

## **Optional Background Papers for the IEAP**

---

### **Summary**

Below is a summary of optional background reading papers for Independent Expert Advisory Panel (IEAP) members ahead of the first panel meeting on Wednesday 20 December 2017. These papers are arranged into two sections: official's papers and externally-commissioned (and associated) papers. Each section is divided into sub-sections covering governance and decision-making, and policy frameworks. This organisation of papers is reproduced in the folder structure of the Secure File Share workspace. Note that redactions have been made from some of these documents in preparation for their public release following the December panel meeting.

### **Part A: Officials' papers**

#### **Governance and decision-making**

**Title: Behind the scenes of an OCR decision in New Zealand**

**Author:** Adam Richardson, Reserve Bank of New Zealand

**Paper type:** Public bulletin article - Reserve Bank Bulletin, Vol. 79 No. 11, July 2016

This is a Reserve Bank information article describing the Bank's Official Cash Rate (OCR) decision-making system. The paper highlights how the Bank reaches a decision on the appropriate setting of the OCR, and communicates the important information behind its policy decision. It explains that the Bank's decision-making process is structured to reduce uncertainty as much as possible (and characterise the remaining uncertainty), help decision-makers understand and balance the risks, communicate the decision/underlying judgements/ risks externally, and ensure that the Bank's policy stance and judgements are constantly reviewed in the face of new developments. The Bank's decision-making system has a variety of features that are common in international practice such as committee-based policy discussions.

**Title: Independence with accountability: financial system regulation and the Reserve Bank**

**Author:** Chris Hunt, Reserve Bank of New Zealand

**Paper type:** Public bulletin article - Reserve Bank Bulletin, Vol. 80, No. 11

This is a Reserve Bank information article that provides Reserve Bank of New Zealand views on the rationale for why financial system-related functions and objectives should be 'delegated' to an independent agency. The article reviews some of the arguments for independent financial regulators, and describes concepts of independence and accountability as they relate to financial system regulation. The article also describes specific independence and accountability arrangements for financial system regulation at the Reserve Bank.

**Title: Reserve Bank of New Zealand Briefing to Incoming Minister (BIM)**

**Author:** Reserve Bank of New Zealand

**Paper type:** Briefing note to the Minister of Finance, October 2017

This note provides an overview of the Reserve Bank of New Zealand. It covers the Bank's roles and accountability, governance and decision-making, operation and organisational structure, and regulatory policy programme. An overview of the background economic environment in New Zealand is also provided.

**Policy frameworks**

**Title: Review of the Reserve Bank Act**

**(and associated letter to the Minister of Finance: "Modernising New Zealand's Macroeconomic Framework: Reserve Bank of New Zealand Act")**

**Author:** The Treasury

**Paper type:** Post-election Treasury advice to the Minister of Finance, October 2017

This paper proposes a comprehensive review of the Reserve Bank Act, including both the monetary policy and financial policy framework. It sets out that, over the past 18 months, the Treasury has undertaken a review of the monetary policy framework. Following this review the Treasury continues to consider that a flexible inflation-targeting regime provides a number of benefits to New Zealand. However, the paper also highlights some areas where the macroeconomic policy framework could be strengthened. These areas include ensuring that the macroeconomic policy framework is adequate to manage a future large shock to economic growth, and reforming the decision-making arrangements for monetary and financial policy. The paper also suggests that the legislative framework for financial stability policy should be included in a review of the Reserve Bank Act.

**Title: New Zealand's Flexible Inflation Targeting Framework**

**Author:** The New Zealand Treasury

**Paper type:** Treasury Report to the Minister of Finance, November 2017 (T2017/2634 refers)

This report discusses how the Treasury views the operation of New Zealand's flexible inflation targeting regime. Under this regime the Reserve Bank aims to stabilise inflation around its inflation target in the medium term whilst putting some weight on stabilising economic activity. The Treasury considers that this framework has delivered significant macro-economic benefits to New Zealand. The report recommends that the Act should provide high level, stable long-term monetary policy objectives because legislation should be enduring. The Act could recognise the consideration monetary policy decision-makers should give to economic activity and employment. A "target-setting mechanism" such as the Policy Targets Agreement (PTA) is seen as the best way to articulate government expectations of how to operationalise broader monetary policy objectives. It also notes that consideration should be given to whether the PTA remains the best such mechanism. Current PTA arrangements have limited scope for broader consultation and input from stakeholders.

