AUSTRALIAN BANKERS' ASSOCIATION INC.

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Australian Productivity Commission and
New Zealand Productivity Commission
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Dear Commissions,

Strengthening economic relations between Australia and New Zealand

The Australian Bankers' Association (ABA) welcomes the opportunity to provide feedback on the Australian and New Zealand Productivity Commissions' discussion draft, '*Strengthening economic relations between Australia and New Zealand*'.

As highlighted in our previous submission, dated 4 June 2012, the movement towards closer economic ties and a single economic market (SEM) between Australia and New Zealand provides benefits to both countries and has been supported by both governments. The ABA and its member banks support moves to streamline the ability of individuals and companies to interact and engage across the Tasman.

In addition to the issues raised in its previous submission, the ABA would like to highlight the following issues for consideration.

1. Withholding Tax Reform

In its previous submission, the ABA highlighted the need for interest and dividend withholding tax reform between Australia and New Zealand. While these were noted in the discussion draft they were not discussed. The ABA would like to highlight again the importance of these issues to creating closer economic ties between the two countries and moving towards a SEM.

To assist New Zealand banks in leveraging the financial position of their Australian parent, the ABA recommends that consideration be given to adopting a similar provision to the Australian withholding tax exemption contained in S128F of the 1936 Income Tax Assessment Act and that this exemption be broadened to cover offshore deposits.

2. Capital Flows

The ABA notes that the discussion draft considers issues concerning imputation credits and looks forward to the issues being discussed further in the final report.

By way of emphasis, the ABA again reiterates that Australia and New Zealand cannot progress to a genuine single economic and investment market without mutual recognition of franking credits. This is arguably one of the more important areas of reform for numerous sectors, not just banking.

The mutual recognition of franking credits would help to minimise some of the distortions in relation to trans-Tasman investments. Mutual recognition would improve the global competiveness of Australian and New Zealand companies by reducing the cost of capital, which, in turn, would increase the return for investors together with the available pool of capital.

3. Prudential

In its previous submission the ABA also highlighted a number of areas of current and proposed divergence in the prudential regulation of Australian and New Zealand financial institutions, as determined by the Australian Prudential Regulatory Authority (APRA) and the Reserve Bank of New Zealand (RBNZ). The ABA would like to

reiterate the importance of those issues and highlight particularly the need to ensure Basel III reforms are not implemented in such a way as to inhibit trans-Tasman relations.

Subsequent to the ABA submission in June, the RBNZ released draft Basel III rules including draft criteria for qualifying capital securities (Additional Tier 1 and Tier 2).[1] APRA has released its final Basel III capital reform package.[2]

The two approaches implement the Basel III reforms in a more conservative form than international standards and ahead of agreed international timetables.

In addition to potentially placing Australian and New Zealand banking institutions at a global competitive disadvantage, the differences between the (draft) APRA and RBNZ criteria provide various hurdles in issuing securities that will qualify under both sets of criteria.

The key areas (but not the only areas) of inconsistency relevant to the issuance of securities are:

- The definition of non-viability.
  - APRA is adopting the Basel Committee definition.
  - RBNZ is adopting a New Zealand specific definition that is not consistent with the Basel Committee definition.
- Amount converted or written-off under capital trigger or non-viability.
  - APRA requires that the face value be either converted or written-off.
  - RBNZ requires the face value and accrued interest be converted or written-off.
  - APRA will not allow the accrued interest to be converted.
- Conversion under capital trigger or non-viability.
  - APRA requires conversion to be into shares that are listed at the time the security is issued.
  - RBNZ will only allow conversion into the issuing banks shares, whether listed or unlisted. As an alternative, RBNZ allows write-off with an ability post write-off to provide compensation to holders in the form of ordinary shares of either the issuing bank or the ultimate parent.
  - APRA will not allow any form of compensation to be provided to holders post a write-off as it views this as a write-back which is prohibited by the Basel Committee.

If these differences are not resolved, they will create unnecessary hurdles to securities issued by an Australian owned New Zealand bank from being able to be structured to qualify under both APRA and RBNZ standards. It is important that these differences be resolved to ensure that Australian owned New Zealand banks can continue to access the capital markets and are not disadvantaged relative to their regional peers.

As highlighted in the discussion draft (on page 127) both countries need prudential regulators to consider the potential impact of their actions 'across the Tasman'. Given the potential negative impacts for both countries from an impairment to issue qualifying securities, the ABA asks for this issue to be further considered.

Yours sincerely,

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Tony Burke

[1] http://www.rbnz.govt.nz/news/2012/4911395.html
[2] http://www.apra.gov.au/MediaReleases/Pages/12_23.aspx