

Strengthening economic relations between Australia and New Zealand

A joint study

May 2012

ANZ Submission to the
Australian and New Zealand Productivity Commissions



EXECUTIVE SUMMARY

ANZ welcomes the opportunity to provide comment to the Australian and New Zealand Productivity Commissions' joint study into strengthening economic relations between Australia and New Zealand.

An effective framework of trans-Tasman regulation is vitally important to ANZ. Differences in regulatory approach can impose significant costs on companies operating across the Tasman. This is particularly true in the banking sector where there is significant commercial integration between Australia and New Zealand.

We also believe there are broader benefits for both countries' economies from increased harmonisation and economic integration. The Australia New Zealand Closer Economic Relations Trade Agreement (CER or ANZCERTA) has increased trade flows and economic growth in Australia and New Zealand. Ongoing effort towards a seamless economy will have benefits for businesses operating between Australia and New Zealand including by assisting Australian and New Zealand businesses, and our economies, to maximise the opportunities in the "Asian century".

In the banking sector, ANZ sees particular benefits in greater harmonisation in the following areas:

- Taxation – to enable the free-flow of capital between Australia and New Zealand through mutual recognition of franking credits and reform of withholding tax in New Zealand;
- Prudential standards – where there needs to be a consistent approach to a global set of standards such as Basel III;
- Crisis management and bank resolution – where there needs to be alignment of bank resolution schemes between Australia and New Zealand given that any bank failure in New Zealand is by logic a failure of an Australian bank;
- Transaction banking – harmonising as much as possible laws affecting account opening procedures to remove the need to identify a customer moving their account from Australia to New Zealand more than once;
- Super portability – Australia needs to enact the legislation necessary to permit the transfer of retirement savings between Australian APRA regulated superannuation funds and New Zealand KiwiSaver funds.

ANZ is a provider of banking and financial services to all parts of Australia and our New Zealand division, ANZ National, is the largest bank in New Zealand by net assets and profit, employing around 9,000 people throughout New Zealand. ANZ therefore considers itself well placed to comment on the need for harmonisation of the banking environment between Australia and New Zealand.

In the banking sector, there is substantial commercial integration between Australia and New Zealand. Over 85 per cent of New Zealand's banking assets are owned by the four major Australian banks. A paper by Australian Treasury officials supports greater regulatory harmonisation on the grounds that it will have benefits both for financial stability and efficiency:

From a financial stability perspective, the actions of one supervisor may have implications in the other country which need to be considered. In addition, due to the high level of commercial integration, the fallout from any financial difficulties in the four major banks is unlikely to be confined to a single country — even if it originates in one country.

From an efficiency perspective, minimising regulatory compliance costs and inefficiencies has direct benefits for banks, consumers and investors. In addition, allowing banks to choose an optimal structure and operate efficiently is important if they are to remain competitive in an increasingly global financial services environment.¹

An effective framework of trans-Tasman regulation is vitally important to ANZ. Differences in regulatory approach can impose significant costs on companies operating across the Tasman. While not all barriers to stronger economic relations between Australia and New Zealand are regulatory, removing unnecessary regulatory hurdles in the provision of financial services will help support the significant trade, investment, population and tourism flows between the two countries.

ANZ National is in effect regulated by both the Reserve Bank of New Zealand (RBNZ) and Australian Prudential Regulation Authority (APRA). Where there are differences in regulatory approach to a similar problem, we typically have to do things twice to comply. This increases compliance costs for ANZ, including increased complexity of staff training, complexity of compliance effort and the associated professional advice and administration costs. These costs are ultimately borne by consumers and we believe disproportionately fall on consumers in New Zealand where most of the duplication occurs.

We note that some effort has been made to harmonise banking regulation, most notably with the establishment of the Trans-Tasman Council on Banking Supervision in February 2005. As noted in the Issues Paper, the Council has not aimed to align regulatory objectives, rules and approaches but rather allow the two countries' regulatory frameworks and regulators to operate with fewer points of potential friction. The process resulted in reciprocal legislation being passed

¹ http://archive.treasury.gov.au/documents/1190/PDF/09_banking.pdf

in Australia and New Zealand requiring supervisors in each country, when taking regulatory action, to seek to avoid disruption to the financial stability of the other country.

Notwithstanding this effort, there remain a number of areas of difference between banking regulation in Australia and New Zealand which would benefit from more uniform approaches. This would improve the efficiency of the Australia and New Zealand banking sector.

BROADER ECONOMIC BENEFITS

As well as benefitting businesses operating in Australia and New Zealand, greater regulatory harmonisation and economic integration will have benefits for our economies and trade between our two countries and with the world.

