



THE TREASURY

Kaitohutohu Kaupapa Rawa

# RBNZ Act Review Panel Meeting 3 Summary of Background Papers

February 2018

## Introduction and contents

This slide pack provides a high-level summary of the background papers that we have provided to you. We will use it when discussing the background and context of the RBNZ Act at the 2 March panel meeting.

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## Background Paper B: Cabinet Paper (2007) – Institutional Arrangements for Prudential Regulation

- This Cabinet paper arose out of the Review of Financial Products and Providers (RFPP) that proposed the prudential regulation of insurers and NBDTs, and the Review of Domestic Institutional Arrangements (DIA) which concluded that the Reserve Bank should be the single prudential regulator.
- The DIA was undertaken by a working group, chaired by Treasury, and also included the Reserve Bank and Ministry of Economic Development (now part of MBIE).
- The Cabinet paper represented the views of the DIA working group, and set out a package of changes designed to:
  - Support the extension of the Reserve Bank’s prudential regulation functions (to cover insurers and NBDTs) by increasing the Reserve Bank’s transparency and responsiveness to Government while maintaining its regulatory independence (for example, through, bolstered monitoring and reporting requirements);
  - Preserve the independence of the Reserve Bank’s monetary policy functions.

## Background Paper B: Cabinet Paper (2007) – Institutional Arrangements for Prudential Regulation

- In respect of the role of the Cabinet and Minister, the paper stated:

Government should have the opportunity to be involved in issues that raise policy considerations, to ensure that the value judgements underpinning policy reflect those of society at large, that policy in specific areas supports the government's wider strategic objectives and that priorities and policy are coherent and consistent across government. At the same time, government involvement in regulatory functions raises a number of risks that need to be guarded against:

- the risk of a perception of government endorsement of regulation and thereby an implied guarantee of regulated entities;
- the risk of poorer quality regulation, if political concerns lead to inconsistency in regulatory approach over time and reduced regulatory certainty, or to regulation that is short-term in focus;
- more opportunity for lobbying by industry, and associated political risks;
- in the case of financial sector regulation, risks to New Zealand's international reputation, given the weight put on independence of regulation in this sector.

The Reserve Bank has independence in setting prudential rules and applying them to banks. It also has independence in determining the outcomes it seeks to achieve, based on the objectives set out in statute. To guard against the risks identified above, the government's engagement with the Reserve Bank should not extend to involvement in these regulatory decisions.

## Background Paper B: Cabinet Paper (2007) – Institutional Arrangements for Prudential Regulation

- In response to the paper, Cabinet agreed:
  - To confirm an earlier in-principle decision that the Reserve Bank be the prudential regulator for the financial system
  - That a new purpose statement be included into the Reserve Bank Act to reflect the increased prominence of the Bank's prudential functions and to increase the Board's monitoring of those functions (reflected in section 1A of the Act)
  - To enhance the Reserve Bank's statement of intent requirements, including through requiring the Bank to take into account comments provided by the Minister of Finance on its prudential regulatory objectives (reflected in sections 162C and 162D of the Act)
  - That the Minister of Finance may direct the Reserve Bank to have regard to a statement of government policy objectives (reflected in section 68B of the Act)

## Background Paper B: Cabinet Paper (2007) – Institutional Arrangements for Prudential Regulation

- In response to the paper, Cabinet agreed:
  - That the Reserve Bank be required to publish the Financial Stability Report six monthly, and that it contain information necessary to allow assessments to be made of the activities undertaken by the Reserve Bank in carrying out its prudential regulation purposes (reflected in section 165A of the Act)
  - That the Reserve Bank be required to produce more assessment of the expected net benefit of its policies (reflect in section 162AB of the Act, which requires the Bank to assess the impacts of regulatory policy, except where they are minor or technical)
  - That the Reserve Bank:
    - would be responsible for the provision of policy advice on prudential regulation to the Minister of Finance; and
    - that the Minister may ask the Bank to provide policy advice and information in relation to any areas in which it has a lead role (reflected in section 33 of the Act)

## Background Paper B: Cabinet Paper (2007) – Institutional Arrangements for Prudential Regulation

### Treasury comment for the Panel

With regard to the power of the Minister of Finance to direct the Reserve Bank to have regard to a statement of government policy objectives, the Treasury and the Reserve Bank have been unable to agree how this power may be used by the Minister to engage with the Bank in the development of its financial sector objectives.

