RESERVE BANK OF NEW ZEALAND

Prudential Supervision Department

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Inquiry into Regulatory Institutions and Practices
New Zealand Productivity Commission
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Dear Steven

Thank you for giving us the opportunity to provide comments on your Inquiry into Regulatory Institutions and Practices.

Please find attached the Reserve Bank's formal submission.

For any questions or clarifications, please contact Cavan O'Connor-Close on 04 471 3914.

Yours sincerely

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Regulatory institutions and practices – RBNZ response to the Productivity Commission report

Q1 What sort of institutional arrangements and regulatory practices should the Commission review?

The Reserve Bank believes that the review should cover a wide range of institutional arrangements and regulatory practices. Apart from the list of regulations on page 3 of the issues paper, e.g. primary legislation, secondary legislation, deemed regulations, etc, it would also be useful to include instances where the regulator has decided against direct regulation in favour of self-regulation or a market-based solution.

New Zealand's institutional arrangements can be complex and it is important that the review takes adequate account of the different arrangements that exist. That means examining institutional arrangements such as direct regulation by government departments, the crown entity and crown agency models, semi-independent and independent regulatory agencies, etc. It is important to recognise the background to each institutional arrangement, also with a view to international best practice in the relevant regulatory area.

Q2 The Commission has been asked to produce guidelines to assist in the design of regulatory regimes. What type of guidelines would be helpful?

Given the different regulatory regimes and the specific requirements that exist across the sectors, it is unlikely that very prescriptive guidelines would be helpful. Guidelines should be sufficiently flexible to account for the multitude in regulatory practice currently in place and could usefully include best practice case studies to illustrate regulatory solutions, as indicated in the issues paper.

Q 3 Does New Zealand have (or need) a unique 'regulatory style' as a result of our specific characteristics?

Every country has its peculiarities and we are no different. However, we have far more in common with other OECD markets than there are differences. It is therefore important for New Zealand to be aligned with international best practice and standards where it makes sense to do so.

For example, one area of difference is the size of our economy. Our smaller market size means that it is not always practical or in our best interest to mirror every single regulatory initiative or institution that significantly bigger economies have. Those bigger economies are usually in a position to dedicate more resources to regulatory affairs and to set up specialised regulatory institutions. The economies of scale that allow that to happen do not always exist in New Zealand and we should be cognisant of that. On the other hand, in the area of prudential regulation, we are generally in a position to implement regulatory changes more quickly than other jurisdictions.

The Reserve Bank does not believe that New Zealand needs its own regulatory style if we mean by that something fundamentally different from other comparable markets. However, we have to ensure that international best practice is fit for purpose in New Zealand. At times this means implementing a New Zealand specific solution which, while based on international practice, is different and unique.

Q 4 What influence has New Zealand's specific characteristics had on the way regulation is designed and operated in New Zealand?

Following on from our response to the previous question, the Reserve Bank has implemented the international standard for prudential regulation of banks in New Zealand. These requirements are set by the Basel Committee for Banking Supervision (BCBS) and commonly referred to as Basel II and Basel III. The vast majority of the Basel requirements are easily applicable to New Zealand. However, given our smaller market size, banks do not generally achieve the level of diversification that their bigger internationally active counterparties in other jurisdictions can attain. Moreover, our banks are heavily exposed to housing and farm lending exposures. The Reserve Bank has therefore tailored the requirements to New Zealand needs. As part of that, the Reserve Bank has, for example, supplemented the Basel requirements with more conservative requirements that better reflect New Zealand conditions.

Another example is where New Zealand is particularly exposed to international developments and needs to act quicker than the time it takes to change international standards. An example of this is the liquidity requirements which the Reserve Bank implemented on the back of the global financial crisis, such as the core funding ratio and the liquidity mismatch ratios. Those requirements, which have strengthened the liquidity positions of New Zealand banks, were brought in ahead of similar requirements subsequently developed by the BCBS.

