May 2004
IMF Country Report No. 04/126

New Zealand: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, and Securities Regulation

This Financial System Stability Assessment on **New Zealand** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on April 8, 2004**.** The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **New Zealand** or the Executive Board of the IMF.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

NEW ZEALAND

Financial System Stability Assessment

Prepared by the Monetary and Financial Systems and Asia Pacific Departments

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April 8, 2004

This Financial System Stability Assessment is based primarily on work undertaken during a visit to New Zealand and Australia from October 30 to November 18, 2003. The mission comprised Anne-Marie Gulde-Wolf (mission chief), Paul Kupiec (deputy mission chief), Barbara Baldwin, Matthew Jones, Jodi Scarlata, Antonio Garcia Pascual, and Charmane Ahmed (all IMF/MFD); Abdelhak Senhadji (IMF/APD); Michael Ainley (banking supervision expert, U.K. FSA), Janet Holmes (securities expert, Ontario Securities Commission), and Barry Topf (foreign exchange expert, Bank of Israel). The main findings of the mission are:

- New Zealand has a profitable and well-functioning financial system, operating in a framework of well-developed financial markets. Short-term risks to stability appear low, given the favorable macroeconomic outlook, and sound and transparent financial policies. Stress tests for systemically important banks show resilience consistent with the sector's relatively high levels of capital and profits. Dynamic stress tests involving shocks to agriculture and to external funding show more persistent effects on bank profits, but do not raise systemic concerns.

- New Zealand's approach to banking regulation is based on disclosure and market discipline, and employs limited prudential requirements. The sole supervisory objective is to ensure systemic stability. Given the high share of foreign ownership, home-country supervision may also act as an additional discipline on bank behavior. Notwithstanding the clear strength of the present framework, the Reserve Bank of New Zealand (RBNZ) would benefit from increased real-time knowledge of potential stress in the banking system.

- The absence of a depositor-protection mandate, along with the foreign ownership of all systemically important banks, would pose unique challenges to the RBNZ if a financial crisis were to occur. The high level of Australian bank ownership suggests that the successful management of systemic challenges will also require close cooperation with the Australian authorities. The RBNZ has been reviewing possible crisis management options and has intensified trans-Tasman cooperation in banking regulation and failure management.

- Recent reforms in securities regulation and the restructuring of the New Zealand Stock Exchange (NZX) have strengthened the securities regulatory framework. To fully implement the IOSCO Principles would require: (i) a stronger regime for prevention and detection of market abuse; (ii) a more robust supervisory regime for market intermediaries and collective investment schemes; (iii) improvements to the disclosure regime for issuers; and (iv) stronger public oversight of private sector monitors.

The mission members drafted this report.

FSAPs are designed to assess the stability of the financial system as a whole and not that of individual institutions. They have been developed to help countries identify and remedy weaknesses in their financial sector structure, thereby enhancing resilience to macroeconomic shocks and cross-border contagion. FSAPs do not cover risks specific to individual institutions, such as asset quality, operational or legal risks, or fraud.

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GLOSSARY

APG	Asia Pacific Group on Money Laundering
APRA	Australian Prudential Regulatory Authority
ASRB	Accounting Standards Review Board
BCP	Basel Core Principles
CAR	capital adequacy ratios
CIS	collective investment schemes
ESAS	Exchange Settlement Account System
FATF	Financial Action Task Force
FSA	Financial Services Authority
FSAP	Financial Sector Assessment Program
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standards
ICANZ	Institute of Chartered Accountants of New Zealand
IOSCO	International Organization of Securities Commissions
LoLR	Lender-of-last Resort
MED	Ministry of Economic Development
MFP Code	IMF Code of Good Practices on Transparency in Monetary and Financial Policies
MOU	Memorandum of understanding
NBFI	Nonbank financial institutions
NZD	New Zealand Dollar
NZFOE	New Zealand Futures and Options Exchange
NZX	New Zealand Stock Exchange Limited and/or New Zealand Stock Exchange (as appropriate)
OCR	official Cash Rate
PTA	Policy Targets Agreement
OMO	open market operations
RBNZ	Reserve Bank of New Zealand
RC	Registrar of Companies
ROSCs	Report on the Observance of Standards and Codes
SC	Securities Commission
SDDS	Special Data Dissemination Standard
SFE	Sydney Futures Exchange
SRO	Self-regulatory organization
TP	Takeover Panel

I. Executive Summary and Overall Stability Assessment

1. **The New Zealand financial sector is dominated by institutions that are based in Australia. Supervisory practices are based on a liberal disclosure-based regime, with limited supervisory intervention. The low savings rate creates a large dependency on foreign funding.** In the absence of appropriate controls, these structural features have the potential to engender vulnerabilities.

2. **The favorable macroeconomic outlook, the profitable and well-functioning financial system, and overall sound and transparent financial policies mitigate the aforementioned vulnerabilities, and make short-term risks appear low.** New Zealand's large net foreign indebtedness position owes entirely to private sector borrowings. Its strong sovereign rating reflects prudent fiscal policies and no net foreign-currency debt. The strength of the financial system reduces concerns about the lack of an active supervisory framework. In the medium and longer run, supervisory enhancements are recommended to ensure that an adequate framework to monitor and support financial stability remains in place.

3. The mission's main findings can be summarized as follows:

- The five foreign-owned banks that dominate the financial system are profitable and well capitalized. For these institutions, the discipline of New Zealand's market-based disclosure regime is supplemented by active home country supervision.

- The foreign exchange market has allowed the private sector to manage its foreign exchange risks and secure cover from a diverse set of counterparties under a wide range of market conditions. Foreign exchange hedging is widespread.

- Stress tests show resilience in the banking sector, consistent with the sector's high levels of capital and profits. Significant exchange rate swings and house price declines could be absorbed by all big banks. Dynamic stress test scenarios involving shocks to agriculture and to external funding costs show more persistent effects on bank profits, but do not raise systemic concerns.

- Banking supervision is based on disclosure and market discipline, with the sole objective of ensuring systemic stability. The supervisory regime employs limited prudential requirements, with no active on-site role for supervisors. The benefits of this regime include low compliance costs, greater flexibility for financial institutions, an enhanced role for market discipline, and reduced moral hazard risks. The ongoing strength of the financial system has reduced concerns about the lack of an active supervisory component.

- The absence of a depositor-protection mandate, along with the foreign ownership of all systemically important banks may pose unique challenges for the RBNZ if a financial crisis were to occur. Outsourcing of New Zealand bank operating systems to parent institutions and Australian depositor preference law may complicate crisis management. These risks have been recognized and control measures are being analyzed. Efforts underway to improve cooperation with the Australian authorities are welcome.

- Nonbank financial institutions (NBFIs), while not systemically important, are also profitable. Overseas regulators provide additional supervision for a handful of the largest nonbank institutions, which account for around half of the assets of the sector.

- Securities markets are relatively small, with trading and ownership concentrated offshore. Restructuring of the New Zealand Stock Exchange (NZX) and reforms in regulation have strengthened the regulatory framework, but some gaps remain that may delay early detection and enforcement actions against improper conduct.

Table 1. Principal Recommendations[1]

Issue	Recommendation
Disclosure-based regime	Maintain the quality, scope, and timeliness of disclosure to ensure it continues to meet best international practice.
Importance of independent directors	Fit-and-proper criteria should continue to apply in a comprehensive manner. The RBNZ could offer independent bank directors the possibility of discussing areas of concerns without absolving directors of their statutory responsibilities.
Surveillance	For banks, monitor more regularly liquidity and large exposure early warning indicators. Consider commissioning third-party reports and establish a small specialist team to make focused, on-site visits on particular aspects of credit and operational risk.
Bank resolution and crisis management	Review possible approaches to bank resolution, and the operational and legal consequences that might arise, with a view to establishing internal operational guidelines.
Nonbank supervision	Review practices and resource needs for the government agencies involved in oversight, especially the offices of the Registrar and the Government Actuary, with a view towards enhancing public access to timely and comprehensive data.
Securities markets regulation	Enhance regulatory framework by including minimum standards of conduct for collective investment scheme operators, improving reporting mechanisms, strengthening standards and penalties relating to market abuse, and strengthening oversight of market intermediaries that are not exchange members.

[1] More specific suggestions are discussed at the appropriate places in the main body of the report and in the standards assessments.

II. MACROECONOMIC, FINANCIAL SECTOR, AND REGULATORY CONTEXT

A. Macroeconomic Background

4. **New Zealand has a resilient macroeconomic framework, benefiting from a series of reforms undertaken over the past 20 years.** Key features include a floating exchange rate, deregulated financial markets, far-reaching privatization, a sound and transparent medium-term framework, and an inflation-targeting framework under an independent central bank. These factors, combined with favorable economic conditions, have underpinned New Zealand's strong real GDP growth rate of nearly four percent per annum since 1999.

5. **Within the above framework, New Zealand has, in the recent past, seen significant capital inflows to compensate for persistent low savings rates.** The country has accumulated a relatively high level of foreign debt, and gross debt now exceeds 100 percent of GDP, with the bulk of this being owed by the private sector. Given the conservative fiscal stance, foreign capital inflows are matched by high private sector borrowing from the banking sector. The strong sovereign rating reflects prudent fiscal policies and no net foreign currency debt by the public sector.

6. **Recent macroeconomic conditions have been favorable, even though the continuing appreciation of the New Zealand Dollar (NZD) may dampen external performance.** Strong domestic demand contributed to high-capacity utilization rates, and unemployment reached a 16-year low in 2003. Inflation declined to about 1½ percent in the year to December 2003, reflecting the impact of the currency appreciation. The currency has appreciated by 66 percent against the U.S. dollar and 36 percent on a trade weighted basis between December 2001 and February 2004. The current account deficit is approaching a three-year high of 4½ percent of GDP, reflecting the relatively strong cyclical position of the New Zealand economy and the substantial appreciation of the NZD (Table 2).

B. Financial Sector Context

7. **New Zealand's financial sector and its regulatory environment underwent significant changes over the past two decades.** Previously dominated by publicly-owned banks, which operated in a tightly regulated market, the sector is now almost fully in private, foreign ownership, and the scope of regulation has been radically reduced from that of the mid 1980s. NBFIs and securities markets have declined in importance and are now secondary players, as banks have expanded their range of activities.

The banking sector

8. **The banking sector includes 18 registered banks and, at end-2002, held assets exceeding $NZ 200 billion (about 160 percent of GDP).** Only two smaller banks are New Zealand-owned, including a recently formed retail bank that is owned by the government-owned post office (NZ Post). Ten banks operate as foreign branches, five are local subsidiaries of foreign parent banks, and one is a joint venture between a foreign bank and a local company.

Table 2. New Zealand: Selected Macroeconomic Indicators, 1999–2003
(End of period, unless otherwise stated)

	1999	2000	2001	2002	2003
Total population (million, end-2002)				3.942	
GDP per capita (2002) in USD				16,762	
Real sector					
Real GDP (percentage change)	4.0	3.9	2.7	4.3	3.5
Nominal GDP (in NZD billion)	105.7	112.3	120.5	126.4	133.1
CPI inflation (e.o.p.)	0.5	4.0	1.8	2.7	1.6
Household savings ratio (in percent of disposable income)	4.8	-0.8	-4.4	-3.1	-8.2
Monetary and credit data (change in annual averages)					
Monetary base	19.0	8.9	9.6	9.2	6.6
Money (M1)	19.5	6.9	15.3	12.8	7.8
Broad money (M3)	3.5	3.4	13.5	11.9	6.1
Domestic credit	8.3	8.5	7.6	12.1	5.3
Yield on government bills	5.2	6.7	5.9	5.8	5.4
Yield on government bonds	6.4	6.9	6.4	6.4	5.8
Reference bank lending rate 1/	8.5	10.2	9.9	9.8	9.8
Yield spread, 90-day to 10-year bonds (b. p., end of period)	166	-66	191	13	41
Stock market index (percent change, end of period)	6.8	-13.8	8.0	-5.1	25.6
Public finances (in percent of GDP)					
Central government financial balance (operating balance)	1.5	1.3	1.6	1.7	3.0
Central government net of revaluations and accounting changes	0.2	0.8	1.8	2.2	4.3
External sector (levels, unless otherwise indicated)					
USD exchange rate (end of period)	0.52	0.44	0.42	0.53	0.66
Trade balance (NZD billion)	-0.8	1.4	3.1	0.7	-1.5
Current account (NZD billion)	-6.7	-5.5	-3.1	-4.7	-5.9
Foreign direct investment (Net, NZD billion)	0.6	2.0	3.0	0.4	...
Portfolio investment (Net, NZD billion)	-3.0	-0.7	0.4	1.8	...
Gross official reserves, e.o.p. (USD billion)	4.5	3.9	3.6	4.8	5.1
Reserve cover (expressed in months of imports) 2/	2.5	2.4	2.6	2.3	3.7
Reserve cover (short-term external debt)	17.7	15.9	15.0	13.0	16.3
Total external debt (NZD billion)	102.9	99.9	110.2	108.8	103.9
of which: Public sector debt (NZD billion) 3/	17.4	17.3	16.7	18.5	18.7
of which: Banking sector debt (NZD billion) - loans only	...	60.3	70.6	71.4	76.0
Central bank short-term foreign-currency liabilities (NZD billion) 4/	0.7	1.4	0.7	1.0	0.7

Sources: Statistics New Zealand, RBNZ, New Zealand Stock Exchange, and New Zealand Treasury.

