Reform of Australian and New Zealand Financial Markets*

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1. Introduction

In surveying recent international trends in financial market regulation, the Bank for International Settlements commented that "the last 25 years have been an eventful time for central banking" (BIS, 1997a, p140), and pointed to the stagflation of the 1970s and radical transformation of the financial environment in the 1980s as key factors in driving change. Central Banks (and Governments), internationally, have made dramatic changes to the *modus operandi* of monetary policy, to the techniques used for prudential regulation and supervision, and in their oversight of payments and settlement systems in attempting to achieve monetary and financial stability. While these changes have occurred partially in response to the changing nature of financial systems, policies of financial deregulation adopted by governments searching for more efficient financial systems and responding to inconsistencies in previous regulatory structures exposed by financial innovation, have also been a key ingredient in the process.

The experiences of Australia and New Zealand match this template, although the regulatory frameworks developed by each government have some key differences[1]. This paper provides an analysis of those experiences, endeavoring to draw out common themes and significant differences. Section 2 provides a general overview of the Antipodean reform experience. This is followed in Sections 3 and 4 with more detailed descriptions of the historical experience and current position in Australia and New Zealand respectively. While the approaches to monetary policy have now largely converged after following different paths during the second half of the 1980s,

approaches to prudential regulation remain quite different. Section 5 focuses upon those differences, examining how each approach addresses some key questions in the design of regulatory structures, Section 6 provides some concluding observations.

2. Antipodean Financial Reform: An Overview

There are a number of parallels between the history of financial reform in Australia and New Zealand, although the paths traversed have differed significantly at certain key junctures. Twenty years ago, both countries had heavily regulated financial systems with an emphasis on direct controls applied primarily to the banking sector. Monetary control and prudential regulation were inexplicably intertwined in both countries under regulatory frameworks developed largely as *ad hoc* adjustments to historical experience. This had led to growth of less regulated financial institutions and financing practices which weakened monetary control mechanisms. Both countries responded with varying changes to the regulatory structure. In the Australian case, the rhetoric favoured market oriented techniques of monetary control, but reality involved occasional extensive use and extensions of direct controls. In the New Zealand case there was an aborted flirtation with financial deregulation from 1976-81. It was not, however, until the first half of the 1980s that financial deregulation became entrenched in both countries, and financial sector supervision started to become divorced from monetary control issues[2].

Driving these changes were a number of similar forces. The stagflationary experience of both countries from the mid 1970s, and inconsistency between budgetary and monetary strategies helped to undermine the feasibility of monetary policies based

around direct control techniques. Financial innovation, prompted in part as a response to regulation, further diminished the effectiveness of direct control techniques. Also important was the emergence of a free market ideology as the dominant political paradigm which favored financial deregulation. More broadly focused policy initiatives, including privatisation agendas, and significant changes to superannuation[3] arrangements for private provision for retirement in both countries have had important consequences for financial markets, by altering flow of funds patterns. In both countries, significant changes to the taxation system occurred in the mid 1980s with the introduction of *dividend imputation* tax systems, and this has also affected financing patterns (by reducing the tax disincentive to equity finance previously arising from "double taxation of dividends" under the classical tax system). In both countries, there has been a significant increase in the relative importance of managed funds and direct equity investments relative to depository institutions.

Australia proceeded down the path of financial deregulation slightly earlier than New Zealand, but the speed and strength of the Kiwi embrace of financial deregulation has seen that nation reach a "minimalist" regulatory structure unlikely to be achieved in Australia in the foreseeable future. While the outcome could be independent of the process followed, intuition would suggest not. Australian deregulation has occurred under the guidance of a number of large scale Government Inquiries into the financial system[4], providing opportunity for a variety of views and interests to find expression and possibly influence the set of reform outcomes seen as politically feasible. The New Zealand developments have been driven from within the political and public sector arenas, with less in the way of formal public discussion and input (although proposals developed within the official sector were distributed to interested parties for

comment). In that respect it might be asked whether the ability of the New Zealand government to introduce a relatively unique supervisory regime based on a clearly articulated, apparently simple, view of the financial system owes something to the nature of this process. Also relevant, however, is the fact that the parlous state of the New Zealand economy in the early 1980s provided a unique opportunity for radical changes which might not normally be politically feasible. Whether the New Zealand model is a superior one to the more complex approach of Australia, or whether it could be adopted in other nations with different institutional characteristics is a question considered later.

Whether financial systems and their regulatory structures can be viewed as tending towards some "steady state" is a moot point. Kane (1981) has popularised the notion of a regulatory dialectic in which financial innovation and regulation are continually reacting to each other and external forces, suggesting that an equilibrium regulatory structure is unlikely. Given the "minimalist" nature of the New Zealand regulation, it might be argued that it has reached something of a steady state, although the question arises (and is considered later) of whether the supervisory structure will induce changes in the structure and operations of the financial sector which are subsequently seen to have undesirable consequences necessitating regulatory revision. In contrast, the Australian financial system is still undergoing significant changes as the recommendations of the recent Wallis Inquiry (Wallis, 1997) are gradually implemented. And although the Wallis recommendations would, in some areas, see the differences between the two regulatory systems diminish, there remain some areas in which there are significant divergences.

Among the areas of similarity, an important one can be found in the approaches to depositor/ investor protection, with both countries eschewing any form of depositor insurance scheme or government guarantees of deposits. (The associated supervisory approaches do, however, differ dramatically – as explained later). Both have also accepted the Bank for International Settlements (BIS) risk based capital adequacy requirements (although the enthusiasm of the New Zealand supervisors for regulatory prescription of such standards appears muted[5] and they have not followed Australia in adopting the amendments to capital requirements based on market risk). Other than such capital adequacy requirements, there are few restrictions imposed in either country on bank activities, and monetary control operates essentially independently of supervision of financial institutions and markets, and without reliance upon direct controls over financial prices. Indeed, under the Australian reforms post-Wallis, the two activities (of monetary control and prudential supervision) are being placed with separate institutions.

The approaches to monetary policy have largely converged. Both Central Banks now operate under a form of *inflation targeting* although the New Zealand approach, premised on a strict assignment of monetary policy to an explicit target inflation rate established in a *Policy Targets Agreement* between the Government and Reserve Bank appears somewhat less flexible than the Australian approach. While the precise organisational and accountability structure for the Australian supervisory authorities under the Wallis proposals is still emerging, greater accountability and independence of the Reserve Bank was affirmed on the appointment of the current Governor in 1996. Again, the Australian arrangements appear to be somewhat more flexible than

those enshrined in *The Reserve Bank of New Zealand Act, 1989*. Whether, in both cases, flexibility is a virtue or vice is discussed later.