Given the close links between the New Zealand and Australian financial system, there is a lot of emphasis on ensuring consistency of our regulations with those on the other side of the Tasman where possible. The Reserve Bank takes any impacts its regulations have on the Australian financial system into consideration, which is a requirement under the Reserve Bank Act. A similar requirement is incorporated in the relevant Australian legislation. There is close engagement between the Reserve Bank and the Australian regulators on matters affecting both our jurisdictions.

Q 5 What other ways of categorising New Zealand's regulatory regimes and regulators would be helpful in analysing their similarities and differences? How would these categorisations be helpful?

Figures 3.1 and 3.2 could also refer to the Reserve Bank Act (1989) as that forms the basis of the Reserve Bank's prudential regime for banks.

The demarcation between social, economic and environmental regulation appears a bit too rigid. There is likely to be considerable overlap. Further categories might be health and financial.

Q 6 Can you provide examples of regulatory regimes with particularly clear or (conversely) unclear objectives? What have been the consequences of unclear regulatory objectives?

The Reserve Bank believes that its mandates under the Reserve Bank Act (1989), the Reserve Bank Amendment Act (2008), the NBDT Bill and the Insurance Prudential Supervision Act (2010) are sufficiently clear as regards the Reserve Bank's regulatory objectives while providing flexibility for interpreting the mandate in accordance with contemporary circumstances. The Reserve Bank's mandate as regards prudential regulation of banks, for instance, is to promote the soundness and efficiency of the financial system. Although there are at times trade offs between soundness and efficiency and the interpretation of efficiency can in certain situations be ambiguous, the comparatively narrow role of the Reserve Bank's mandate supports the clarity of its role.

Q 7 Where regulators are allocated multiple objectives, are there clear and transparent frameworks for managing trade-offs? What evidence is there that these frameworks are working well/poorly?

In promoting the soundness and efficiency of the financial system there are at times situations where there are trade offs to be made between the two objectives. This can give rise to discussions as to how much efficiency considerations should constrain the soundness objective. However, this is not a serious issue most of the time. In fact, there are also many instances where the two complement one another. And where there is a potential trade off, the efficiency objective can also work as a useful check on the soundness objective.

Q8 Can you provide an example of where assigning a regulator multiple functions has improved or undermined the ability of the regulator to achieve the objectives of regulation?

Q9 Can you provide examples of where a single agency is responsible for both industry promotion and the administration of regulations? What processes are in place to align the incentives of the regulator with the desired regulatory outcomes? What evidence is there of success or failure?

Q 10 Are there example of where regulators have clearly defined policy functions? Conversely, are there examples of where the policy functions of a regulator are not well defined? What have been the consequences?

The Reserve Bank is responsible for prudential policy making as well as the regulations that follow on from that role and the supervision and enforcement of those regulations. These tasks are divided up between the policy and supervision teams with a separate enforcement function which resides elsewhere in the Bank.

This may be somewhat different from the regulatory design in other areas where the policy-making and compliance functions may be separated. Prudential regulation is a highly specialised and technical area and in practice there is a lot of interaction between the individual teams. This interaction exists in the policy-making stage as well as when it comes to supervision and enforcement of regulatory requirements. The Reserve Bank believes that having all of these functions unified albeit spread across different, specialised teams is the correct approach to prudential supervision. It allows for synergies and economies of scale to be exploited which leads to more efficient regulation and policy-making than other constellations would. Separating policy-making and compliance functions can lead to duplication of effort and raises the scope for misinterpretation of policy aims.

Q 11 Can you provide examples of where two or more regulators have been assigned conflicting or overlapping functions? How, and how well, is this managed?

In general, there is little overlap with other regulatory authorities in New Zealand. Some of the Reserve Bank's work may impact other government institutions such as the Treasury and the Financial Markets Authority and vice versa. Where that is the case, early and regular engagement with those other institutions is sought. There are also memoranda of understanding with the Treasury and the FMA.