1/ This is a surveyed retail interest rate and represents a “base” lending rate offered to new business borrowers, weighted by each surveyed institution’s total NZ dollar claims.
2/ Imports of goods and services (excluding factor income).
3/ Annual figures for 1998 and 1999, December quarter for 2000–02, June quarter for 2003.
4/ Remaining maturities of one year or less.

Table 3. New Zealand: Financial Soundness Indicators, 1999–2003
(In percent, unless otherwise indicated)

	1999	2000	2001	2002	Jun-03	Sep-03
Banking sector 1/						
Total system assets (NZD billion)	158.4	180.1	189.6	204.5	212.5	...
Total assets of locally incorporated banks (NZD billion)	107.9	116.0	126.7	135.2	142.5	...
Share of system assets in foreign branches	31.9	35.6	33.2	33.9	32.9	...
Capital adequacy 2/						
Tier 1 regulatory capital to risk-weighted assets (weighted average)	7.1	7.7	7.6	8.5	8.6	...
Minimum observed tier 1 regulatory capital to risk-weighted assets	6.5	6.7	6.3	7.1	7.7	...
Total regulatory capital to risk-weighted assets (weighted average)	10.3	11.1	10.7	11.3	11.4	...
Minimum observed total regulatory capital to risk-weighted assets	9.6	9.6	9.5	10.5	10.3	...
Aggregate system equity to aggregate system assets	3.2	2.8	2.7	2.5	2.4	...
Aggregate equity asset ratio for locally incorporated banks	4.6	4.3	4.0	3.7	3.5	...
Asset composition						
Investments as a percentage of total system assets						
Balances with central banks and other financial institutions	4.0	3.9	4.4	3.7	3.8	...
Government bond holdings	1.8	1.7	1.4	1.5	1.3	...
Other trading securities	7.6	6.5	5.9	5.8	5.0	...
Total liquid assets	13.4	12.1	11.7	11.0	10.1	...
Loans, advances and lease finance	77.0	72.9	75.8	75.9	75.9	...
Sectoral distribution of loans to total loans						
Households	47	46	45	45	47	48
Financial sector 1/	7	6	5	6	5	4
Insurance sector 1/	1	0	0	0	0	0
Construction sector 1/	1	1	1	1	1	1
Communications sector 1/	1	0	0	0	0	0
Non-residents 1/	7	11	13	14	13	12
Mortgage loans (residential and commercial) 1/	50	58	56	57	59	59
Aggregate risk-weighted assets to total assets 1/	67	64	65	64	63	63
Asset quality and provisioning						
Aggregate impaired assets to total assets (in basis points) 1/	34.1	30.4	31.7	25.4	28.1	...
Aggregate impaired and past due assets to total assets (in basis points)	47.8	44.8	88.4	53.6	55.7	...
Aggregate total provisions to total assets (in basis points) 3/	43.7	39	36.3	35.3	43.1	...
Aggregate specific provisions to total assets (in basis points) 3/	12.7	10.3	8.1	9.5	8.8	...
Aggregate total provisions to total impaired and past due assets 3/	91.4	87.1	41.1	65.9	77.4	...
Aggregate specific provisions to impaired assets 3/	37.2	33.9	25.4	37.4	31.3	...
Earnings and profitability						
Profit before tax and provisions to average assets	1.5	1.5	1.7	1.9	2.0	...
Profit after tax and extraordinary items to average assets	1.1	1.1	1.1	1.3	1.3	...
Profit after tax and extraordinary items to average equity	22.5	24.0	24.6	26.1	24.2	...
Interest margin	2.4	2.3	2.3	2.6	2.6	...
Noninterest income to total revenues	36.1	37.8	36.7	32.4	32.4	...
Total operating expenses to total revenues	56.9	54.8	48.4	45.5	44.0	...
Funding and liquidity						
Liquid assets to total assets	13.4	12.1	11.7	11.0	10.1	...
Liquid assets to deposits and other borrowings	28.6	26.9	23.7	22.3	19.8	...
Loans, advances, and lease finance to deposits and other borrowings	105.2	105.9	102.2	101.6	100.2	...

Table 3. New Zealand: Financial Soundness Indicators, 1999–2003 (continued)
(In percent, unless otherwise indicated)

	1999	2000	2001	2002	Jun-03	Sep-03
Funding and liquidity (continued)						
Loans, advances, and lease finance to NZD retail funding	192.8	195.5	188.1	186.0	185.0	...
Liabilities to related entities to total liabilities	16.2	19.3	15.5	12.7	11.1	...
Share of total liabilities owed to nonresidents	29.2	31.0	33.9	30.5	29.0	29.3
FX denominated liabilities to total liabilities	21.9	22.5	22.6	18.2	19.4	19.3
Share of FX denominated liabilities owed to related entities	53.5	39.2	47.5	37.5	33.0	33.0
Banking sector sensitivity to market risk						
Avg. peak end-of day interest rate exposure as a share of equity 4/	1.9	1.6	1.5	1.4	1.4	...
Avg. end-of period interest rate exposure as a share of equity 4/	1.5	1.3	1.2	1.3	1.1	...
Avg. peak end-of day FX exposure as a share of equity (b.p.) 4/ 5/	6.8	7.8	6.1	6.2	10.3	...
Avg. peak end-of day equity exposure as a share of equity (b.p.) 4/	0.6	0.6	1.8	1.2	0.6	...
Insurance sector indicators -Life Insurance						
Growth rate of gross premiums written (% change from last year)	3.9	-8.6	-5.3	2.9	...	...
Life Surplus to Total Assets	13.0	12.0	13.9	16.6	...	...
Investment income / Investment assets	9.5	6.4	2.8	-3.1	...	...
Insurance sector indicators - Non Life Insurance						
Growth rate of gross premiums written (% change from last year)	3.8	4.9	-2.2	4.3	...	...
Combined ratio	99.1	100.0	101.3	98.5	...	...
Investment income to investment assets	4.9	6.3	5.5	4.0	...	...
Underwriting profit to net investment income	16.4	-0.2	-18.7	42.6	...	...
Solvency Margin	63.5	61.8	67.2	59.7	...	...
Household sector indicators						
Rate of growth of assets	5.9	1.2	4.6	9.0	...	...
Rate of growth of liabilities	10.5	6.8	8.0	10.0	...	...
Rate of growth of housing value	5.2	1.0	5.2	14.8	...	23.8
Rate of growth of personal bankruptcies	-6.9	-8.6	8.6	-10.4	...	3.8
Net financial assets to disposable income	72.6	67.2	60.8	47.6	...	...
Debt servicing cost to disposable income	8.0	9.1	8.4	9.0	...	9.2
Corporate sector indicators						
Corporate debt to equity ratio	87.9	93.2	96.4	95.0	...	...
Growth rate of company liquidations	-29.7	-22.6	-26.9	-47.2	...	...
EBITDA to interest expenses	248.7	251.8	257.9	325.1	...	...
ROA	4.0	3.7	3.6	4.6	...	...
ROE	9.5	9.5	9.6	12.4	...	...
Current ratio	127.9	121.0	124.3	130.5	...	...

Source: Reserve Bank of New Zealand, Ministry of Economic Development, Statistics New Zealand.

1/ Excludes interbank exposures, NZD claims for residents, all non-resident claims.
2/ Includes only local incorporated banks.
3/ Excludes interbank exposures. June 2003 flow data represent 12 month running totals.
4/ Simple average of order in council market risk measures. June 2003 flow data represent 12 month running totals.
5/ 1998 average excludes one small bank with an extreme reported value.

Table 4. New Zealand: Financial System Structure, 2000–02
(End of period, unless otherwise stated)

	Number			Assets (NZD billion)			Percent of Total Assets		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
Banks	18	17	17	180.1	189.6	204.5	70.7	71.2	73.6
Domestic	1	2	2	1.4	1.7	2.2	0.5	0.6	0.8
Foreign-owned branches	11	10	10	64.2	62.3	69.3	25.2	23.4	24.9
Foreign-owned, incorporated locally	6	5	5	114.6	125.0	133.0	45.0	46.9	47.8
Nonbanks	311	303	290	74.5	76.8	73.5	29.3	28.8	26.4
Managed funds 1/	56	56	56	47.5	47.9	44.4	18.7	18.0	16.0
Life insurance companies	39	40	36	12.4	12.0	10.7	4.9	4.5	3.8
Non-life insurance companies	85	83	75	3.7	4.0	3.5	1.5	1.5	1.3
Finance companies	46	48	50	6.0	7.7	9.2	2.4	2.9	3.3
Building societies 2/	10	10	11	2.4	2.6	2.9	0.9	1.0	1.0
Credit unions	74	65	61	0.4	0.4	0.4	0.2	0.2	0.1
Bonus Bonds Trust	1	1	1	2.1	2.2	2.4	0.8	0.8	0.9
Total financial system	329	320	307	254.6	266.4	278.0	100.0	100.0	100.0

Sources:
Banks - Individual Bank Disclosure statements.
Superannuation - Government Actuary annual report, with 2002 estimated from RBNZ partial survey data.
Managed funds - RBNZ quarterly and annual surveys.
Life insurance companies & Non-life insurance companies - MED, Insurance and Superannuation Unit.
Finance companies - Reserve Bank, Annual Statistical Return and Reserve Bank Bulletin June 2003.
Building societies - Reserve Bank, Annual Statistical Return.
Credit unions - Report of the registrar of credit unions.

1/ Managed funds (superannuation, unit trust, group investment funds, excluding insurance companies): data are funds under management. Include ten large charities as fund managers.
2/ Building societies have added to them the Public Service Investment Society (PSIS), a similar kind of savings intermediary.

9. **New Zealand's banking sector is profitable and well capitalized**. Over the last five years aggregate industry return on assets has exceeded 1½ percent, and after-tax returns on equity have consistently exceeded 20 percent. Capitalization, whether measured by equity-asset ratios or by regulatory capital measures, is above international minimum prudential benchmarks. The aggregate equity-asset ratio of locally incorporated banks is 4.6 percent. Tier 1 regulatory capital adequacy ratios (CARs) are all in excess of 8.5 percent and total CARs are approaching 11.5 percent (Table 3). Among registered banks, the least well-capitalized institution has a Tier 1 CAR of 7.7 percent and a total CAR of 10.3 percent. Impaired assets are low, comprising only slightly more than 0.5 percent of bank assets.

General and specific provisions cover about three-quarters of total impaired and overdue assets.

10. **The banking sector is dominated by five registered banks.** They hold nearly 90 percent of the sector's assets and deposits (Table 4), and earn more than 80 percent of industry profits. One of the five banks operates as a branch of an Australian parent, despite a recently amended rule that is intended to require local incorporation for systemically important banks. The other four banks are subsidiaries of Australian parent banks.

11. **Banks are retail oriented, with mortgage lending amounting to nearly 60 percent of the overall loan portfolio, and have only modest exposures to other sectors.** Agricultural loans are the second most important group, accounting for slightly more than 11 percent of lending. Lending for purposes other than property acquisition may be understated in official statistics, as consumer and small business loans reportedly are often secured by residential property. Given the high share of mortgages, recent increases in house prices have given rise to concerns about a possible reversal of property prices. Banks have argued that risk mitigating factors include the low average loan-to-value ratios of about 60 percent, conservative conditions on new lending (with most lending above a loan-to-value ratio of 80 percent covered by mortgage insurance). Also, there is a substantial increase in the demand for housing due to net immigration and cultural preference for home ownership. Stress tests conducted as part of the Financial Sector Assessment Program (FSAP) (Section III) examine this issue further.

12. **The banking system is funded to a large extent by domestic deposits.** A significant share of the country's capital inflows are, however, borrowings undertaken by the banking sector. About 30 percent of bank liabilities (nearly 50 percent of GDP) are owed to nonresidents (Table 3). About half of the foreign liabilities of banks are to affiliates. About one-third of banks' foreign borrowing is denominated in NZDs, with the rest split between Australian dollars, U.S. dollars, and other currencies, generally swapped back into NZDs. Only a minor share of the foreign borrowing is on-lent in foreign currency.

