
The Reserve Bank of New Zealand Amendment Act 2006

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This article discusses the Reserve Bank of New Zealand Amendment Act 2006, passed in October, which implements the Government's response to the recommendations of the Trans-Tasman Council on Banking Supervision. The Act amends part of the existing Act passed in 1989 and is being matched by equivalent legislation in Australia. The legislation provides greater assurance of cooperation between New Zealand and Australian regulators by imposing obligations on them to consult each other and to avoid actions that may have a detrimental effect on financial stability, without unduly constraining the actions of the regulators. There have also been some other minor amendments to the 1989 Act, which are also discussed in the article.

1 Introduction

Parliament passed new legislation amending the Reserve Bank of New Zealand Act 1989 (the Act) in October. The Reserve Bank of New Zealand Amendment Act 2006 (the Amendment Act) implements the Government's response to the recommendations of the Trans-Tasman Council on Banking Supervision (the Council) and also makes some minor amendments to the Act. The legislation has been matched by equivalent legislation in Australia.¹ The Australian and New Zealand legislation promotes trans-Tasman coordination of financial sector regulation, and represents an innovative approach to home-host banking supervision. Although the Amendment Act came into force on 1 November, the trans-Tasman provisions will be brought into force at in December by Order in Council so that their timing can coincide more closely with the Australian equivalent legislation. The Australian legislation was passed on 28 November 2006 and will come into force in December on the day it receives the Royal Assent.

Below we explain the work of the Council, examine what the trans-Tasman provisions in the Amendment Act will do and look briefly at the other amendments in the new legislation.

2 Origin of the legislation

The Trans-Tasman Council on Banking Supervision was

established by the Minister of Finance, the Hon Dr Michael Cullen, and the Australian Treasurer, the Hon Peter Costello, in February 2005 as a forum to progress trans-Tasman issues in banking regulation. The Council comprises representatives of the Australian and New Zealand Treasuries, the Reserve Banks of Australia and New Zealand and the Australia Prudential Regulation Authority (APRA).

The Council's mandate is to promote a joint approach to trans-Tasman banking supervision that delivers a seamless regulatory environment. Trans-Tasman coordination of financial sector regulation has been seen as an important part of the Government's Single Economic Market Agenda,² reflecting that the Australian and New Zealand banking markets are among the most highly interdependent in the world. Approximately 90 percent of New Zealand banking system assets are owned by Australian-owned banks and New Zealand banking assets represent approximately 15 percent of the total assets of Australian-owned banks. This interdependency makes the home-host relationship between Australia and New Zealand particularly important. Home-host relationships between supervisors allow for more effective cross-border supervision of banks with operations in more than one country. The Basel Core Principles for Effective Banking Supervision³, which are intended to provide

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¹ Known as The Financial Sector Legislation Amendment (Trans-Tasman Banking Supervision) Act 2006.

² A "single economic market" has been defined as "a geographic area comprising two or more countries in which there is no significant discrimination in the markets of each country arising from differences in the policies and regulations adopted by each country". See *Australian and New Zealand Competition and Consumer Protection Regimes*, Productivity Commission Research Report, 16 Dec 2004, p XII.

³ Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision*, Oct 2006, available at <http://www.bis.org>

an internationally agreed set of minimum requirements for effective banking supervision, state that cross-border supervision requires cooperation and information exchange between the home and host supervisors.⁴

The Council's terms of reference require it to⁵:

- enhance cooperation on the supervision of trans-Tasman banks and information sharing between respective supervisors;
- promote and review regularly trans-Tasman crisis response preparedness relating to events that involve banks in both countries;
- guide the development of policy advice to both governments, underpinned by the principles of policy harmonisation, mutual recognition and trans-Tasman coordination; and
- report to Ministers on legislative changes that may be required to ensure APRA and the RBNZ can support each other in the performance of their current regulatory responsibilities at least regulatory cost.

In August 2005, the Council made its recommendations to Ministers on the legislative-changes part of the terms of reference. Earlier this year, the Minister of Finance and the Australian Treasurer announced that the Australian and New Zealand Governments had agreed to the legislative changes recommended by the Council. They described the proposed changes as comprising the following elements⁶ :

- General provisions that require each regulator to support the other in fulfilling the other's statutory objectives and, wherever reasonably possible, to avoid actions that could have a detrimental effect on financial system stability in the other country.
- A specific reference to the definition of "detrimental actions" to actions that interfere with or prevent the provision of outsourced services to a related party in the

other country.

