MEMORANDUM FOR	Independent Expert Panel
FROM	Reserve Bank of New Zealand
DATE	11 December 2017
SUBJECT	**Comments on:**
	Decision-making and Governance at the Reserve Bank of New Zealand
	(Report by Iain Rennie, commissioned by the New Zealand Treasury)

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1. The Reserve Bank welcomes reviews of its decision making process so as to ensure they are fit for purpose. Consequently, the Reserve Bank initiates regular internal reviews. The Report by Iain Rennie makes several suggestions which are sensible, and the Reserve Bank supports. However, we believe that much of the analysis underpinning the report was insufficient, and consequently the conclusions of the report are unreliable, or would require considerable further analysis.

2. Proposals for change to the governance framework of the Bank should not be made lightly and need to be motivated by evidence that changes would improve upon the current framework. The Report does not define the nature of the problem it is seeking to address and needs a clearer analysis of the current decision-making framework and why it needs amending. In proposing a particular set of changes to the decision-making framework, the Report fails to provide options and does not demonstrate why the particular changes proposed would result in better policy decisions for monetary or financial policy in New Zealand.

B. General Comments on the Report

3. The Report provides a high level summary of current governance and decision-making arrangements at the Reserve Bank and notes the challenging environment in which policymaking occurs. Its observations about the uncertainties decision-makers face, the contentious nature of some policy decisions, and the potential cost of policy errors are all valid points. So too are the potential risks of group-think and of failing to consider a sufficient range of viewpoints.

4. The Report makes no attempt to document the processes that the Bank actually uses to support its decision-making, beyond the high level parameters established by the Act. Nor does The Report attempt to evaluate the mechanisms that the Bank currently has in place to help ensure that its decision-makers confront a broad range of policy perspectives, including a wide range of views of those outside the Bank. There is, for example, no mention of the role of the broader group of MPC members in providing policy advice to the Governing Committee, the use of external advisers on the MPC, the Bank's programme of business and financial sector liaison, its active public outreach

programme, or its participation in the international financial and economic community. These are all ways in which the Bank considers a diversity of external views and perspectives ahead of its monetary policy decisions.

5. The Bank would agree with the Report's contention that committee-based decisions tend to be better than those made by individuals. That view is borne out by the decision-making literature and is also reflected in predominant international practice, which generally sees monetary policy decisions made by some kind of committee (albeit in many different forms). The desirability of committee based decision making was the reason that the Governing Committee was established in 2014. The use of committees for financial policy decisions is less prevalent.

6. The Report makes no attempt to peruse the various operating models for monetary or financial policy decision-making in use around the world, the pros and cons of each, or the extent to which particular models might be suitable for New Zealand. Several times the Report notes that the Reserve Bank's decision-making framework is not 'best practice' and that its recommendations for change would take it in that direction. This begs the question as to what world 'best practice' actually is. While it is now commonly accepted that some form of committee-based decision-making is an essential ingredient of best practice, there is little convergence of opinion regarding institutional structures. For financial regulation in particular, institutional arrangements are diverse across countries. Decision-making models range from purely internal committees or councils through to decision-making bodies that rely exclusively on external members and everything in between.

7. We note that the Report's recommendations for change would establish a decision-making structure broadly similar to that adopted by the Bank of England when it assumed responsibility for prudential supervision and regulation in 2012. Whatever its merits for the UK, it is wrong to label this model as 'best practice' given the broad range of other models countries use. This is particularly so given the relatively short period over which the UK model has been tried and tested. It is unfortunate that the Report does not consider and discuss other alternatives.

C. Comments on Specific Recommendations for Change

Policy Statement (R1)

8. The Report proposes that a policy statement for financial policy be developed (R1) as a formal requirement under the Act. This would set out instructions for the operation of financial policy, including clear objectives, other government objectives that should be taken into account, guidance on trade-offs between competing objectives; and directions on how to handle particular types of shocks.

9. While the aim of such a statement is understandable, it must be recognised that the soundness and efficiency objectives of financial stability policy cannot be readily boiled down to simple numerical targets in the manner of a policy targets agreement (PTA) for

monetary policy. Nor is it likely that writing prescriptive guidelines for handling financial shocks is either possible or desirable.

10. A formal policy statement would have merit if the aims of such a statement were to publicly establish the general direction of the Bank's policy work programme and set general expectations around the matters the Bank should consider when undertaking financial policy. To a large extent the potential contents of a policy statement are already provided by the Minister's annual Letters of Expectations (LOE) to the Governor and the Board and the Bank's published Statement of Intent. It is worth considering whether consolidating these items into a single policy statement would aid clarity.

Committees (R2), (R3), (R5), (R6)

11. The recommendation that monetary policy and financial policy decision-making should have separate committees (with some overlapping membership) seems reasonable given the different tools, goals and skillsets used in monetary and prudential policy. However, The Report's recommendation for three committees (one each for micro- and macro-prudential policy) is not desirable. These two arms of prudential policy are so closely related that separating the decision-making appears to make little sense.

