FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

RESERVE BANK OF NEW ZEALAND
TE PŪTEA MATUA

THE TREASURY
Kaitohutohu Kaupapa Rawa

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

New Zealand Council of Financial Regulators Members' Submission to the Australian Financial System Inquiry

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The New Zealand submission to the Australian Financial System Inquiry (FSI) comes from the New Zealand Council of Financial Regulators (NZ CoFR). NZ CoFR members would like to extend their thanks to the Australian Treasurer Joe Hockey for the invitation to make a submission to the Inquiry.

NZ CoFR consists of four permanent members: the Financial Markets Authority (FMA); the Ministry for Business, Innovation and Employment (MBIE); the Reserve Bank of New Zealand (RBNZ); and the New Zealand Treasury. NZ CoFR aims to contribute to the efficiency and effectiveness of New Zealand's prudential and financial markets regulatory model and to promote the stability of the New Zealand financial system by providing a forum to review industry trends and issues. Amongst CoFR's objectives is to ensure coordination across its membership on issues relating to financial regulation, and as such it is ideally placed to provide a contribution to the Inquiry.

Approach taken by NZ authorities

The close interconnections that exist within trans-Tasman financial markets mean that there are significant benefits from a consistent approach between the New Zealand and Australian authorities. Financial market policies between the two countries are already substantively aligned, but in considering how to improve and adapt the Australian system to emerging challenges it is important to consider the extent to which policies are compatible and whether they facilitate regulatory cooperation, act to improve market efficiency, and are structured to reduce the cost of compliance for trans-Tasman financial and business operations.

New Zealand and Australian agencies already meet regularly within the trans-Tasman Banking Council (TTBC) to discuss trans-Tasman cooperation on financial service sector issues. The shared importance both countries place on coordinated action is reflected in the TTBC mandate, which includes guiding policy based on principles of harmonisation, mutual recognition and trans-Tasman coordination. The TTBC has been instrumental in supporting the New Zealand and Australian authorities working closely together on many matters related to the smooth functioning of the financial system.

In this context, NZ CoFR members welcome the opportunity to comment on the FSI Interim Report, to continue this productive relationship for the benefit of both nations. The submission provides high-level input based on New Zealand's recent policy experiences, and looks to foster positive outcomes around a consistency of approach across an integrated trans-Tasman market.

In preparing our submission, NZ CoFR has sought to share recent policy experiences to:

- Address specific observations or questions raised by the submission
- Emphasise areas where more coordination could be beneficial
- Share our experience where Australia may be considering similar policies.

There are a number of issues where New Zealand has relevant policy experience that we would like to share with the Inquiry. These include: consumer-focused financial product disclosure, which forms a cornerstone of New Zealand's recent overhaul of securities legislation through the Financial Markets Conduct Act 2013 (FMC Act); small- and medium-sized enterprises' (SMEs) access to finance, also addressed through the wider disclosure exemptions in the FMC Act; superannuation fees, reformed under the KiwiSaver (Periodic Disclosure) Regulations 2013; and improving the resilience of banks including by raising risk weights on housing.

In addition to the material provided in this submission, NZ CoFR members would like to extend an offer of further assistance to the Inquiry if useful, for example additional detail or discussion on any aspect of this submission.

Background to NZ CoFR's submission

Both countries have a shared interest in the functioning of the Australian financial system given the Australian financial presence in New Zealand, and the cross-border investment and trade links between the nations. For example, Australian banks hold around $360 billion of assets in New Zealand, equivalent to 85.8% of total New Zealand banking assets (according to Reserve Bank of New Zealand data from June 2014). Furthermore, Australian-owned companies also have significant market shares in the New Zealand insurance and fund management sectors, with for example, 68% of Kiwisaver funds and over 80% of the insurance sector managed by Australian-owned providers. New Zealand also has significant investment in Australia, with around $26bn of portfolio investment representing around 43% of New Zealand's total portfolio investment abroad. Australia reciprocates with around $10bn, nearly a fifth of their foreign portfolio investment.

With such strong mutual ties and interdependent markets, having due regard for the effectiveness of financial markets is crucial to financial stability in both countries. This has worked very well in the past, facilitated by a common regulatory philosophy on most regulatory issues, however there is an ongoing risk of increasing compliance costs should policies not continue to be aligned.

In this context, NZ CoFR warmly welcomes the opportunity to feed into the consultation on the Interim Report and to provide input. We hope that these comments can add substantive value to the deliberations taking place in Australia.

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Differences in capital outcomes between IRB and standardised banks

FSI Observation

The banking sector is competitive, albeit concentrated. The application of capital requirements is not competitively neutral. Banks that use internal ratings-based (IRB) risk weights have lower risk weights for mortgage lending than smaller authorised deposit-taking institutions (ADIs) that use standardised risk weights, giving the IRB banks a cost advantage.