A further area of overlap is with the Australian Prudential Regulatory Authority due to the biggest banks in New Zealand being owned by Australian parent banks. An MoU exists with APRA and there is frequent engagement with APRA.

Q 12 Are there examples of where regulators are explicitly empowered or required to cooperate with other agencies where this will assist in meeting their common objective?

The Reserve Bank of New Zealand Act (2010) requires that we take into account the effects of our regulatory decisions on Australia's financial system stability. Concretely, the Reserve Bank must "*to the extent reasonably practicable, avoid any action that is likely to have a*

detrimental effect on financial system stability in Australia." A similar requirement applies to the Australian regulators for any potentially negative impacts on New Zealand's financial stability. In practice, is generally broad agreement as to the regulatory response to an issue that could potentially have trans-Tasman implications and a close dialogue is maintained on issues affecting both countries.

Q 13 Can you provide examples of where two seemingly similar regulatory areas are regulated under different regulatory structures? What factors have contributed to differences in regulatory structures?

The Reserve Bank is the prudential regulator of banks, non-bank deposit takers and insurance companies in New Zealand. The latter two were added to the Bank's regulatory scope when Government decided in 2005 that the Reserve Banks should be the sole prudential regulator New Zealand's financial system. The implementation of regulations differs across all three sectors. For banks, they are implemented via changes to their conditions of registration. For insurers it is done through direct regulations and standard setting, e.g., solvency standards. NBDTs are regulated by regulations made under the Reserve Bank Amendment Act (2008).

These differences reflect the different points in time when the sectors came within the scope of the Bank's prudential regime. In practice, there are differences in terms of the speed with which the Bank can make changes to regulations or impose new ones.

Q 14 Are the dimensions or regulator independence discussed in Figure 4.3 helpful in thinking about New Zealand regulators?

Yes.

Q 15 Which of these dimensions of independence is most important to ensure a regulator is seen to be independent?

The four dimensions seem to be equally important if the aim is to ensure genuine regulatory independence. However, that may or may not always be the aim. For reasons of accountability and democracy, some regulatory decisions may need to be taken by government and parliament directly. For the Reserve Bank, all four categories are of importance for maintaining our regulatory independence.

Q 16 Can you provide examples of where a lack of independence or too much independence according to one of the dimensions undermines the effectiveness of a regulatory regime?

N/A

Q 17 What should be the limits of regulatory independence? What sorts of regulatory decisions should be the preserve of Ministers rather than officials?

N/A

Q 18 Do you agree with the list of features in Figure 4.3 which indicate a need for more or less regulatory independence? What other criteria are missing?

The Reserve Bank agrees with the features determining the degree of regulatory independence. Prudential regulation of the financial system is an area where the costs and benefits are long term, a high degree of technical expertise is required and with potentially politically powerful private interests.

Q 19 Is regulatory capture more or less likely in a small country? Can you provide examples of capture in New Zealand?

Every regulator has to guard against regulatory capture, regardless of the country's size. Interactions between the regulator and regulated entities in smaller countries may be more informal and potential conflicts of interest issues may arise more often. However, in the vast majority of instances, these can be managed. In bigger economies, there may be a greater risk of regulatory capture from the regulator trying to keep up with latest innovations and other channels. The Reserve Bank aims to maintain an arm's length relationship with the entities it regulates. Adherence of international best practice and staff rotations can also be useful for reducing the scope for regulatory capture.

Q 20 Are there other institutional forms for government-established regulations?

No comment

Q 21 Do particular types of institutional form lend themselves to more enduring regulatory regimes?

Q 22 What are the key differences of institutional forms in terms of their regulation, operational, institutional or budgetary independence?

Q 23 Are there aspects of regulatory independence that are more or less important in regulating state power or government-provided/funded services?

Q 24 Are there other types of government structure than those listed above? Howe well do they work?

No comment

Q 25 What type of governance and decision-making structures are appropriate for different types of regulatory regimes?