There are significant differences in the regulatory structures of the two nations. While both explicitly distinguish between "banks" and other financial institutions, the Australian approach does not involve such a clear cut distinction between banks and others. The New Zealand approach also places no restrictions on foreign ownership of banks or other financial institutions. In Australia the government has retained some restrictions on foreign ownership of major extant financial institutions, while otherwise allowing freedom of entry. The New Zealand approach places prime emphasis on the disclosure of information by banks to the public and gives no role to separate supervisory oversight, whereas the Australian approach gives the prudential regulator a key role in monitoring and supervising financial institutions. These differences reflect alternative approaches to attempting to ensure that incentive and accountability structures are such as to avoid moral hazard problems and to ensure that good corporate governance practices and effective market discipline is in place.

While both countries reject the notion of depositor insurance or *de jure* or *de facto* government guarantees of deposits, there is a fundamental difference in the underpinning thinking regarding approach to deposit safety. Whereas official Australian committees of inquiry into the financial system have asserted the merits of the existence of a risk free "safety haven" for depositors, enabling them to avoid risk assessment issues, the New Zealand model gives no credence to such a view[6]. This finds reflection in an Australian approach which involves the authorities monitoring

individual bank safety, in contrast to a New Zealand approach which perceives a role for the authorities only in the case of systemic crisis.

Rather than differences of principle between the two approaches, perhaps the most significant difference is the practical consideration that the Reserve Bank of New Zealand is largely a “host” supervisor, reflecting the fact that virtually all of the New Zealand banking sector (and thus financial sector) is foreign owned. (See Appendix 4). In contrast, the Australian financial system is still dominated by Australian owned financial institutions. (See Appendix 2). Whether a New Zealand “minimalist” model of supervision can effectively operate in a system where institutions are largely domestic entities, or whether freedom of entry and ownership can be expected to lead to a situation in which overseas entities dominate (facilitating such a supervisory model), are questions which warrant attention. For while the New Zealand model is sometimes held up as an example of how a deregulated financial system can be achieved and be viable, there is *de facto* regulation through home country supervision of the parent banks. Since the New Zealand banking sector can be interpreted (perhaps unfairly) as largely a part of the branch and subsidiary network of the Australian banking system, the success of the New Zealand supervisory model could be argued to be largely dependent on the success of the Australian approach.

3 The Australian Reform Process

3.1 The Pre-Reform environment

The Australian regulatory structure until the late 1970s was one of direct controls largely focused upon the banking sector[7] and reflected largely ad hoc responses to various events since and during World War II. The variable reserve requirement (Statutory Reserve Deposit (SRD) ratio), central bank power to impose limits on bank lending, and controls on bank interest rates can all be traced to war time initiatives. The secondary Liquid and Government Securities (LGS) reserve ratio on Trading Bank asset portfolios emerged during the l950s as attempts by the Central Bank to control bank lending were found to be thwarted by the policy of pegging bond yields and subsequent elasticity of the supply of primary reserve assets. The (generally constant) minimum LGS requirement was seen as the fulcrum upon which changes in the SRD ratio (the main policy weapon) operated to affect bank lending.

Trading banks were also precluded from paying interest on chequing accounts, and maturity restrictions limited (interest bearing) deposits to maturities in excess of thirty days. Indeed, until l980, the only market determined bank interest rates were those on "large" overdrafts and negotiable certificates of deposit. In return for these regulations, many of which had prudential overtones (holding safe assets, preventing destructive interest rate competition), the Trading Banks had access to lender of last resort facilities at the Central Bank and were generally perceived to have *de facto* guarantees of deposit safety. The banks also were the only authorised foreign

exchange operatives and helped administer the exchange control system which limited official forward cover (under the fixed (but adjustable) rate system and subsequent crawling peg system from 1976 to 1983) to a limited set of trade transactions.

The Savings Banks also faced quite restrictive regulation. Deposit raisings were restricted to the personal sector and subject to interest rate ceilings, and asset portfolios were restricted essentially to government paper and household mortgage debt. Mortgage interest rates were also subject to ceilings. On the deposit side, only "at call" and "notice of withdrawal" accounts were permitted (although the state (government owned) savings banks were permitted to offer chequing accounts). Other “thrift” institutions such as Building Societies and Credit Unions came under State government legislation, and were generally subject to similar, but slightly less restrictive, regulation.

From this brief review of banking regulation operating until the late 1970s, three features warrant emphasis. First, even in those markets open to them, banks were heavily constrained via interest rate controls and "tax" effects of various regulations. In the inflationary l970s these constraints had much greater bite, and innovative ways of avoiding them were developed[8]. Second, bank involvement in a number of important markets (such as wholesale funds and consumer loan markets) was restricted. Innovation (naturally) occurred: banks developed finance company subsidiaries; the merchant banking sector grew as subsidiaries of overseas banks entered (and domestic banks took equity stakes to the extent regulations permitted); other NBFIs grew rapidly.

A third feature was the structure of the government paper market. The enforced holdings of government debt by Trading and Savings Banks have already been noted, but the "captive" market extended much further to official money market dealers and (via tax concessions) to life offices and pension funds. Around 70 per cent of non official holdings of government debt were in captive portfolios, creating significant distortions to the demand side of the market. On the supply side, the primary market arrangements were not conducive to the conduct of market operations, with both Treasury Note and Bond issues being largely demand determined at institutionally determined and relatively inflexible yields. In this environment, it was not surprising that despite an expressed preference for "market oriented" measures, monetary policy operated until the l980s mainly by use of direct controls.

3.2 Structural Change and Reform

The Australian financial system has been profoundly changed by the process of financial deregulation since the late 1970s[9]. At that time, the banking sector was heavily regulated, foreign (and, it was believed, other) entry into banking was prohibited, banking and securities markets activities were segmented, public sector security markets were rudimentary, and financial market prices (exchanges rates and interest rates) were subject to government regulation. NBFIs, which were subject to less regulation, had grown more rapidly than banks over the previous decade (although some of the institutions involved were bank subsidiaries).

l979 was a turning point. The Campbell Committee of Inquiry was formed in January l979 and although it did not report until November l98l its existence focused attention upon ongoing developments in the financial markets. Moreover, the government did not (often could not) wait for its committee's report to alter the face of the financial system.