Nonbank financial institutions (NBFIs)

13. **The nonbank financial sector accounts for only a quarter of financial system assets (Table 4).** Among the different institutions, managed funds—superannuation funds, unit trusts, and group funds—account for the largest share of system assets at 16 percent. Insurance companies account for another five percent of assets, followed by finance companies with three percent of assets. Building societies and credit unions are quite small, with less than one percent of system assets.

14. **The managed funds industry is the most important vehicle for investing household funds outside of the banking system, accounting for $NZ 44 billion in assets at end-2002.** Almost two-thirds of managed funds are invested in unit trusts or group investment funds. Two of the largest funds-management companies are owned by major banks and two by large multinational insurance companies. Private superannuation funds are

also a significant component of the managed funds sector, accounting for $NZ 17 billion in assets at end-2002. However, the removal of tax incentives has reduced the importance of these funds as a vehicle for household savings. A new government-run New Zealand Superannuation Fund was established in 2001 to partially pre-fund the public pension system. At end-January 2004, it had about $NZ 3.1 billion in assets, and is expected to grow by about $NZ 2 billion a year.

15. **The insurance sector in New Zealand remains small relative to other countries.** Measured in premiums per capita, New Zealand ranks only twenty-eighth in the world. Life insurance is dominated by a bank subsidiary and three subsidiaries of major foreign insurance companies, but the remaining four large banks also have life insurance affiliates. The life insurance sector has gradually declined in importance over the past five years, due to competition from other products and institutions. In contrast, the nonlife sector has enjoyed stable growth and now amounts to almost twice the life insurance market by premium income. Two government-run agencies (the Accident Compensation Commission and the Earthquake Commission) provide mandatory workers compensation/accident insurance and earthquake insurance, respectively. These agencies held approximately $NZ 5.9 billion and $NZ 4.1 billion in assets at end-June 2003.

16. **Finance companies, building societies, and credit unions undertake bank-like activities and finance themselves largely by deposit taking.** Finance companies and building societies have grown rapidly in the past five years, but remain small compared to the major banks. Credit unions have declined in size and membership, holding less than one percent of total financial system assets. Finance companies operate in areas not fully covered by the major banks, including household lending (where finance companies provide over a third of consumer credit); higher-risk property lending; and vehicle, plant, and machinery leasing. Building societies concentrate on deposit taking and property lending only. The largest finance company is a subsidiary of one of the major banks; most others are privately held. The sector is profitable, with returns on equity above 20 percent for the sector as a whole, and returns on assets of around 2 percent. Building societies, which are member-owned, are also profitable but lag behind banks and finance companies, with returns on equity averaging nine percent for the last three years and return on assets averaging about 0.75 percent.

Securities markets

17. **New Zealand equity markets are comparatively small with market capitalization of about 44 percent of GDP.** Reflecting a preference for property investment, ownership of New Zealand-listed equities remains mostly in the hands of offshore investors and domestic institutional investors, with only about one-fourth held directly by households. Securities market intermediaries include share brokers, futures dealers, investment advisers, and managers of collective investment schemes (CIS). The New Zealand Stock Exchange (NZX) is the country's only registered securities exchange and was demutualized in December 2002. Efforts are underway to increase access by small- and medium-size enterprises (SMEs), including the recent launch of a new market with listing standards tailored to SMEs. The

parent corporation of the New Zealand Futures and Options Exchange (NZFOE)—the only futures and options exchange in the country—has announced that trading in NZFOE products will be transferred to Australia in 2004.

C. Supervision and Regulation

18. **New Zealand regulators do not carry any duty to protect individual depositors or policyholders, or to safeguard individual institutions, unlike many other jurisdictions**. There is no official deposit protection or policyholder protection scheme. The New Zealand supervisory and regulatory framework was introduced as a component of the financial sector reforms initiated in the 1980s, while much of the current nonbank regulatory framework, particularly in relation to securities markets, was established in the 1970s.

The banking sector

19. **The current supervision framework is built around three main pillars: self discipline, market discipline, and regulatory discipline**. A cornerstone of the self-discipline component is a requirement that directors attest quarterly that their bank's risk-management systems are adequate, and that they are being properly applied. This procedure reinforces self discipline and reduces complacency by threatening civil and criminal penalties in case of noncompliance and by exposing directors in the event of misleading or adverse disclosures. Market discipline is promoted through the issuance of quarterly disclosure statements on the bank's financial condition, risk profiles, and risk-management policies. Market discipline is reinforced by the absence of deposit insurance, and a cultural ethos of "buyer beware." The disclosure requirements and associated audit requirements are meant to ensure that higher-quality data is provided to creditors and investors on a more frequent basis than would otherwise be the norm. Finally, regulatory discipline is enforced through the application of various prudential requirements by the RBNZ, which is charged with licensing and supervising registered banks.

20. **The RBNZ has a range of enforcement powers, and complements self- and market discipline with off-site reviews and high-level discussions with banks**. Activities include regular RBNZ scrutiny of all quarterly disclosure statements, maintenance of active working relationships with banks through annual consultation with senior management, as well as through more informal contacts, regular meetings with other bank regulators and credit-rating agencies, and annual meetings with the boards of the larger banks. However, the RBNZ lacks a regular or targeted on-site supervision program, even though its Act does provide the necessary powers to do so. Recent legislative changes have expanded the RBNZ's powers in certain areas, including a prior approval requirement for all significant changes in bank ownership. The 2003 amendments to the RBNZ Act have also clarified and expanded the Bank's registration and enforcement powers and obligations.

21. **The RBNZ achieved material compliance with most Basel Core Principles in the assessment of observance, in spite of the special features of the regulatory framework.** Where differences exist, for example, in the monitoring of credit risks, these relate in some

cases to a conscious decision to leave oversight of such risks largely to the market. In other cases, certain risks that are not supervised are not currently relevant to New Zealand.

22. **A second layer of supervision is provided by the home-country supervision of all the systemically important banks and their nonbank subsidiaries**. The parent companies of the local banks have generally imposed their own credit culture and risk-management policies, systems, and procedures on their subsidiaries; such systems have already been vetted by the home-country supervisor and are designed to meet its prudential requirements. Home supervisors also conduct periodic on-site visits. The RBNZ has signed memoranda of understanding with the Australian Prudential Regulation Authority and the U.K. Financial Services Authority. The RBNZ maintains regular contact with foreign authorities, but does not participate in on-site work nor does it receive supervisory reports sent to home-country regulators.

Nonbank financial institutions and securities markets

23. **Oversight of much of the nonbank sector and securities markets is indirect**. Reliance is placed upon a combination of market disclosure, rating agency assessments, monitoring activities of self-regulatory organizations, trustees and auditors, and licensing and registration requirements for certain categories of institutions.

24. **For both the nonbank financial sector and securities markets, substantial reliance is placed on self-regulatory organizations, trustees acting as private monitors, and on the auditors of financial statements to ensure the provision of accurate information**. Additional oversight is provided by regulators outside of New Zealand for a handful of the largest institutions (which account for over half the sector's total assets), because they are subsidiaries of large multinational banks or insurance companies. A large number of NBFIs are not monitored by an overseas regulator or an exchange, since they are domestically owned. While none of them is systemically important, the failure of any of the larger nonbank institutions could nevertheless have a significant impact on market stability through negative reputational effects on other institutions.

25. **The Ministry of Economic Development (MED) is the main regulator of nonbank institutions through its various business units, including the Registrar of Companies and the Government Actuary.** The MED has a role in ensuring compliance with applicable laws for insurance companies, superannuation funds, building societies, and credit unions, and to a more limited extent finance companies and managed funds. The legal framework grants it some enforcement powers, including the ability to: (i) compel the entities they regulate to provide additional information, as deemed necessary to facilitate oversight and keep investors informed; (ii) appoint auditors; (iii) suspend registration; and (iv) place companies in statutory management or liquidation. Despite these powers, ongoing oversight, including review of periodic financial reports, is limited for some sections of the nonbank sector.

26. **For the securities sector, the principal regulator is the Securities Commission, while the Takeovers Panel and Registrar of Companies have more narrowly defined mandates**. The principal elements of the securities regulatory framework are: initial and ongoing disclosure requirements for public issuers, including collective investment schemes; entry standards and oversight of some market intermediaries (principally exchange members); supervision of most collective investment scheme operators by trustees and private supervisors; regulation of takeovers; and certain restrictions on abusive conduct in secondary markets. For securities markets, the NZX and the NZFOE establish and monitor prudential standards and rules for the conduct of trading on the exchange, including disclosure requirements. Most other market intermediaries, however, are subject to minimal or no regulatory supervision. This includes, most notably, investment advisors.

27. **The government, securities regulators, and NZX are taking steps to raise the quality of securities regulation to high international standards**. To date, the government has provided sufficient funding to the Securities Commission and the Takeover Panel to enable them to fulfill their responsibilities. Management of NZX is investing in its regulatory functions and it cooperates with the Securities Commission and the Takeover Panel in addressing regulatory concerns in areas of shared responsibility. Overall, the main government regulatory agencies, MED, Securities Commission and the RBNZ, seem well coordinated and maintain close contacts that enable them to monitor issues relating to cross-linkages between NBFIs and banks. However, some gaps remain in the regulatory framework. These gaps may make it more difficult for securities regulators to detect incompetent or fraudulent conduct at an early stage and, in some instances, to take effective enforcement action. The government and securities regulators are aware of these weaknesses, are familiar with the relevant international best practices, and intend to carry out significant reforms in the next few years.

28. **New Zealand's observance of the Financial Action Task Force (FATF) Principles for Anti–Money Laundering and Combating the Financing of Terrorism (AML/CFT) is being assessed by a team from FATF and the Asia Pacific Group on Money Laundering (APG).** Field work has been completed, and the ROSC from the assessment will be circulated to the Board once it is completed.

III. Short-Term Stability Issues

29. **In all areas of short-term stress considered, the exposures of the New Zealand financial system appear well-contained.** Systems are in place to ensure an adequate response if stresses were to occur.

A. Stress Testing the Financial System

30. **In preparation for the FSAP, the RBNZ coordinated a stress-testing exercise among the five systemically important banks.** Stress tests were undertaken by banks and results were aggregated by the RBNZ. The mission did not have access to individual bank data.

31. **The stress tests focused on risks judged relevant to the New Zealand market (Table 5).** Stress testing of the Australian parent groups of New Zealand banks was beyond the scope of the New Zealand FSAP. Available data suggest that Australian banking groups are profitable and well capitalized, with the New Zealand operations accounting (on average) for less than twenty percent of group assets or profits. The mission reviewed the publicly available reports on APRA's stress tests of these groups, which focused on Australian property price risks and found these risks to be manageable. Risks perceived most important to New Zealand bank operations at this stage include significant changes in exchange rates, New Zealand interest rates, property prices, and the price of agricultural output. The stress test also included two dynamic macroeconomic scenarios, one based on the outbreak of foot-and-mouth disease, a scenario that would lead to a significant shock to agricultural output and far-reaching repercussions on the economy at large. A second scenario simulated a sharp increase in the cost of foreign funding for New Zealand banks.

32. **The results show a high degree of resilience of the banking system.** Market-risk shocks applied to bank trading books (which were large shocks compared to historical experience) produced only small losses, given the small size of the bank's trading book (Table 6). A maximum loss for one bank of less than 15 percent of pre-tax profits emerges if nominal New Zealand interest rates were to increase by 300 basis points, and bank positions were all fixed at their most disadvantageous internal risk management limit. Results of the credit-risk scenario, involving a 20 percent decline in property prices and some decline in household income, would differ depending on, among other factors, portfolio concentration on commercial property. The worst individual bank loss estimate would be below half of the bank's March 2003 annual pre-tax profits. These results are, in part, due to the characteristics of bank mortgage portfolios in New Zealand, including a 60 percent average loan-to-value ratio, and several contract features that allow homeowners to remain current on their loans while facing temporary unemployment and reductions in income.

33. **Results of the foot-and-mouth scenario suggest it would not pose a risk to the solvency of the major banks.** The dynamic scenarios are based on macroeconomic assumptions provided by the RBNZ (Table 8). Results of these dynamic stress tests are summarized in Figures 1 and 2. For the foot-and-mouth scenario, such a shock would impose a modest but long-lasting drag on the profitability of systemically important banks. These banks' direct exposures to the agricultural sector are contained, and the exchange rate depreciation associated with the scenario bolsters the profitability of other export industries. In mission discussions, banks offered the opinion that the stress scenario assumptions were perhaps too optimistic, and that a serious outbreak of foot-and-mouth disease might have more wide-ranging effects than anticipated in the RBNZ simulations.