Further, key elements of New Zealand's public management model upon which the 2007 policy decisions were based (particularly the Crown Entities Act 2004) were further reformed in 2013 (at around the ten-year mark). These reforms included:

- providing a statutory basis for monitoring departments, clarifying their role, functions, and powers
- increasing the focus for Crown entities to work across boundaries in the collective interests of government; boards were given an expanded duty to ensure the entity collaborates with other public entities where applicable
- broadening the scope for the use of directions to support a whole-of-government approach (to help better achieve functional leadership objectives)
- revisions to key accountability document requirements, including the addition of a Statement of Performance Expectations

# Background Paper C: A Short History of Prudential Regulation (RBNZ Bulletin - Vol.79, No.14, August 2016)

Author: Dr Chris Hunt, RBNZ

- Before 1986: heavy regulatory controls and no direct prudential supervision of banks.
- The Reserve Bank of New Zealand Amendment Act 1986 created a “light-handed” supervisory regime to complement the financial sector deregulation of the mid-80s.
- Key features that have endured over time:
  - Systemic focus
  - No depositor protection mandate
  - Bank registration premised on the use of the term “bank” as opposed to constraints on the activities of banking
  - Emphasis on failure management
  - No on-site inspections reflecting a light-handed and low cost approach to supervision
  - Financial disclosure underpinning an emphasis on market discipline
  - Placing the responsibility for the sound management of a financial institution primarily on the shoulders of directors and senior managers (self-discipline).

## Background Paper C: A Short History of Prudential Regulation

- Deregulation led to risk-taking in the financial sector and financial stress at the BNZ and others, and public confidence in the financial sector declined.
- The RBNZ Act 1989 introduced a more proactive approach to prudential regulation, relative to the initial prudential regime, but the emphasis was still on the benefits of self and market discipline.
- Early ‘philosophical’ debate within the RBNZ between the Economics Department (market view) and the Banking Supervision Department about the future of the prudential regime.
- The result of this debate was a new disclosure regime introduced in 1996 that enhanced the focus on self and market discipline and reduced a number of previously prescribed prudential rules and regulations.
  - Financial and prudential information publicly available and subject to external audit, with no ‘private information’ available to bank supervisors
  - Mandatory credit ratings
  - Director attestation as to the veracity of publicly disclosed information
  - Banking supervision was premised on minimising moral hazard, and the compliance and efficiency costs associated with the more heavy handed approach seen elsewhere.

## Background Paper C: A Short History of Prudential Regulation

The regulatory pillar was gradually strengthened after the appointment of a new Governor in 2002

- The Reserve Bank Act Amendment Act 2003 clarified and strengthened the RBNZ's supervisory powers.
- Local incorporation (2003) and outsourcing (2006) policies response to growing dominance of Australian-owned banks in NZ financial system

The scope and nature of regulation and supervisory activities have grown since the GFC

- New policies: Basel I & II (2008 & 2013); liquidity (2010), OBR (2012), macro-prudential (2013)
- More intensive approach to supervision (e.g., more engagement with bank directors; use of private information; improvements in 'off-site monitoring framework)

But:

- Prudential supervision still focuses on the financial system as a whole rather than individual institutions
- Greater supervisory resource is directed towards the larger, systemically important institutions
- Supervision does not rely on on-site inspections and supervisory resources remain comparatively low.