**Title: The Monetary Policy Framework**

**Author:** The Treasury

**Paper type:** The Treasury internal paper, November 2017

This paper summarises the Treasury's recent work reviewing the operation of monetary policy in the current economic environment, including the case for alternative monetary policy frameworks/targets. The experience of the global financial crisis (GFC), the lethargic post-GFC economic recovery, and resulting period of persistently low inflation and interest rates has renewed debate on the tools of macroeconomic stabilisation policy globally. These debates include the role and effectiveness of flexible inflation targeting in stabilising the economy following a large downturn, and the role/scope of macro-prudential policy. Many of the economic issues that are arising globally are relevant to New Zealand, such as low inflation and high asset price inflation in an extended period of low interest rates. It explains that recent international reviews have concluded that flexible inflation targeting remains appropriate, although some adjustments to central bank mandates and institutional arrangements have been made. There has also been widespread reform of financial stability frameworks. The Treasury's work did not identify an alternative macroeconomic stabilisation framework that would likely perform better than flexible inflation targeting in the contemporary New Zealand context.

**Title: An international comparison of inflation-targeting frameworks**

**Author:** Amber Wadsworth, Reserve Bank of New Zealand

**Paper type:** Public bulletin article - Reserve Bank Bulletin Vol. 80 No. 8, August 2017

This article compares the inflation-targeting frameworks of ten advanced economy central banks. It assesses how New Zealand's PTA compares to other advanced economy inflation targeting frameworks and how the specifications in each framework compare to the actual practice of each central bank. The comparison focuses on five components of an inflation-targeting framework: the inflation target definition, communication of monetary policy, secondary considerations, assessment of inflation-targeting performance, and framework reviews and revisions. The paper suggests that while the formal inflation-targeting frameworks differ between each central bank, in practice each bank operates in a similar manner. The work finds a high degree of consistency among the central banks in inflation target setting, monetary policy communications, and performance assessment. There is more variability in the financial stability considerations central banks take into account when setting monetary policy, and how inflation-targeting frameworks are reviewed/revised.

**Title: Legislative framework for financial stability in the Reserve Bank of New Zealand Act 1989**

**Author:** Reserve Bank of New Zealand

**Paper type:** Memo to the Independent Expert Advisory Panel on the review of the Reserve Bank Act 1989, December 2017

This memo provides Reserve Bank of New Zealand views on the overall framework for prudential regulation in New Zealand. The paper provides an outline of the prudential framework under the Reserve Bank of New Zealand Act 1989, the role of the Minister of Finance in prudential policy setting, macro-prudential policy, previous reviews of the Act, and the International Monetary Fund's (IMF's) Financial Sector Assessment Programme (FSAP) review of New Zealand in 2016.

## **Part B: Externally-commissioned (and associated) papers**

### **Governance and decision-making**

**Title: Decision-making and Governance at the Reserve Bank of New Zealand (and associated summary Treasury report to the Minister of Finance “Summary of Iain Rennie Report on Decision-making and Governance - RBNZ”)**

**Author:** Iain Rennie

**Paper type:** Independent consultant report to the New Zealand Treasury, April 2017

This is a Treasury-commissioned consultant report reviewing decision-making and governance at the Reserve Bank of New Zealand. The report was written by former State Services Commissioner Iain Rennie. The report recommends changes to the Reserve Bank’s decision-making and governance settings in three key areas: the codification of a committee, the role of the Board, and the role of the Treasury. The key recommendation is to legislate for a committee-based decision-making model for monetary and financial policy to replace the currently legislated single decision-maker model (Governor). The report also supports narrowing the Board’s role to an independent performance assurance function, albeit with strengthening their ability to do this. The report envisages a role for the Treasury in the periodic review of the Policy Targets Agreement (PTA) and advising on a proposed government policy statement on financial regulation, alongside administration of parts of the Reserve Bank Act.