Key CoFR message

- NZ CoFR recognises the Inquiry's concerns that IRB approach potentially harms the competitiveness of some banks.
- The RBNZ is of the view that maintaining prudent levels of capital in the banking system, as well as within individual institutions, is a cornerstone of prudential regulation. Hence we fully support a conservative approach towards capital regulation in Australia.
- Although not the main objective, one outcome of the RBNZ's recent housing review is a reduction of the gap in risk weights between IRB and standardised banks.

The Inquiry rightly points out that, for some portfolios, there are significant differences in capital outcomes between banks using the IRB approach and those using the standardised approach to capital. The NZ CoFR members share concerns that such differences may have negative implications for competition, particularly where lower capital outcomes for IRB banks could not be justified by less-risky portfolios or the more detailed risk differentiation that one might expect from advanced modelling.

The IRB framework was originally put in place to allow banks to use their internal risk models to inform the calculation of regulatory capital. Banks' internal models were expected to improve risk management through improved risk differentiation and have led to a lower capital requirement than through the standardised approach (although this was never an objective of the IRB approach in the Basel II framework).

NZ CoFR members note that IRB status imposes significant and costly requirements on banks, including those around the development, monitoring, validation and governance of internal models. Not every bank has the necessary resources or capabilities to attain IRB status, and for many standardised banks employing such resources in order to achieve IRB status would be disproportionate to the size of their operations.

The Inquiry proposes some initial ideas as to how the gap between IRB and standardised risk weights can be closed. However, before aligning the two sets of banks by reducing the weights standardised banks use, it is worth assessing the appropriateness of those lower risk weights. IRB banks' risk weight outcomes could be more aligned with those of standardised banks. The RBNZ has some experience that might be useful to the Inquiry – the recent RBNZ Housing Review adjusted the correlation parameter for the housing portfolio in order to achieve higher capital requirements for IRB banks' high loan-to-value ratio mortgage lending. In addition the RBNZ has used floors and overlays in a number of areas to constrain outcomes under the IRB approach where it considers that those outcomes cannot be justified by the modelling or better risk differentiation.

Small and medium sized enterprises' access to finance

FSI Observation

There are structural impediments for small- and medium-sized enterprises to access finance. These impediments include information asymmetries, regulation and taxation.

Key CoFR message

- The Inquiry may benefit from examining aspects of New Zealand's Financial Markets Conduct Act (FMC Act) that seek to assist small- and medium-sized enterprises to access finance, such as crowd-funding and peer-to-peer lending, allowing growth markets to employ reduced disclosure regimes, and widening disclosure exemptions for issuers seeking funding for early-stage and private companies.
- The potential economic benefit from having more publically listed SMEs needs to be assessed against risks to investors and financial markets more generally.

The Inquiry observes that structural impediments exist in Australia for small- and medium-sized enterprises (SMEs) to access finance, identifying information asymmetries as a barrier to funding and a cause of higher loan interest rates for SMEs. SME access to capital markets is also identified as a barrier to raising capital due to the high fixed costs of raising funds.

Access to finance by SMEs has also been a particular focus for New Zealand and changes have been made under the FMC Act to remove structural impediments and support SME access to capital markets. These changes are outlined in further detail below.

Crowd-funding and peer-to-peer lending

Crowd-funding and peer-to-peer lending have been enabled under the FMC Act since 1 April 2014 such that prospective operators of crowd-funding and peer-to-peer lending platforms can now apply to the FMA to become licensed intermediaries. By licensing the providers themselves, fewer regulatory burdens are imposed on those seeking access to funding via licensed providers. Crowd-funding and peer-to-peer lending are likely to be of particular benefit to smaller firms who may find it difficult to access finance through more traditional methods.

Companies offering shares, and borrowers offering debt securities through these licensed providers are not required to supply investors or borrowers with a full product disclosure statement, although some minimum disclosure is required. Subject to any limitations introduced by licensed providers, a company could potentially raise up to $2 million in equity and debt capital through such offers in any 12-month period. Issuers and borrowers making offers through such licensed providers remain subject to the obligation not to engage in misleading or deceptive conduct.

'Growth' or 'stepping-stone' markets

The FMC Act also includes provisions for the development of regulations allowing 'stepping stone markets' within which disclosure requirements and conduct rules can be adapted to the particular market, issuers, and investors involved. The creation of such markets has been possible under existing securities law via Ministerial exemption, but, in recognition of the wider economic benefit that might be gained from these markets, the FMC Act facilitates the exemption process more effectively.

NZX has recently been granted a Ministerial exemption and is developing a 'growth' market aimed at SMEs looking to raise early-expansion and expansion capital. The exemption allows the market to operate with an alternative form of 'prescribed' continuous disclosure rather than full continuous disclosure of all price sensitive information. The alternative disclosure regime is intended to put in place clear, unambiguous disclosure obligations that are less costly to firms, whilst still providing adequate ongoing information to the market. This is largely done through 'brightline' tests for matters and events that firms listed on the market must disclose.