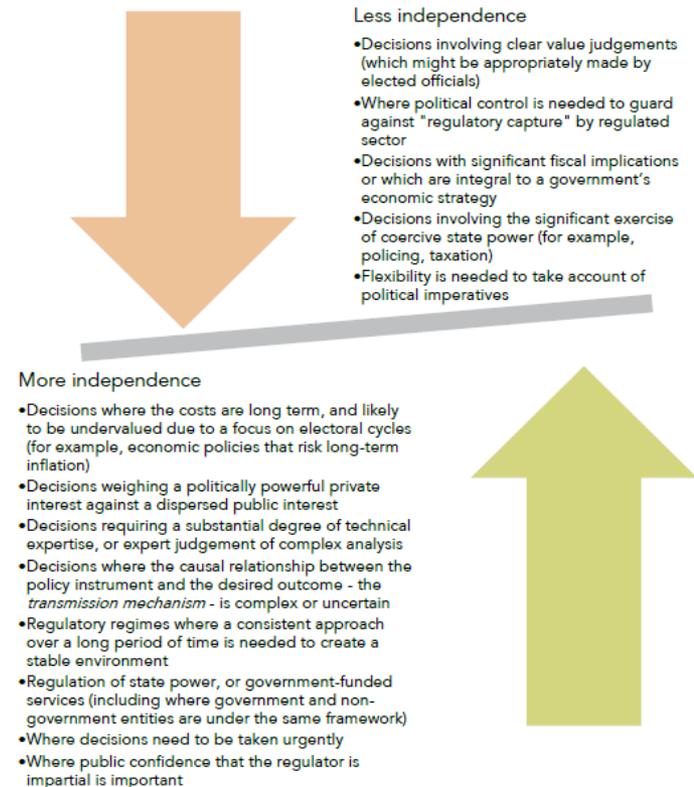
# Background Paper D: Independence with accountability (RBNZ Bulletin – Vol 80, No 11 2017)

Author: Dr Chris Hunt, RBNZ

- The delegation of financial system-related objectives and powers to an independent agency marks a form of pre-commitment on the part of government to the long run goal of financial stability. This helps reduce the risk of politicisation of policy making and avoids the classic ‘time inconsistency’ problem’ where government may act in its own interests over the short term.
- The article provides a qualitative assessment of the RBNZ’s arm’s length relationship from government across 4 dimensions: institutional, regulatory, supervisory and budgetary independence.
- The reassignment of powers from democratic institutions to an unelected body like the RBNZ raises the issue of how to compensate for a lack of political legitimacy.
- A strong accountability framework helps ensure that the RBNZ discharges its functions in a way that satisfies Parliament, government ministers and a wide set of stakeholders. In doing so, accountability can build legitimacy if the public can see that regulatory decisions take place in a fair and transparent way.

Dr Hunt refers to the Productivity Commission’s framework of arguments for delegating regulation to an independent agency, reproduced below (*Regulatory Institutions and Practices*, p218):

Figure 9.3 Features indicating a need for less or more regulatory independence



## Background Paper D: Independence with accountability

### The main accountability arrangements at the Reserve Bank are:

- Objectives are stated in the RBNZ Act but they are fairly broad, allowing considerable discretion as to their pursuit. On their own, they provide an insufficient basis for holding the Reserve Bank to account.
- Statement of Intent and Annual Report tabled in Parliament and the Financial Stability Report must be presented to Parliament by the Minister.
- The Minister may remove a Governor who is not adequately carrying out the Bank's functions or not discharging their duties adequately.
- Section 68B allows the Minister to direct the Bank to have regard to government policy.
- The Bank must carry out regulatory impact assessments of policies before adoption, except policies of a minor or technical nature.
- There are other informal non-statutory channels, eg consultation and publication of submissions.

## Background Paper D: Independence with accountability

### Constructing robust accountability arrangements is not straightforward in financial policy.

- Concepts such as financial system “soundness” and “efficiency” are open to different interpretations and not easily translated into a single, quantifiable benchmark.
- Multiple objectives can at times conflict.
- The specific accountability arrangements that govern monetary policy performance, for example, may not easily translate to the financial stability area. In the case of the latter, greater emphasis should be placed on *ex ante* forms of accountability tied to the robustness and transparency of the decision making process itself, rather than on *ex post* performance metrics.

### For these reasons, the Bank of International Settlements argues that:

- extra-statutory statements of objectives are an important means of clarifying broad statutory objectives, including ways of managing any trade-offs that might exist.