The Campbell Inquiry was established by a Liberal government with a strong free market philosophy (if not record) and was directed to focus upon the efficient operation of the financial system. This they did from a perspective which emphasised the benefits of free markets and took as fundamental the propositions that: competitive neutrality should apply; social and sectoral objectives should be tackled through fiscal measures rather than through interference with financial markets; some risk free, deposit type, asset should be available to unsophisticated investors. With the exception of their proposals regarding prudential regulation, the report advocated minimal government intervention. Monetary policy considerations received little attention.

While the Campbell Committee was in progress, changes in the financial system happened apace. The Federal government began to experiment with new methods of issuing government debt, leading quickly to adoption of a tender system. Changes in the procedures for State (and Federal) authorities' loan raising began, ultimately leading to a significant market in State government debt by the late 1980s. In February l98l a new banking licence was issued signaling that entry to banking was, in fact possible and a few months later two bank mergers were approved, reducing the number of major banks to four. Consolidation was occurring in other areas (building

societies, credit unions) as well and December l980 saw the introduction of Cash Management Trusts (money market mutual funds).

Apparently by chance, the entry of Cash Management Trusts coincided with the removal of all controls on bank deposit interest rates (except that on cheque accounts) although continued regulation of some asset interest rates (on housing loans for Savings Banks and "small" loans for Trading Banks), limited the ability of banks to vary deposit rates. The removal of bank deposit restrictions in December l980 marks the start of a massive process of deregulation commenced by the Fraser Liberal government and surprisingly accelerated by the Hawke Labor government elected in March l983--whose party platform had until recently contained a call for bank nationalisation. Given that party's traditional stance, the process was remarkably uncontentious--due in part to the general support for deregulation given by a second Inquiry (the Martin group) set up by Labor to review the Campbell Report's findings in the light of Labor's objectives. Appendix 1 presents a summary of major events, and indicates four major phases in the transition from a regulated to less regulated system in the 1980s.

The first, the actions in December l980, has already been discussed. The second, in mid l982, saw a further step in the deregulation of banks and their ability to compete with other sectors: remaining interest rate ceilings were raised; banks were allowed to enter short term deposit markets not previously permitted to them; the "tax" effect of reserve requirements was reduced; Reserve Bank guidelines limiting bank lending growth were removed (and ended as a technique of monetary management); and

lending opportunities for Savings Banks were expanded by the reduction in their LGS ratio.

The third phase in the deregulatory process was that of deregulation of the foreign exchange market culminating in the floating of the exchange rate and removal of most exchange control regulations in December l983 and authorisation of 40 new foreign exchange dealers in June l984. The fourth phase identifiable from Appendix 1 is that commencing in late l984 (although partly foreshadowed earlier). Banks were given freedom to pay interest on cheque accounts and compete freely in short term deposit markets. All remaining loan rate ceilings other than those on housing mortgages were scrapped, and captive market requirements on banks reduced and abolished for life offices and pension funds.

In addition to these changes, late l984 also saw applications invited for foreign bank licenses of which l6 were announced as successful in early l985. Concurrently, freedom of entry into merchant banking was announced (as a temporary--later continuing--measure) enabling foreign banks to enter or rationalise existing Australian interests. Additionally, Australian banks were allowed to obtain full interests in merchant banking subsidiaries while the deregulation of the stock market in l984 allowed banks a 50 per cent shareholding in stockbrokers. Completing this catalogue of changes was the scrapping in April l986 of interest rate ceilings on new home mortgage lending by Savings Bank.

Subsequently, policies towards supervision or regulation of the financial system have followed a process which some have referred to as “reregulation’, although such a

description ignores the reduction in barriers to financial conglomerates operating across the entire spectrum of financial markets (including banking, insurance, funds management and securities markets) which continued to occur. In accordance with international agreements, banks (and other depository NBFIs) have been subject to capital requirements, through the imposition of minimum capital requirements linked initially to counterparty or credit risk (since 1987 for banks) and more recently to market risk arising from trading activities. Risk based capital standards are also applied to life offices and stockbroking firms. Greater supervision of banks' internal risk management systems has also been put in place.

Rather than a process of "reregulation" it is perhaps more appropriate to see these developments as the prudent response of a government widely perceived to be a defacto insurer of the liabilities of certain financial institutions, endeavouring to prevent the moral hazard inherent in any insurance type arrangement. As part of the supervisory process, marked changes have also been made in the supervisory structure. The Insurance and Superannuation Commission (ISC) was established in 1987 to supervise the insurance and superannuation industries. State based powers over securities regulation and supervision of NBFIs, which impeded a nation wide policy, have been standardised and the Australian Securities Commission (ASC) and Australian Financial Institutions Commission (AFIC) established (in 1991 and 1992 respectively) to supervise companies and the securities industry, and NBFIs respectively. Concerns over the possibility of inconsistent regulation led to the formation of a Council of Financial Supervisors in 1992, comprising those two bodies, the Reserve Bank (RBA) and the ISC.

It is widely accepted that the 1980s process of financial deregulation was not ideally handled in Australia. Newly deregulated institutions in an unfamiliar competitive environment expanded credit rapidly contributing to asset price inflation and a minor financial crisis in the late 1980s. With the aid of hindsight, two deficiencies in the process were apparent – both reflecting gaps in the analysis of the Campbell and Martin Committees. One was the lack of attention paid to the operation of monetary policy in a deregulated financial system. In particular, the Reserve Bank was unable to determine the extent to which credit growth was a natural consequence of reintermediation (based on prudent lending by deregulated institutions) rather than a relaxation of credit standards. The other deficiency was the lack of attention paid in the analysis of deregulation to agency problems inherent in financial institutions. As a result, there was no coherent strategy to enhance corporate governance, accountability and market discipline or develop appropriate techniques of prudential supervision and suitable capital standards to accompany the removal of a plethora of regulatory constraints on managerial freedom[10].

Under the Wallis Committee proposals, a further round of regulatory restructuring is currently underway, involving the establishment of a prudential regulator of all financial institutions separate to the Reserve Bank which retains responsibility for monetary control[11]. At one level, this aggregation of prudential regulatory responsibilities can be seen as a rationalisation of the prudential supervisory process. At another level, however, the separation of monetary control and supervisory responsibilities can be seen as an attempt to minimise the perception of de facto government guarantees – since the prudential regulator has no significant asset base which could be used to compensate depositors in a failed institution.