Whilst there is potential economic benefit in having more SMEs listing on public markets, the potential benefit needs to be assessed against risks to investors and New Zealand's financial markets more generally. The FMC Act sets out statutory criteria against which the risks and benefits of 'stepping stone' markets that might be developed are to be assessed. The FMA is currently considering the rules for the new growth market.

Other recent changes to assist SMEs

The FMC Act also addresses uncertainty around exclusions from the disclosure requirements in the previous regime, widening and clarifying disclosure exclusions including raising capital from experienced investors and investors that they have a relationship with, and for small offers of debt or equity (for example angel investor networks).

The FMC Act also seeks to reduce compliance costs to businesses offering employee share schemes, by allowing businesses a means of retaining more capital to invest, and to issuers of listed financial products (excluding derivatives) who wish to offer same class quoted financial products.

Fees for superannuation funds

FSI Observation

There is little evidence of strong fee-based competition in the superannuation sector, and operating costs and fees appear high by international standards. This indicates there is scope for greater efficiencies in the superannuation system.

Key CoFR message

- New Zealand's recent disclosure reforms under the KiwiSaver (Periodic Disclosure) Regulations 2013 were intended to raise awareness of fee levels and provide a clear comparison between funds.
- New Zealand conducted a review and appointment process recently for the default KiwiSaver funds resulting in lower average fees. The fee levels for default providers set the baseline for the wider market. The process for appointment may be of interest to the FSI.

Fees for New Zealand KiwiSaver funds are lower on average than for Australian Superannuation Guarantee funds, despite a much smaller size. NZ CoFR members note that the Inquiry has already considered the approach taken to the KiwiSaver fees through the recent Grattan Institute report[1]. The Grattan report uses the New Zealand default provider review process as an example of how Government can influence fees. We outline this process below, in addition to recent regulations increasing transparency of fund provider metrics.

Background on New Zealand's retirement income system and KiwiSaver

1 Minifie, J., Cameron, T. and Savage, J., (2014) *Super Sting: how to stop Australians paying too much for superannuation*, Grattan Institute, Melbourne, p. 25.

New Zealand has a retirement income system comprising of three pillars:

1. New Zealand Superannuation benefit: a universal, non-means tested benefit payment to all over 65s (subject to minimum residency and offsetting of overseas state pensions).
2. KiwiSaver: an incentivised, opt-out, voluntary workplace savings scheme.
3. Private retirement savings.

KiwiSaver was launched in 2007 and is therefore not as well developed or as significant to the New Zealand economy (NZ$21 billion under management) as the Superannuation Guarantee scheme is to the Australian economy. KiwiSaver differs from its Australian counterpart in that it is one of 'soft-compulsion' whereby salary and wage earners are automatically enrolled upon commencing a new job with a right to opt-out. Around 80% of the labour force participates in KiwiSaver. Salary and wage earners can make contributions of 3, 4 or 8% of gross salary (or more if they wish) with employers required to contribute at least 3%. The self-employed can opt-in and have no minimum contribution requirement. Contributions are locked in until age 65 with some exceptions for first home purchase and financial hardship withdrawals.

The financial incentives offered to KiwiSaver members are: a one-off NZ$1,000[2] 'kick-start' payment upon commencement and a tax credit up to a maximum NZ$521 p.a. (NZ$ 0.50 for every NZ$1 of contributions).

Private sector KiwiSaver providers receive members' contributions via the Inland Revenue Department. Members are free to change between KiwiSaver providers and the funds must action a transfer request within 30 days. There are 29 providers in total. Nine of these providers have default funds for members who do not actively choose a fund or provider.

Fee levels

The weighted average fees for all KiwiSaver funds are: average fixed fee of $29.50 p.a. plus an average variable fee of 0.863% p.a. of funds under management (excluding the small number of funds with performance fees). The average fee for the nine KiwiSaver default funds is $31 p.a. plus a weighted average variable fee of 0.5% p.a. of funds under management. It is to be expected that default provider fees are lower given their minimal marketing costs.

Default funds

Default funds account for 22% of all KiwiSaver members and 20.5% of total funds under management. The default funds have a conservative[3] investment mandate. The Government appoints default providers for a seven year term. The most recent tender for the second seven year term concluded in early 2014 and resulted in the appointment of nine default providers' on 1 July 2014. New members are allocated sequentially to the default funds and re-appointed default funds

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2 The NZD/AUD exchange rate as of 11 August 2014 is: NZ$1 = A$0.9125

3 Only 15-25% of assets may be invested in 'growth' assets such as equities or property with the remainder in fixed interest or cash assets.

retain their members from their previous term (non-reappointed funds' members would be distributed evenly among the successful default funds).

