prosper and its people are not to be denied increasing living standards, the efficient use of resources of capital savings and manpower is of paramount concern".