Table 5. Sensitivity Stress-Test Scenarios

Scenario	Market-Risk Scenarios
	Exchange Rates
1	30 percent depreciation of the New Zealand dollar relative to all other currencies
2	30 percent appreciation of the New Zealand dollar relative to all other currencies
	Interest Rates
3	300 basis point increase in interest rates across the NZ yield curve
4	300 basis point increase in the long end (5+ years) of the NZ yield curve, short rates unchanged
	Credit-Risk Scenarios
Scenario	*Commodity Prices*
1	A decline in the dairy payout to $2.50/kg for two consecutive years
	Property prices and economic weakness
2	20 percent decline in residential property prices, with unemployment rising from 5 to 9 percent, and households' real disposable income falling by 4 percent
3	20 percent fall in commercial property prices, 20 percent fall in corporate earnings

Source: RBNZ.

Table 6. Market Risk Results [1/]

Shock	Average Loss as a Percent of 2003 Profits 2/	Largest Individual Bank Maximum Risk Loss as a Percent of 2003 Profits [2/]
Assuming Typical Bank Exposure		
1	1.98	2.75
2	-1.00	0.39
3	2.75	3.82
4	0.43	0.91
Assuming Worst Case Exposures		
1	3.80	8.60
2	-0.70	2.80
3	6.20	14.40
4	3.60	7.10

Source: RBNZ.

1/ Negative numbers represent gains.
2/ Actual reported annual pre-tax profit for the 12-month period ending in March 2003.

Table 7. Credit Risk Results

Year	Average Cumulative Loss as a Percent of 2003 Profits 1/	Largest Individual Bank Loss as a Percent of 2003 Profits 1/
	Credit Shock 1	
1	3.09	8.33
2	4.35	11.38
	Credit Shock 2	
1	8.31	15.84
2	18.78	32.56
3	28.39	44.11
	Credit Shock 3	
1	1.90	3.46
2	6.63	10.79
3	9.76	19.50

Source: RBNZ.

1/ Actual reported annual pre-tax profit for the 12-month period ending in March 2003.

Table 8. Model Assumptions

Foot-and-Mouth Disease Scenario Assumptions
80 percent decline in meat exports
20 percent depreciation of the New Zealand dollar against all other currencies
50 basis point increase in the risk premium for New Zealand dollar denominated assets
A decline in the long-term capital/output ratio and net foreign assets.
Increase in Offshore Funding Costs
A depreciation of the New Zealand dollar by 40 percent
An increase of short- and long-term interest rates to 18–20 percent
A permanent increase in the risk premium on New Zealand dollar-denominated assets

Source: RBNZ.

34. **The results of the funding-costs-stress scenario show greater potential for loss.** Bank profitability falls in the early quarters of this scenario as market risk and banking book losses are generated from a rise in interest rates and the sharp depreciation of the NZD. Eventually, higher interest rates generate greater interest revenues as credits mature and are

repriced, but the rate rise and the weak economy cause a rise in residential mortgage defaults, particularly on mortgages associated with investment properties. Lending to commercial property developers is also expected to generate losses, yet the losses to the banking sector will be attenuated by the losses that will be absorbed by mezzanine creditors, primarily finance companies and contributory mortgage companies. While banks suffer depressed profits, the results do not suggest that any bank's capital position would be endangered by this scenario.

Figure 1. Foot and Mouth Disease Scenario

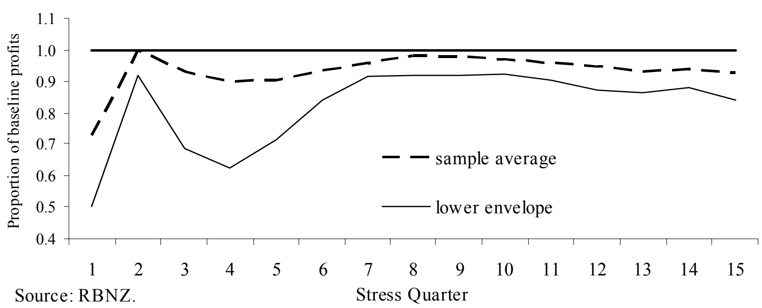
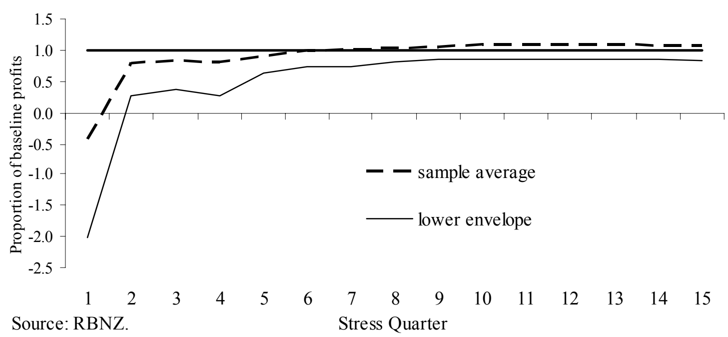


Figure 2. Funding Shock Stress Scenario



B. Nonbank Financial Institutions

35. **The NBFIs are small in comparison to the banking system, but are able to offer a wide range of financial products similar to those offered by banks**. NBFIs are subject to prospectus and investment statement requirements under the Securities Act. However, NBFIs are not subject to quarterly disclosure and directors' attestations as required of banks. As a result, there is little timely quantitative information that is readily available to depositors and market participants. Most NBFIs are only required to report their financial results on an annual basis, and often with a substantial reporting lag, although additional disclosures are

required if there have been material adverse developments since the date of the most recent prospectus. Furthermore, the government entity largely responsible for collecting this information, the MED, has only limited capacity to compile and aggregate the relevant data.

36. **The main NBFIs are affiliates of the major banks or multinational financial groups and benefit, to some extent, from the regulation imposed on their parents**. However, the lack of timely and comprehensive disclosure of individual and aggregate data for the sector potentially reduces the effectiveness of market discipline. It may also hamper effective early intervention, should significant problems in the sector develop which, given ownership links and similar business practices, have the potential for direct or indirect spillover effects on banks. Efforts to coordinate and strengthen data collection and disclosure would help regulators, market participants, and depositors to have a more accurate and timely picture of developments in the sector.

C. Foreign Currency Exposure and Functioning of Exchange Markets

37. **The stability of the financial system could be sensitive to a number of foreign-exchange-related issues, due to high dependence on international trade and capital flows.** These include the management of exchange rate risk, access to overseas funding, and the liquidity of the foreign exchange market. Appropriate risk management and well functioning markets indicate, however, that short-term risks related to foreign exchange at this time seem contained.

Foreign currency exposure

38. **Exchange rate risk in New Zealand is well understood and managed actively by banks and other market participants**. Markets have coped successfully with considerable volatility in the exchange rate. From January 1997 to November 2000, the New Zealand dollar depreciated by about 45 percent against the U.S. dollar, and it subsequently appreciated by 73 percent by February 2004. As a result, banks require the adoption of hedging policies when considering applications for loans by corporations. A very high percentage of foreign-currency-denominated overseas debt is hedged: over 96 percent in the banking sector and 78 percent in other sectors, thus greatly reducing balance sheet risks. Approximately 70 percent of the hedging is done using financial contracts with the remainder naturally hedged against foreign exchange assets or receipts. Operational foreign exchange risk is also very conservatively managed with large exporters consistently hedging receivables and forecasting receipts over their planning horizon. The public sector has no net foreign-exchange-denominated debt.

39. **There is little evidence of major residual NZD exchange rate risk remaining for the country**. Exchange rate risk is frequently intermediated separately from the credit risk (via the derivative markets) and often passes through a number of intermediaries, with market participants themselves unaware of the end-recipient. New Zealand institutions and statistical services do not attempt to identify market participants in any systematic fashion, and thus it is difficult to determine the ultimate bearer of NZD risk. However, the following

factors seem to mitigate any possible risk for New Zealand: (i) counterparties to hedges seem to be varied, but all of them are nondomestic entities, including foreign households and retail investors, overseas insurance companies and fund managers, and international currency overlay investors and hedge funds; (ii) market participants appear to be widely dispersed geographically and are relatively numerous, so the risk is not overly concentrated in one country or type of investor; and (iii) the demand for New Zealand dollar risk appears to be fairly steady over time, as evidenced by the ability to hedge New Zealand currency risk consistently over time and in a large variety of market conditions, and the fact that almost half of New Zealand's international financial liabilities are denominated in domestic currency.

Foreign exchange market

40. **The foreign exchange market in New Zealand functions efficiently and provides a reasonable degree of liquidity, commensurate with the size of the New Zealand economy.** Seven banks are currently market makers in the NZD, and most trading now takes place outside of New Zealand—primarily in Australia, but also in London and New York. In April 2001, average daily trading volume in Australia and New Zealand was approximately $NZ 2.8 billion in the spot market and $NZ 13 billion in the swap market. There are indications that trading volumes have declined, possibly substantially, since then. Trading spreads are similar to those of other comparable currencies. Settlement risk is present but will be greatly reduced when the New Zealand dollar becomes eligible for inclusion in the Continuous Linked Settlement (CLS) Bank, currently expected by end-2004.

41. **The RBNZ maintains limited liquid reserves (approximately $NZ 4.3 billion) and the technical capability to intervene in foreign exchange markets, although it has not intervened since 1985**. This framework provides a limited safety net, as it would allow the bank to intervene in order to restore liquidity to a severely disrupted FX market, reducing possible systemic risks for the New Zealand economy. The RBNZ has recently recommended to the Minister of Finance that the RBNZ, as one of its policy implementation tools, should have the capacity to intervene to influence the level of the exchange rate when the rate was "exceptionally and unjustifiably" high or low.

D. Money and Bond Markets

42. **The money market in New Zealand consists of a range of short-term debt instruments, including treasury bills, bank bills, and commercial paper, together with a variety of derivative financial instruments, such as bank bill futures, interest rate swaps and options, and forward-rate agreements**. Secondary markets for most instruments exist, with the market for bank bills and their futures being the most liquid. The secondary market for treasury bills and commercial paper is much less liquid because investors tend to hold these instruments until maturity. Trading activity is dominated by five or six of the major banks and three brokers.

43. **New Zealand bond markets are dominated by government bonds, with around $NZ 21.8 billion outstanding**. Government bonds are the most liquid instrument, with daily turnover in the secondary market around $NZ 3 billion, mostly in repo transactions. The bonds are issued through the New Zealand Debt Management Office, a branch of the New Zealand Treasury, with the RBNZ acting as agent. There are about 10 active bidders in the regular tenders, held approximately 12 times a year. In the secondary market, there are seven price makers and three active brokers. The larger corporates, banks, and state-owned enterprises with investment-grade credit ratings issue corporate bonds, mostly by tender or private placement. At present, there are around $NZ 7.2 billion outstanding for approximately 30 issuers, mostly with maturities of three to seven years. Most issues are illiquid. There is also a relatively large market in Eurokiwi bonds (presently around $NZ 11.9 billion outstanding), which are denominated in NZD and offered by offshore entities to investors outside of New Zealand.

E. Systemic Liquidity Provision

44. **The RBNZ is actively involved in liquidity management through its daily open market operations (OMO), including foreign exchange swaps**. It also has a range of standing facilities, in the context of the overnight interest rate target (the Official Cash Rate or OCR). The interbank market for overnight funds appears to function well, with most banks able to meet their liquidity needs either from other market participants through secured and unsecured lending or from the daily injection of funds through OMO. Market frictions occasionally occur when there are imbalances in holdings of government bonds (such as one bank accumulating a large position in cash or government securities). In these circumstances, banks prefer to pay a penalty rate (of 25 or 30 basis points above the OCR) to the RBNZ for the use of its standing facilities. This is in preference to paying banks holding surplus liquidity a rate at or above the OCR when secured with government securities, and depart from the market convention of settling transactions at the OCR rate. The repeated nature of transactions in a small market with a limited number of players seems to promote the maintenance of this convention.

45. **The RBNZ appears to have sufficient information to be able to detect and respond to any short-term liquidity difficulties should they arise**. The RBNZ has frequent contact throughout the day with market participants and collects information on a daily basis on interbank lending positions. The RBNZ also monitors transactions in the payment system for signs of settlement difficulties.[2] However, the fact that the market does not always clear because of stickiness in the price raises issues about how the market might react to disruptions in interbank markets. The standing facilities in place provide a convenient mechanism for banks to acquire liquidity from the central bank in the event of market

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[2] The mission did not undertake an assessment of the payment system. The RBNZ did provide a detailed self-assessment of the Core Principles for Systemically Important Payment Systems, which did not indicate any major deficiencies.

frictions. The RBNZ has adequate powers under the Reserve Bank Act to provide lender-of-last-resort (LoLR) facilities, but since the revision of the Reserve Bank of New Zealand Act in 1989, the RBNZ has not provided emergency liquidity support to any institution. The RBNZ is presently reviewing its internal policies relating to LoLR facilities in connection with efforts to formalize crisis management approaches.

IV. MEDIUM-TERM AND STRUCTURAL ISSUES

46. **The ongoing changes in the financial sector landscape and ownership patterns imply a need to reinvigorate the regulatory and operating framework to keep it up-to-date**. Adaptations may be called for in several areas. First, the regulatory approach may leave the RBNZ and other regulators at times without the optimal level of information to make informed judgments about systemic issues. Second, there are open questions regarding how a financial crisis might be addressed. Finally, increased financial interdependence with Australia and other financial centers may need to be more explicitly acknowledged in the formulation of the regulatory framework.

