Outcomes of the Financial Sector Assessment Programme for New Zealand

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This article reviews the main findings from the recent assessment of the New Zealand financial system by the International Monetary Fund, under the Financial Sector Assessment Programme (FSAP). The FSAP assessment concluded that New Zealand's financial system is currently in a strong position and that the banking supervision framework is broadly in line with international standards.

The FSAP report made recommendations in four key areas of banking supervision: on-site supervision, bank failure and distress management, disclosure of information and bank corporate governance. These recommendations are largely addressed by policies currently under development within the Reserve Bank.

1 Introduction

In May this year, the International Monetary Fund (IMF) published its review of New Zealand's financial system (IMF, 2004).[1] The review was carried out during the last quarter of 2003 under the Financial Sector Assessment Programme (FSAP), a joint IMF-World Bank initiative that assesses the adequacy of a country's financial sector regulation and supervision and identifies potential vulnerabilities in the financial system.

The FSAP report made a range of recommendations for improving New Zealand's financial sector regulation, in light of the relevant international standards, and for reducing potential risks to the financial system. Most of the recommendations relate to the Reserve Bank's role in banking regulation and supervision, reflecting the fact that banks dominate New Zealand's financial system.

This article summarises the key recommendations from the FSAP and discusses their relevance in the context of New Zealand's financial system. The article also highlights current or upcoming projects within the Bank that address many of the FSAP recommendations. Before doing this, however, it is useful to briefly explain what an FSAP assessment involves and how the process unfolded for New Zealand.

The FSAP process

The FSAP assessment for New Zealand was a major undertaking, involving more than 40 government agencies, financial institutions and industry organisations. The Reserve Bank acted as the lead authority and coordinated the FSAP process. The main government agencies responsible for financial sector regulation – the Reserve Bank, Securities Commission, Ministry of Justice and Ministry of Economic Development - spent several months preparing for the FSAP, during which they compiled data for the FSAP assessors and completed comprehensive self-assessments of New Zealand's compliance with the relevant international standards and codes. The FSAP assessment was conducted by a team of IMF staff and contracted international experts.

There are essentially two aspects to an FSAP assessment.[2] The first aspect includes a review of short-term vulnerabilities and medium-term risks to the financial sector, an analysis of its resilience to an economic or financial shock, and an assessment of the institutional capacity to respond to a financial crisis. This part of the assessment may draw on a range of analytical tools such as 'stress testing' and small economic models. The components are brought together in the Financial Sector Stability Assessment (the FSSA report), produced by the IMF.

The second aspect is an assessment of a country's compliance with a set of international standards and codes that are regarded as best practice. The assessments against the standards and codes, taking the wider legislative and regulatory setting and institutional structure into account, form the Report on the Observance of Standards and Codes

1 The report can be downloaded from www.imf.org/external/pubs/ft/scr/2004/cr04126.pdf.

2 Mortlock and Woolford (2003) provide more detail on the structure of an FSAP assessment.

(the ROSC report). The following standards and codes are routinely included as modules in an FSAP assessment, although decisions on which modules to include are made on a case-by-case basis:

- the Core Principles for Effective Banking Supervision, relating to the framework for licensing and supervising banks;
- the Objectives and Principles of Securities Regulation, relating to securities market regulation;
- the Code of Good Practices on Transparency in Monetary and Financial Policies, relating to transparency in monetary policy and financial sector regulation;
- the Forty Recommendations issued by the Financial Action Task Force, on anti-money laundering and combating the financing of terrorism;
- the Core Principles for Systemically Important Payment Systems; and
- the Insurance Core Principles and Methodology, relating to insurance sector regulation.

Not every country completes all of these modules, as the scope of an FSAP assessment depends on the relevance to a country's financial system and the priorities and resources of the IMF or World Bank. It was agreed that the New Zealand FSAP assessment would include only the first four modules. The FSAP team felt that there were no systemic stability concerns in the payment systems area, and that the Bank's self-assessment of payment systems was sufficient.[3] Life insurance sector regulation was excluded because it was not considered to be sufficiently relevant to an assessment of systemic stability.

The FSAP team visited New Zealand to conduct its assessment during October and November last year. The IMF Executive Board discussed the final versions of the FSSA and ROSC reports in April this year, and the reports were made available on the IMF website in May.