**Title: Peer review and expert comments on “Decision-making and Governance at the Reserve Bank of New Zealand”**

**Authors:** Donald Kohn, Charles Goodhart, David Archer

**Paper type:** Treasury-commissioned-review comments on draft independent consultant report, May 2017

These are Treasury-commissioned documents that include peer review and expert comments on a draft version of Iain Rennie’s consultant report. They include peer review from Don Kohn and Professor Charles Goodhart, two international reviewers with significant central banking experience. It also contains expert comment from David Archer, a former Reserve Bank of New Zealand Assistant Governor and current Head of Central Banking Studies at the Bank for International Settlements (BIS). The authors are supportive of the report’s central recommendation to codify a committee-based approach to decision-making for the Reserve Bank’s monetary and financial policy functions. The comments raise various points of detail about the draft recommendations, many of which are reflected in the final Rennie report. But in some areas the comments of different reviewers are conflicting, highlighting continuing expert debate over the details of committee design. For example the peer reviewers have different views on the appropriate number of external members on a committee and the best approach to transparency.

**Title: Reserve Bank comments on “Decision-making and Governance at the Reserve Bank of New Zealand”**

**Author:** Reserve Bank of New Zealand

**Paper type:** Memo to the Independent Expert Advisory Panel on the review of the Reserve Bank Act, December 2017

This memo provides the Reserve Bank’s views on Iain Rennie’s consultant report. The memo comments on the report’s approach generally, as well as on specific recommendations. While the Bank considers that several suggestions presented in the paper appear sensible, it believes that much of the analysis underpinning the report is insufficient. Consequently, the Bank suggests that the conclusions of the report require further analysis.

**Title: Reflections on the Reserve Bank of New Zealand’s Monetary Policy Round**

**Author:** Philip Turner

**Paper type:** Public bulletin article - Reserve Bank Bulletin Vol. 80 No. 5, July 2017

This information article is a Reserve Bank-commissioned peer-review of the Bank’s monetary policy decision-making process. The review was written by Philip Turner, former Deputy Head of the Monetary and Economics at the BIS. Turner’s main conclusion is that the monetary policy process at the Reserve Bank works well. He finds that the Bank’s forecast round is designed to consider a range of economic analyses and to ensure open and comprehensive debate. A variety of efficient processes are identified, including coherent/tractable economic modelling and practical business sector perspectives from external advisers. Turner encourages the Bank to continue its forward agenda of research into emerging inflation trends to assist in the evolution of monetary policy decision-making.

**Title: The Bank of England’s decision-making structure for macro-prudential policy and financial stability**

**Author:** Piers Ovenden

**Paper type:** Independent consultant report to the New Zealand Treasury, May 2017

This is a Treasury-commissioned consultant report outlining the Bank of England’s institutional arrangements for making macro-prudential and financial stability policy decisions. The report was written by Piers Ovenden, former Bank of England official. The report outlines the structure, membership, appointment process, scope and functioning of the Bank of England’s Financial Policy Committee and the Prudential Regulation Committee. The report covers inter-committee coordination and stakeholder engagement. Transparency and accountability mechanisms are also outlined, alongside governance and oversight by the Court of the Bank of England and the Independent Evaluation Office.