A. Banking Supervision

47. **New Zealand led the way in disclosure when it was first introduced, and it achieved a high degree of financial sector stability within this framework.** Since that time, international best practices for disclosure have evolved and, in some instances, have surpassed practices in New Zealand. Disclosure remains a valuable discipline on banks, and New Zealand's banking system is more transparent than many others. However, the information disclosed in the quarterly statements could be enhanced to provide more effective market discipline. Disclosure statements do not appear to be widely used at the retail level, and are not sufficiently comprehensive or timely to be used by wholesale counterparties for assessing creditworthiness, nor for some supervisory judgments. It would, therefore, be appropriate to review the contents of the statements and supplement them with focused, prudential information directly for the supervisor. The RBNZ might benefit from having its own set of early-warning indicators, which should include, inter alia, information on individual bank liquidity and large exposures.

48. **There are almost no independent supervisory checks on banks' systems and controls, aside from external auditors' checks.** This reflects the current regulatory philosophy, but such checks need not be overly intrusive, if properly focused. They can also add value, both in identifying incipient weaknesses in individual banks and by enabling the RBNZ to draw best-practice lessons for the banking system as a whole. The RBNZ might consider commissioning third-party reports and establishing a small, specialist team in-house to make focused, on-site visits on particular aspects of credit and operational risk.

49. **Directors play a critical part in the New Zealand approach to banking supervision.** It is therefore important that the fit-and-proper criteria be kept under review and the vetting process be sufficiently thorough. The role is demanding, and independent

directors might benefit from more regular communication with the RBNZ, perhaps at an annual meeting to review developments and any issues they might have.

B. Crisis Management

50. **New Zealand's regulatory philosophy and the absence of depositor protection, in conjunction with the almost fully foreign-owned banking system, would pose particular challenges if a banking crisis were to emerge.** Key concerns for crisis resolution include: (i) the ability of the RBNZ to act as an LoLR; (ii) foreign bank branches being systemically important; and (iii) subsidiaries of foreign banks, while having legal standing, being unable to be economically viable on their own.

Lender-of-last-resort powers

51. **Under the Reserve Bank Act, the RBNZ is required to act as an LoLR when needed to ensure the soundness of the financial system.** In formulating its LoLR policies, the RBNZ has specified that it would only provide credit to an institution whose solvency is not in material doubt, after the institution had fully exhausted market sources of liquidity, and where it is necessary to maintain the stability of the financial system.

52. **The RBNZ's monitoring may not provide sufficient information at the onset of a sudden crisis situation.** The information that would be used by the RBNZ to independently determine an institution's eligibility for LoLR operations have not been formally articulated. The RBNZ may not have access to sufficiently timely and detailed supervisory data that could be utilized to make a speedy judgment about an institution's solvency. The RBNZ can request further information from a bank under Section 93, but a response may take significant time. The present LoLR system relies heavily on directors' or parent-banks' attestations as to the solvency of a New Zealand bank operation. The RBNZ may wish to consider again whether additional or more timely information might help it reach a better judgment on solvency in a crisis situation.

Problem bank resolution policies

53. **The RBNZ approach to banking supervision and the dominance of foreign institutions in the financial system may complicate bank resolution, especially in the case of systemically important institutions.** The "hands-off" supervisory approach and reliance on disclosure requirements may delay detection of emerging problems, thus lengthening supervisory response time in a crisis. Furthermore, the range of remedial actions that the RBNZ can take in response to a bank in difficulties is complicated for foreign branches by legal uncertainties surrounding which assets and liabilities would be subject to statutory management control. For a foreign-owned subsidiary, the dependence on the parent bank can present difficulties in determining the true condition of the bank, and could also give rise to cross-jurisdictional issues and other delays. These issues are particularly acute for New Zealand, because all of the systemically important banks are foreign-owned.

54. **To enhance financial stability, the RBNZ has been reviewing a range of alternative policy options, including a specific open-bank resolution policy based on recapitalization by creditors.** The RBNZ has been conducting feasibility studies and is attempting to clarify IT-related and other issues, with a view to making it operational. The options to effect a bank resolution could include other alternatives such as a government bail-out, a recapitalization with loss sharing between the government and depositors, orderly liquidation, or a "lifeboat" rescue by the banking industry. The RBNZ's bank resolution policies are not yet fully defined and warrant further assessment, in the context of the overall range of options available to address bank failures and resolution.

C. Cooperation with Australia

55. **The recent increase in Australian ownership of banking assets has raised the awareness of the high degree of interdependence between New Zealand and Australia's banking systems.** Specific concerns about this interdependence include: (i) loss of control over systems and functions; (ii) effects of Australian depositor protection on New Zealand depositors; and (iii) regulatory harmonization between both countries. All issues are under review by the RBNZ and are actively discussed with Australian counterparts; however, the dialogue may need to be intensified to achieve satisfactory progress in a reasonable time frame. In parallel with these discussions, the RBNZ is working on stand-alone policies regarding local incorporation, director attestations, and outsourcing, in recognition of the need for more immediate responses to certain developments.

56. **Closer integration of foreign-owned banks and other financial institutions has led to increasing outsourcing of IT and management functions to parent companies**.[3] Such outsourcing has been driven by efficiency considerations and occurred both in subsidiaries and in branches of foreign banks. The RBNZ estimates that at least half of the banks operating in New Zealand are no longer operating as separable entities, given that account and back-up information may not be readily available on site in New Zealand or in an accessible back-up site. While this will not be a concern in normal times, it will be a serious impediment to the RBNZ's actions in case of a systemic crisis.

57. **To avoid further "hollowing out" of core functionality, the RBNZ is working with banks on assessing where core functions are being located.** It plans to use the conditions of registration to ensure that necessary management skills and back-up sites are available in New Zealand. Preliminary discussions of the issue have taken place with the Australian regulators, but further contact and a coordinated response to "third-party outsourcing" might be necessary. The RBNZ might also want to consider increasing its systematic knowledge about the core functionality of the New Zealand banks through a targeted audit of banks.

[3] Parent companies themselves have also outsourced some services, possibly beyond the full reach of the home-country regulator.

58. **A second concern for the New Zealand authorities relates to the possible effects of the Australian depositor-preference scheme and its possible negative effects on New Zealand depositors in case of a crisis.** The Australian depositor-preference scheme prescribes priority of Australian depositors over assets in Australia in the case of a bank resolution. The issue is of particular concern in the case of one systemically important bank operating as a branch of an Australian bank, as the parent bank may be able to shift assets easily to Australia. However, there are also concerns that interbank-lending operations might make it possible for banks operating as subsidiaries to concentrate assets in the home country to the detriment of New Zealand depositors. The connected lending limits imposed by the RBNZ may reduce the risks associated with asset shifting, and the RBNZ is also discussing the issue with the Australian authorities, but the issue remains.

59. **Banks in New Zealand are effectively subject to home- and host-country regulations**. Given the more "hands-on" approach pursued by the Australian regulators, the additional compliance requirement for New Zealand banks arises mainly in the preparation of quarterly rather than six-monthly disclosure statements. There are also some differences in capital adequacy requirements, and the RBNZ also imposes additional requirements concerning connected lending limits. Going forward, though, as the regulatory regime changes, issues could arise; for example, with regard to Basel II where New Zealand plans to implement the standardized approach and Australia plans to adopt the internal ratings-based approach. The extent and possible implications of such reforms should be discussed among regulators before a final decision on new regulation is made.

OBSERVANCE OF STANDARDS AND CODES—SUMMARY ASSESSMENTS

Summary of Assessments of International Standards and Codes

Basel Core Principles for Banking Supervision (BCP)

New Zealand has a unique regulatory system, but has nevertheless achieved a significant degree of compliance with the BCP.

- Supervision is conducted mainly through disclosure, director attestation, and more frequent external audit requirements, but there are also key prudential requirements on capital, on connected lending, and on the composition of bank's boards of directors.
- There is a general consensus among industry participants that director attestations have instilled a strong discipline with respect to oversight of a bank's risk-monitoring and management systems.
- With respect to principles addressing credit (CP 7) and risk management (CPs 12 and 13), a primary reliance on disclosure and director attestation allows information gaps that may compromise the RBNZ's ability to detect or anticipate incipient problems.
- On other principles, including those addressing acquisitions or investments by banks (CP 5), large exposure limits (CP 9) and onsite supervision (CP 16), there is limited RBNZ intervention; creating actual or potential gaps that could undermine the effectiveness of its supervision program.
- The RBNZ's role in anti-money laundering (AML) needs to be clarified; its hands-off approach in the AML area creates significant vulnerabilities in an environment where the relevant government agencies are underresourced and their respective roles still ill-defined. Responsibilities for AML duties should be clearly assigned by mutual agreement between the relevant agencies.

IOSCO Objectives and Principles of Securities Regulation

Recent changes in securities regulation and the restructuring of NZX have strengthened the regulatory framework. Further reforms are planned.

- Securities regulators and NZX are making good use of their powers. In particular, the broad inquiry and information-sharing powers of the Securities Commission, combined with its new enforcement powers, have enabled it to work with other authorities to deal with many of the investor protection concerns that have arisen. However, some gaps remain in the regulatory system.
- NZX exercises important regulatory functions, supervising two of the most important classes of participants in organized markets (NZX share brokers and listed companies). It has made significant investments in regulation since its demutualization. The Securities Commission is encouraged to develop a program for monitoring the NZX's continued operational capability and fitness to perform these functions.
- While securities and futures dealers that are exchange members are subject to high entry standards and ongoing oversight, most other categories of market intermediaries are subject to little or no oversight.
- Minimum standards of conduct for collective investment schemes operators and better reporting mechanisms would enhance the ability of trustees and private supervisors to monitor collective investment scheme operators.
- There are some weaknesses in standards and penalties relating to market abuse; however, draft legislation to address these matters is expected in 2004.

Code of Good Practices on Transparency in Monetary and Financial Policies

- The RBNZ exhibits a high degree of transparency in all aspects of its conduct of monetary policy and banking supervision. The objectives, responsibilities, accountability structures, and transparency obligations are specified in legislation. The RBNZ issues a wide range of material on a timely basis to explain its performance, including the quarterly *Monetary Policy Statement* and *Bulletin*, post-election briefing papers, and website. The RBNZ issues an annual report and financial statements, which are subject to external audit and publicly disclosed.
- There is a high degree of transparency in the securities regulatory framework, but its complexities could be better explained. Each regulator should include on its website a common description of the securities regulatory regime, outlining its respective roles, responsibilities and interrelationships, with relevant links across agencies' sites.

Anti-Money Laundering and Combating the Financing of Terrorism

- A team from the Financial Action Task Force (FATF) and the Asia Pacific Group on Money Laundering (APG) is assessing observance of FATF's Principles for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT). A summary assessment will be forwarded separately to the Board when completed.

SUMMARY ASSESSMENT OF OBSERVANCE OF THE BASEL CORE PRINCIPLES[4]

A. General

60. **This assessment of the Basel Core Principles for Effective Banking Supervision (BCP) was conducted during October and November 2003 onsite in New Zealand**. The BCP assessment was undertaken within the framework of the FSAP for New Zealand.

61. **The assessment is based on several sources:** (i) a comprehensive self-assessment by the New Zealand authorities; (ii) detailed interviews with staff from the Reserve Bank of New Zealand; (iii) laws, regulations and other documentation on the supervisory framework and on the structure and development of the New Zealand banking sector; (iv) interviews with staff from the Australian Prudential Regulatory Authority; and (v) meetings with officers and directors of individual banking institutions as well as with members of the auditing profession. The assessors benefited from the full cooperation of the New Zealand authorities and received all necessary information.

62. **The New Zealand financial system is dominated by the banking sector, which comprises 18 registered banks holding assets exceeding $NZ 200 billion (about 160 percent of GDP).** The banking sector is, in turn, dominated by 5 systemically important institutions, all Australian-owned, holding nearly 90 percent of the sector's assets and deposits. Only two, smaller banks are New Zealand-owned, including a recently-formed retail bank that is owned by the New Zealand Post Office which enjoys an explicit guarantee from its parent. This is the one exception to the strong "free-market" approach generally espoused by the authorities.

63. **New Zealand's banking sector is profitable and well-capitalized.** Over the last five years, aggregate industry return on assets has exceeded 1½ percent, and after-tax returns on equity have consistently exceeded 20 percent. Capitalization, whether measured by equity-asset ratios or regulatory capital measures, is above international minimum prudential benchmarks. Impaired assets are low, comprising only slightly more than 0.5 percent of bank assets. General and specific provisions cover about three-quarters of total impaired and overdue assets.