2 Key findings of the FSAP

The broad conclusion of the FSAP assessment was that the current strength of New Zealand's financial system, the favourable economic outlook and sound financial policies provide an effective buffer against systemic risks. The regulatory framework for the financial sector was found to be generally appropriate for New Zealand's circumstances, and with some refinements it should continue to provide a basis for maintaining a sound financial system.

The following section summarises the main findings of the FSAP assessment. Many of the findings relate to the Reserve Bank's responsibilities in bank regulation and supervision and in promoting a sound financial system. Box 1 summarises the key findings relating to agencies other than the Bank.

Short-term and medium-term stability issues

The FSAP report noted that the five banks that dominate New Zealand's banking system have been profitable and well capitalised for many years, and the average credit rating for New Zealand banks is among the highest in the world.[4] It was noted that banks have learned from the difficulties they faced in the late 1980s and early 1990s, and have developed strong credit cultures and risk management systems.

The strength of the banking sector, and sound economic policies over the last 15 years or so, has allowed the financial sector to weather a number of shocks in recent years, such as the Asian financial crisis, with few signs of distress. The stress testing exercise conducted by the Bank as part of the FSAP indicated that the major banks could withstand a range of sizeable shocks (see Box 2).

The FSAP report noted that New Zealand's approach to banking supervision emphasises the roles of bank directors and managers in promoting sound risk management, and the role of market discipline in creating incentives for banks to manage their risks prudently. The Bank has a range of powers for enforcing supervisory requirements on banks, such as requiring banks to obtain and disclose a credit rating, quarterly disclosures of a range of financial and risk-related

3 Stinson (2003) includes a summary of this self-assessment.

4 Since the FSAP, the ANZ Bank has purchased the National Bank of New Zealand.

Box 1
FSAP findings and recommendations outside the banking sector

The FSAP covered two key areas outside the Bank's sphere of responsibilities: the supervision of non-bank financial institutions and the regulation of securities markets. The main regulatory authorities in these areas (respectively, the Ministry of Economic Development and the Securities Commission) are considering the FSAP findings within their current work programmes. Briefly, the main findings were:

Non-bank financial institutions: Oversight of most of the non-bank financial sector relies substantially on the roles of trustees, who are appointed by the institution to represent the interests of creditors, and auditors, who are responsible for auditing the prospectuses of financial institutions. With a few exceptions, there is no formalised licensing or supervision of non-bank financial institutions. The FSAP team found that disclosure by non-bank financial institutions may not be timely or comprehensive enough to ensure adequate market oversight, and that there is no official oversight of trustees. The report recommended a review of the practices and resource needs for the government agencies involved in this sector, with a view towards improving public access to financial data.

Securities markets: New Zealand is compliant with the majority of the principles relating to securities market regulation. Recent reforms in securities regulation and the restructuring of New Zealand Exchange Limited were found to have strengthened the regulatory framework. The FSAP team noted that the framework could be further enhanced by developing minimum standards of conduct for collective investment scheme operators and better reporting mechanisms, strengthening standards and penalties relating to market abuse, and improving oversight of market intermediaries that are not exchange members.

Box 2
Stress testing the banking system

An important part of the FSAP is assessing the vulnerability of the financial system to a major economic or financial shock. The Reserve Bank conducted a stress testing exercise with the five largest banks, where the Bank provided the scenarios and supporting material, and asked the banks to calculate the impact of defined shocks on their balance sheets and profitability. The Bank collected and reviewed the banks' results and provided aggregated results to the FSAP mission.

The scenarios included a range of large, one-off shocks to financial markets (including a sharp fall in the exchange rate and a large increase in interest rates) and a substantial fall in house prices. There were also two dynamic scenarios that attempted to capture medium-term impacts on the banking system: an outbreak of foot-and-mouth disease, based on previous work on the possible impacts (RBNZ, 2003); and a shock to international investor confidence, resulting in reduced access to offshore funding.

The results suggested a high degree of resilience among the major banks. On average, the market and credit risk shocks substantially reduced profits at the time of the shock, but none of the banks reported net losses. The results from the dynamic scenarios indicated, beyond the initial shock, only a modest drag on banks' profits in the medium-term relative to the baseline assumptions. None of the shocks resulted in a serious deterioration in bank asset quality or capital adequacy.