12. The Report does not satisfactorily consider all the factors relevant to external membership on the Policy Committees (R3). In essence, the Report's argument is that externals would bring a diversity of views to the table, which is true. However, the Report does not consider the practicalities, particularly for financial policy, of finding suitably qualified and un-conflicted committee members in a small country like New Zealand.

13. The Report seems confused on the composition and balance of internal and external members in the three committees that are recommended. The proportions of internals and externals would obviously be important to the dynamics of the committees and the balance of voting power. There is a strong argument that external members should not be able to out-vote the internal members if the latter are in agreement. Such an occurrence could severely undermine the influence of the Governors and the credibility of the institution.

State Services Commission to advise Minister on appointment of governors and external committee members (R4)

14. The Report recommends that the State Services Commission should advise the Minister of Finance on the appointment of the Governor, Deputy Governors and external committee members. This would replace current arrangements under which the Board recommends appointment of the Governor to the Minister and appoints the Deputy Governors on recommendation of the Governor.

15. The proposed change lacks a compelling justification. The Commission has no particular expertise in central banking or financial regulation. Under the proposed model, (it would seem) the Commission would not otherwise be closely involved in the affairs of the Bank

other than through the five yearly appointments of the Governors and externals (since reviewing the performance of the Bank would remain the responsibility of the Board). This is in stark contrast to the situation in the broader public sector under which the Commission retains a role in overseeing the performance of chief executives and their agencies.

16. The Bank's Board is obviously much closer to the issues facing the Bank, its culture and internal environment and therefore is arguably better placed to play a central role in recommending appropriate Governor candidates to the Minister (and vetting the Governor's recommendations for deputy positions). If the concern is that the Board has relatively limited experience in recruitment, an agency like SSC could potentially offer process advice or support to a board-managed process but this would be a rather different proposition.

17. In any case, the Report's recommendation begs the question what, if any, input the Board would be expected to provide to the process of selecting a Governor (and what input the Governor would be able to make into the selection of his or her Deputies). In addition to their policy responsibilities, the Deputies and any other senior staff on the policy committees would (presumably) continue to be senior managers of the Bank and continue to have a significant bearing on the Governor's wider accountabilities. As in any other senior management context, it is essential that the Governor has confidence in his or her senior staff. There are few examples where a Chief Executive has no input into the selection of the senior management team.

18. It is also surprising that the Report does not confront the dangers that could arise in a system where appointments to the Policy Committees were made by the Minister of Finance. While the Report's recommendation appears to be made largely on the grounds of ensuring decision-makers have democratic legitimacy (as per the discussion in para 102), the potential risks of political appointments are not considered.

MPC members to articulate individual views in Public (R7)

19. We agree with the Report that there should be protocols governing individual committee member's communication. The proposition that members of the monetary policy committee would be able (and expected) to highlight their individual policy views in public is problematic. While this approach is clearly adopted in some countries (notably the UK, US), we believe such an approach could be destabilising in a small open economy like New Zealand. Any perception of a rift between committee members would be likely to add unhelpful noise to the communication of policy as well as inviting outside lobbying around particular views. There are more constructive ways of conveying divergent viewpoints and the balance of risks around monetary policy decisions.

D. Broader governance of the Bank

20. A significant limitation of the Report is that it does not provide a fully articulated proposal for the governance of the Reserve Bank. The paper's recommendations for change are partial as they only cover the Bank's monetary and financial policy functions. There is little or no examination of decision-making arrangements for the Bank's other functions and roles – such as the issuance and distribution of currency, the provision of payment services or the management of financial system liquidity – and how these would dovetail with the proposed changes for policy arrangements. Nor does the Report broach the broader governance of the Bank in respect of its finances, risk management, human resources, health and safety, public outreach and infrastructure.

21. This narrowness carries over to the discussion of the role of the Board. The Report makes no attempt to evaluate the quality of the processes and rigour of the Board in its assessment of the Bank's performance. In para 157, the Report says there "is an argument that there is no need for an RBNZ Board going forward" noting that the "inclusion of external policy makers into the monetary and financial decision-making processes weakens the case for an external board". Although the Report does not recommend that the Board be dis-established, the comment clearly ignores the fact that the Board has a role in scrutinising the Bank's performance across a broad range of external and internal functions.

22. Based on the discussion in paras 151-160, The Report envisages that decision-making and accountabilities outside of monetary and financial policy would continue to reside with the Governor as Chief Executive of the Bank and that the Board would continue its performance monitoring of the Bank in these matters. While this seems a reasonable position, it leaves open questions about the potential interactions between decisions taken by the policy committees and the accountabilities of the governor as Chief Executive. For example, regulatory policy decisions taken by the policy committees could have significant ramifications for the Bank's budget, resources and infrastructure needs. The Report does not consider how these interactions would be managed.