3.3 The Current Australian Framework

Australian monetary control and prudential supervision are now effectively independent activities. Both the techniques used are, and the responsible bodies will soon be, effectively separated – a quite different situation to that prevailing prior to the 1980s.

Monetary control is effected by Reserve Bank market activities aimed at achieving a level of liquidity which ensures that the short term interest rate target announced by the Reserve Bank is achieved. The development of a monetary policy based on the announcement of a target short term interest rate dates from January 1990, and has involved over twenty changes in the target level since that date. Unlike its counterpart in New Zealand, the RBA has not been made explicitly accountable for achieving a target short term outcome for a single ultimate goal of policy (inflation), but adjusts its policy stance as it sees fit in the light of general economic conditions. Inflationary factors are however a very important determinant of those decisions, with an agreed medium term inflation target of 2-3 per cent having been adopted since 1996 as an objective of policy, and as an anchor for the formation of private sector expectations. MacFarlane (1997) dates the start of an "inflation targeting regime" for monetary policy as 1993 (following a monetary targeting regime between 1976 and 1985, and a "checklist" approach in the interim years), although formalisation of this approach

occurred with the 1996 Statement on the Conduct of Monetary Policy (Reserve Bank of Australia, 1996).

The adoption of this approach to policy has been facilitated by an explicit debt management policy framework, and introduction at the start of the 1980s of effective tender systems for the primary market for government debt. More recently, changes to the operations of Exchange Settlement Accounts have facilitated a more transparent means of liquidity management (and seen the demise of the Authorised Short Term Money Market Dealers).

Policy transparency has been increased with the six monthly production of a Semi-Annual Statement on Monetary Policy, and six monthly appearances by the Governor of the Bank before a Parliamentary Committee. Changes in policy are announced publicly and well documented. These developments, formalised in 1996, were also accompanied by an affirmation of the independence of the Reserve Bank in its conduct of monetary policy. Although the Reserve Bank Act (1959) established the power of the Bank's Board to act in an independent manner, in practice the ability of the Treasurer to veto decisions (and the necessity to obtain the Treasurer's explicit approval to use many direct control techniques in the earlier years where these were in vogue) had limited the effective independence. While there has been no formal change in arrangements, the explicit affirmation of the Bank's independence and necessity of public mechanisms for a government override of policy provides evidence of an acceptance of Bank independence. However, it would still seem to be the case as Davis and Lewis (1988) noted that "the authority of the Bank rests on the personality and style of the Reserve Bank Governor and his officials" (p251).

Prudential supervision of financial institutions is, under changes currently in process, to be the responsibility of the Australian Prudential Regulation Commission, which will have responsibility for supervising deposit taking institutions (including banks), life and general insurance companies, and superannuation schemes. The prudential regulator is to be empowered to establish prudential regulations on relevant licensed entities, and non licensed entities are generally to be precluded from offering key products such as deposits, insurance, retirement income products. The key plank in the prudential supervision process is the implementation of risk based capital adequacy requirements. The Australian approach sees " disclosure… as supportive of prudential regulation, not an alternative to it" (Wallis, 1997, p336). Disclosure and market conduct matters impacting upon financial institutions and providers of financial services (including exchanges and OTC markets), regulation of corporations, and finance sector consumer protection, are to be the province of the Australian Corporations and Financial Services Commission, ACFSC, (the successor to the Australian Securities Commission). Notably, the Wallis Report has recommended that finance companies and merchant banks not be supervised by APRA, but come under the purview of the ACFSC.

4. The New Zealand Reform Process[12]

4.1 The Pre Reform Environment

In reaching the current “minimalist” regulatory structure, financial reform in New Zealand has traversed a somewhat volatile path, although since 1984 there has been a consistency of purpose and direction limited only by the demands of international harmonization.

Prior to the election of the Labor Government in 1984, the New Zealand financial system was heavily regulated, although over the previous two decades there had been bouts of financial liberalisation which were quickly reversed as macroeconomic conditions threatened economic stability.

In the 1960s, the regulatory framework was one based on direct controls on banks (reserve ratios, controls on bank advances, interest rate controls) accompanied by growth of non bank institutions which thwarted low interest rate policies and induced moves to regulate non bank institutions. Easing of some direct controls in the 1969 Budget (including the abolition of capital issues controls, deposit interest rate flexibility) unaccompanied by more general changes to the conduct of monetary policy led to the expected effect of rapid monetary expansion and a return to regulation. Over the first half of the 1970s, the myriad of regulations created incentives for innovation by less regulated institutions and constrained banks' adaptability, and weakened monetary control. Leung (1991) notes that the Trading

Bank share of private sector credit fell from over 62% at the end of the 1960s to below 54% by 1984.

1976 saw a renewed attempt at financial deregulation with a relaxation of bank interest rate controls and a move towards more market related interest rates on government debt. However, the incomplete nature of this adjustment meant that monetary control was still found wanting and direct controls were strengthened in the early 1980s (and some interest rates frozen in line with the wage and price freeze introduced in mid 1982). Indeed, in surveying financial deregulation in New Zealand, the OECD commented that:

> "By 1982, financial markets were as heavily regulated as they had been in the early 1960s – a movement in stark contrast to the trend seen in most other OECD countries" (OECD 1989, p 42).

4.2 Structural Change and Reform

1984 saw a fundamental change in the approach to financial regulation in New Zealand following the election of the Labor government in July 1984. Liberalisation commenced virtually immediately (with the revoking of interest rate controls) and by the end of 1984 changes to the structure of government securities market had been made, other interest rate regulations on banks which inhibited their competing in certain markets were removed, credit growth limits abolished, and restrictions on international capital flows relaxed. In early 1985, all compulsory ratios on financial institutions were removed[13] and the exchange rate floated. Among private sector

initiatives, the New Zealand Futures Exchange was established and the first cash management trust appeared in 1985.

The flurry of deregulatory activity was formalised and extended in the *Reserve Bank of New Zealand Amendment Act 1986*. Underpinning the approach were principles of achieving competitive neutrality, increasing contestability, and development of a prudential supervision policy consistent with economic efficiency. Significant changes included: a licensing regime for banks (rather than a legislative entry barrier) with entry conditional on meeting general prudential criteria (capital, expertise, good standing, etc); ability of foreign owned institutions to become licensed banks; introduction of a disclosure regime; explicit rejection of de jure or de facto deposit insurance; freedom for other institutions to undertake "banking business" but prohibition on their use of the term "bank"; recognition of a failure management role for the Reserve Bank; introduction of the *Policy Targets Agreement* approach to monetary management. Also in June 1986, the Stock Exchange was deregulated, with fixed commissions abolished and incorporation of stockbrokers allowed. By 1987, the OECD was able to comment that:

> "Reform of monetary management and of the financial system has possibly been more profound than in any other area of the economy or for that matter elsewhere in the OECD" (OECD 1987, p39).