We will publish more details on the stress testing exercise later in the year.

information, and director attestations on the adequacy of their banks' risk management systems. The Bank reinforces these with a selection of prudential rules, such as minimum capital ratio requirements and limits on lending to connected parties.

The FSAP team concluded that although New Zealand relies heavily on offshore finance to fund its current account deficit, exchange rate risk is well understood and managed by the financial and corporate sectors. The market for hedging foreign exchange risk is deep and liquid, which has mitigated the impact of large swings in the exchange rate in recent years.

Institutional capacity to respond to financial crises

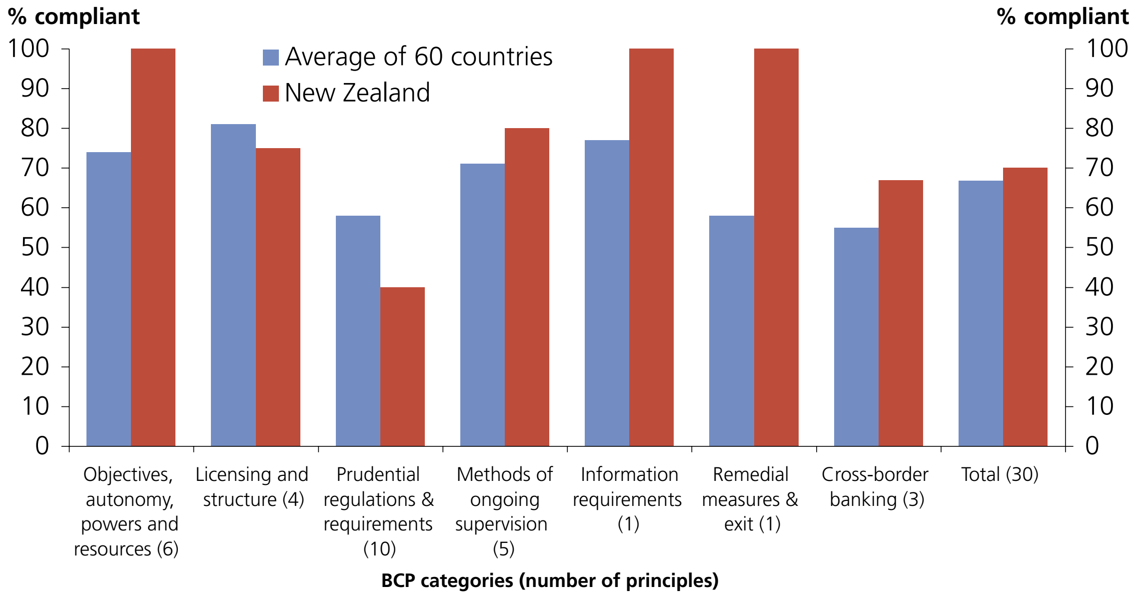
The FSAP report concluded that the organisation and structure of New Zealand's banks would create unique challenges in the event of a financial crisis. The basis for this view is that all of the systemically important banks are foreign-owned, and although most of these banks operate in New Zealand as a separate legal entity, core functions such as IT, accounting and risk management are increasingly being outsourced to parent banks or other overseas companies. In a crisis situation, it may be difficult to isolate the assets of a New Zealand bank or keep it operating as a separate entity, which would limit the Bank's options for resolving the crisis. Reflecting this, the report made a number of recommendations for further strengthening the Bank's capacity to manage financial distress events.

Financial sector regulation compared to international standards

The FSAP team assessed New Zealand's compliance with the Basel Core Principles for Effective Banking Supervision (BCPs) - a set of international guidelines for banking supervision developed by the Basel Committee on Banking Supervision, the international standard-setting body in this area. Although the standards and codes are not binding, they have become accepted as benchmarks of international good practice, and hence provide a useful framework for assessing a country's regulatory arrangements in the banking sector.