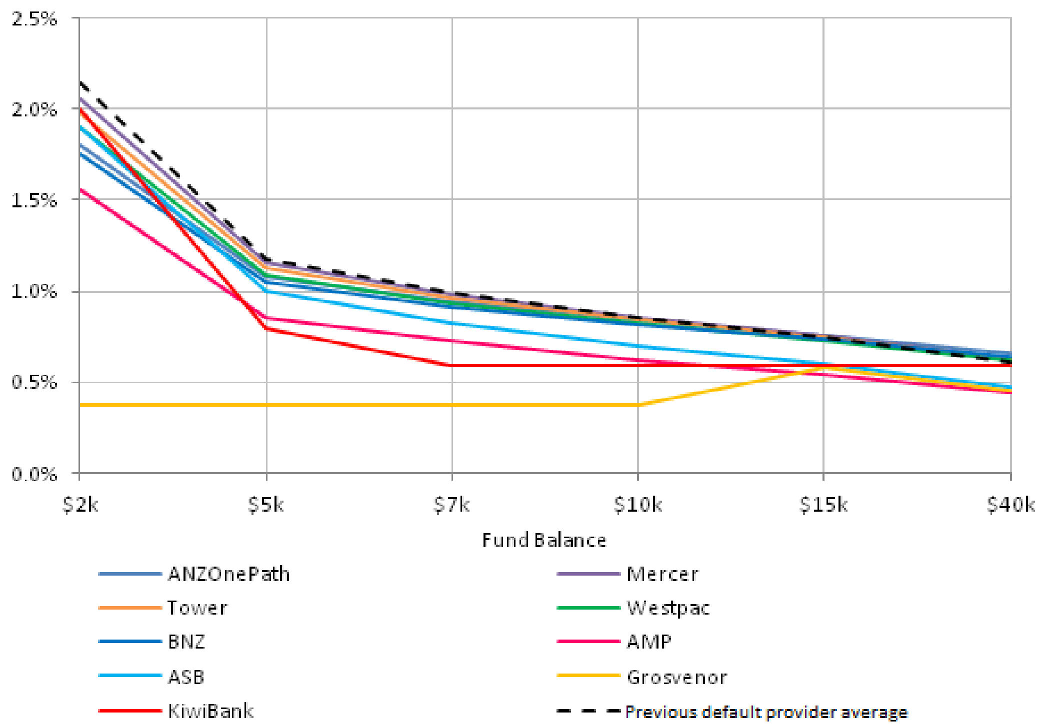
Default fund tender process

The default fund tender process was structured to be a competitive process and was administered by the MBIE. A Request for Proposal document set out the criteria for assessment. An independent Evaluation Panel of five private sector experts assessed the responses from providers supported by a fees assessor and negotiator in addition to private sector consultants each responsible for project management, financial due diligence, probity, process assurance, and legal advice.

A two-stage process was adopted to assess proposals. In the first stage, the Evaluation Panel scored the submissions on their technical merits. This resulted in a small number of submissions being ruled out. In a second stage, the remaining submissions were assessed for their fee proposals in greater detail and submitters had a further opportunity to amend their fee proposal. Submitters were ranked on the basis of the overall scores and officials provided Government Ministers with the outcome of the assessment and recommendations. Ministers decided on the appointment of nine default providers with the decision announced on 28 March 2014 to take effect from 1 July 2014 for a seven year term.

The tender process did result in lower average fees for the default funds in comparison to the fees for default funds in the preceding seven year period as Figure [1] below shows.

Figure [1]: Fees as a percentage of different fund balances for default KiwiSaver funds effective from 1 July 2014 (Source: Treasury analysis March 2014)



The Government also encouraged competition between default providers by ensuring that default fund managers must permit transfers into their schemes. A considered decision was made to weight fees by 30% and weight balance sheet strength, governance and other technical requirements by 70% towards the overall score. A greater weighting of the assessment scoring to fees may have lowered fees even further. Furthermore, while officials were very pleased with how the tender process was carried out, alternative procedures once a group of technically proficient providers had been identified (e.g. auction process or tender on fees alone) may have resulted in a different outcome. Finally, it appears from anecdotal evidence that the wider KiwiSaver provider market is becoming more fees-focused, but it is unclear what role the default provider review and appointment process had on this. Nevertheless, the arrangements for default providers do set the baseline for fees in the wider KiwiSaver market.

Other policies which have affected fees

New Zealand's recent disclosure reforms under the *KiwiSaver (Periodic Disclosure) Regulations 2013* were intended to deal with many of the issues in regards to raising awareness of fee levels and providing a clear comparison between funds. Providers are now required to provide quarterly reports of a number of relevant metrics, including fees and total expense ratios. These regulations have also allowed the development of an online fund-finder fee calculator by the *Commission for Financial Literacy and Retirement Income*, to allow consumers to compare information about funds, including on fees (http://fundfinder.sorted.org.nz/).