The Reserve Bank has functioned well under the single decision maker model since the late 1980s. However, the Reserve Bank has a very clear role in a limited number of areas which require a high degree of technical expertise and this decision-making model may not be the most appropriate set up for other institutions.

Q 26 How effective and consistent are the review and appeals processes provided for in New Zealand regulatory regimes?

and

Q 27 Can you provide examples where the review and appeals processes provided for are well-matched of poorly suited to the nature of the regulatory regimes?

and

Q 28 What are the advantages and disadvantages of a general merits review body like the Australian Administrative Appeals Tribunal?

A merit review is likely to be more useful where decisions are not based on highly technical expertise. For example, the legislation underlying insurance supervision/regulation and the NBDT bill provide for full de novo appeals against negative fit and proper findings. Fit and

proper is more difficult to define and do not require particular technical expertise. In such instances, courts may usefully provide guidance through their decisions on appeals.

Merit reviews on prudential decisions would be significantly more problematic and may not lead to additional benefits versus the already existing judicial reviews. Prudential decisions are inherently technical and judges do not usually have that technical or industry expertise. Merit reviews could also impede the regulator's flexibility to adapt to new situations and may lead to gaming or unmeritorious claims by regulated entities.

The availability of a judicial review means that there is already an avenue for reviewing the process following which decisions were reached. It looks at whether the decision was made according to law, whether regulated entities were consulted fairly and had their views taken into account, whether facts relied on were correct and whether a decision is reasonable or proportional. This already captures key elements of a merits review. A good process leads to good regulatory outcomes, and regulated entities already have a remedy against inadequate processes.

Q 29 Can you provide examples of regimes where risks are borne by a regulator, regulated party, or the public/consumers, but they are not best placed to manage those risks?

No, the regimes we administer tend to ensure that risks are borne by those in the best position to manage them. Although there is an argument that depositors are not well-placed to assess the risks of depositing money in a particular bank, the banking regime has been structured to minimise this risk (through disclosure, market discipline, credit rating requirements, etc.) to the extent it is possible.

Q 30 Can you provide examples of where the mix of funding sources contributes to the effectiveness or ineffectiveness of a regulatory regime?

As we are funded solely through our funding agreement with the government, we are not in a position to comment on this. Note we do not charge licensing fees to the entities we regulate.

Q 31 Is the mix of funding sources for individual regulators consistent with their stated funding principles?

Our primary source of income is return on investments we hold. The amount of this income we use to cover expenses is negotiated with the Minister of Finance in a funding agreement that has a five year term. These funding agreements are consistent with enabling us to retain operational independence from government while not giving rise to any risk that an individual employee would obtain any benefit from taking imprudent risks with the Bank's funds.

Q 32 Which New Zealand regulators (or regulatory regimes) provide good examples of open and transparent funding arrangements? Can you provide examples where the transparency of funding needs to be improved?

The funding arrangement negotiated between the Bank and the Minister of Finance is open and transparent. The Reserve Bank of New Zealand Act specifies the requirement for the Bank to enter into a funding agreement with the Minister, the terms that must apply to the agreement, and the matters that it must cover. Once negotiated, the agreement must be presented to the House within 12 sitting days of it being entered into and it must be ratified by the House before it is effective. The agreement is made available on the Reserve Bank website. These arrangements ensure that the agreement is open and transparent.

Q 33 Can you provide examples where a regulator's funding arrangements support or undermine its independence?

As each funding agreement lasts for a term of five years, our funding arrangements support operational independence while ensuring accountability for use of resources. The term of the agreements means that funding is not contingent on the Bank delivering specific policy outcomes. This enables the Bank to pursue its objectives (as stated in the Act) without facing undue political pressure.

Q 34 What approaches are there to identifying, building and maintaining workforce capability? How effective have they been?

And

Q 35 What restrains or enables a regulator to develop the capability they need in the New Zealand context?