## Background

- In 2017, the IMF undertook a comprehensive review of New Zealand's financial system (Financial Sector Assessment Programme, FSAP) , with a particular focus on the quality of financial sector regulation and supervision.
- The assessment was conducted taking into account the unique characteristics of the New Zealand banking industry, in particular the high level of concentration and dominance by Australian subsidiaries.
- The next few slides summarise observations and recommendations in relation to supervision and crisis management.

## Author: International Monetary Fund

### Supervisory framework and resourcing

#### IMF Observations on the current framework

**The approach of the RBNZ to supervision should be strengthened by increasing the weight of regulatory discipline in its three-pillar framework.** The RBNZ approach to supervision relies on three pillars: self, market, and regulatory discipline. The authorities have strengthened regulatory discipline since the last FSAP, but the three-pillar framework should be improved by adopting a more intensive approach to supervision. This would increase the ability of supervisors to be proactive to exercise regulatory discipline and obtain reliable information to enforce self- and market-discipline. The RBNZ is encouraged to issue enforceable supervisory standards on key risks, review the enforcement regime to promote preventive action, and initiate on-site programs targeted on areas of high risk. In addition, clarifying the responsibilities of the Treasury and RBNZ on financial sector issues and reinforcing the role and autonomy of the RBNZ as prudential regulator and supervisor would enhance the ability of the RBNZ to respond swiftly to ongoing and emerging risks.

(FINANCIAL SYSTEM STABILITY ASSESSMENT - Executive summary p6)

**Increasing supervisory resources for all financial sectors is key.** This would support the highly qualified RBNZ staff in improving the effectiveness of the supervisory process, enhancing their knowledge of financial institutions' operations, and deepening risk assessment of supervised entities—and strengthening their ability for early preventive action.

(FINANCIAL SYSTEM STABILITY ASSESSMENT - Executive summary p7)

#### The IMF recommendations

- Increase RBNZ resources for the supervision and regulation of banks, insurance companies, and FMIIs
- Strengthen cooperation and collaboration arrangements with Australian authorities
- Clarify responsibilities of the Treasury and RBNZ on financial sector issues to reinforce the role of RBNZ as prudential regulator and supervisor
- Issue enforceable standards on key risks, governance, risk management, and controls to make RBNZ's supervisory expectations more transparent and support supervisory preventive action
- Review and extend the enforcement regime to promote preventive action and enhance sanctions powers, including by eliminating ministerial consent for directions, and making compliance with RBNZ policy documents evidence of prudent practice
- Initiate on-site programs to test the foundation of the three pillar approach and directors' attestations, and increase supervisory engagement with institutions in order to require appropriate action

## Author: International Monetary Fund

### Macroprudential framework

#### IMF Observations on the current framework

**Strengthening the macroprudential framework is important.** The financial system is dominated by four major banks with similar business models in which the majority of assets are associated with housing loans. Direct exposures among them are relatively limited, but the potential for spillovers is elevated. Credit has resumed strong growth during the last few years, putting pressure on funding and increasing concerns with the housing sector. So far, the authorities have applied exposure limits to loans with high loan-to-value ratios (LVR) which, while strengthening the profile of banks' portfolios, have had limited effects given rising housing prices. Adding a debt-to-income cap to the macroprudential toolkit would enhance systemic resilience by limiting the risks from growing household indebtedness. Imposing additional loss-absorbency requirements for domestic systemic banks, and allowing an effective accountability of the RBNZ without jeopardizing the integrity and independence of its macroprudential decision-making process are also recommended.