**Title: Independent Review of the Operation of Monetary Policy in New Zealand**

**Author:** Lars Svensson

**Paper type:** Externally-commissioned report to the Minister of Finance, February 2001

This paper was prepared for a review of the monetary policy framework held in the early 2000s. The report findings and recommendations relate to the early years of New Zealand's inflation targeting monetary policy framework. The review's terms of reference covers: the way in which monetary policy is managed in pursuit of the inflation target, the instruments of monetary policy, the information used by the Reserve Bank in its decision-making, the monetary policy decision-making process and accountability structures, the coordination of monetary policy with other elements of the economic policy framework (including prudential policy), and the communication of monetary policy. Recommendations are ordered into four areas concerning: the Policy Targets Agreement (PTA), governance and accountability issues, data issues, and other (largely technical) issues for the Reserve Bank. One key recommendation from the review is that the Reserve Bank move to a committee-based decision-making structure for monetary policy.

**Policy frameworks**

**Title: Reserve Bank Prudential Regulation of Banks**

**Author:** James Every-Palmer QC

**Paper type:** Independent consultant report to the New Zealand Treasury, August 2017

This is a Treasury-commissioned consultant report reviewing aspects of the statutory framework for the setting of prudential requirements by the Reserve Bank. The report notes that the present framework is centred around conditions of registration which are imposed on banks under the Act. The detailed rules are, however, contained in a series of documents known as the Banking Supervision Handbook. The report notes that the legislative framework for prudential regulation has remained the same for nearly three decades while the practice of prudential regulation has changed significantly. The report suggests that an accountability deficit has arisen in respect of the Act as the prudential requirements imposed on banks operate as laws imposed by administrative decision-making without sufficient Parliamentary oversight. The report notes there are a number of ways to correct this deficit, including treating the Reserve Bank's requirements as disallowable instruments (similar to Australia), using merits review or more tightly prescribing the range of matters in relation to which the Reserve Bank may impose prudential requirements and proving the Minister of Finance with a clear mandate to advise the Reserve Bank of policy matters to be taken into account in operating the prudential regulatory regime. The report prefers the third approach.

**Title: The Design, Implementation, and Governance of Macroprudential Policy**

**Author:** Prasanna Gai

**Paper type:** Independent consultant report to the New Zealand Treasury, July 2017

This is a Treasury-commissioned report that highlights the main issues in the design and governance of a macroprudential policy regime. It justifies the implementation of a macroprudential framework, evaluates the efficacy of the main tools, and outlines the key considerations for governance arrangements. The report's justification for macroprudential intervention rests on the existence of negative externalities in the financial system that arise at the aggregate level. The report argues that consideration of systemic financial stability risks is so important that New Zealand's Memorandum of Understanding (MoU) on macroprudential policy should be of equal significance as the PTA for monetary policy. The report stresses the importance of clear objectives and processes to ensure accountability. It argues that the objectives of macroprudential policy should relate primarily to financial system resilience, but also to broader macroeconomic risks that may arise as a result of systemic imbalances. The report compares New Zealand's regime to other regimes internationally, and concludes with a series of recommendations on how the current MoU and associated governance arrangements could be strengthened. In terms of Governance, the report recommends that decisions-making should shift to a committee structure that sits within the Reserve Bank, with involvement from the Minister of Finance and the Treasury. It argues that macroprudential tools should be approved by the Minister of Finance because of their potential to have significant distributional implications for the general public.

**Part C: Other background papers**

**Title: Code of Conduct for Reserve Bank Board Members**

**Author:** Reserve Bank of Australia

**Paper type:** website link

This material outlines the expected conduct of Reserve Bank of Australia Board members.

**Title: New central bank act (and accompanying summary from the Reserve Bank of New Zealand)**

**Author:** Norway royal commission

**Paper type:** Report from the royal Commission to the Minister of Finance, June 2017

This paper reports on Norway's recent independent review of the primary legislation underpinning the Norges Bank. The report includes a review of the mandate, and decision-making and governance structure, of the Norges Bank.

**Title: What Rule for the Federal Reserve? Forecast Targeting**

**Author:** Lars Svensson

**Paper type:** Working Paper

This paper analyses the implementation of monetary policy under the Federal Reserve's dual mandate of price stability and maximum employment. The paper considers various dimensions of monetary policy implementation including the Federal Reserve's decision-making process, communication, and accountability for policy decisions.