The BCPs were developed with an eye towards more conventional approaches to supervision, which tend to rely on extensive prudential requirements and on-site inspections of banks. In contrast, New Zealand's approach to bank supervision places greater emphasis on bank self-discipline and market discipline to provide incentives for prudent

Figure 1
Degree of compliance with Basel Core Principles



management, and enforces this through public disclosure of information and directors' attestations on their banks' risk management. The FSAP report acknowledged that while the Bank's approach often uses different means than those envisaged in the BCPs, it generally meets the same objectives. Reflecting this, the FSAP team concluded that New Zealand is compliant or largely compliant with 16 of the 25 BCPs.[5]

Figure 1 shows that the overall degree of compliance was similar to the average of the 60 countries that had completed an FSAP assessment by the end of 2001. However, the comparison group consists mostly of developing and transitional economies, which tend to be less compliant with the standards. New Zealand is less compliant than the few advanced countries that have undergone a BCP assessment.

The main areas of non-compliance relate to the use of prudential requirements and the absence of on-site examinations of banks. In the BCPs, the supervisor is expected to provide banks with a range of guidelines and limits on their activities, including setting criteria for major acquisitions and investments, approving systems for identifying large credit exposures, evaluating lending policies, and setting guidelines or imposing limits on managing various types of risk. The supervisor is also expected to evaluate banks using a combination of off-site monitoring and on-site examinations.

The New Zealand approach to supervision minimises the use of direct regulation, and does not involve on-site supervision. Instead, the Bank emphasises disclosure of information to allow monitoring of banks' risks by the market – which includes depositors, creditors, analysts and competing banks – and to encourage sound risk management practices.

Banks are required to disclose comprehensive details about their operations on a quarterly basis, and the disclosure statements are subject to a full external audit at year-end and a limited audit review at the half-year. In addition, bank directors must attest on a quarterly basis on several key prudential matters, such as the adequacy of the bank's risk management systems and the accuracy of disclosure statements. This requirement focuses directors' attention on matters of prudential importance, and obliges them to take responsibility for ensuring that their bank operates in a prudent manner.

The Bank's choice of approach to banking supervision stems from its statutory powers and responsibilities. The purpose of supervision, as set out in section 68 of the Reserve Bank of New Zealand Act 1989 (the Act), is to:

- promote the maintenance of a sound and efficient financial system; and
- avoid significant damage to the financial system that could result from the failure of a registered bank.

The focus of supervision in New Zealand is on systemic stability, rather than on safeguarding individual institutions, as in some other countries. Similarly, there is no explicit obligation to protect depositors and other bank creditors. The absence of a safety net also reduces the moral hazard problem associated with centralised supervision and regulation, making market discipline a more powerful force than would otherwise be the case.

The Act also contains an explicit efficiency objective for banking supervision and other financial stability responsibilities. The Bank aims to foster a competitive and innovative environment in the banking sector by ensuring that regulatory compliance costs are reasonably low, that any regulatory interventions are well-targeted and cost-effective, and that entry into the New Zealand banking sector is open, subject to meeting the conditions for bank registration.

The FSAP mission recognised that this less intrusive approach has clear strengths in the New Zealand context, and made recommendations for improving compliance that were consistent with the current approach. In most cases, the Bank has acknowledged the potential improvements in the supervisory framework that were identified by the assessors, and is either currently working, or plans to carry out work, on these issues.

5 The first BCP has six sub-categories, so there are effectively 30 principles in total. On this basis, New Zealand is compliant with 21 out of 30 principles, as indicated in Figure 1.

3 FSAP recommendations and Reserve Bank responses

This section details the main FSAP recommendations relating to banking supervision and notes where they correspond to the Bank's work programme. The recommendations fall into four broad categories: on-site supervision, financial system crisis management, supervisory information and bank corporate governance.

3.1 On-site supervision

FSAP recommendation: *The Reserve Bank should make use of its powers under the Act to commission third-party reports on banks' systems and controls, and/or establish a small, specialist team in-house to make focused, on-site visits on particular aspects of credit and operational risk.*

The Act does not give the Bank the power to conduct on-site supervision of banks, which are a key aspect of conventional approaches to banking supervision. However, section 95 of the Act allows the Bank, as a routine part of the supervision process, to require a registered bank to supply a report on almost any aspect of a bank's operations, including corporate, financial, and prudential matters. The report must be prepared by an independent party approved by the Bank on terms of reference specified by the Bank, and the Bank can require the report to be published.