(FINANCIAL SYSTEM STABILITY ASSESSMENT - Executive summary p6)

#### The IMF recommendations

- Strengthen institutional arrangements for macroprudential policy by increasing communication efforts and transparency when adjustments to the framework are being considered.
- Maintain an effective accountability of the RBNZ that does not jeopardize the integrity and independence of its macroprudential decision making process.
- Enhance the operational basis for macroprudential policy by including DTI limits in the macroprudential toolkit.
- Implement DTI measures if the changes to the LVR do not substantially reduce the risks in the housing sector.
- Increase capital requirements to reflect the risks posed by the concentration of the financial sector in four main banks.
- Review liquidity regulatory requirements aiming to reduce banks reliance on the provision of liquidity by the RBNZ

## Author: International Monetary Fund

### Crisis management

#### IMF Observations on the current framework

**The crisis resolution framework needs to be enhanced further.** The Open Bank Resolution (OBR) framework, which aims to avoid the use of public funds when resolving systemically important banks, is a step in the right direction. To enhance its credibility and strengthen the financial safety net, the introduction of deposit insurance would be the best option. Absent support for deposit insurance, a second option is to legally establish a de minimis exemption from freezing and haircutting deposits in OBR, set at an appropriate level. The decision-making process in a crisis and the exercise of resolution powers need to be clarified. The RBNZ should be the sole resolution authority, with clear mandates and responsibilities, requiring the approval of the Minister of Finance (MoF) only for resolutions with fiscal or systemic implications.

FINANCIAL SYSTEM STABILITY ASSESSMENT (Executive summary p7)

#### The IMF recommendations

- Strengthen domestic crisis management arrangements:
  - Reach ex ante agreement on roles, responsibilities and decision making processes
  - Preposition logistics and communications plans
  - Complete initial work on plans to mobilize resources in a crisis
  - Complete procedural guidance for appointment of a statutory manager, implementation of OBR and other resolution tool-kit options
  - Test domestic preparations in simulation exercises.
- Reconsider the merits of deposit insurance, or in the continued absence of policy support, introduce a limited depositor preference to provide legal certainty for the de minimis exemption contemplated in OBR.
- Revise the RBNZ Act in line with IPSA and the NBDT Act to remove the role of the Minister in issuing directions

#### The IMF recommendations (continued)

- Revise the RBNZ Act to provide greater clarity and certainty in resolution:
  - Insert objectives in resolution including protection of depositors and the public interest.
  - Require accountability reporting against the resolution objectives in both the RBNZ Act and IPSA, and NBDT Act when revised as recommended above
  - Clarify that the RBNZ is the sole resolution authority
  - Insert an express requirement for Ministerial consent for resolutions with fiscal or systemic implications only
  - Clarify Treasury's role as a provider of advice to the Minister on the RBNZ recommendations regarding resolution
  - Provide express bail-in powers to the statutory manager
- Ex ante agreement on reporting requirements and decision-making procedures for OBR and other resolution options with fiscal or systemic implications.
- Provide a legal foundation to exempt from continuous disclosure requirements information on resolution if such disclosure would be harmful to effective resolution.

## Key extracts from the Productivity Commission's report on regulatory institutions 2014

### The report finds common issues across the regulatory landscape in New Zealand:

- “A 2013 review of New Zealand’s regulatory management systems found “general weaknesses across agencies in undertaking and utilising review processes” and concluded that “[w]e tend to have a ‘set and forget’ mind set to regulation.” (p.46)
- Almost two-thirds of public sector chief executives who participated in a Commission survey on regulatory regimes either strongly agreed or agreed with the proposition that agencies with regulatory functions “often have to work with legislation that is outdated or not fit for purpose”. (p.38) “Their independence could be enhanced by the greater use of secondary legislation (including that made by regulators), and ensuring greater consistency in allocating legislative material between primary legislation and secondary legislation.” (p. 215)

### And reviews must take a holistic approach:

- While 70% of businesses said that the regulatory requirements in New Zealand are “sometimes” contradictory or incompatible with each other, the report suggested that “looking at the overall system, rather than individual regimes, will better allow the conflicts and contradictions to be identified and dealt with.” (p.29)

## Key extracts from the Productivity Commission's report on regulatory institutions 2014

### Regulatory institutions need to be designed to provide:

- clarity of role, as clear regulatory roles and objectives are critical to regulator accountability and focus; for compliance by regulated parties and the legitimacy of the regulatory regime (Chapter 8);
- an appropriate institutional form and degree of independence to enable them to function as intended (Chapter 9);
- good governance and decision-making arrangements, and appropriate allocation of decision rights, including where and how discretion is exercised (Chapter 10);
- appropriate mechanisms for reviewing regulatory decisions (Chapter 11);
- adequate funding, according to good principles for the recovery of the costs of regulatory activities – and where the funding mechanism does not create perverse incentives for either the regulator or regulated parties (Chapter 12); and
- strong monitoring and oversight arrangements to ensure that regulatory agencies are effective, efficient and accountable and that regimes are working as intended (Chapter 13).