And

Q 36 What are the gaps in regulator workforce capability? Can you provide examples?

For our regulatory functions, we require both specialists and people with transferable skills. Specialists are required in some technical areas such as actuarial work. Examples of more transferable skills, in the sense that they are valuable across the public and / or private sector though not necessarily easy to find or acquire, are policy analysis and excellent relationship management.

For the specialist roles, we have to recruit, often from a limited pool in New Zealand. Otherwise, we have a well-established programme of graduate recruitment and training across all the Reserve Bank's policy functions which includes the regulatory area. We also recruit from the industries that we regulate, and we cross-skill staff (for example training a person who came from industry X in the different features of industry Y).

There are no specific gaps in regulator capability currently: we recruit and retain high quality policy and regulatory staff. However, this is a small function tapping a limited market in New Zealand, and we remain vulnerable to loss of specific technical expertise in specialist areas.

Q 37 What is the potential to improve capability through combining regulators with similar functions, compared with other alternative approaches?

No comment

Q 38 When do changes to institutional arrangements work best to improve capability, and when are other solutions preferable?

No comment

Q 39 Can you provide examples of strengths and challenges in the way regulators monitor and enforce regulations? What are the consequences?

Strengths in the ways regulators monitor regulations:

- in general we have a well developed understanding of our entities and the regulations. Consequence: our monitoring can be done reasonably efficiently and effectively;

- we have (in general) well established relationships with our entities. Consequence: proactive disclosure and open dialogue is more likely;
- we have (in general) reasonably sophisticated entities. Consequence: that the entities themselves are more aware of their obligations and less in need of "education"

Challenges in the ways regulators monitor regulations:

- lack of resources/sophistication among some entities that we regulate. Consequence: they are not as aware of their obligations. (Sometimes this is a resourcing/costs issue). Challenge is how to lift that level of awareness and how to resource any such activity (eg "education);
- There is a risk that some supervisors may not be as aware as is ideal of the industry practices in the industry that they monitor (put another way – lack of industry background among some supervisors). Consequence: risk of inefficiencies arising due to that knowledge/experience gap. The challenge is how to get that experience and background – appropriate recruitment, secondments? etc.
- In NZ by necessity we are all to some extent "generalists". This is due to market size. Consequence: potential absence of specialist resource in areas that need specialisation. Challenge is how to develop the necessary expertise in particular fields when it is needed (outsource, recruit?)

Q 40 Do New Zealand regulators have access to a sufficient range of enforcement tools? If not, what evidence is there to suggest that a broader range of tools would promote better regulatory outcomes?

Sufficient Range

- AML/CFT[1] – yes
- NBDTs – no, but our recent review of the operation of the NBDT regime has recommended changes in that regard
- Insurers – yes
- Banks – yes

The Reserve Bank considers that a broader range of regulatory tools promotes better regulatory outcomes primarily because there is more scope for the sanction to "fit", and otherwise be proportionate to, the offence/breach. Regulators are more likely to use a proportionate sanction than a disproportionate sanction.

Q 41 What sort of regulatory regimes are suited to more (or less) discretionary enforcement?

The Reserve Bank considers that we have adequate (and appropriate) discretion in relation to our enforcement powers. The discretion extended in our case is appropriate for the regulatory regimes that we monitor and enforce, being in general (reasonably) sophisticated financial regimes where issues that arise are often not "black and white" and discretion in relation to the exercise of enforcement powers is necessary.

Q 42 Can you provide examples of where a regulator has too much or too little discretion in enforcing regulations? What are the consequences?

Examples of too much discretion? None relevant to us
Examples of too little discretion? None relevant to us
Consequences (general observations):

- with too much discretion the primary risk is that enforcement powers will be exercised in an inconsistent, perhaps even "random" way. The primary mitigant for this risk is

[1] Anti-money laundering and countering financing of terrorism

for the organisation to have procedures that ensure that, despite the discretion, the decision making process is consistent and otherwise actively addresses the risk of inconsistency (perceived or real). The Reserve Bank has such procedures.