64. **The general preconditions are substantively met**. New Zealand accounting standards, for example, are consistent with international best practice and New Zealand has announced its intention to adopt International Accounting Standards (IAS) with effect from January 1, 2007. There will be scope for early adoption from January 1, 2005.

65. **The legal framework for bank supervision appears robust.** The RBNZ Act provides a range of powers to address both compliance and safety and soundness concerns

[4] This assessment was prepared by Michael Ainley (U.K. FSA) and Barbara Baldwin (IMF/MFD).

that may arise with respect to a bank. While the powers of day-to-day supervision fall completely within the RBNZ's purview, the consent of the Minister of Finance is required to invoke certain "crisis management" powers. In theory, this could hinder the Reserve Bank's ability to apply its enforcement powers promptly but, in practice, there is no evidence of any political (or industry) interference in the ongoing supervision of banks.

66. **Self-discipline, in the form of clear Directors' responsibilities (see below), and market discipline are cornerstones of the New Zealand approach to banking supervision and strongly reinforce regulatory discipline.** Banks are subject to comprehensive disclosure requirements. The regime requires frequent public reporting by banks, and financial statements must be audited twice annually (though audits of mid-year statements are limited in scope).

67. **Banking supervision in New Zealand is focused on systemic goals.** Unlike many other jurisdictions, New Zealand regulators do not carry any duty to protect individual depositors, or to safeguard individual institutions. There is no official deposit protection scheme. The Reserve Bank is empowered to act as a lender of last resort when needed to ensure the soundness of the financial system, but the RBNZ Act is not prescriptive in how this responsibility is to be carried out. The Reserve Bank is currently reviewing its crisis management arrangements.

B. Main Findings—Summary

68. ***Objectives, Autonomy, Powers, and Resources (CP1)*****:** The framework for the supervision of banks is sufficiently robust. The RBNZ Act specifies that the Reserve Bank has sole responsibility for bank registration and supervision. It sets out regulatory objectives and principles, and provides broad rulemaking powers. Systems are in place to ensure that the RBNZ's activities are carried out in a transparent manner. Information on the financial strength and performance of the banking industry is publicly available. Formal funding arrangements are in place through five-year agreements negotiated between the Governor and the Minister of Finance. The funding agreement has not yet acted as a constraint on the RBNZ's ability to carry out its functions, and it includes a clause that requires the agreement to be reviewed in the event that there are any material changes in the nature or extent of the work undertaken by the RBNZ in respect of any of its designated functions.

69. **The RBNZ has at its disposal a broad spectrum of tools to carry out routine supervision and corrective action as necessary.** Some tools, such as the ability to commission or conduct onsite reviews, could now be implemented, selectively, to improve the effectiveness of the supervisory framework. As already noted, use of certain crisis management powers must be approved by the Minister; some of the "middle range" powers in this group, such as the giving of directions to a bank, might more appropriately be placed directly under the Reserve Bank's powers.

70. ***Licensing and Structure (CPs 2-5)*****:** There are clear restrictions surrounding the use of the word "bank" and its derivatives. However, the business of banking is not regulated per se, and deposit taking is not restricted to banks. Nonbank financial institutions which accept

deposits are subject to much less comprehensive registration requirements than banks. This would appear to create the potential for confusion among consumers of financial services, though the authorities maintain that the public has been well educated about the different categories of financial institutions. There are no laws or regulations that define permissible types of acquisitions and investments for registered banks, and banks are not required to obtain supervisory approval for acquisitions or even to notify the Reserve Bank of such events. Although it would be possible to introduce a condition of registration requiring supervisory approval for specified types of acquisitions and investments, this is viewed as inconsistent with the RBNZ's philosophy of supervision. The RBNZ has recently strengthened regulations governing changes in bank ownership, and are currently considering enhancements to the fit and proper principles applicable to bank owners.

71. ***Prudential Regulations and Requirements (CPs 6-15)*****:** Although the RBNZ has the authority to set prudential regulations on a range of issues, it has done so only selectively. At present, there are explicit rules governing capital adequacy and connected lending. For the other risks addressed in this set of principles, the authorities underscore that management of these matters is the responsibility of bank directors, who are best-placed to understand the individual institution's risk profile and appetite and to design and implement risk management systems accordingly. The director attestations and audited disclosure requirements have contributed to a quite extensive system of checks and balances within the major banks. While this approach works effectively for certain of these principles, delivering the underlying objectives (including CPs 8 and 14), it appears less effective, even when complemented with annual consultations with bank management, in the areas of credit (CP 7) and risk management (CPs 12 and 13). The RBNZ's role in the area of money laundering should be reviewed as part of the current intergovernmental examination of anti-money laundering measures.

72. ***Methods of Ongoing Supervision (CPs 16-20)*****:** In keeping with its supervisory philosophy, the Reserve Bank does not conduct onsite inspections of banks. It has the ability to commission independent, onsite reviews under Section 95 of the RBNZ Act, but has not yet made regular use of these powers. It is now actively considering doing so. Its offsite supervision program is more conventional, but here too is limited essentially to receiving and analyzing information that is available to the general public. More up-to-date "early warning" information from banks, including liquidity, would strengthen the Reserve Bank's day-to-day supervision. The Reserve Bank does closely monitor banks' compliance with disclosure requirements, and regularly requires corrective action in the form of a revised statement or subsequent amendment in the event of errors or omissions. The Reserve Bank also retains the right, used periodically, to request additional information or more frequent reporting if considered necessary for supervisory purposes; this can extend to information regarding associated persons or affiliates of the bank.

73. ***Information Requirements (CP 21)*****:** Quarterly public disclosure of comprehensive financial information on registered banks is a central component of the RBNZ's approach to supervision. Local accounting standards are generally consistent with international best practice, and New Zealand has announced its intention to adopt International Accounting Standards with effect from January 1, 2007.

74. ***Formal Powers of Supervisors (CP 22)*:** The RBNZ has a range of supervisory tools to effect corrective action in cases where banks fail to meet prudential requirements or where depositors are threatened in any other way. A "hierarchy of supervisory response" has been established, involving procedures for elevating supervisory enforcement matters within the Reserve Bank if informal approaches prove unsuccessful. As already mentioned, the Minister of Finance would have to approve the use of certain "crisis management" powers specified in the Act.

75. ***Cross Border Banking (CP 23-25)*:** The RBNZ is empowered to undertake globally consolidated supervision, and the RBNZ Act facilitates the sharing of supervisory information by providing the necessary confidentiality. Banks are supervised on a consolidated basis, and this would apply to any overseas branches or subsidiaries, but New Zealand-incorporated banks currently have no material international operations.

C. Recommended Action Plan and Authorities' Response

Table 1. Recommended Action Plan to Improve Observance of the Basel Core Principles

Reference Principle	Recommended Action
Powers to Address Safety and Soundness Concerns and Remedial Measures (CPs 1 and 22)	Finalize a crisis-management strategy. Explore possible forms of cooperation with the Australian authorities, as appropriate.
Permissible Activities (CP 2)	The ability of nonbank institutions to accept deposits does create a potential loophole for regulatory arbitrage, and this matter should be kept under review in light of reputational risk issues.
Credit Policies (CP 7)	Consider selective and focused use of Section 95 powers to verify banks' credit procedures and controls. This could take the form of an independent third-party report. Alternatively the Bank could establish its own small risk review team to carry out such reviews. This would probably require the Act to be amended to give the Bank the explicit power to carry out routine on-site inspections.
Large Exposures (CP 9)	Consider obtaining more frequent data directly from the banks. This could form part of a set of early warning prudential indicators, which could also include liquidity.
Market Risks (CP 12)	As CP 7.
Other Risks (CP 13)	As CPs 7 and 9. In these areas, the information which the RBNZ gets from disclosures and consultations needs to be supplemented, as it is not comprehensive or current.
Money Laundering (CP 15)	The RBNZ's role in this area should be reviewed as part of the current intergovernmental examination of anti-money laundering measures.
On- and Off-Site Supervision (CP 16)	Off-site work could be complemented by setting up a specialist risk-review team for themed visits to banks and by up-to-date early-warning indicators (CPs 7 and 9 above).

Authorities' response

76. **The RBNZ provided the following response to the assessment.**

77. "The RBNZ believes that New Zealand has a strong banking system and a framework of supervision which suits its circumstances well. The framework is based on some foundations which distinguish New Zealand, to some extent at least, from many other countries:

- The primary goal of supervision is systemic stability and not depositor or creditor protection.
- The RBNZ has an explicit duty to pursue efficiency as well as soundness.
- Supervisory methods are aimed as far as possible at strengthening the incentives for prudent behavior, by encouraging strong governance within banks and market disciplines, and as a consequence detailed and prescriptive rules are kept to a minimum.

These features inevitably lead to some differences in the way some things are done in New Zealand compared with the situation in other countries. New Zealand generally places relatively more emphasis on giving responsibility and accountability for risk management to banks and their directors, and to auditors and other external reviewers, and relatively less emphasis on direct oversight by the supervisor. The Reserve Bank of New Zealand thinks this suits policy objectives and the New Zealand context well.

78. The compliance assessment acknowledges that the New Zealand approach has genuine strengths, that disclosure continues to provide a discipline on banks and that attestation requirements are taken seriously by directors, but notes that the approach adopted leaves some potential or actual gaps.

79. The RBNZ's view is that all of the high-level Basel Core Principles are addressed within the New Zealand framework, but not always in a conventional manner. Our decisions to use alternative methods have been conscious and we believe that those methods are generally effective. Nevertheless, we acknowledge some of the potential gaps in the supervisory framework identified by the assessors. We either already have work underway or plan to carry out work soon on ways of addressing these gaps. For example, work on crisis management strategies and capacity, and on increased co-operation with Australian authorities, has been underway for some time. Over the coming year we also will be looking at making greater use of our powers to require banks to undergo independent reports on key matters of prudential interest, at whether policies relating to the role of directors and auditors need to be bolstered, and at whether there is a need to supplement information in disclosure statements with additional reporting to the supervisor. Disclosure requirements are reviewed periodically to ensure that they continue to reflect global best practice; further reviews are planned.

80. Overall, the RBNZ remains satisfied that our basic approach to supervision is appropriate for New Zealand's current circumstances, but we accept that some refinements are needed to ensure that it would continue to be effective in a less benign economic environment."

SUMMARY ASSESSMENT OF OBSERVANCE OF THE IMF'S CODE OF GOOD PRACTICES ON TRANSPARENCY IN MONETARY AND FINANCIAL POLICIES[5]

TRANSPARENCY OF MONETARY POLICY

A. General

81. **The assessment of practices relating to monetary policy within the framework of the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies was based mainly on the detailed self-assessment prepared by the RBNZ.** The assessment also entailed a review of the relevant documents maintained on the RBNZ's website, including the *Annual Report*, the *Bulletin*, the *Policy Targets Agreement*, the *Monetary Policy Statement,* the Reserve Bank of New Zealand Act 1989, *Agency Agreement*, *Operational Guidelines of the RBNZ*, amongst others. In addition, discussions were held with members of the Bank staff, commercial banks and other financial market participants.

B. Main Findings—Summary

82. **The RBNZ exhibits a high degree of transparency in all aspects of its conduct of monetary policy.** The broad objectives, responsibilities, accountability structures, and transparency obligations are specified in legislation. The RBNZ issues a wide range of material on a timely basis to explain its performance across its functions, including the quarterly *Monetary Policy Statement* and *Bulletin*, post-election briefing papers, and website. The RBNZ issues an annual report and financial statements, which are subject to external audit and publicly disclosed.

83. ***Clarity of roles, responsibilities and objectives of monetary policy*****:** Under the Reserve Bank of New Zealand Act 1989 (the Act)—which constitutes the RBNZ and governs monetary policy in New Zealand—the sole objective of monetary policy is the achievement and maintenance of stability in the general level of prices. This objective is operationalized by way of a Policy Targets Agreement (PTA) entered into between the Minister of Finance and the Governor of the RBNZ. The PTA specifies the precise policy target to which monetary policy is to be directed. The PTA is a public document and is accessible on the RBNZ website. As part of the governance arrangements applicable to monetary policy, the objectives and conduct of monetary policy are required by the Act to be transparent.

84. **In addition to its monetary policy functions, the Bank's other functions are also contained in the Act.** These include: the power to deal in foreign exchange (Section 16); the power to temporarily suspend foreign exchange business (Section 22); the duty to advise the Minister of Finance/Treasurer on foreign exchange matters (Section 23); the duty to manage foreign exchange reserves (Section 24); the sole right to issue currency in New Zealand

[5] This assessment was prepared by Jodi Scarlata, (IMF/MFD).

(Section 25); the power to act as lender of last resort (Section 31); the duty to give financial sector policy advice to the Minister of Finance/Treasurer (Section 33); the power to maintain securities registry services (Section 35); and the power to register and supervise banks (Section 67 and various sections in Part V of the Act).