## Key extracts from the Productivity Commission's report on regulatory institutions 2014

### It will be appropriate for regulators to have more independence in certain circumstances...

- There is widespread agreement of the importance of regulation being undertaken by independent regulators. It will usually be appropriate for regulatory powers to be exercised independently of political control so they are not used for partisan purposes where the risks are long term, where powerful private interests are at stake, and where a substantial degree of technical expertise is required.[...] Arguments for political control must be weighed carefully against the benefits of providing a credible long-term commitment to an impartial and stable regulatory environment. (p8)
- The OECD *Best practice principles for the governance of regulators* (2013b) note that independent regulators should be considered when: a regulator needs to be seen to be independent to maintain public confidence; government and non-government entities are regulated under the same framework; and decisions have a significant impact on particular interests, so impartiality must be protected. (p. 217)
- The Victorian State Services Authority *Review of the rationalisation and governance of regulators* (2009) states that Independent regulators are established to: provide credible commitments over the long term; create a stable and predictable regulatory environment; develop focus and expertise; and manage political risks. (p. 217)
- “The duties of independent regulators and the interests of elected politicians will periodically diverge. It is undesirable for politicians to interfere in the decisions of independent regulators. Political intervention in independent regulators will undermine the authority of the regulator, encourage lobbying and special pleading, and contribute to an uncertain environment that deters foreign investment and harms businesses by increasing the cost of borrowing.” (p236)

# Key extracts from the Productivity Commission's report on regulatory institutions 2014

## ...and less in others:

- Less independence might be appropriate where, for example, decisions involve clear value judgements; significant fiscal implications or which are integral to a government's economic strategy; or political control is needed to guard against "regulatory capture" by the regulated sector; decisions involving the significant exercise of coercive state power; or Flexibility is needed to take account of political imperatives; (p. 218)
- "Independent regulators are never truly separate from the political process. They operate under the authority and according to laws which Parliament can change. All branches of government – Parliament, courts and other agencies in the Executive – monitor the activity of the regulator (see Chapter 13). Political intervention in regulatory decisions can be legitimate, and it can be exercised for good or ill." (p.236)

## Key extracts from the Productivity Commission's report on regulatory institutions 2014

### The report comments on the RBNZ's governance arrangements and statutory objectives:

- “[The variety in decision-making models in New Zealand] partly reflects a tendency for regulatory functions to be grafted onto existing regulatory agencies without the governance arrangements necessarily changing. This is the case with the RBNZ, for example, where its governance arrangements were established in 1989 and largely designed for its primary function of monetary policy. Little specific regard was given then to the governance issues applicable to its regulatory functions. Moreover, since 1989, its regulatory functions have expanded substantially, but its governance arrangements have not changed...RBNZ submitted that the current model was appropriate and had allowed it to function well (sub. DR 99). However, at least in some respects, the differences do not appear to be well anchored to sound regulatory governance principles.” (pp.268-269)
- “Uncertainty about the meaning of objectives undermines the credibility and effectiveness of regulatory regimes.” (p.201) The Productivity Commission uses the RBNZ Act as an example where there are opposing views on whether a specific statute has clear objectives.
- However, the Productivity Commission's report does not acknowledge that the governance arrangements of the Reserve Bank were considered in 2007 when the Reserve Bank was given the role of single prudential regulator which widened the Reserve Bank's scope to include prudential regulation of non-bank deposit takers and the regulation and supervision of insurance companies. Refer to the 2007 Cabinet paper