There is some evidence that increased fee-based competition is already happening in New Zealand, with fee levels featuring in providers' advertising campaigns. While it is too early to judge the overall impact of these changes, Officials will assess the KiwiSaver fund manager market in the medium term.

Asset allocation of superannuation funds

FSI request for further information

We note that the FSI has questioned whether the allocation of superannuation assets is optimal and whether liquidity and other rules create inefficiencies (pp. 2-110 to 2-115).

Key CoFR message

- New Zealand officials are keen to follow the Inquiry's findings on any distortions in capital markets caused by policies toward superannuation funds.
- While comparatively 'young' and a non-compulsory scheme, KiwiSaver does not appear to have had distorting effects on the capital markets.

Too big to fail

FSI Observation

During the GFC, significant government actions in a number of countries, including Australia, entrenched perceptions that some institutions are too-big-to-fail. These perceptions can be reduced in Australia by making it more credible to resolve these institutions without Government support.

Key CoFR message

- The role institutions play providing or supporting critical financial market infrastructure, such as payment systems, defines systemic importance.
- System stability can be approached in a range of ways, but it is important that countries have options to resolve institutions, while retaining access to core services.
- Steps to reduce the expectation that public support will be forthcoming can strengthen institutions and reduce the probability of crises.

The Inquiry makes the observation that actions taken by governments in a number of countries may have entrenched perceptions that some institutions are too-big-to-fail. We agree that it is important that government policy should act to minimise the expectations that public support will be forthcoming to minimise moral hazard and ensure markets accurately price risk.

There are a number of ways this could be accomplished. A major challenge is to identify policy options that act to:

- improve market efficiency;
- limit the impact on the wider economy;
- strengthen market discipline on the bank's creditors.

The use of the "*too big to fail*" label has grown in popularity, although the term may mischaracterise the problem, which could unduly bias policy in a particular direction. The role an institution plays providing or supporting critical financial system infrastructure is a more important determinant of systemic importance than size in and of itself. Payment systems must continue to function and a loss of access to accounts could prove disruptive. In considering options we would encourage careful consideration of options to protect critical financial market infrastructure with careful consideration of the potential impact on market efficiency.

The thrust of international work has been to provide options to allow systemic banks to fail in a structured way that minimises the risk of contagion to other parts of the financial system. The inquiry's interim report provides a reasonable survey of the range of options being considered in other jurisdictions from increased capital to improve resilience ex ante through to stronger resolution powers to ensure systemic institutions can fail in an orderly fashion.

New Zealand has taken a number of steps to improve the stability of the New Zealand banking system, which shares a similar level of concentration to that observed in the Australian banking system. New Zealand was quick to:

- implement the Basel III capital standards;
- tighten risk weights on housing to address an emerging risk with potential systemic implications;
- proactively introduce liquidity requirements ahead of global standards following the shock to capital markets through the global financial crisis.

Other jurisdictions have imposed the requirement that systemic banks hold additional capital. New Zealand has not considered targeted capital requirements as the direct financial cost of failure would be borne by the bank's creditors. Targeted capital requirements, should they be used, should avoid any suggestion that some institutions are considered "too big to fail". As such, it is important to consider the other reasons additional capital requirements are required to, for instance, influence the probability of failure or to reduce the wider economic and social costs of failure should the institution fail.

It is neither possible nor desirable to entirely remove the risk of failure. The cost to market efficiency could start to outweigh the benefits of additional regulatory requirements should regulators adopt an overly risk averse approach. As such, we support the Inquiry's approach to consider the regulatory requirements for capital alongside the need to invest in the pre-planning and pre-positioning of additional regulatory powers to respond to financial failure.

Despite industry concentration, the New Zealand framework continues to anticipate periodic bank failures and seeks to ensure that these failures can be managed in structured way. The long-term costs associated with bank failures are likely to be best managed by having a range of options available and having the flexibility to employ those options as appropriate on a case-by-case basis. We consider it imperative that these options include tools capable of resolving systemic institutions whilst maintaining core services.

The recently implemented Open Bank Resolution policy is an example of such a tool. It facilitates the resolution of a failed bank and is largely in line with the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions[4]. It adds to the set of options available in New Zealand but it is not the only resolution option. Others include a joint Trans-Tasman solution, liquidation, government support or an industry solution with government support.

The failure of a systemic institution will carry costs, regardless of the tool. It is therefore vital that appropriate powers are in place to enforce losses on shareholders in the first instance, and creditors if necessary, to minimise the costs on taxpayers.

Pre-planning and pre-positioning for financial failure are vital elements of a robust crisis management framework and need to be carried out at multiple levels. This is likely to include both material modifications to internal procedures and systems within institutions to enact resolution tools when required, and system wide structures and arrangements to support resolution processes (e.g. payments system rules to maintain functionality during a failure). Furthermore, it is essential that regulatory authorities and governments conduct their own pre-planning to ensure that procedures are in place to support timely, coordinated responses.