- with too little discretion the primary risk is perhaps overkill (no ability to moderate sanction in worthy cases).

Q 43 Can you provide examples of where risk-based approaches have been used well? What are the critical pre-conditions for effective implementation of risk-based approaches to compliance monitoring and enforcement in New Zealand?

A risk-based approach is being used by us in relation to our monitoring obligations as an AML/CFT supervisor. The risk-based approach is in essence based on a recommendation from FATF[2]. The risk-based approach enables the Reserve Bank to focus its supervisory activities on the reporting entities that represent the highest risk of money laundering and financing terrorism. This approach has worked well to date and (we consider) is being used well. The other AML/CFT supervisors have also taken a risk-based approach to their supervisory activities.

Critical pre-conditions? AML/CFT is unusual perhaps because in essence FATF has "mandated" the use of that approach by AML/CFT supervisors. In general however, the primary pre-condition seems to be the existence, among the relevant regulated sector, of variety in the risk represented by the individual persons who comprise the sector.

Q 44 What are the challenges to adopting risk-based approaches in New Zealand?

No comment

Q 45 Can you provide examples of where regulatory regimes require too much or too little consultation or engagement? What are the consequences?

No – we value the level of engagement we have with the entities we regulate and feel it helps us develop policies that are responsive and appropriate to achieving the desired outcomes.

Q 46 What are the characteristics that make some regulations more suited to prescriptive consultation requirements than others?

Prescriptive consultation requirements may suit regulatory regimes where the regulated community is in the best position to understand the feasibility and implications of particular policy positions. For example, the Bank consulted heavily in the lead up to the introduction of BS19 (the bank handbook chapter that imposed the LVR restriction) in order to ensure that the policy was designed in such a way that a bank could reasonably be expected to be able to comply. For example, the initial imposition gives banks a six month window over which to calculate their LVR lending in order to accommodate pre-approvals. Industry consultation helped inform the length of this lead time.

Q 47 What forms of engagement are appropriate for different types of regulatory regime? When do formal advisory boards work or not work well?

Our experience has been that public submission processes work well for our regimes. Those with an interest in our regimes generally have sufficient knowledge and resources to respond to our consultation processes. We have found advisory boards useful where the scope of a regulatory initiative is sufficiently broad that it is useful to have a general discussion with

[2] Financial Action Task Force

representatives of the affected groups about the issues under consideration. However, as many of the regulations we implement are extremely specific, public submissions that enable formal, considered responses are often beneficial for both stakeholders and the Bank in understanding the key issues with a proposal.

Q 48 How can the challenges of working in partnership with Māori be met by regulatory agencies? What models, methods, and approaches are most successful?

No comment.

Q 49 What elements of a regulatory regime's design have the biggest influence on culture? Why?

The institutional independence promoted in the Act has an important effect on the culture of the Bank. There is a strong institutional sense of making good policy to achieve medium to long-term outcomes rather than promoting particular philosophical perspectives. The Reserve Bank's institutional independence helps promote independent thinking within the Bank. This allows differing views to be debated so that final policy outcomes are well-considered and robust.

Q 50 How well do regulatory agencies ensure consistency of approach between or amongst regulatory staff, so that individual variations are minimised?

Major decisions made with respect to individual entities (e.g. capital model changes, capital issues etc.) are made through an internal decision making process. Therefore, although an analyst or small group of analysts makes the initial recommendation, managerial and committee oversight ensures consistency in approach. We also maintain a separate enforcement team for more serious breaches to ensure matters are adequately investigated and any resulting sanctions are consistently imposed. We have strict internal processes for reporting and documenting any potential infringements, which again facilitates consistency of application.

Q 51 Can you provide examples where the culture or attitude of the regulator has contributed to good or poor regulatory outcomes?

No comment.

