



# Bulletin

*Vol. 81, No. 6*

*June 2018*



## Reserve Bank of New Zealand *Bulletin*

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ISSN 1177-8644

# Banking conduct and culture – The Reserve Bank’s role and efforts ahead

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The following article was issued on 24 May.

A key task of the Reserve Bank is to promote a sound and efficient financial system. The Financial Stability Report due out 30 May 2018 gives our view on the state of New Zealand’s financial system, and challenges and issues ahead.

An important part of our financial ecosystem are New Zealand registered banks. It is pleasing we are generally well serviced by domestically-owned and global banks, providing us world-class banking services at reasonable cost.

Globally, and especially following the mid-2009 financial crisis, there has been significant, vocal, public concern about the drivers and cultures of bank behaviour. Are banks too profitable, too short-term, incentivised to over-lend, insufficiently sound, too large to be managed, too global to be regulated, and too open to operational and security risks?

These are all valid questions that can be asked of many industries, not just banks. They are just as relevant to insurers, whom we also regulate. However, banks play a special role. It is an industry in which the ‘fear of failure’ of a bank can lead to its failure. And the failure of one large bank

can lead to the failure of the whole system. It is difficult to think of other industries with the same susceptibility.

New Zealand’s financial ecosystem has been remarkably robust over recent decades but it is not immune to threats. The dominance of banks in our financial system, and their concentrated foreign ownership, is real. The plethora of recent Australian-led banking inquiries is unprecedented, the most significant being the ongoing Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. The concerns that gave rise to these inquiries should be heeded, not just by Australian-owned banks, but by all financial service providers in New Zealand, including our own domestically-owned banks and insurers.

We are very aware of all of these issues and spend an enormous effort to assess and manage New Zealand’s financial vulnerability to bank failures. These efforts include policies to limit or prepare for such events – which aren’t always popular with regulated entities. But our policies are necessary to both reduce the risk of a crisis and put the New Zealand financial system in a better position should a crisis happen. We also check that banks are complying with our rules, and we agree with the IMF that we need to put more effort into this. We are looking to build our resources to do so.

The general public hear plenty of noise from these institutions and local commentators as to whether we are doing too much, or too little, too often. The noise is confusing to the non-expert. We get that. The topic is technical, we deal with institutions in confidence at times, and many New Zealanders have not experienced first-hand a financial crisis.

It is our job to plan for the worst without unnecessarily getting too much in the way of business-as-usual activities. To help clarify these issues for any one concerned: when a bank registers to operate in New Zealand they are:

**First**, operating in New Zealand.

This means they must abide by the laws of the land, and these are often different to where they came from. For example, we need the locally incorporated banks to have local directors, who are bound by domestic law and must attest to the bank being sound. These directors should be closest to the bank decision making, and are liable for these decisions.

New Zealand also has a unique set of investor, consumer, tax, and prudential laws that banks abide by. As such, we share our bank insights, where relevant, with the Financial Markets Authority and the Commerce Commission – amongst others – to best ensure all bases are covered.

And, for foreign-owned banks, the risks in New Zealand are different from their home base. This is why we demand that all banks are well capitalised (have a ready financial buffer) to meet unexpected New Zealand outcomes. This level of capital will differ from their home base, because their home base differs.

As a regulator, we cannot own these risks – no regulator is close enough day to day to do so. This is why we do our best to make sure banks

operate transparently in New Zealand, with disclosures that enable their customers, competitors, and all regulators – home and host – to look into key operating metrics of banks.

Our most innovative step in transparency is the pending launch of our Bank Financial Strength Dashboard on 30 May. We implore people to log on and learn about banking, their banks, and their bank's competitors. What capital buffer do they have, can they meet unexpected payments, and are they well rated by other global financial watchdogs?

**Second**, foreign-owned banks have foreign regulators. Banking challenges are similar globally, and global banks have 'home' regulators, making us the 'host' regulator.

There are global guidelines and practices for regulators, which form the basis of our requirements.

We respect and work with home regulators and global guidelines, and we do our best to dovetail with their insights and work priorities. If we don't, we would not be efficient, and we would miss valuable lessons and information.

However, we operate in New Zealand, and just like anywhere else in the world, we will have additional 'host' requirements that supplement the home regulations. These include our director attestations, specific New Zealand legal requirements, capital and other prudential requirements tailored to New Zealand risk, and our transparency rules. The sum of the parts should add to more than the whole if we work well. When we review policies we start with the global and Australian rules, and then ask are there good reasons that we should be different from those rules.

We get measured from time to time on how well we replicate international standards and by extension our home regulators' activities, for example the recent IMF Financial Sector Assessment Programme.

Replicating for its own sake may not be the best fit to New Zealand circumstances. We prefer to understand and assess what home regulators have done, repeat where specifically necessary for New Zealand conditions, and supplement them with relevant New Zealand requirements. So, a tick from the IMF for 'replication' is inferior to a tick for 'supplementing' when it comes to home-host arrangements. We got plenty of ticks for 'supplementing' in the most recent IMF assessment. We deliberately drew a line through some of the replication, where international approaches are not a good fit for New Zealand.

Importantly, no matter how good the co-operation between home and host regulators is in normal times, a significant fissure always crops up between home and host regulators when an important bank fails. Each country needs to be able to manage the impact on their system and minimise the risk of their whole system collapsing.

No foreign government can commit their current or future taxpayers to bailing out foreign country depositors or shareholders. It is untenable politically. This is why we insist on adequate capital (the fence at the top of the cliff) and prepositioned crisis management capability (the ambulance at the bottom of the cliff), so banks can continue to operate in the system, and let the public get on with their business.

The ambulance is called 'open bank resolution', which is supported by other important prudential policies such as New Zealand bank 'standalone' capability for basic banking services.

Third, and finally, when we regulate any licensed entity we need to do so in a manner that is both sound (safe) and efficient (dynamic and competitive).

Our challenge is to balance and explain how we are giving weight to the efficiency side of the equation. And, being equitable across all banks, not just those banks from other jurisdictions.

Our challenge is to ensure everyone gets treated fairly based on their specific activities and risk characteristics – to ensure New Zealanders continue to benefit from a global-class banking system. We are fortunate to have a sound and broadly efficient banking system. We discuss these outcomes in our six-monthly Financial Stability Reports, with the next due on May 30.

Recent bankers' complaints about our activities tend to focus on three issues: NZ-specific capital, the role of attestation requirements, and the need to prove their ability to resolve a bank failure inside the legal and fiscal bounds of New Zealand.

These are all part of doing business here in New Zealand. It is profitable business, and our goal is for consumers to be well served, taxpayers' money preserved, and our financial systems sound and efficient.

Our aspiration is to have the best 'regulator-regulated' relationship in the world built on mutual respect. This doesn't mean we will always agree with regulated entities. What it does mean is we will be clear and consistent on our position, engage with regulated entities in open and responsive manner, and balance soundness and efficiency considerations.

This is our service promise to regulated entities.

All said and done, the effectiveness of all of our efforts rests very much on the conduct and culture of the banks that operate in New Zealand. Culture determines 'how they do things'.

- responsibilities this implies?
- Do banks acknowledge the home-host regulator relationship, giving each appropriate respect? And,

- Are banks willing to compete in both a sound and efficient manner for the long-term - beyond the tenure of a current CEO or Board? This means investing in the people, systems and capabilities needed for a sustainable New Zealand bank business.

In the face of the revelations of the Australian Royal Commission, and working with the NZ Financial Markets Authority, we are asking these conduct and culture questions of New Zealand registered banks.