There are real costs associated with all of these elements of pre-positioning, but these are likely to be outweighed by the benefit of enhanced crisis management in the long run. The RBNZ has quantified the anticipated costs of pre-positioning a bail-in policy (that is, the New Zealand Open Bank Resolution policy). Analysis suggests there was a material benefit from the introduction of bail-in powers. A bail-in policy may reduce the fiscal cost of crises. However, we anticipate the primary benefit of a bail-in policy will come through a reduced probability of crises should markets accurately price the risk of failure following a reduction of an implicit government guarantee (see http://www.rbnz.govt.nz/regulation_and_supervision/banks/policy/5014272.pdf).

[4] http://www.financialstabilityboard.org/publications/r_111104cc.pdf

Macroprudential

FSI Observation

A number of jurisdictions have implemented new macroprudential toolkits to assist with managing systemic risks. The effectiveness of these for a country like Australia is not yet well established, and there are significant practical difficulties in using such tools.

Key CoFR message

- The RBNZ has decision-making powers for macro-prudential policy under the Reserve Bank of New Zealand Act 1989. In the New Zealand context, it is a logical adjunct to the Reserve Bank's responsibility for financial stability, and enables the coordination of monetary and macro-prudential policy.
- We agree with the Inquiry that experience with macro-prudential tools is limited in advanced economies, and caution needs to be exercised in implementing such tools. However, the Inquiry can take some confidence from New Zealand's experience.
- Developing an explicit framework for macro-prudential policy can add clarity to how prudential instruments will be used to target financial stability, thereby potentially reducing uncertainty in the financial system.

The prudential regulation function in New Zealand has long had a focus on the stability of the financial system, similarly to Australia. New Zealand has some practical experience in the area of macro-prudential policy, which may be of assistance to the Inquiry in making recommendations on the Australian macro-prudential framework.

In New Zealand, a specific policy framework has been created for macro-prudential policy. A Memorandum of Understanding (MoU) between the RBNZ and the Minister of Finance on macro-prudential policy was signed in 2013, to provide "clarity on the objectives and instruments for macro-prudential policy, so that emerging systemic risks are able to be addressed in a timely manner". The key elements of the framework, are:

- Macro-prudential policy is expected to involve actively varying prudential tools over time to promote financial stability, aiming to (i) increase the resilience of the financial system, and thus the scope for banks to continue lending during a period of rising loan losses and/or reduced liquidity and (ii) dampen the extremes of the asset and credit price cycle.
- Four agreed macro-prudential tools: (i) a counter-cyclical capital buffer (ii) sectoral capital requirements (iii) a core funding ratio and (iv) loan-to-value restrictions for residential mortgages.
- The RBNZ has decision-making powers for macro-prudential policy. The advantages in the New Zealand context of this are that it is a logical adjunct to the Reserve Bank's responsibility for financial stability, and enables the coordination of monetary and macro-prudential policy. However, we recognize that different frameworks are being adopted across countries, partly reflecting the characteristics of the existing institutional frameworks.
- The MoU focuses on the application of macro-prudential tools to registered banks but acknowledges that, in some circumstances, it may be desirable to apply macro-prudential instruments more widely.

The RBNZ will advise the Minister of Finance of any proposed changes to the macro-prudential framework. This includes proposals to add new macro-prudential tools, or to broaden the regulatory perimeter to include non-banks.

The RBNZ has some practical experience in implementing macro-prudential policy, having introduced a speed limit on high loan-to-value lending in October 2013. This experience may be useful in assessing the potential for an explicit macro-prudential policy framework in Australia. The key features of the policy were:

- A clear goal of moderating risks to financial stability associated with rapid growth in house prices. At the outset, the RBNZ outlined its expectations for the likely moderating effect of the restrictions on house prices and credit growth. To date, the effect of the speed limit has been towards the upper end of these expectations.
- Prior to implementation, the RBNZ consulted widely with the industry. This enabled the industry to plan for implementation, and to quickly comply with the policy well within the 6 month transition window allowed.
- The RBNZ was conscious of potential negative effects on efficiency and potential for financial activity to move to the unregulated parts of the system. This led to (i) the use of a speed limit approach, allowing some high-LVR lending to continue, (ii) the decision that the limit will be temporary; and (iii) the use of exemptions (including loans for construction, where a tightening in availability had the potential to worsen housing imbalances).
- The RBNZ coordinated the speed limit with monetary policy. The RBNZ believes that the speed limit, by dampening inflation pressures associated with housing and credit demand, may have allowed the monetary policy tightening cycle that commenced in March 2014 to begin somewhat later. In turn, the recent tightening of monetary policy is expected to support the financial stability objective of the speed limit.

We agree with the Inquiry that experience with macro-prudential tools is limited in advanced economies, and caution needs to be exercised in implementing such tools. Nevertheless, the Inquiry can take some confidence from New Zealand's experience. Developing an explicit framework for macro-prudential policy can arguably add clarity to how prudential instruments will be used to target financial stability, thereby potentially reducing uncertainty in the financial system.