A second phase of financial reform occurred in the 1990s "concerned with re-engineering some of the basic legal infrastructure for banking and commerce and overhauling supervision arrangements" (OECD, 1998) particularly with regard to

reliance upon public disclosure and minimal supervision. In 1996 significant changes were introduced to bank supervision arrangements which involved further increase in public disclosure requirements, increased accountability of managers and directors, and a reduction in the prudential regulation of banks (such as removal of limits on particular exposures and requirements to provide additional information to the Reserve Bank). In essence, reliance upon disclosure and market discipline of individual banks has become a replacement for, rather than a complement to, official prudential supervision. Underpinning these changes have been the objectives of: increasing the role of market discipline; minimisation of compliance costs; removing taxpayer risk (associated with bail outs of failed institutions); improving the corporate governance structures of banks by strengthening incentives and accountability for bank management and directors.

4.3 The Current Position

The New Zealand supervisory system as at the start of 1998[14] is premised on a clearly articulated, simple, model of the workings of a market system – albeit one with which many might take issue. Fundamental to the approach, is reliance on public disclosure of information and an appropriate incentive structure (for customers of, and decision makers within, financial institutions) to ensure that “important” financial institutions behave prudently and will not undermine financial system stability.

A distinction is made in the supervisory structure between “banks” and other financial institutions, whereby institutions wishing to use the label of “bank” must be registered by the RBNZ and must meet certain prudential requirements. Those prudential

requirements involve meeting certain standards for registration (minimum capital of $NZ 15 million, good standing, prudential management, etc) and adhering to a public disclosure regime (and BIS style minimum capital requirements) once registered. There are no limitations on the ownership structure of a registered bank other than that the owners (entities or individuals) will have incentives to appropriately monitor activities. Prudential rules are essentially limited to capital requirements based on risk weighted assets and limits on exposures to connected parties. Capital requirements for market risk have not been adopted and "there are no prudential rules applying to asset quality, large exposures (except connected person exposures), country risk, liquidity, or market risk" (RBNZ 1997a, section 6 p 3)

The disclosure regime involves quarterly publication of a detailed General Disclosure Statement (GDS), together with a Key Information Statement (KIS) directed at the non-expert investor, which provide relevant financial information (credit ratings, guarantees, capital position, impaired assets, exposures, profitability, size, etc) to enable investors to assess the institution's financial health. The GDS relates to the bank and banking group as a whole, whereas the KIS relates to the banking group (the registered bank and its subsidiaries). While it is accepted that the typical bank customer will not study or fully understand these disclosures, "we expect that journalists, financial analysts, investment advisers and other professionals will, and that any significant "news" about changes in a bank's financial condition will spread quickly" (RBNZ, 1997b, section 3, p2)

There is no system of depositor preference (vis a vis other creditors) nor is there any form of deposit insurance, and a key element of the approach is to avoid any

impression or prospect of contingent taxpayer liability should a bank fail. Public provision of information and an incentive structure for depositors to monitor bank and thus deposit riskiness is one part of the total approach. The other element is the establishment of an accountability structure which gives bank management and directors strong incentives to ensure that "correct" information is disclosed and that banks have systems and procedures in place to ensure prudent operation. The outcome, it is hoped, is an efficient financial system, not hamstrung by costly compliance and regulation, in which the possibility of bank failure is minimal and non-contagious. As Brash (1997) notes the effectiveness of such an approach will depend upon the "infrastructure" which supports disclosure (corporate law, accounting and auditing standards, the ability of external accountants and auditors, the expertise of financial analysts).

Should a registered bank run into problems, the RBNZ has specific crisis management powers aimed at avoiding significant damage to the financial system. These range from its ability to place banks under direction or management to its ability to provide liquidity support and Lender of Last Resort facilities (to both banks and other institutions) in case of systemic crisis. The Reserve Bank has outlined broad principles which it will apply, emphasizing that it will only intervene in the affairs of a failed bank where systemic issues assume importance, and in doing so would avoid placing taxpayer funds at risk rather than losses being borne by shareholders and creditors (including depositors).

Other financial institutions fall outside of the RBNZ registration and disclosure regime, even though they are able to undertake exactly the same activities as

registered banks. Such financial institutions (which include life offices, managed funds, finance companies, merchant banks, building societies and credit unions) are subject to the provision of the Companies Act (1993) and the Securities Act (1978). Under the Act, the New Zealand Securities Commission oversees the activities of securities markets, deposit taking institutions (other than banks), and managed funds, and imposes prospectus requirements, public provision of investment product statements, and trustee and trust deed requirements on institutions issuing public debt instruments. Following changes to the relevant Acts in 1996, offers to the public no longer need to be accompanied by the registered prospectus but only by an "Investment Statement" (which can be provided electronically). Where banks have subsidiaries engaged in "non-banking" business, such as insurance or funds management, these activities are supervised by other regulatory bodies.

One outcome of the New Zealand approach has been the transformation of the structure of the financial sector into one dominated by registered banks, which are virtually 100% foreign owned. As at mid 1997, there were 19 banks (of which 18 were foreign owned) accounting for 73% of the assets of the New Zealand financial system. A further 16% of total assets were under the control of managed funds, and a relatively small number of other types of institutions were in existence. In such an environment, it might be argued that the significance of regulation applying to other institutions is minor. However, such institutions are able to offer the same set of products as registered banks (should they so wish). They can thus look like, feel like, be like banks – but cannot use the label of bank. Should such an institution get into difficulties, the obvious question is whether the delineating of banks from non banks by the labelling process will be sufficient to prevent the possibility of contagion

occurring and spilling over to banks. Likewise, it should be asked why the use of the term bank should be restricted to registered institutions – since alternative labels such as "disclosing institution" could be used. Most likely, there are safety overtones associated with the "bank" label and public perceptions of government backing which give such labelled institutions a competitive advantage. However, until the situation is put to the test and depositors lose money from a registered bank failure, this hypothesis remains untested.