85. **The procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing body of the central bank are clearly specified in legislation.** Overdrafts by the government are permitted by the Bank. The details of the terms under which any overdraft is advanced are not generally disclosed, but the Agency Agreement between the Government's Debt Management Office and the Reserve Bank will shortly be placed on the Bank's website. While the amounts of advances, credits and overdrafts to the Government are disclosed monthly on the RBNZ website, there is no disclosure of the terms of these transactions. It is recommended that the terms of these advances and overdrafts be disclosed.

86. ***Open process for formulating and reporting monetary policy*:** The Act requires the RBNZ to report publicly on its performance in various ways, including via publication of an Annual Report and in Monetary Policy Statements. In practice, the RBNZ issues a wide range of material to explain its performance across its functions, including articles in the Bulletin, post-election briefing papers (issued immediately after a general election has been held) and in various publications on the RBNZ website. Section 15 of the Act requires the RBNZ to issue a Monetary Policy Statement at least every six months to explain its monetary policy decisions and set out its thinking on possible future economic developments relevant to inflation. The RBNZ has had a long-standing practice of issuing these statements approximately every quarter, rather than six monthly. The RBNZ includes comprehensive medium-term economic forecasts in the MPS.

87. **The Governor and other senior RBNZ staff generally give seminars to business audiences immediately following the release of a Monetary Policy Statement, to explain the RBNZ's monetary policy decision and related issues.** The Governor also makes numerous speeches throughout the year explaining monetary policy and other issues relevant to the RBNZ's functions. Other senior staff also give occasional presentations to various external audiences.

88. ***Public availability of information on monetary policy*:** While New Zealand has not yet applied to subscribe to SDDS, for several years central bank data have complied with SDDS standards in all significant respects. A forward release calendar is disseminated on the Bank's website for a range of central bank data that corresponds to the subset specified by SDDS. All of these data are disseminated with coverage, periodicity and timeliness parameters that meet SDDS standards.

89. **A summary statement of financial position is issued on the Bank's website at a specified date each month.** The timing of the release is publicly disclosed. The statement discloses information on aggregate market transactions and key balance sheet items.

90. **The RBNZ maintains an active public information service. In addition to a detailed website, www.rbnz.govt.nz, the following documents are also published**: RBNZ *Annual Reports* and *Monetary Policy Statements*; post-election briefing paper—the most recent one being issued in August 2002; RBNZ *Bulletin*—issued quarterly; RBNZ *Discussion Papers*—issued on an ad hoc basis; speeches by the Governor and other senior staff; brochures and pamphlets issued by the RBNZ (including on the functions and structure of the RBNZ and on issues relevant to understanding its functions).

91. ***Accountability and assurance of integrity by the central bank*:** The Governor and other RBNZ officials can be required to appear before Parliament's Finance and Expenditure Committee. This generally occurs four or five times a year, typically after the release of each Monetary Policy Statement and Annual Report. The Committee occasionally conducts fuller enquiries into the RBNZ's operations (as it does for many government agencies).

92. **The RBNZ is required to prepare and publish comprehensive financial statements which comply with accepted accounting practices.** The financial statements, accounting policies and systems, and internal controls are subject to annual external audit. In addition, the Act empowers the Minister of Finance to engage an external party to review other aspects of the RBNZ's operations as he or she sees fit.

93. **The Act contains a number of provisions relating to the conduct of personal financial affairs of directors and staff of the Bank, including rules relating to conflicts of interest;** it provides legal protection to directors and staff of the Bank, stating that they shall only be personally liable for exercising powers conferred by the Act in bad faith or omitting in bad faith to exercise a power conferred by the Act; and it makes provision for the Government to indemnify the RBNZ, officers or employees of the RBNZ, statutory managers of registered banks, among others, for liability arising from exercising powers or omitting to exercise a power conferred by the Act.

C. Recommended Action Plan and Authorities' Response

Table 2. Recommended Action Plan to Improve Observance of IMF's MFP Transparency Code Practices—Monetary Policy

Reference Practice	Recommended Action
Practice 1.2.1	The details of the terms under which any overdraft is advanced should be disclosed.
Practice 1.2.2	Disclosure should be made of all relevant details of the amounts and terms of credits, advances or overdrafts provided to central government by the Bank, and the terms and conditions of government deposits with the Bank

Authorities' response

94. All comments by the authorities have been incorporated and they are in agreement with the assessment.

Transparency of Banking Supervision

D. General

95. **The assessment of transparency in banking supervision was based on a detailed self-assessment prepared by the RBNZ,** a review of the relevant documents maintained on the RBNZ's website, and discussions with members of the RBNZ staff, commercial banks and other market participants.

E. Main Findings—Summary

96. ***Clarity of roles, responsibilities and objectives*****:** The RBNZ is the sole authority responsible for registering and supervising banks, and has no supervisory jurisdiction over other categories of financial institution. The RBNZ Act 1989 (the Act) sets out the RBNZ's functions, powers, accountability structures and transparency obligations. The RBNZ has responsibilities in a range of financial system areas, including: the registration and supervision of banks; responding to financial distress events affecting registered banks; acting as lender of last resort; providing advice to the government on the operation of the financial system; coordinating and promoting legislative change in areas that relate to banking; and overseeing and operating the payment system. All of these functions are disclosed and explained publicly, including in the RBNZ's Annual Report, on the RBNZ website, in brochures and in the RBNZ Bulletin.

97. **An MOU between the domestic regulatory agencies is being developed and is expected to be publicly disclosed.** The RBNZ has publicly referred to the nature of the financial sector regulatory framework, including the nature of cooperation between regulatory agencies. This information is presented on the RBNZ website.

98. ***Open process for formulating and reporting financial policies*****:** The Act requires the RBNZ to explain its approach to implementing policy, which is to be done in the case of bank registration and supervision by the issuance of a Statement of Principles. The Act requires the RBNZ to report publicly on its performance in various ways, including via publication of an Annual Report. In practice, the RBNZ issues a wide range of material to explain its performance across its functions, including articles in the quarterly Bulletin, post-election briefing papers, and in various publications on the RBNZ website.

99. **The RBNZ Board is required to keep the RBNZ's and Governor's performance across all the RBNZ's functions under constant review.** The Board comprises non-executive directors appointed by the Minister of Finance (including the Governor) and is chaired by a non-executive director. Under the Act, the Board is required to issue an annual report on its assessment of the RBNZ's and Governor's performance, and the report is publicly released. The Board periodically meets with the Minister of Finance and is required by the Act to report to the Minister any concerns it may have in relation to the RBNZ's or Governor's performance.

100. ***Public availability of information on financial policies*****:** The RBNZ publicly releases a number of documents in the area of banking supervision, either in hard copy or on the website. Part V of the RBNZ Act contains all of the relevant powers and responsibilities for the RBNZ in the area of registration and supervision. The RBNZ Annual Report provides an overview of the RBNZ's functions and broad indicators of performance by function, while the banking supervision handbook contains the Statement of Principles and all prudential regulations. Regular articles published in the RBNZ Bulletin on the state of the banking system summarize developments in banking supervision.

101. ***Accountability and assurance of integrity*****:** The Governor and other RBNZ officials can be required to appear before Parliament's Finance and Expenditure Committee. This generally occurs four or five times a year, typically after the release of each Monetary Policy Statement and Annual Report. The Committee occasionally conducts fuller enquiries into the RBNZ's operations, but rarely discusses the RBNZ's financial stability functions in any detail.

102. **The RBNZ is required to prepare and publish comprehensive financial statements which comply with accepted accounting practices.** The financial statements, accounting policies and systems, and internal controls are subject to annual external audit. In addition, the Act empowers the Minister of Finance to engage an external party to review other aspects of the RBNZ's operations as he or she sees fit.

F. Recommended Action Plan and Authorities' Response

Table 3. Recommended Action Plan to Improve Observance of IMF's MFP Transparency Code Practices—Banking Supervision

Reference Practice	Recommended Action
Practices 5.2 and 6.1.5	Details of the MOU between domestic regulatory agencies should be made public.

Authorities' response

103. **All comments by the authorities have been incorporated and they are in agreement with the assessment**.

TRANSPARENCY OF SECURITIES REGULATION AND SUPERVISION.

G. General

104. **The assessment of securities regulation transparency was based on the detailed self-assessment prepared jointly by the Securities Commission, Takeovers Panel and Registrar of Companies.** The assessment also entailed a review of the relevant documents maintained on the agencies' respective websites, discussions held with members of the staff of the aforementioned agencies, and other financial market participants.

H. Main Findings—Summary

105. **There is a high degree of transparency in the securities regulatory framework, but the complexities of the oversight regime are not always well explained.** Each regulator should include on its website a common description of the securities regulatory regime, outlining its respective roles, responsibilities and interrelationships, with relevant links across agencies' sites. In addition, it would be helpful if legislation was accessible in its entirety, as opposed to by articles and sections only.

106. ***Clarity of roles, responsibilities and objectives*:** The financial agencies responsible for implementing securities regulation in New Zealand are the Securities Commission (SC), the Office of the Registrar of Companies, and the Takeovers Panel (TP). The Securities Act establishes SC, defines its powers and functions, regulates the offer of securities to the public, and confers on ROC the responsibility of registering prospectuses and associated documents for the offer of securities to the public. The Securities Markets Act enacts rules about insider trading, disclosure by public issuers, substantial security holder disclosure, disclosure of dealings by directors and officers of public issuers, registration of exchanges, and dealings in futures contracts. It confers on SC the power to regulate in these areas. The Takeovers Act provides for the establishment and constitution of TP, the enactment of a Takeovers Code, and the regulation of company takeovers. The Companies Act contains rules of law about the incorporation, constitution and administration of companies. It establishes the ROC and confers regulatory powers on the holder of that office.

107. **The procedures for appointment, terms of office and criteria for removal of officials are specified in the relevant legislation**; however, for the ROC, the terms limits and criteria for removal exist only insofar as ROC falls within the State Sector Act and there are no detailed specifications for officials of the ROC. The relationship between the SC and the TP is set out in the functions of the Commission in the Securities Act. Elements of the relationship between the SC and NZX are publicly disclosed and there are MOUs in force between the SC and NZX and between SC and TP which are also made available to the public. The SC, ROC and the banking prudential regulator, the RBNZ, meet quarterly as the Financial Regulators' Coordination Group. The agencies all have websites in which their operations and relationships are described. The Group comprises the RBNZ, Takeover Panel, Securities Commission, Ministry of Economic Development, Government Actuary, Registrar of Companies, Official Assignee for New Zealand, Serious Fraud Office, and Commerce Commission. An MOU between the domestic regulatory agencies is being developed and is expected to be in place before the end of 2004, at which point it will be publicly disclosed.

108. ***Open process for formulating and reporting financial policies*:** SC is empowered to publish a report or a comment made in the exercise of its functions, and makes extensive use of this power. The Official Information Act applies at the end of the inquiry, so that any member of the public may request access to information held by SC. The Ombudsman acts as appeal authority in respect of any request declined. SC regularly issues and publishes policy and practice guidance, both on its website and in its quarterly bulletin.

109. **TP is subject to the Official Information Act**. TP must give reasons for granting an exemption and these must be published although it may defer or omit publishing in particular cases on the ground of commercial confidentiality. Transparency is required in respect of its inspection and inquiry work. The TP's policies for administering key sections of the Code are published and explained. The Panel discloses its regulatory framework, and aspects of its operating procedures via its website, press releases, annual report and Code Word. The Panel widely publicizes its decisions and the reasons accompanying them within a legally specified timeframe.

110. **Financial policies affecting securities regulation are subject to extensive prior consultation with affected parties, whether contained in statutory regulations, financial reporting standards, exchange rules or policy statements of a financial agency**. The agencies are required to act independently in formulating new policies, as expressed in the Output Agreement with the Minister of Commerce. Policy changes are published and subject to notice and comment requirements.

111. ***Public availability of information on financial policies*****:** The TP and SC maintain active programs of communication with the investment community and the general public, including annual reports and quarterly bulletins. The SC uses its extensive powers of comment to report on the application of the law. The RC, through the Companies Office publishes an annual report detailing the activities of the Companies Office. The government agencies report extensively on their financial and service performance and significant regulatory action taken in their annual reports.

112. ***Accountability and assurance of integrity*****:** Officials of all Crown entities are required, when asked, to appear before the responsible Parliamentary Committee. The primary context for a request will routinely be the entity's annual budget or annual report but Committee Members can be expected to ask a very wide variety of questions about policies, objectives, activities, performance, quality of regulation and state of the markets. Select Committees have powers to obtain information, and to request and require attendance of persons.