- A requirement that, where reasonably practical, the regulators consult each other before exercising a power that is likely to be detrimental to financial stability in the other's country.
- A requirement that an administrator or statutory manager advise the regulator if they have reasonable cause to believe that the proposed exercise of a function or power by them is likely to have a detrimental effect on financial stability in the other country.

The Amendment Act and the reciprocal Australian legislation are the result of these decisions. The provisions of the Amendment Act are examined below.

3 What the legislation does

The Amendment Act incorporates the Council's recommendations into the Reserve Bank of New Zealand Act. When looking at the benefits of the trans-Tasman provisions it is necessary to consider them along with the Australian equivalent legislation, the Financial Sector Legislation Amendment (Trans-Tasman Banking Supervision) Bill 2006. This is because the benefits to New Zealand will result from the enactment of the Australian legislation, while the amendments to the Reserve Bank of New Zealand Act impose duties on the Reserve Bank and a statutory manager appointed under the Act that will benefit Australia.

Trans-Tasman cooperation

The trans-Tasman amendments are in Part 5 of the Act, which covers the registration of banks and the prudential supervision of registered banks, including provisions dealing with the statutory management of a registered bank.

New section 68A deals with trans-Tasman cooperation and is the key section in the Amendment Act. It has two prongs. The first prong requires the Reserve Bank, when performing its prudential supervision functions or duties, or exercising powers under Part 5, to support prescribed Australian financial authorities in meeting their statutory responsibilities relating to prudential regulation and financial

⁴ Above, principle 25.

⁵ Refer Media statement from Dr Michael Cullen, 'Solid progress in Cullen-Costello bilateral', 17 February 2005, www.beehive.govt.nz

⁶ 'Ministers announce key achievements in the trans-Tasman single economic market agenda', Joint media statement by Hon Dr Michael Cullen with Australian Treasurer the Hon Peter Costello, 22 Feb 06, available at www.beehive.govt.nz

system stability in Australia. This provision formalises the cooperation that already takes place between New Zealand and Australia and will facilitate the sharing of information and consultation. This will be particularly important during a time of crisis when national interests can diverge.

The expression “prescribed Australian financial authority” has been defined as meaning an Australian public authority prescribed by regulations made under section 68A. It will apply to APRA but the statute allows for flexibility. For the purposes of this article, we will refer to APRA rather than to prescribed Australian financial authorities.

The word “support” is intended to have its ordinary meaning. The clause in practice will require the Reserve Bank and APRA to support each other in ways such as providing and sharing information, cooperation on policy development, and coordination on matters of common interest, particularly crisis preparation and management⁷.

The second prong of new section 68A requires the Reserve Bank, again when exercising its prudential supervision powers, to “avoid any action that is likely to have a detrimental effect on financial system stability in Australia”. In accordance with the Council’s recommendation, this phrase is defined in the legislation as including “an action that prevents or interferes with any outsourcing arrangement”. “Outsourcing arrangement” is also defined and means “an arrangement for business, or functions relating to any business, of an authorised deposit-taking institution to be carried on by a person other than that authorised deposit-taking institution”. “Authorised deposit-taking institution” (commonly referred to as an ADI in Australia) is defined in the Amendment Act by reference to Australian legislation and refers to bodies corporate that have been authorised by APRA to carry on banking business. Included among ADIs are banks, building societies and credit unions.

The legislation requires that the Reserve Bank consult with, and consider the advice of, APRA prior to taking an action that the Reserve Bank has reasonable cause to believe is likely to have a detrimental effect on financial system stability

in Australia. The duty placed on the Reserve Bank is not absolute; it is confined to situations where the Reserve Bank considers it reasonably practicable in the circumstances, having regard to urgency or other similar constraints. This requirement and its Australian equivalent will be particularly important in a crisis situation, as this is when, in the absence of the legislative requirements, the risk of one regulator taking actions that undermine those of the other regulator is heightened, with potentially significant consequences for the stability of both financial systems. Despite their different legislative objectives, in normal circumstances, the respective interests of the Reserve Bank and APRA are well aligned. However, in times of crisis, these interests can diverge and the decisions taken by one regulator could have an adverse impact on the other jurisdiction. Examples of this could include the situation where the two regulators wish to take different actions in response to an impending crisis, eg, when a shock affects the two countries differently.