The New Zealand approach to financial sector regulation is also characterised by a rigidly specified monetary policy role for the Reserve Bank, involving a high degree of independence and accountability[15]. In conjunction with the deregulation of 1984, the focus of monetary policy was shifted to a single goal of price stability. Under the Reserve Bank Act of 1989, this was formalised, where the specific target for inflation is agreed and documented in Policy Target Agreements between the Government and Bank. The Governor of the Reserve Bank is accountable for achieving that target, although certain caveats are provided for events (such as significant tax increases or oil price increases) where continued commitment to short term price stability would involve excessive economic costs. Moreover, the Bank is given a high degree of autonomy in pursuing that target, with any government wishing to deviate from the inflation target having to publicly override the PTA and renegotiate the PTA. As part of the Bank's accountability, public documentation of policy is required through a *Monetary Policy Statement* published at least every six months. In mid 1997, as part of this process, the Bank commenced publication of (both current values of and its forecasts for) the Monetary Conditions Indicator (MCI) which attempts to capture in a single index the impact of interest rates and exchange rates on economic activity.

With seigniorage from the note issue formally returned to the government, financial autonomy is achieved through formal five year funding agreements negotiated with the government.

5. Alternative Visions

In reviewing international developments in Central Banking over the past 25 years, the BIS noted that "this process has led to a greater emphasis on transparency, market incentives and the credibility of policies" (BIS, 1997a, p143), with the last of these factors inducing greater Central Bank autonomy and accountability, and specification of clearer goals for policy. The experiences of both Australia and New Zealand conform to this broad picture, but with some significant differences in the approaches adopted. Notably, the New Zealand approach involves apparently simple answers to the complex questions of how to ensure monetary and financial stability. Whether such simple answers work, or whether (echoing Kane's (1981) regulatory dialectic perspective) this will change the financial environment in such a way as to reduce the complexity of the questions or vitiate the effectiveness of those simple answers, is an important issue.

In the realm of monetary policy, both countries have converged upon apparently similar approaches. Both work with established inflation targets which provide the nominal anchor for private sector expectations and act as a benchmark against which credibility can be judged. Both provide semi-annual statements of monetary policy, and other relevant information, aimed at achieving policy transparency. Both provide for Central Bank autonomy, subject to a public political "override" process.

Despite those similarities, there are a number of subtle differences which suggest a more "hard line" approach by New Zealand.

The inflation targets in Australia are set with a medium term focus and allow for the Reserve Bank to operate by "taking account of the implications of monetary policy for activity and therefore employment in the short term" (RBA, 1996, p2). In New Zealand, the inflation targets are short term, albeit with specified caveats to allow for variation due to certain real sector or fiscal events. In both cases the commitment to a specific inflation target value is thus "conditional". Which, if either, approach provides greater credibility, and which is more compatible with overall effectiveness of macroeconomic policy are debatable issues.

While both countries have adopted freely floating exchange rates, there appears to be greater willingness of the Australian authorities to countenance intervention in the foreign exchange market if market trends seem at variance with market fundamentals. In essence, the Reserve Bank of Australia appears willing to accept that "market psychology" may sometimes go awry.

It is in the area of Central Bank autonomy that subtle differences are potentially the greatest. In Australia, the Reserve Bank Board includes the Secretary of the Treasury and is responsible for the formulation of monetary policy. While the Governor, as Chairman of the Board, can presumably drive the policy process, the potential exists for policy to be influenced at Board level by Treasury and Government views. In New Zealand, the "Board has no involvement in directing Reserve Bank policy, monetary or otherwise, and Board members do not receive market-sensitive information ahead of the markets. The Board's primary function is to monitor the Reserve Bank's performance, reporting to the Treasurer." (RBNZ, 1997c, p6). A second difference concerns funding. The RBNZ operates effectively as a "cost centre", relying upon five

yearly agreed allocations from the government to meet its operating costs. The RBA, on the other hand, receives the seigniorage from the note issue, out of which it can meet operating costs and remit a dividend to the Government.

Both countries now provide for a degree of separation between monetary policy and prudential supervision. In the New Zealand case, this arises from the central Bank largely eschewing responsibility for prudential supervision, except at a minimal level associated with bank registration requirements. Other (non bank) financial institutions and financial markets are supervised by the Securities Commission. In Australia, APRA is to be the separate prudential supervisor of depositor institutions and life offices, while supervision of securities markets and other financial institutions (finance companies and merchant banks) is to be undertaken by the ACFSC. In both countries, the Reserve Bank is responsible for supervision of payments systems.

In designing the supervisory structures, each country has identified a class of institutions as banks which are treated specially, but neither has effectively answered the long standing question of “are banks special”. In New Zealand, anyone is able to undertake “banking activities” (although compliance with the Securities Act is required), but use of the label of “bank” is restricted to registered institutions. Registration is, however, open to all who meet the minimum requirements. In Australia, use of the bank “label” is similarly restricted, but a separate classification of institutions undertaking similar activities is made, and these are also supervised by APRA. However, activities such as deposit taking and life insurance are not permitted unless the institution is supervised. In both cases the issue is in effect whether there is

a regulatory case for whether certain financial products should only be allowed to be offered by a set of licensed /supervised institutions.

Regulatory restrictions on the use of the label “bank” suggest that the term has some information content, and it must be asked from whence that arises. An obvious answer is that public perceptions are that institutions called banks are different in some way, and that allowing unlimited use of the label would lead to some form of market failure involving customers not adequately discriminating between institutions. If so, reliance upon disclosure to achieve market discipline seems inadequate.

The approaches adopted towards supervision are where the greatest variance arises. The New Zealand approach appears to be premised on a view that disclosure is a (perfect) substitute for prudential regulation, which is in distinct contrast to the Australian perspective. Consequent to the preceding difference, the New Zealand approach relies on the prudential supervisor having (virtually) no “insider information” about the financial condition of registered banks, in contrast to the Australian approach where such information is obtained via regular reporting requirements and (in recent years) on-site inspections. Indeed, in this regard, the New Zealand approach appears to be one which involves a stance somewhat at variance to that generally accepted by Central Bankers and Prudential Supervisors. For example, the New Zealand approach does not appear to meet a number of the “core principles for effective banking supervision” released in 1997 by the BIS (BIS, 1997b). Notable discrepancies involve: principle 7 (evaluation of bank policies, practices and procedures regarding loans and investments); principle 9 (prudential limits restricting

bank exposures to single or groups of related borrowers); principle 16 (on-site and off-site inspection).