The Bank has not exercised its section 95 powers to date out of a desire to avoid weakening the incentives for bank directors to take responsibility for the sound management of their banks. In addition, before the amendments to the Act in 2003, the range of issues to which a report could apply was limited mainly to accounting systems and internal controls (Twaddle, 2004).

Notwithstanding the merits of the current approach, there are times when other tools, such as independent reports on banks, could be appropriate. Banks' risk exposures and risk management systems are becoming increasingly complex, and there are times when a focused review by an independent party can provide greater assurance around a bank's risk management capacity. Moreover, the FSAP report noted that periodic reviews of banks' systems and controls, through the use of independent reports, need not be overly intrusive if they are properly focused. The Bank can also contribute to trans-Tasman cooperation on banking supervision by coordinating independent reviews with on-site examinations of Australian banks by the Australian Prudential Regulatory Authority.

The Bank is currently developing a framework for requiring independent reviews of banks' systems and controls, and recently established a small team within the Financial Stability Department that will specify and implement these reviews. The Bank intends to use independent reviews as a selective tool to provide additional scrutiny of banks' risk management capacity in ways that are compatible with retaining bank director and senior management responsibility for ensuring strong risk management processes. This step will bring New Zealand's approach to supervision closer into line with international standards, while preserving the strengths of the current approach.

Bank resolution and crisis management

FSAP recommendation: *The Reserve Bank should continue to review possible approaches to bank resolution and the operational and legal consequences that might arise, and finalise a crisis management strategy, exploring avenues for co-operation with Australian authorities where appropriate.*

Periods of financial distress are expected to be very rare, but it is essential for the Bank to be able to respond quickly and effectively to any event that poses a threat to the soundness of the financial system. The Bank has several projects underway that aim to strengthen its existing preparedness for a range of financial crisis events.

The Bank is working to operationalise its role as the lender of last resort for the financial system. Under section 31 of the Act, the Bank has a responsibility to act as lender of last resort to the financial system. It can provide liquidity to the financial system as a whole or to an otherwise solvent financial institution that has exhausted all private sector sources of liquidity.

The Bank's policies will need to identify more precisely the circumstances in which it may provide liquidity, the possible terms and conditions that may apply to the lending, and the nature of disclosure arrangements for lending. This strand of work also includes the development of closer coordination arrangements with the Australian financial authorities, in the case of providing liquidity to Australian banks in New Zealand.

The Bank is also developing options for responding to a bank failure. One option that has been under development for some time is the use of depositors' and other creditors' funds to absorb the losses of, and possibly recapitalise, an insolvent bank.[6] A number of IT-related and other issues need to be resolved in order to make this plan operational. Other options that will be considered include a 'life boat' rescue by the rest of the banking industry, the separation of a troubled bank into a 'good' bank and a ' bad' bank, and different structures for winding down a failed bank.

The high degree of integration between the New Zealand and Australian banking systems increases the likelihood that a financial sector crisis will affect both countries. The Bank is working with the Australian financial sector authorities to develop a framework for coordinating responses to trans-Tasman financial crisis events.

To bring these strands together, the Bank is developing a crisis management manual to guide it in responding to different crisis situations. The Bank will further build and test its crisis management capacity through periodic simulations of bank crisis situations.

Supervisory information and disclosure

FSAP recommendation: *The Bank should take steps to address gaps in supervisory information, in order to maintain the quality, scope, and timeliness of disclosure and ensure it continues to meet best international practice.*

The FSAP report noted that there are certain areas where supervisory information falls short of what is required in other countries as a means of anticipating banking problems. For example, quarterly disclosure statements contain no reporting on liquidity, limited information on large credit exposures, and only very general descriptions of risk management systems.

6 Carr (2001) provides an outline of this option.

The report recommended that the Bank should review the contents of the statements in certain areas and supplement them with focused, prudential information directly for its own use. In addition, the Bank could use existing information sources, such as the data on liquidity and inter-bank exposures that the Bank observes through its daily liquidity management operations, to develop early-warning indicators of bank distress.

Comprehensive disclosure requirements for banks were introduced in the mid 1990s as an important element of banking supervision. The Bank occasionally supplements disclosure-based information with data obtained privately from banks where necessary to assess their financial condition. In addition, the Bank periodically reviews the disclosure regime and has made several incremental improvements since its introduction.