The Australia New Zealand Closer Economic Relations trade agreement (CER or ANZCERTA) underpins the economic and trade relationship between Australia and New Zealand. Since its inception on 1 January 1983, the CER has delivered many benefits in terms of trade flows and economic growth in Australia and New Zealand. Total Australian investment in New Zealand increased from \$27 billion in 2001 to \$74 billion in 2011.² Similarly total New Zealand investment in Australia increased from \$17.6 billion in 2001 to almost \$30 billion in 2011.³

The most recent review of the CER focused on moving towards a single economic market, the goal of which is to create a seamless trans-Tasman business environment, minimising the distortions created by different regulatory and policy settings.

A trans-Tasman outcomes implementation group was established to oversee implementation of the program to accelerate regulatory harmonisation. The options for harmonisation have been guided by the following principles:

1. Persons in Australia or New Zealand should not have to engage in the same process or provide the same information twice.
2. Measures should deliver substantively the same regulatory outcomes in both countries in the most efficient manner.
3. Regulated occupations should be able to operate seamlessly between each country.
4. Both Governments should seek to achieve economies of scale and scope in regulatory design and implementation.

² Australian Bureau of Statistics, *International Investment Position, Australia: Supplementary Statistics, Calendar Year 2011*, 5352.0

³ Australian Bureau of Statistics, *International Investment Position, Australia: Supplementary Statistics, Calendar Year 2011*, 5352.0. It is important to note that the level of New Zealand investment in Australia peaked at almost \$43 billion in 2007 and has since fallen due to the global financial crisis – but it is still above 2001 levels.

5. Products and services supplied in one jurisdiction should be able to be supplied in the other.
6. The two countries should seek to strengthen joint capability to influence international policy design.
7. Outcomes should seek to optimise net trans-Tasman benefit.⁴

Ongoing effort towards a seamless economy will have benefits for businesses operating between Australia and New Zealand and continue to grow trade and investment. It will also assist Australian and New Zealand businesses, and our economies, to be more competitive in the global environment. The world is going through a once in a century shift in the global economic and political order toward Asia.

Australia and New Zealand are strategically well placed due to our geographic location and abundance of hard and soft commodities. There is a high level of demand for these commodities in emerging Asian countries and we expect this to continue for a number of decades to come. Our close relationship presents an opportunity for Australia and New Zealand to learn from each other and examine areas where we can work together to maximise the opportunities in Asia. In particular, reducing the regulatory burden on business will put us in the best position to compete in the global economy.

TAXATION

While it is unlikely that the Australian and New Zealand tax systems will be harmonised, there is longstanding bilateral support for improving the degree of cooperation between the two systems. ANZ sees particular benefits in greater harmonisation of taxation in areas which will enable free-flow of capital between the two countries and improve access to offshore funding markets.

MUTUAL RECOGNITION OF FRANKING AND IMPUTATION CREDITS

An important driver for a single economic market between Australia and New Zealand is the free-flow of capital between the two countries. However, existing policies regarding the recognition of New Zealand imputation credits in Australia and Australian franking credits in New Zealand impede the free-flow of capital across the Tasman. This current double taxation of trans-Tasman profits distorts investment decisions and is inconsistent with the concept of a single economic market.

Mutual recognition of Australian franking credits and New Zealand imputation credits would allow Australian shareholders to use New Zealand imputation credits (and New Zealand shareholders

⁴ Trans-Tasman Outcomes Implementation Group, <http://archive.treasury.gov.au/ttoig/content/tor.asp>

to use Australian franking credits), thereby making it more attractive for investors to invest across the Tasman.

Under mutual recognition the capital markets of Australia and NZ would become more integrated and competitive. The pool of investors from which capital could be sourced would be expanded and the cost of capital reduced as equity returns would no longer carry the tax inefficiency from double taxation.

While mutual recognition has been supported by the New Zealand Government, the Australian Government has been more reluctant due to concerns that it may significantly reduce Australian tax receipts. We believe there are broader benefits and the Australian Government should consider options to implement mutual recognition in this area.

WITHHOLDING TAX REFORM

Withholding tax imposed on interest paid from New Zealand (that is, on offshore borrowings) currently constrains access to offshore markets at competitive prices and hampers the ability of New Zealand banks to leverage the Australian parent's position.

While recent changes have been made to the New Zealand Approved Issuer Levy regime, these developments remain too narrow and generally do not apply to accessing offshore debt markets. As such, ANZ recommends the New Zealand withholding tax regime be aligned with the Australian withholding tax exemption under section 128F of the Income Tax Assessment Act, which applies to interest paid on certain "publicly offered" debentures and debt interests, where all prescribed conditions are met. In addition consideration should be given to broadening the withholding tax exemption to offshore deposits.