See: Dunstan, A (2014) 'The interaction between monetary and macro-prudential policy, Reserve Bank of New Zealand *Bulletin,* 77:2.

International comparability of bank capital requirements

FSI Observation
Australia has implemented some aspects of global prudential frameworks earlier than a number of jurisdictions. It has also used national discretion in defining capital ratios. When combined with other aspects of the prudential framework and calculated on a consistent basis, Australian banks' capital ratios (common equity tier 1) are around the middle of the range relative to other countries. However, differences such as those in definitions of capital do limit international comparability.

Key CoFR message

- While international regulatory consistency may improve the comparability of outcomes, the RBNZ believes that there is no one-size-fits-all policy and considers it important for national regulators to tailor policies to their specific needs.
- Comparability across and within countries can be improved despite differences in regulations across countries and we welcome any work to improve international comparisons of capital ratios, and will continue to work on improving comparability across banks within New Zealand.

The report rightly raises the issue of complexity of the Basel capital calculation for IRB banks. The RBNZ is also concerned that the complexity of the Basel II and Basel III frameworks obfuscates banks' capital ratios and makes across-country and within-country comparisons difficult. Differences in outcomes across countries may reflect many factors, including national discretions exercised within the Basel II and Basel III frameworks as well as differing supervisory approaches.

While the RBNZ default position has generally been to adopt international guidance on prudential requirements, we will continue to only do so where it is in New Zealand's wider interest. On a few occasions, we have consciously decided to depart from the Basel Committee's recommendations or have implemented policies ahead of the Basel Committee's recommendations or principles. Examples of this include the RBNZ's decision not to implement a leverage ratio or a D-SIFI charge and the early introduction of quantitative liquidity requirements in New Zealand.

While international regulatory consistency may improve the comparability of outcomes, the RBNZ believes that there is no one-size-fits-all policy and considers it important for national regulators to tailor policies to their specific needs. In general capital requirements in Australia and New Zealand are reasonably well aligned, not least due to a shared regulatory capital philosophy which emphasises conservative capital outcomes. Except for housing and rural portfolios, our IRB banks tend to use models similar to their parent banks in Australia, although they may be calibrated to a slightly more conservative outcome in New Zealand to take account of our specificities such as smaller markets and fewer data points.

Nevertheless, we believe that comparability across and within countries can be improved. Therefore we would welcome any work that attempts to aid international comparisons of capital ratios and will continue to work on improving comparability across banks within New Zealand.

Corporate Governance

FSI Observation
To contribute to the effectiveness of the financial system, sound corporate governance requires clarity of the responsibilities and authority of boards and management. There are differences in the duties and requirements of governing bodies for different types of financial institutions and, within institutions, substantial regulator focus on boards has confused the delineation between the role of the board and that of management.

Key CoFR message

- The Inquiry rightly points out the importance of sound corporate governance and the need for clarity of the responsibilities of boards and management.
- FMA agrees that clarity of regulator expectations on the roles and responsibilities of boards is important and, to this effect, is currently working to refresh its Principles and Guidelines on Corporate Governance. Given the interconnectedness of our markets and the number of entities that operate within both the Australian and New Zealand financial systems (including those that are dual listed), New Zealand is keen to follow the Inquiry's findings and any future recommendations aimed at ensuring good governance.

Financial product disclosure

FSI Observation
The current disclosure regime produces complex and lengthy documents that often do not enhance consumer understanding of financial products and services, and impose significant costs on industry participants.

Key CoFR message

- New Zealand shares Australia's concern over current financial product disclosure documents.
- The Inquiry may benefit from examining the new disclosure regime instigated by New Zealand's Financial Markets Conduct Act. The new regime aims to deliver shorter, more effective disclosure that is tailored to meet the needs of a prudent but non-expert investor.

NZ members note that the Inquiry is considering policy options relating to financial product disclosure. We share the concerns raised by the Inquiry regarding the length, complexity and usability of disclosure documents. These are areas New Zealand has given much thought to in recent years in the context of a major overhaul of securities law - the Financial Markets Conduct Act 2013 (FMC Act). Some of the FMC Act is now in force with the remaining parts (including the disclosure requirements) effective from 1 December 2014.

Whilst it is too early to determine the full effect the FMC Act will have on New Zealand's capital markets, analysis of the steps taken in New Zealand may assist the Inquiry in making recommendations on the Australian disclosure regime.

Many of the changes to securities law made under the FMC Act resulted from recommendations made by a 2009 industry-led taskforce on the development of capital markets. The taskforce noted that New Zealand's financial product disclosure regime had resulted in documents that were difficult to understand. The taskforce also noted that providers had discretion to present data relating to their financial products in the most favourable light. This resulted in varying forms of disclosure, particularly in relation to fees, and meant that investors could not easily compare disclosed information between providers.