However, international best practices for disclosure have evolved in recent years, and in some cases have surpassed practices in New Zealand. Most significantly, the new Basel Capital Accord (Basel II), which is due to take effect at the end of 2006, includes a framework for strengthening market discipline (Pillar 3) that goes beyond the Bank's current disclosure requirements.

The Bank will be reviewing the disclosure regime in light of these international developments, with a view to maintaining a strong disclosure environment for banks. The next review will consider various possible enhancements, such as additional reporting to the Bank on liquidity and on large exposures, and the possibility of introducing some form of timely reporting for significant changes to a bank's financial condition.

Corporate governance

FSAP recommendation: *The Reserve Bank should complete work on enhancing "fit and proper" criteria for bank directors and senior managers, and consider ways to reinforce the role of independent directors.*

Directors play a critical part in the New Zealand approach to banking supervision. The 'self discipline' aspect of supervision places heavy reliance on bank directors and senior managers, and governance arrangements that allow them to exert meaningful oversight and management of the bank. It is crucial to ensure that there is a thorough vetting process for appointing directors. The BCPs require the supervisor to carry out "fit and proper" checks on bank directors and senior managers.

With the recent amendments to the Act, the Bank now has to consider the suitability of directors and senior managers when registering banks, and has the option of considering it on an ongoing basis through a bank's conditions of registration (Twaddle, 2004). The Bank is close to implementing new policies on the use of these powers, having consulted on proposals with the industry.

The second issue is the effectiveness of directors and corporate governance within banks. The Bank has developed policies to encourage sound governance in the banking sector, including comprehensive disclosure requirements and director attestations. The requirements imposed on bank directors complement and reinforce the standard duties of care applicable to company directors generally, as codified in the New Zealand Companies Act (Mortlock, 2002).

Locally incorporated banks are required to have at least two independent directors and a non-executive chairperson on their board. This requirement is intended to increase the board's capacity to exercise appropriate scrutiny over the performance of managers, and to reduce potential conflicts of interest between a New Zealand bank and its parent bank or other related parties.

Last year, the Bank sent a comprehensive survey to the boards of all registered banks, seeking information on a range of matters, including the means by which directors satisfy themselves that their banks' disclosures are not false or misleading, and that their systems for controlling risks are robust (Bollard, 2003). Drawing on the insights from this survey, as well as recent international developments in corporate governance, the Bank is preparing a consultation paper on bank governance issues, with proposals for possible changes to current policies. The issues raised in the consultation paper are likely to include:

- whether a minimum of two independent directors is sufficient, and whether the definition of "independence" is strong enough;
- whether the scope of directors' attestations should be widened to include additional aspects of bank risk management, such as outsourcing arrangements;
- whether to provide guidance to banks on corporate governance arrangements, focusing particularly on the role of the board; and
- the use of independent reviews of governance arrangements in banks.

The FSAP report noted that a bank director's role is demanding, and independent directors in particular would benefit from more regular communication with the Bank. The Bank meets with the boards of the larger banks on a fairly regular basis, but it generally does not meet with the boards of all banks, and does not meet separately with independent directors. The consultation paper will address the possibility of more regular and focused discussions with bank directors.

The Bank's local incorporation policy also aims to strengthen bank governance. In 2000, the Bank introduced a requirement that banks must be incorporated in New Zealand if they are systemically important, or if they are based in a country that has inadequate disclosure requirements or applies a depositor preference scheme. The policy ensures that such banks are governed by a local board of directors who have a duty to act in the best interests of the New Zealand bank.

4 Other issues

The FSAP report noted several other areas where financial regulation could be enhanced, without making specific recommendations. Many of these areas are already on the Bank's work agenda, and the FSAP assessors were generally supportive of the direction of current policy developments. This section briefly highlights the recent developments in those areas.

External vulnerability and foreign reserves

New Zealand depends on continuing capital inflows to fund its current account deficit. Notwithstanding the current favourable conditions, this leaves the economy vulnerable to a shift in market sentiment, which at worst could lead to extreme disorder in the foreign exchange market as investors 'rush for the exits'. The Bank holds a reserve of foreign currencies for use in such an event, but in absolute terms the level of reserves has been largely unchanged since 1985, and appears relatively low by international standards.