Outsourcing provides another practical example of where the interests of the regulators could be at variance. When the Council was given the task of considering legislative changes that were necessary to allow for greater cooperation between regulators, regulatory policy on outsourcing was an area that was identified where more cooperation between supervisors would be beneficial. Prudential regulators, including the Reserve Bank and APRA, have outsourcing policies⁸ that provide some restrictions on outsourcing by registered banks. These policies are generally designed to ensure that the risks to a bank, and/or the wider financial system, from the failure of a service provider are able to be appropriately managed. Where the service provider is regulated by another regulator in another jurisdiction, that regulator’s duties and powers may cause it to intervene in a way that interferes with the provider’s performance, to the detriment of financial stability in the other jurisdiction.

The Amendment Act will require the Reserve Bank to consult with APRA before the Reserve Bank interferes with an outsourcing arrangement. The reciprocal Australian legislation will require APRA to do the same. This consultation

⁷ See Hansard, 19 October 2006, speech for second reading, the Reserve Bank of New Zealand Amendment Bill, Hon David Cunliffe, Minister of Immigration, on behalf of the Minister of Finance. Available at <http://www.parliament.govt.nz>

⁸ The Reserve Bank’s outsourcing policy is set out in BS11 in the Banking Supervision Handbook and is on the Reserve Bank’s website: <http://www.rbnz.govt.nz/finstab/banking/outsourcing/index.html>

will increase the likelihood of the regulators taking into account the interests of the other's financial system and of them considering alternative actions. This will be particularly beneficial for New Zealand, as most of the outsourcing that has occurred between banks in the two countries has been from New Zealand banks to service providers, including parent banks, in Australia. The enactment of the Australian equivalent legislation will allow the Reserve Bank to better manage banks' current outsourcing practices and provide for a better balance between efficiency gains to banks and the protection of the financial system.

Statutory manager to avoid actions likely to have a detrimental effect

New section 121A of the Amendment Act implements the Council's fourth recommendation and deals with statutory management⁹. It imposes a duty on the statutory manager to consult where the statutory manager has reasonable cause to believe that an action of theirs is likely to have a detrimental effect on financial system stability in Australia. In that situation, the statutory manager is required to notify the Reserve Bank as soon as practicable and to obtain the Reserve Bank's written consent before taking the action. The statutory manager may consult with APRA about whether an action is likely to have a detrimental effect on financial system stability in Australia. The Reserve Bank is required to provide details to APRA before granting written consent to the statutory manager in such a situation. Again, these duties are not absolute. The statutory manager is not required to notify the Reserve Bank and the Reserve Bank is not required to notify APRA where they are satisfied that it is not reasonably practicable to do so in the circumstances, having regard to urgency or other similar constraint.

Other amendments to the Act

The Amendment Act also made some minor changes to the

Reserve Bank Act. These provisions came into force on 1 November. They:

- amend the definition of "financial institution" to clarify the Reserve Bank's ability to seek an Order in Council declaring a person to be a financial institution;
- update the provisions obliging the Reserve Bank to keep a register of banks so as to make the provisions more technologically neutral; and
- include directors of the Reserve Bank within the classes of persons entitled to protection from liability and a Crown indemnity when carrying out their functions under the Act.

4 Conclusion

The Reserve Bank of New Zealand Amendment Act 2006 and the reciprocal Australian legislation represent a path-breaking advance in home-host supervisory cooperation. In his speech for the third reading of the bill, the Minister of Finance said that the legislation "draws a realistic balance between the desirability of trans-Tasman co-operation, and the independence and discretion of each prudential regulator, within international boundaries"¹⁰.

The legislation will provide greater assurance of cooperation between the regulators by imposing obligations on them to consult each other and to avoid actions that may have a detrimental effect on financial stability, without unduly constraining the actions of the regulators. The legislation should lower regulatory costs and enhance the maintenance of financial stability. It represents a significant step for the coordination of banking regulation on both sides of the Tasman.

⁹ A registered bank and any associated person of a registered bank may be placed into statutory management under Part 5 of the Reserve Bank of New Zealand Act. This is done pursuant to section 117 by the Governor-General by Order in Council, on the advice of the Minister given in accordance with a recommendation of the Bank. The grounds on which a registered bank may be declared to be subject to statutory management are set out in section 118.

¹⁰ See Hansard, 19 July 2006, available at <http://www.parliament.govt.nz>