New Zealand's new disclosure regime incorporates both layered disclosure and better information presentation about financial product offers. More specifically:

- The first layer is the short product disclosure statement (PDS) which will be highly prescribed and subject to page limits, for example 12 pages for simple managed funds and around 60 for equity securities. These disclosure statements will include a two page key investment summary (KIS) to present the key facts about the product.
- A further layer of information will be lodged via the online financial products offers register. Issuers must lodge all other material information not in the PDS, including full financial statements, other relevant independent reports and valuations, trust deeds and material contracts. The online register will be a publicly searchable database designed to benefit investors, advisors and other market participants including by improving search efficiency and comparability across providers.

Financial Advice

FSI Observation

Affordable, quality financial advice can bring significant benefits for consumers. Improving standards of adviser competence and removing the impact of conflicted remuneration can improve the quality of advice. Comprehensive financial advice can be costly, and there is consumer demand for lower-cost scaled advice.

Key CoFR message

- New Zealand shares Australia's desire to see a strong and respected financial advisory sector and its concern over the quality and accessibility of financial advice and is keen to follow the Inquiry's findings in this regard.
- The Inquiry's findings will provide useful context for New Zealand's review of the Financial Advisers Act 2008, which is scheduled to commence in 2015.

The Inquiry points out that quality financial advice can bring significant benefits for consumers. It also notes that quality advice can be undermined by conflicted remuneration structures, while suggesting a range of policy options for improving adviser competence. New Zealand shares similar concerns about the quality of financial advice and the appetite of investors to consult advisors and is keen to follow any future recommendations made by the Inquiry in this regard. We are also interested in understanding any proposals the Inquiry may make to improve the accessibility of financial advice, including through more cost-effective scaled or limited advice. The Inquiry's findings will provide useful context for New Zealand's review of the Financial Advisers Act 2008, which is scheduled to commence in 2015.

Income products for retirees / annuitisation

FSI Observation There are regulatory and other policy impediments to developing income products with risk management features that could benefit retirees. ***Key CoFR message*** • New Zealand officials are keen to follow the development of policies for the de-cumulation phase in Australia as these will inform New Zealand retirement income and KiwiSaver policy. • The Government has supported the New Zealand Commission for Financial Literacy and Retirement Income commencing a broadly representative review to determine the viability of different approaches to the voluntary annuitisation of savings, including KiwiSaver balances.

New Zealand does not have a market for annuities products or other de-cumulation products for retirees. Some private providers appear to be active in establishing annuity-style products to meet perceived demand from retirees with growing KiwiSaver balances.

As outlined above, KiwiSaver has only been in existence for seven years but will grow in significance for providing retirees with income in the de-cumulation phase. New Zealand officials are therefore very interested in any developments in relation to income products for retirees in Australia.

The Commission for Financial Literacy and Retirement Income released a report on retirement income policies in 2013 recommending that the Government establish a broadly representative review to determine the viability of different approaches for the voluntary annuitisation of savings, including KiwiSaver balances.

Mutual recognition/ joint voice

FSI Observation Government efforts to promote Australia's policy interests on international standard setting bodies have been successful. Domestic regulatory processes could be improved to better consider international standards and foreign regulation, including processes for collaboration and consultation about international standard implementation, and mutual recognition and equivalence assessment processes. ***Key CoFR messages*** • New Zealand is committed to pursuing mutual recognition opportunities with Australia for the benefit of both countries. • Any changes to the financial services regulatory regime in Australia may impact existing mutual recognition arrangements. We suggest that this should be considered in any revised policy-setting environment.

Since 2008, the Mutual Recognition of Securities Offerings (MRSO) has provided a 'passport' approach to trans-Tasman offers of financial products. The MRSO enables issuers of securities to use one disclosure document to offer shares, debentures, or managed or collective investment schemes to investors on both sides of the Tasman, subject to meeting certain requirements. The scheme has proven to bring significant cost savings for issuers offering securities and also benefits investors by providing them with a wider range of investments.

In 2012, the FMA and the Australian Securities and Investments Commission also announced a mutual recognition programme for financial advisers which enables financial advisers to provide services in each other's countries based on the qualifications and experience they have attained from their home country.

We are mindful that any changes to the financial services regulatory regime in Australia may impact existing mutual recognition arrangements. We suggest that any revised policy-setting environment should prioritise the consideration of the benefits of a strong mutual recognition arrangement.

New Zealand also sees considerable benefits in working together with Australia to achieve mutually beneficial outcomes on international standards setting. Speaking with a single joint trans-Tasman voice on areas of mutual interest can enhance both Australia’s and New Zealand’s domestic policy interests and has assisted with development of standards in the past. For example, the current work on development of a managed funds passport for the Asia region.

Consistent with its membership of IOSCO, New Zealand continues to work with regulators in other jurisdictions to coordinate international standard-setting.

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