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# Closer financial integration between Australia and New Zealand? Lessons from the EU

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# The Issue

While other countries round the world have responded to the GFC by integrating their financial systems and regulatory responses more closely together, Australia and New Zealand have if anything moved further apart except in so far as they are both responding independently to the same Basel/FSB initiatives.

The EU in particular has moved a long way with banking union and a proposed capital markets union.

The UK and US have moved to joint resolution plans for major banks while NZ has gone to OBR, ignoring Australia.

Are there lessons for us in this?

# Outline

- I. A preface on monetary union
- II. Banking union
- III. Capital markets union
- IV. Other facets of financial integration
- V. Concluding remarks

# I. A preface on monetary union

Banking union and other facets of closer financial integration do not require prior monetary union, either in the EU or elsewhere.

- Their usefulness stems from existing linkages;
- Banks run across borders inside and outside euro area (esp. UK).

Banking union in the EU has some odd contortions resulting from the need to agree a 'union' without a Treaty change (because that would have been impossible).

- ECB could be given responsibility for regulating banks under the existing treaty;
- Only euro area countries are represented on Governing Council so only these countries are fully in the main decision making.

## II. Banking union

Three parts:

Harmonised regulation (especially on capital standards);

Single Supervisory Mechanism (SSM);

Single Resolution Mechanism (SRM);

Structural change as in Volcker Rule (US) or Vickers (UK) and single deposit insurance not (yet) agreed.

Gains from harmonisation obvious in compliance costs.

Who would set standards – some Trans-Tasman Banking Council spin off to match the role of the European Banking Authority (EBA)?

# SSM equivalent?

There are clear gains from having a single supervisor.

- Better information, lower compliance costs;
- Difficult issues for RBNZ - should it act as agent for APRA or let APRA act direct through a local office? Like in the EU, all small financial institutions would remain RBNZ responsibility.
- There is no easy way of handling disagreement with unequal size countries/banking systems – no one country dominant in EU – in practice NZ would need to adopt Australian rules and decisions.

# SRM is where the main gains lie

SRM presumes SSM (no resolution responsibility without supervision).

Single Resolution Board (SRB) in Brussels – how would this be replicated?

Follow UK-US agreement. Resolution should normally be undertaken at group level by parent country – thereby keeping all systemically important foreign subsidiaries operating. i.e. Single Point of Entry approach.

This implies that the parent would hold the TLAC (total loss absorbing capacity).

- Burden not just Australia as shareholders/creditors international;
- In group, some TLAC can be provided through the subsidiaries.

## SRM 2

SRB would therefore be minor and NZ minority role would suffice.

But what happens if NZ subsidiary fails but parent healthy?

- Not a realistic hypothesis as parent would look weak if did not support subsidiary?

Reputation risk;

- NZ would apply current rules? (NZ OBR does not recapitalise).

Who pays?

- Bank Recovery and Resolution Directive (BRRD) assumes creditors;

- It requires asset separation, transfer powers, bailing in and bridge bank tools;

- But EU has both deposit insurance and depositor preference – this would be needed for NZ.



# Single Resolution Fund (SRF)

EU doesn't only require deposit insurance but a funded resolution fund in each country – mutualised gradually in the case of the euro area (funding rejected by Murray FSI).

- Small scale (1% of covered liabilities);
- Can only be used after an 8% bail in;

Too small - need recourse to the taxpayer to prop up confidence in banking system as a whole.

- Guarantees, injections into all banks as in TARP etc.;
- Major change for both countries.

Australia needs to act – Murray inquiry.

NZ scheme is not credible without deposit insurance.

Joint scheme cheaper and more efficient.

# Other issues

Macro-prudential – national responsibility but overall monitoring body as in EU with European Systemic Risk Board?

Lender of Last Resort – remains responsibility of central banks as currency dependent.

- Only lend to solvent institutions – supposedly.

## III. Capital markets union

Only a Green Paper so far;

Harmonising tax arrangements would help;

Efficiency gains from a single market?

More alternatives to bank lending needed, especially for SMEs?

## IV. Other facets of financial integration

Pensions/superannuation:

- EIOPA long-standing EU concern but not a GFC issue;
- Could be made more portable – issue of retirement income;
- NZ has actually made it less friendly – KiwiSaver can no longer be used to buy a first home in Australia;

Monetary union problems in euro area do not help encourage any thought about monetary or fiscal union.



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## V. Concluding remarks

Australia has little to lose from closer financial integration with NZ and it could help efficiency of regulation and reduce compliance costs.

The problem is for NZ where it would lose a lot of independence – however moving to SPOE for the 4 main Australian owned banks would offer a considerable advance over OBR.

NZ would be like individual small countries in EU or perhaps more like Norway which has to comply without a seat at the table – if small non-euro countries volunteer for the SSM/SRM this might be an indicator of net benefit.