Do these differences matter? One important issue concerns the question of the credibility of the assertions that government will not "bail out" depositors or other creditors of failed banks or other institutions. The New Zealand model, by explicitly eschewing a role for Central Bank supervision aims to distance the government from responsibility for deposit safety. The Australian model does not have that aura of distance. The issue is a complex one, made more complicated by the internationalisation of banking. The New Zealand approach relies on market discipline of banks and some (unknown) rate of bank failures could be expected to occur in such an environment. Whether that rate would be higher or lower than under a supervisory system is a moot point, although the Australian approach is premised on a view that it would be higher. The critical concerns are whether, when a failure occurs, one system is superior in enforcing the "no bail out" policy under political realities, and whether there are different likelihoods of contagion. Unfortunately, the New Zealand model does not provide a potentially useful testing ground for those questions, because of the internationalisation of its banking industry. Ultimately, banks in New Zealand are subject to home country regulation, by virtue of their overseas parentage.

This raises the final area of difference warranting comment, that of competition and ownership policy in the financial services industry. The New Zealand approach is premised on the view that there should be no regulatory constraints on the ownership of financial institutions (except for the requirement to meet general "acceptability"

requirements), including freedom of entry and acquisition for foreign based entities. While the Wallis Inquiry was of the view that current restrictions on foreign ownership of the largest Australian financial entities (the “six pillars” policy) should be removed, they were of the view that “a large scale transfer of ownership of the financial system to foreign hands should be considered contrary to the national interest” (Wallis, 1997, p 61). In New Zealand, such a transfer has occurred. To what extent this reflects the existence of efficiencies arising from internationalisation of banking (with consequent messages for Australian policy makers), ownership consequences of a “work out” of a distressed banking sector, or “flight” of local bank directors from the legal risks or harshness of competition associated with operating purely domestic banks in the deregulated environment, are important questions for the designers of regulatory structures in other nations.

In Australia, there is clearly still a perspective that “banks are different”, and that this is relevant to the design of regulatory policy. In New Zealand, policy is premised on there being no difference between banks and other institutions, but in practice the restricted use of the bank label induces such a difference.

6. Conclusion

The activities of, and regulation of, financial institutions are replete with agency problems, and the Australian and New Zealand regulatory systems provide interesting contrasts in approach to the resolution of such problems.

The New Zealand model is premised on the view that adequate disclosure of information[16] can resolve the standard owner-depositor conflict and obviate the need for government monitoring which can lead to the development of agency relationships involving government as a principal through (implicit or explicit) protection of depositors. That alone would be inadequate, since the opaque nature of financial institutions gives an important role to agency relationships involving bank management. Here the New Zealand model pays particular attention to legal responsibilities of, and possible penalties for, bank directors and management, and aims to maximize the effect of market discipline through (virtually) no restrictions on ownership or takeover, and the possibility of enhanced product market competition through the information provision requirements.

In contrast, the Australian approach is less sanguine about reliance upon improved information and market forces to ensure a sound financial system. Government monitoring of management of financial institutions is seen as a necessary complement to market discipline, a view consistent with the premise that governments may be able to obtain access to better information from financial institutions than can the private sector. However, once government takes on some responsibility for monitoring the management of financial institutions, the credibility of assertions that other stakeholders (e.g. depositors) will not be protected against loss is called into question by the nature of the political reality. While the Wallis reforms involve separation of the prudential supervisor from other agencies (such as the Central Bank) in an attempt to enhance the credibility of those assertions, that approach assumes (without any supporting evidence) that government administrative and organizational structures can alter public perception of political realities.

From an international perspective, the decisions by both countries to adopt policies which eschew explicit depositor protection but within quite different regulatory structures each aimed at providing credibility of a "no bail out" policy make for interesting case studies. Designing appropriate tests of the efficacy and efficiency of those national regulatory structures for financial system safety and efficiency, which take appropriate account of the internationalization of financial systems, provides an exciting challenge for future research.

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Appendix 1
Financial Reform Calendar: Australia

Date	**Event**
1947	Commonwealth Government attempt to nationalise banks
1960	Reserve (Central) Bank separated from Commonwealth (Trading) Bank
1970	Bank (Shareholdings) Act (1972) applied restrictions to maximum ownership share in banks
1971	$A linked to $US instead of Pound
1974	Financial Corporations Act passed providing for direct controls on NBFIs but those provisions not proclaimed
December 1980	Interest rate ceilings on most bank deposits removed
1981	Report of Australian Financial System Inquiry (Campbell Inquiry)
March 1982	Maturity controls on bank deposits relaxed, permitting increased competition in short term markets
May 1982	Interest Rate on Trading Bank SRD accounts increased from 2.5 per cent to 5 per cent.
June 1982	Treasury Bond Tender introduced. Lending Restrictions on Trading Banks abolished.
August 1982	Savings Bank LGS type requirement reduced from 40 per cent to 15 per cent, they are permitted to accept corporate deposits, and are given greater asset flexibility.
December 1983	Australian dollar floated and exchange control regulations largely abolished
December 1983	Martin Review Group Report
June 1984	40 new foreign exchange dealers authorised
August 1984	Interest rate prohibition on cheque accounts removed
September 1984	Applications for bank licences from foreign banking interests invited. Temporary suspension of foreign investment guidelines regarding merchant banking. Abolition of 30/20 rule for life offices and pension funds.
April 1985	Interest rate ceiling on "small" bank loans (under $100,000) removed leaving the housing interest rate the only one subject to control
May 1985	Abolition of 18 per cent LGS convention and gradual phasing in of prime assets ratio (of 12 per cent) announced.
April 1986	Removal of interest rate ceiling on bank home mortgage lending announced
1988	BIS risk weighted capital adequacy requirements introduced
1990	"Six Pillars" policy introduced
1991	Martin Committee Report
1991	Australian Securities Commission (ASC) established as regulator of corporations, securities and futures markets
1992	Foreign banks allowed to open branches and restrictions on new bank entry lifted
1992	Australian Financial Institutions Commission established
August 1996	Statement on the Conduct of Monetary Policy issued, outlining policy objectives, Reserve Bank accountability and independence
1997	Report of the Wallis Inquiry into the Financial System
1997	Adoption of BIS market risk capital adequacy requirements for banks
1998	Government announces establishment of Australian Prudential Regulatory Authority as recommended by the Wallis Report