We acknowledge the concern with removing withholding taxes on interest in that parties can lend directly to New Zealand borrowers without paying tax in New Zealand on the interest earned.

However, in ANZ's view the overall effect of relaxing the withholding tax regime should be positive as it provides New Zealand banks with a source of funds which is currently not being accessed. We consider the changes to the existing tax law to be appropriate given the role that banks play in intermediating the New Zealand credit supply.

PRUDENTIAL STANDARDS

As noted earlier, with over 85 per cent of New Zealand's banking assets owned by the four major Australian banks. Substantial commercial integration exists between Australia and New Zealand. Given the closeness of the two systems, a more consistent approach is needed by the

prudential regulators on both sides of the Tasman. At present, different regulatory approaches are often taken to similar issues.

The Basel Committee on Banking Supervision released a package of reforms in 2010 to raise the level and quality of regulatory capital in the global banking system (Basel III). The Basel III reforms address the lessons learnt from the global financial crisis by providing a revised set of standards for capital and liquidity. This has provided a number of examples where different approaches have been taken by RBNZ and APRA to these global standards.

For example, the RBNZ is running a more accelerated implementation timetable than APRA. The RBNZ implemented its liquidity policy in 2010 which required ANZ to run a project in New Zealand to make the required changes. While the specific project implementation costs were not large, there were significant impacts on our resources in ANZ's Treasury and Market Risk functions. As APRA is now finalising its own Liquidity requirements, ANZ's New Zealand business will now need to do further work to ensure it can also comply with the APRA requirements.

In addition, there are a number of regulatory differences between RBNZ's and APRA's approaches to their capital rules. The RBNZ's capital rules result in ANZ National being required to hold more capital than under equivalent APRA calculations. This difference is expected to increase even further under additional proposed RBNZ methodology changes. This difference means that:

- ANZ National is disadvantaged when sourcing funding from offshore as investors typically concentrate on headline capital ratios and there is limited ability to explain local regulators' methodology differences;
- ANZ National must hold more capital to achieve the same capital ratio as an Australian bank, resulting in a lower return on equity for the same level of underlying risk; and
- Within the ANZ Group, ANZ National needs to compete for capital on a risk-return basis and this can impact the ability for ANZ National to attract capital.

CRISIS MANAGEMENT AND BANK RESOLUTION

Australia and New Zealand have taken very different approaches to ensuring the banking system in each country continues to operate in the event of a bank failure. Given the interdependency of the banking systems in the two countries, this should be a key area of policy cooperation. An actual crisis is likely to impact on both Australia and New Zealand either directly or indirectly. In a crisis, Australian and New Zealand regulators will have similar interests and we would expect regulator actions to be closely coordinated.

GENERAL APPROACH TO CRISIS MANAGEMENT

Over the last decade, the RBNZ has put in place a range of measures which are intended to assist the New Zealand financial system cope with a financial crisis. These include requiring local incorporation of large foreign-owned banks and deposit-takers and developing an outsourcing policy. The key element of the outsourcing policy is the requirement that large banks must have the legal and practical ability to control and execute any outsourced functions in a crisis. This includes functions which are performed by its Australian parent.

In 2003, ANZ acquired the National Bank in New Zealand. The RBNZ required that any transfers or outsourcing of the National Bank's core banking functionality will require RBNZ's further consent. At the time RBNZ Governor, Dr Alan Bollard, said core functionality includes "all management, operational capacity and systems necessary to operate the bank on a standalone basis in the event of a failure of an outsourcing provider, including parent bank."⁵ This was subsequently formalised in the RBNZ's Outsourcing policy in 2005.

We understand the RBNZ's priority to ensure that New Zealand's financial system can function even in times of extreme stress. However, it also needs to ensure that, in achieving this, it promotes efficiency in its financial sector and consumer benefit. Economies of scale mean it would be significantly less costly for ANZ to run a single system from one site to support our businesses in both Australia and New Zealand. In recent years, ANZ has spent over A\$100 million to upgrade our New Zealand core banking system to comply with the RBNZ's conditions on the National Bank acquisition and the outsourcing policy more broadly. This included returning core banking functions for the existing New Zealand business from Australia to New Zealand. In addition, the requirement to maintain two systems results in large additional costs in ongoing system maintenance, support and upgrade. This cost is disproportionately borne by consumers in New Zealand.