Q 52 Can you provide examples where the culture within a regulator supports or inhibits staff in making difficult decisions, particularly where those decisions may be unwelcome to government, regulated parties or the general public? How?

As the Bank is run on a single decision maker model, staff are empowered to make recommendations that would not necessarily be popular without concern for personal repercussions. Naturally authority is delegated down, but normally most decisions would be signed out by the relevant manager, head of department, or the Deputy Governor, meaning that decisions are clearly the institution's view, rather than identifiable as belonging to a particular analyst.

Q 53 Can you provide examples where a regulator places too much value on managing risks to itself, relative to other priorities (such as the regulatory objective, or customer service)? What are the consequences?

No comment.

Q 54 Can you provide examples of regulators whose approach to their business is largely shaped by their reliance on a particular profession? How might that approach be different if it drew on a wider range of professions?

No comment.

Q 55 Can you provide examples of how accountability or transparency arrangements improve or undermine the effectiveness of a regulatory regime?

The Reserve Bank is accountable to Parliament and to the Minister of Finance and overseen by the Reserve Bank board. These arrangements have worked well for the Reserve Bank and the areas for which it is responsible. For the Reserve Bank, it strikes the right balance between accountability and operational independence while also keeping compliance costs low.

The Reserve Bank is very much aware of the importance of transparency in its decisions. A comprehensive framework for policy-making exists and includes extensive stakeholder consultation on practically all regulatory decisions. Stakeholder feedback plays a significant role in the decision-making process and a summary of submissions, including responses to specific consultation questions, is often published. The Reserve Bank also communicates its regulatory decisions, their underlying rationale and issues to be analysed in its regular publications such as the Financial Stability Report.

We believe that accountability and transparency, including stakeholder engagement, are very important for a regulator to gain acceptance for and to maintain a high quality and effective regulatory framework.

Q 56 What types of accountability or transparency arrangements are appropriate for different types of regulatory regimes?

No comment.

Q 57 Are the problems that the Commission identified in the assessment of local government regulatory performance also evident in the assessment of central government regulatory performance? If not, how do the problems differ for central government?

No comment.

Q 58 Can you provide examples of where performance assessment of regulatory regimes is working well, need improvement?

No comment.

Q 59 When are feedback loops being used well to improve the performance of New Zealand regulatory regimes? When aren't they?

No comment.

Q 60 Can you give examples of indicators or proxies that are effective as early warning signs of regulatory noncompliance or failure?

In respect of the prudential supervision of financial institutions, regulatory failure is not synonymous with the failure of a financial institution. Financial regulation does not have a goal of zero failure of financial institutions, and the failure of a financial institution is not a regulatory failure. The supervision of financial institutions by the Reserve Bank is aimed at

maintaining a sound and efficient financial system, and avoiding significant damage to the financial system that could result from the failure of a financial institution. Failure of the Reserve Bank to achieve these objectives would be a regulatory failure.

Financial regulation sets outs the prudential rules within which financial institutions must operate. These rules are both quantitative and qualitative (e.g. minimum amount of capital that must be held, characteristics of the board of directors). These regulations are complex and wide ranging and are set out in legislation, regulation, and conditions of licensing imposed by the Reserve Bank.

Regulatory non-compliance is the failure of supervised institutions to comply with prudential requirements. Regulatory non-compliance by supervised financial institutions is constantly monitored by the Reserve Bank by means of the analysis of information provided by the financial institutions. The information to be provided is determined in the legislation, regulation and licensing conditions. Some is publically available and some is provided just to the Reserve Bank. The Reserve Bank compares that information with prudential regulatory requirements. The Reserve Bank receives a wide array of information that potentially can give warning of regulatory non-compliance by financial institutions.

When actual or potential non-compliance is detected the Reserve Bank has established procedures for dealing with specific situations.

Q 61 Can you provide examples of regulatory regimes with effective processes for formally or informally raising concerns about potential regulatory failures? What examples are there of regimes that handle this poorly? What are the consequences?

No comment