The Bank recently conducted an extensive analysis of the optimal level of foreign reserves for intervening to stabilise a disorderly foreign exchange market. This project involved cross-country and empirical analysis, the development of a theoretical model, and discussions with other central banks. The FSAP assessors reviewed and supported the analysis, and noted that regular assessments of the optimal level of reserves would be valuable. As a result of this work, the Minister of Finance and Cabinet recently agreed to the Bank's request for an additional NZ$1.9 billion of reserves for this purpose (RBNZ, 2004).[7]

Stress testing

In light of the results from the stress testing exercise in the FSAP, the Bank is examining the value of conducting stress tests on a regular basis. Any future stress testing is likely to cover fewer scenarios than in the FSAP, and would focus on specific areas of interest. The Bank is also looking at developing models that would allow it to perform in-house stress tests, although this would still require close consultation with the banking industry.

Outsourcing

New Zealand banks have increasingly made use of outsourcing of IT systems and other functionality, either to parent banks or third parties, to reduce their costs in areas such as risk management, accounting and computer processing. The Bank is generally supportive of outsourcing, as it provides considerable scope for efficiency gains in the banking industry. However, there are associated risks that need to be addressed. For example, if a parent bank failed and the New Zealand subsidiary was placed in statutory management, it is unclear whether the statutory manager would have access to the core functions needed to operate the bank on a self-contained basis.

The recent amendments to the Act allow the Bank to place restrictions on outsourcing activities as part of the conditions of bank registration (Twaddle, 2004). The Bank is currently working with banks to improve its understanding of current outsourcing arrangements, with a view to developing policy proposals for consultation. The finalised outsourcing policy will require banks to ensure that necessary systems, information and management capacity are accessible to a statutory manager in New Zealand in the event of a bank failure situation, and that more generally, the board and management of a bank in New Zealand can maintain the bank's operations if the parent bank is in distress.

Trans-Tasman cooperation

The recent increase in Australian ownership of New Zealand banks has reinforced the importance of cooperation and coordination between the regulatory authorities in both countries. New Zealand's approach to supervision already dovetails quite closely with the Australian approach, which means that most of the efficiency gains from closer regulatory integration have probably already been achieved. However, there is considerable scope for gains on issues relating to financial sector soundness, such as crisis management coordination.

The Bank will continue to strengthen its relationship with the Australian Prudential and Regulatory Authority and the Reserve Bank of Australia, especially in regard to information sharing, policy co-ordination and crisis management. These three authorities, along with the New Zealand and Australian Treasuries, are members of a working group looking at ways of better integrating the two countries' banking regulations.

7 This is distinct from the use of foreign exchange intervention as an additional monetary policy tool. See www.rbnz.govt.nz/foreignreserves/intervention/index.html for briefing materials on both topics.

Anti-money laundering

The FSAP included an assessment of the framework for countering money laundering and the financing of terrorism. The assessment was conducted on behalf of the IMF by the Financial Action Task Force (FATF), the international body responsible for setting standards in this area, and by the regional Asia Pacific Group on Money Laundering (APG). New Zealand is a member of both the FATF and APG.

At the time of writing, the text of the FATF/APG report had not been finalised. The early indications are that New Zealand meets the majority of the FATF standards, but has some areas for improvement, such as strengthening the legal framework for combating aspects of money laundering, possibly tightening the supervisory arrangements in relation to money laundering, and increasing resources for the relevant government agencies.

The FATF/APG report and the ROSC report raised the issue of the lack of a framework for monitoring financial institutions' compliance with money laundering and terrorist financing requirements. The Ministry of Justice is currently coordinating an inter-agency review of anti-money laundering arrangements, which will provide advice to government on changes needed to respond to the FSAP recommendations, and to meet the revised international standards that FATF has recently adopted.

5 Conclusion

In recent years, the Bank has increased its focus on issues relating to financial sector stability, and has taken a fresh look at the banking supervision and regulation regime to ensure that it remains effective and appropriate for New Zealand's banking system. The FSAP assessment was a valuable opportunity for an independent, wide-ranging review of the current framework and the policies under development, and the Bank welcomed the perspectives of the FSAP assessors.

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