Appendix 2
Assets of Australian Financial Institutions

	Total Assets of Financial Institutions ($bill)				Foreign controlled%*
	1978/79	1986/87	1995/96	1996/97	
Reserve Bank	10.3	26.1	37.0	50.9	
Banks	51.6	185.8	486.6	547.8	14.5
Non-bank financial corps					
Permanent building societies	8.8	18.3	13.1	10.6	0
Credit co-operatives	1.5	7.3	15.5	16.9	0
Authorised money market dealers	1.6	2.2	4.1		
Money market corporations	5.0	39.6	59.9	67.1	94
Pastoral finance companies	1.0	6.8	2.9	3.2	
Finance companies	15.9	29.5	34.8	36.2	37
General financiers	1.6	7.7	11.4	14.1	
Total	35.3	111.4	141.7	148.0	
Life offices & super funds					
Life insurance offices	12.3	46.3	127.3	145.7	35.5
Total	23.1	100.0	282.2	335.0	
Other managed funds					
Cash management trusts		3.4	7.0	10.7	
Common funds		4.2	4.6	5.8	0
Friendly societies	0.3	3.5	7.9	7.3	0
Public unit trusts	0.8	15.9	48.4	67.5	42
Total banks, NBFIs & managed funds	111.2	424.1	978.3	1122.1	
Other financial institutions					
General insurance offices	8.4	22.6	60.4		31
Intra-group financiers	0.4	4.4			
Other (FCA) fin corps	0.1	0.9			
Intra-group + Other fin corp	0.5	5.2	7.2	8.0	30
Securitisation vehicles			14.3	20.9	30
Co-op housing societies	1.4	2.0	1.6		

* Sector Assets controlled by foreign owned institutions (June 1996)

Source: Reserve Bank of Australia: Bulletin, December 1997
Wallis (1997, Table 10.2)

Appendix 3
Financial Reform Calendar: New Zealand

Date	Change
1962	Deposit Interest Rate Ceilings removed; controls on Capital Issues removed
1965	Non-Bank institutions voluntarily submit to “captive market” requirements on holding of government debt, which are subsequently formalised as reserve requirements
1967	Controls on Capital Issues reintroduced
1969	Capital Issues controls abolished, variable reserve ratio for trading banks replaced by fixed ratio, removal of interest rate limits on bank deposits over $25,000
1971	Exchange rate peg changed from Sterling to USD
1972	General controls on interest rates offered by deposit institutions introduced; variable secondary reserve asset ratio introduced; selective quantitative lending targets abolished;
1973	Exchange rate changed to peg against TWI
1976	Interest on Deposit regulations revoked; controls on overdraft lending rates abolished
1978	Private sector lending guidelines set
1978	*Securities Act*
1979	Crawling peg exchange rate system introduced
1981	Government threats to penalise excessive interest rate competition; extension of 1979 Financial Services Regulations to allow Reserve Bank control of lending rates;
1982	Freezing of some loan interest rates (reflecting wage and price freeze); controls on deposit interest rates; maximum credit growth guidelines issued by Reserve Bank; Exchange rate regime returned to fixed rate (against TWI)
1983	Bond tender program introduced; deposit rate controls removed (but loan rates still constrained, and adjustments made to ceiling rates)
1984	Reintroduction of deposit interest rate controls
July 1984	New Government elected initiating deregulation; most interest rate controls revoked
1984	Changes to Reserve Bank bond market dealings; removal of interest prohibition on short term bank deposits and of ceiling on savings deposits; removal of credit growth guideline; liberalisation of international financing transactions and exchange controls
March 1985	Floating of Exchange rate
1985	Abolition of all compulsory ratios on financial institutions
1986	*Reserve Bank of New Zealand Amendment Act 1986*; Liberalisation of entry into banking (based on registration rather than licensing); new supervisory framework not based on minimum capital or liquidity ratios but on improved information provision
1988	Separation of cash and debt management activities from Reserve Bank central banking functions
March 1989	Introduction of Basle risk weighted capital adequacy requirements
1989	*Reserve Bank of New Zealand Act*; introduced Policy Targets Agreement
1993	*Companies Act 1993*
January 1996	Public Disclosure Regime for Banks introduced; reduction in extent of prudential regulation on banks; accountability of bank directors increased
October 1997	Legislative changes requiring simplified “Investment Statement” to accompany offers of securities rather than registered prospectus
January 1998	Reserve Bank releases proposals to refine disclosure arrangements

Appendix 4
Structure of the New Zealand Financial System: 1997

Type of Institution	Number		Share of Total Assets
		Of which foreign owned	
Banks	19	18	73
Managed Funds	na		16
Life Offices	34	Majority	7
Finance Companies	29	Minority (but majority by total assets	2
Specialised Mortgage Providers	na		<1
Merchant Banks	na		<1
Building Societies	11		<1
Credit Unions	110		<1

Source: Reserve Bank of New Zealand (November 1997).

END NOTES

[*] I am grateful to Rolf Cremer, Ross Garnaut and other participants at the 24th PAFTAD conference for valuable comments

[1] Holmes (1994) provides an earlier comparison.

[2] Davis and Lewis (1988) and Walsh (1988) provide concise overviews of developments in financial regulation and monetary policy in each country up until the mid 1980s.

[3] Australian changes (Davis and Harper,1992, Covick and Lewis,1997)have encouraged growth in superannuation (despite some reductions in the tax advantages) whereas the New Zealand tax changes of 1987 stifled the growth of superannuation schemes (Bowden, 1996).

[4] Lewis (1997) provides an overview and comparison of the major financial system inquiries.

[5] Brash (1997) notes that "we believe that disclosure alone would ensure that banks would maintain capital at least equal to the 8% minimum" (p5).

[6] Moreover, whereas in Australia bank depositors have the benefit of "depositor preference" over other creditors in the event of liquidation, no such preference ranking exists under New Zealand legislation.

[7] The Labor government passed the Financial Corporations Act in 1974 which provided for direct controls on Non Bank Financial Institutions, but only those sections relating to collection of statistics were proclaimed.

[8] The dramatic growth in banks' commercial bill acceptances is one example. Another prompted by foreign exchange market regulations was the growth of the forward foreign exchange hedge market.

[9] Appendix 1 provides an overview of major changes, while Appendix 2 illustrates the changes in the institutional structure which have occurred.

[10] A more detailed analysis is presented in Davis (1995).

[11] A Payments System Board is also to be housed within the Reserve Bank.

[12] See OECD(1998) for a recent overview of financial reform in New Zealand.

[13] See RBNZ (1986) Chapter 5 for a detailed list of ratios which were abolished.

[14] A brief overview can be found in New Zealand Treasury (1997).

[15] See Brash (1993) for more detail.

[16] The absence of depositor preference over other creditors is also relevant to incentives given to depositor monitoring.