113. **The ROC, TP, SC must all prepare financial statements that comply with GAAP and which are audited by independent auditors.** The Auditor-General is required to audit the financial statements prepared by the SC and TP and must express an independent opinion on the financial statements and report that opinion to the public. The Commission's annual report must be presented to the House of Representatives. Internal governance procedures and conflict of interest guidelines are described in the establishment laws and annual reports. The legal protections for members and staff of SC and TP are stated in the establishment laws and protects from liability those persons exercising powers of inspection under the Act.

I. Recommended Action Plan and Authorities' Response

Table 4. Recommended Action Plan to Improve Observance of IMF's MFP Transparency Code Practices—Securities Regulation

Reference Practice	Recommended Action
Practice 5.1	Provide an overall description of securities regulation (i.e., the responsible agencies, their roles, interrelationships, etc) in one unified format on the websites as well as linkages across websites of the relevant agencies. The ROC website, embedded within that of the MED, might be made more accessible and user friendly. Make legislation available in its entirety (as opposed to section by section)
Practice 5.2	The MOU should be placed on the websites of all relevant regulatory bodies.
Practice 6.1.5	All MOUs should be made publicly available, unless sensitivity requirements necessitate otherwise.

Authorities' response

114. The relevant agencies have provided comments on the above assessment, which have been duly incorporated, and they are in agreement with the overall assessment.

Summary Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation (IOSCO Principles)[6]

A. General

115. **This assessment is based on the authorities' self-assessment**; a review of relevant laws, procedures and publicly available information concerning the authorities, the New Zealand Securities Exchange (NZX) and the New Zealand Futures and Options Exchange (NZFOE); and interviews with the authorities and market participants. The assessment used the Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation adopted by IOSCO in October 2003.

116. **New Zealand markets have been undergoing significant change**. NZX demutualized in late 2002, self-listed in 2003, and recently launched a new, regulated market targeted at developing and non-traditional enterprises. SFE Corporation (SFE), NZFOE's parent corporation, will transfer trading in NZFOE products to Australia in 2004 and has

[6] This assessment was prepared by Janet Holmes (Ontario Securities Commission).

entered into a deal with NZX for the trading on SFE of products based on NZX-listed securities.

117. **The SC is the principal statutory regulator, while the TP and RC have more narrowly defined roles.** The Ministry of Economic Development (MED) is involved in policy development, while NZX exercises self-regulatory functions. NZX firms and their associated brokers are the most significant class of market intermediaries operating in organized equity markets, while most secondary market trading in New Zealand public companies involves issuers listed on NZX (or an overseas market).

B. Main Findings—Summary

118. **Recent reforms and NZX's restructuring have strengthened the securities regulatory framework.** The authorities are aware, however, that additional reforms are needed to fully implement the IOSCO Principles, and have committed to introduce them.

119. ***Principles Relating to the Regulator (1-5)*:** Although the regulatory scheme is complex, each regulator's functions and powers are transparently set out in legislation, as well as websites or other publications. Structures exist to ensure that the regulators achieve high standards of procedural fairness and remain accountable. The SC and TP are operationally independent, while the RC is expected to exercise decision-making powers independently. Although the regulators do not have adequate powers to fully implement all the IOSCO Principles, generally they are fulfilling their existing mandates and exercising effectively the powers they have. Furthermore, the Government has shown its willingness to provide requested funding to enable the regulators to fulfill their increasing responsibilities.

120. ***Principles of Self-Regulation (6-7)*:** The regulatory system places substantial reliance upon SRO-type functions performed by regulated exchanges. Since NZX's demutualization, its management has been investing more in regulatory functions. The SC and Minister assess a securities exchange's willingness and legal capacity to carry out SRO-type functions as part of the exchange registration process, but do not assess the adequacy of the exchange's resources or of its operators' integrity and fitness. There is some ongoing oversight of registered securities exchanges. The SC interacts regularly with NZX, both formally under a Memorandum of Understanding (MOU) and informally. There is, however, no formal oversight plan for NZX.

121. ***Principles for Enforcement (8-10):*** The SC, TP, and NZX have very broad inspection, investigation and surveillance powers. These powers enable it to exercise a greater degree of oversight than might otherwise be the case in a regulatory scheme, like New Zealand's, that does not provide for comprehensive supervision of market intermediaries. Collectively, the regulators also have a relatively wide and flexible range of enforcement tools. The regulators have shown their willingness to respond promptly to concerns by undertaking inquiries, taking enforcement action, or referring the matter to the appropriate authority.

122. ***Principles for Cooperation (11-13)*****:** The SC can and does share information with other domestic authorities without the need for external approval. Each of the securities regulators, MED, NZX and NZFOE can enter into information-sharing agreements, and several agreements have been or are in the process of being executed. There are also close informal ties between the SC and other securities regulators. The SC signed the IOSCO Multilateral Memorandum of Understanding in October 2003. The SC's powers, capability and willingness to cooperate with overseas regulators were subjected to a rigorous screening process by a team of IOSCO experts before it was accepted as a signatory.

123. ***Principles for Issuers (14-17)*****:** There are comprehensive disclosure requirements for public issuers' offer documents, which are reviewed by the RC and in the case of NZX listed companies, by NZX as well. The SC can prevent an offering from continuing if the offering documents or related advertisements are misleading. The Government has provided additional funding to the SC to develop criteria for risk-based reviews of disclosure documents and intends to introduce legislation in 2004 to enhance the regulators' powers to enforce disclosure standards for offerings. The continuous disclosure requirements applicable to listed companies provide for sufficient, timely disclosure. Unlisted issuers, however, are required to report financial results only once a year and do not have to submit audited, annual financial statements to the RC until almost six months after year-end.

124. **Accounting standards are of a high and internationally acceptable quality**. Accounting standards are approved by the Accounting Standards Review Board (ASRB), an independent Crown entity that is accountable to Parliament through the Minister. The ASRB has recommended that all New Zealand entities should be required to adopt International Financial Reporting Standards commencing in January 2007. The Institute of Chartered Accountants of New Zealand (ICANZ) is an SRO that develops and enforces auditing standards. ICANZ decisions are subject to judicial review, but its interpretation processes are not subject to the oversight of a regulator or other body acting in the public interest. MED's review of the Financial Reporting Act, however, is expected to include a review of audit standard-setting, and the SC-led corporate governance project has now been finalized and published (*Corporate Governance in New Zealand – Principles and Guidelines*).

125. ***Principles for Collective Investment Schemes (17-20)*****:** The marketing of collective investment schemes (CIS) is subject to comprehensive disclosure requirements applicable to all public offers of securities. CIS also must file audited annual financial statements. CIS are operated within a framework of trust law, which requires CIS operators to act with due care in the unit holders' best interests. Since many matters are negotiated between the CIS operator and its trustee or supervisor, there can be significant variations in investor protections across various schemes. Although there is no program for ongoing regulatory oversight of CIS operators or their trustees or supervisors, the SC and other regulators exercise their inspection and enforcement powers to deal with problems arising in respect of certain operators.

126. ***Principles for Market Intermediaries (21–24)*****:** Firms and brokers who participate directly in regulated markets in New Zealand are subject to comprehensive entry standards assessed by the relevant exchange. These market intermediaries also must comply with the

exchange's prudential requirements and standards for internal organization and operational conduct. NZX has implemented a pro-active compliance program for NZX firms. Most other market intermediaries are subject to few entry standards or ongoing standards of conduct, and are not subject to regular supervisory oversight. The securities law reform commencing in 2004 is expected to involve a comprehensive review of the regulatory scheme for market intermediaries.

127. ***Principles for Secondary Markets (25-29)***: A market cannot hold itself out as a securities exchange (or futures exchange) unless it obtains registration (authorization) from the Minister or SC, respectively. Otherwise, a market can operate without registration (authorization) unless the Minister requires the market to obtain registration (authorization) or cease carrying on business. The registration process does not provide for an assessment of the market operator's competence, sufficiency of resources or integrity. The SC has broad powers to inquire into the affairs of regulated and unregulated markets.

128. **Although general fraud and consumer protection laws can be used to address some forms of manipulative or unfair practices relating to securities, securities legislation does not expressly prohibit market manipulation**, the dissemination of misleading information (except in respect of offers) or front running, and provides only for a civil cause of action and a civil penalty in respect of insider trading. NZX and NZFOE have rules prohibiting, and systems to detect, illegal, manipulative and deceptive conduct on its markets, and work closely with the SC to address concerns that arise. Furthermore, the Government intends to introduce legislation in 2004 providing for reform of the securities trading law, including the establishment of criminal and civil penalties for these activities.

129. **NZX appears to have developed appropriate procedures to monitor and address large exposures, default risk and market disruption**. Formal and informal arrangements exist to enable market operators, regulators, other relevant domestic authorities and overseas authorities to share information on large exposures of market participants.

C. Recommended Action Plan and Authorities' Response

Table 5. Recommended Action Plan to Improve Observance of the IOSCO Principles

Reference Principle	Recommended Actions
Principles 7, 8, 25 and 26	• Amend legislation to include comprehensive, high level entry and ongoing standards for regulated exchanges' integrity, competence, financial capacity, internal controls, powers and duties. • The SC should develop a formalized oversight plan for regulated exchanges. • Amend legislation to enable the SC or the Minister to require a registered exchange to amend any or all of its conduct rules. • The NZX should adopt a broader definition of "independence" (applicable to the individuals constituting the Special Division of its disciplinary body, deciding matters involving NZX in its capacity as a listed company), or disciplinary functions in respect of NZX should be transferred to an independent body, such as the SC.
Principle 9	• Implement the reforms in the remedies and penalties section of the Cabinet Paper, *Investment Advisers*.

Principle 14	• Devote more resources to the review of disclosure documents, so that regulators can conduct comprehensive reviews of issuers' disclosure records through risk-based review systems. • NZX-listed companies should be required to notify NZX (in confidence) when they rely on the exemption to make timely disclosure of material developments, enabling NZX to spot-check appropriate reliance on the exemption and facilitating surveillance. • Amend the Financial Reporting Act to provide for more timely disclosure of annual financial information by unlisted public issuers.
Principle 15 (and 9)	• Amend the companies legislation to supplement existing self-help remedies. • Amend the securities legislation to require substantial security holders, directors and officers to file their notices of transactions in a central, public, easily accessible electronic register.
Principle 16	• ICANZ's interpretation process should be overseen by a regulator or other body acting in the public interest. • Amend the NZX Listing Rules to require immediate disclosure of the resignation, removal or replacement of an external auditor.
Principles 17-20	• Amend the securities legislation to provide for: (1) greater oversight of contributory mortgage brokers; (2) high level entry and ongoing standards concerning CIS operators' honesty and integrity, competence, financial capacity, internal controls, powers and duties; (3) general conflict of interest standards for CIS operators and their trustees or supervisors; (4) minimum standards for CIS operators to provide periodic and timely reports to trustees or supervisors (or to the appropriate regulator), (5) minimum requirements for trustees or statutory supervisors to conduct periodic inspections of CIS operators and make timely reports to the SC of any material contraventions by CIS operators of applicable standards.
Principles 21-24	• Enact legislation providing for more comprehensive oversight of market intermediaries that: (1) requires minimum entry standards relating to integrity, financial capacity, competence, operational capability, internal controls; (2) requires periodic reports to the regulator or SRO; and (3) enables the regulator to take effective enforcement action if these standards are not met.
Principle 24	• Securities regulators and SROs should develop a comprehensive crisis management plan for dealing with the potential failure of market intermediaries.
Principles 27-29	• Amend the securities legislation to specify high level standards for regulated exchanges' trading systems and rules with respect to trade transparency, unfair trading practices, management of large exposures, default risk and market disruption.
Principles 28 (and 9)	• Implement the Government's proposed reforms to the securities trading law.

Authorities' response

130. The New Zealand authorities consider the FSAP mission's findings and recommendations helpful, and note that, in many areas, work is already underway to further improve observance of the IOSCO Principles.

131. The authorities note the FSAP team's endorsement of the forthcoming law reforms relating to the introduction of comprehensive prohibitions on market manipulation, insider trading and enhanced penalties and enforcement powers. The authorities welcome the constructive technical recommendations designed to improve New Zealand's observance of the IOSCO Principles, and will give consideration to them. The team's suggestions with

regard to regulatory oversight of market intermediaries and collective investment schemes will be considered in the proposed reviews of the relevant legislation to be undertaken in the near future.

132. The authorities note the recommendation that legislation be amended to specify standards for regulated exchanges' rules with respect to trade transparency, unfair trading practices, management of large exposures, default risk and market disruption. The authorities consider that the broad public interest test in the current legislation provides flexibility for these things and others to be considered when approving exchange rules, and is preferable to a prescriptive approach.

133. The Securities Commission has decided to develop a formal oversight plan for regulated exchanges this year and has informed NZX. It is most likely that details of this plan, once settled, will be published. The oversight plan will cover some of the matters identified by FSAP as appropriate "ongoing standards" for regulated exchanges and the Commission expects to report on its oversight actions.