OPEN BANK RESOLUTION

In 2008, the Australian Government implemented a Financial Claims Scheme administered by APRA, guaranteeing deposits held in Australian Authorised Deposit Institutions (ADIs) up to \$250,000 per depositor per institution. In the event of the failure of an ADI, APRA would seek to recover what money it can from the failed institution. Any shortfall would be made up by a levy on the rest of the industry, ensuring taxpayers do not carry the risk of a bank failure and depositors do not bear any upfront cost given the low likelihood that any bank will need to access the Scheme.

The New Zealand Government ruled out the introduction of an ongoing compulsory deposit insurance scheme. The New Zealand Government held the view that deposit insurance is difficult

⁵ A Bollard, After the National Bank acquisition: living with big Australian banks, Address to the Australasian Institute of Banking and Finance, 6 November 2003

to price and blunts incentives for both financial institutions and depositors to manage risks properly.⁶

The New Zealand Government's approach is Open Bank Resolution (OBR). The OBR system allows the bank to be open for full-scale or limited business on the next business day after being placed under statutory management. Customers can then access their accounts to some extent while a solution to the bank's failure is found.

These different approaches mean that ANZ is required to run separate projects to comply. ANZ has consulted with the RBNZ on OBR and is putting together an implementation plan which will require significant technology investment by the June 2013 deadline. That said, ANZ has concerns about the different approach:

- There is limited analysis of the macro-economic impact of OBR; and
- There needs to be greater alignment of approaches to bank failure between Australia and New Zealand given that any bank failure in New Zealand is by logic a failure of a major Australia bank.

The need for greater integration in this area is supported by the Financial Stability Board (FSB) of the Bank of International Settlements which recently undertook a peer review of Australia. In its September 2011 report, the FSB found that there has been improvement in coordination with New Zealand on crisis management. However, the FSB says the finalisation of a joint resolution package with New Zealand "would further assist" cross-border crisis management.

SEAMLESS TRANSACTION BANKING

From a consumer perspective, a key benefit of regulatory harmonisation would be the ability to move their banking relationship from one country to another with minimal procedural steps. This would be similar to the way a customer of a Victorian-domiciled account can open an account with the same bank in NSW without needing to undergo additional account opening and identification procedures.

In ANZ's view, the Australian and New Zealand governments could most usefully support these efforts by harmonising as much as possible laws affecting account opening procedures. For example, each country currently imposes separate obligations on banks to verify the identity of customers at account opening.

This means that a customer with an Australian-domiciled account moving to New Zealand would need to re-establish his or her identify when opening a new account in New Zealand, even where

⁶ RBNZ, Open Bank Resolution policy – Q&A, <http://www.rbnz.govt.nz/finstab/banking/4368385.html>

the New Zealand bank is part of the same banking group (and is branded the same) as the customer's Australian bank.

Governments could assist in smoothing this process by establishing a mutual recognition scheme for customer identification requirements on banks as part of anti-money laundering and counter terrorist financing law. This scheme would recognise compliance with the identification requirement in one country as satisfying the separate requirements in the other jurisdiction.

Understandably, successful mutual recognition schemes are based on the participating jurisdictions having broadly consistent regulatory regimes.

SUPER PORTABILITY

At present, customers who wish to do so cannot move their superannuation accounts across the Tasman.

Superannuation members in Australia can only apply for early release of their superannuation savings on severe hardship grounds and on compassionate grounds. If an Australian superannuation member moves to New Zealand, they cannot use permanent migration to New Zealand as a basis for early release of their super, even if it is for the purpose of rolling their super to the New Zealand Government's retirement savings program, KiwiSaver.

On 16 July 2009, the Australian Treasurer and New Zealand Finance Minister announced the Trans-Tasman Retirement Savings Portability Scheme memorandum of understanding (MoU). The MoU permits transfers of retirement savings between Australian APRA regulated superannuation funds and New Zealand KiwiSaver funds.

The Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Act was passed by the New Zealand Parliament in 2010 giving effect to the MoU in New Zealand. However, the proposed changes are yet to be enacted in Australia.

In order to achieve trans-Tasman super portability, Australia needs to enact the legislation necessary to finalise the establishment of the scheme.

CONCLUSION

As a provider of banking and financial services to all parts of Australia and New Zealand, an effective framework of trans-Tasman regulation is vitally important to ANZ.

Differences in regulatory approach can impose significant compliance costs on companies operating on both sides of the Tasman. While not all barriers to stronger economic relations

between Australia and New Zealand are regulatory, removing unnecessary regulatory hurdles in the provision of financial services will support the significant trade, investment, population and tourism flows between the two countries. We believe it will also assist Australian and New Zealand businesses and our economies to be globally competitive and support trade with other countries, particularly in Asia.