Macroprudential policy in a Host banking system

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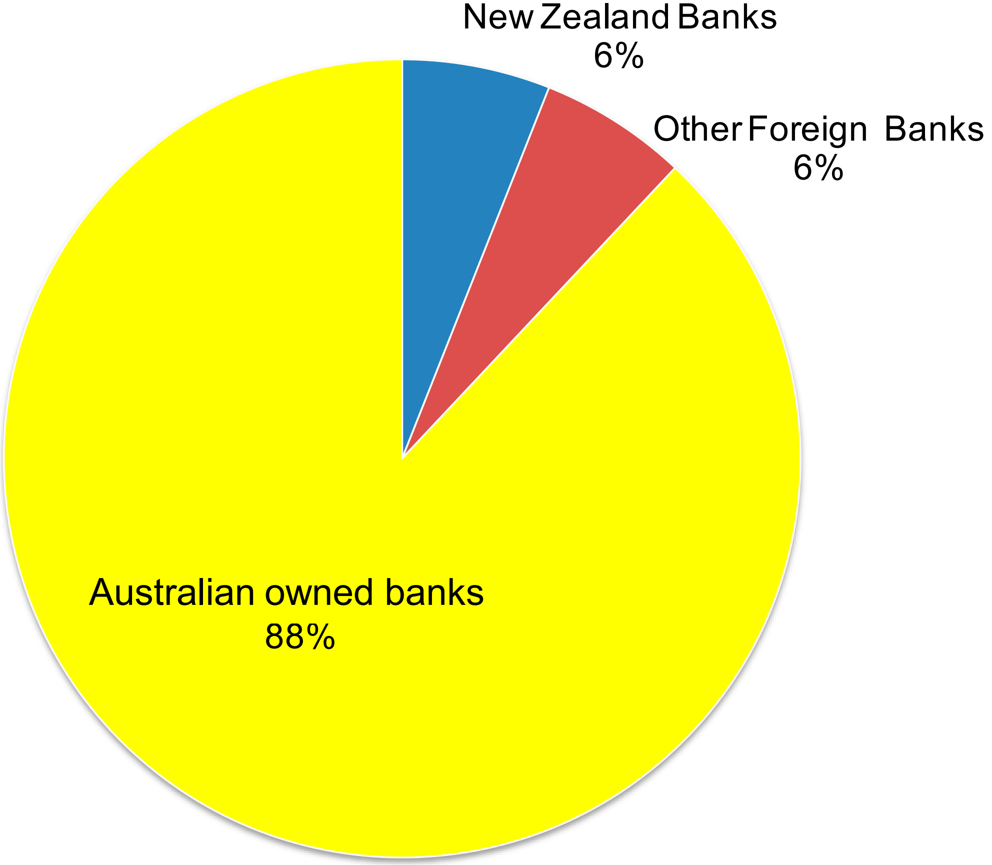
Independent policy is possible in a strong host regime

1. New Zealand banking system dominated by foreign banks
2. But RBNZ has established a strong host supervision regime
3. Allowing independent micro and macro prudential initiatives

New Zealand system dominated by Australian owned banks



Share of total banking assets

NZ host regime strengthened over past 10 years

1. Local incorporation required for all ‘systemic’ banks

2. “Outsourcing policy” implemented: Key functions must be under control of the NZ subsidiary

3. Legislative changes to reduce Australia - NZ tensions in a crisis

4. Closer RBNZ - APRA cooperation

“Outsourcing policy” now fully in place

- Large banks must have legal and practical ability to control and execute vital functions, in particular:
  - Settlement of obligations in a crisis
  - Core retail banking transactions
  - Risk management functions
  - Financial monitoring
- Control of systems is key, not their location

Australian & NZ laws require APRA and RBNZ to:

- Support each other in performing their statutory duties
- Avoid actions likely to worsen financial stability in the other country, where practicable

And closer policy coordination

- Trans-Tasman Banking Council established 2005
- Closer links between RBNZ and APRA
  - Staff secondments
  - More frequent meetings
  - Participation in each other’s visits to the large banks
  - Information sharing
- Joint crisis exercise

What does this host regime achieve?

- Host ability to monitor and regulate the structure of bank balance sheets
- Host influence on governance standards through requirements on local boards
- Hence, regulatory control of domestic financial system despite foreign ownership
- Consistent with RBNZ mandate to:
  1. Promote a sound and efficient financial system; and
  2. Avoid systemic damage from a bank failure

Some differences in home v host prudential regimes

- Both APRA and RBNZ will be early adopters of Basel III
- But some tailoring of the NZ regime to local conditions
  - Basel II risk weights for housing and agriculture
  - No leverage ratio in NZ
- RBNZ Introduced a prudential liquidity policy in 2010 which is similar in spirit but different in detail to the Basel III liquidity proposal
- Macro-prudential policy approaches may be quite different

But main benefit of host regime is ability to manage financial shocks

- Regime insulates domestic banks from external shocks via ring-fencing of resources and control of key functions
- Gives RBNZ the ability to take over and manage a large failing bank without shutting down essential retail payments functions – hence minimising systemic effects
- Small host countries can be vulnerable in a crisis – this is when a strong host regime will come into its own

End