## Background Paper F: Time to review the RBNZ Act 1989

Authors: Helen Dervan, Senior Lecturer, AUT, and Simon Jensen, Partner, Buddle Findlay

### The article identifies deficiencies in the RBNZ Act in several areas:

- Decision-making:
  - The single decision-maker model does not ensure that a wide range of thought, challenge, skills and perspectives forms part of the decision-making process.
  - When the UK adopted Twin Peaks post-GFC, it established statutory multi-member committees to undertake prudential regulation for the Bank of England [...]. The independent members are there to challenge thinking and avoid “group-think”, a type of defective decision-making which arises particularly where group members are of a similar background and insulated from outside opinions.
- Consistency with international principles:
  - The IMF has expressed significant concerns about the supervisory philosophy, approach and method utilised by the RBNZ in undertaking its prudential role.

## Background Paper F: Time to review the RBNZ Act 1989

### The article identifies deficiencies in the RBNZ Act in several areas:

- Statutory objectives and clear responsibilities
  - “The RBNZ’s statutory objectives are out-of-date and enable the operation of a regulatory and supervisory regime that does not comply with international best practice in terms of supervision, depositor protection and bank resolution policy.”
  - “Having only broadly worded, high level statutory objectives directed at a systemic level helps explain why the RBNZ has been able to adopt an unconventional “hands-off” supervisory approach and not conduct detailed on-site inspections.”
  - “[...] prudential regulators in other comparable jurisdictions have objectives that operate at a lower level and specifically require promotion of the safety and soundness of individual institutions.”
  - “Having only broadly worded, high level statutory objectives directed at a systemic level helps explain why the RBNZ has been able to adopt an unconventional “hands-off” supervisory approach and not conduct detailed on-site inspections. In short, its statutory objectives do not require it to do so... However, it must be recognised that the RBNZ’s statutory objectives are out of step with those in comparable jurisdictions, as is its supervisory philosophy and method.”
  - “New Zealand designed some initial bank resolution policies after the Asian financial crisis in 1999 and, arguably, it has gone from being a world leader in bank resolution policies to a country that lags significantly behind international best practice. This may, in part, be because of the out-of-date objective in the 1989 Act, but may also result from the Act placing sole responsibility for bank resolution on the RBNZ when there is a wider group of stakeholders that should be considered.”

## Background Paper F: Time to review the RBNZ Act 1989

### The article identifies deficiencies in the RBNZ Act in several areas:

- Depositor protection
  - The 1989 Act does not require the RBNZ to consider the interests of depositors when it is prudentially supervising banks [...] this is in contrast to other comparable jurisdictions which specifically recognise the critical position of depositors [...] RBNZ’s position is out of step with international best practice.”
  - “The RBNZ’s traditional justification for refusing to introduce deposit insurance is that it would weaken self discipline by banks and market discipline by depositors and reduce the incentive on depositors to monitor their banks [...] The fundamental flaw in this position was, arguably, exposed by the fact that, during the GFC and from 2008 to 2011, a temporary retail deposit guarantee scheme was introduced to reassure New Zealand depositors [...].”
- Relationship with monetary policy
  - The Act arguably does not optimise the operation of the Twin Peaks model by ensuring that monetary policy and prudential regulation are dealt with on an equal footing.
- On resourcing and funding, the article notes that:
  - the IMF found, “although RBNZ staff are highly qualified, insufficient resources are a ‘serious impediment to developing an effective and intrusive supervisory approach carefully tailored to the characteristics of New Zealand’s banking industry’. Better resourcing would require an increase in the number of specialist staff to undertake more intensive supervision and risk assessment. Obviously, this would require an increase in RBNZ funding. If the Government is committed to improving prudential regulation and supervision in New Zealand, it must loosen the purse strings and better fund the RBNZ”.

## Background Paper F: Time to review the RBNZ Act 1989

### The article concludes that

- “There is no doubt that the adoption of Twin Peaks has significantly improved the regulation of New Zealand’s financial markets. However, simply changing the institutional model of regulation is not sufficient to protect New Zealanders. Financial markets are highly complex, competitive and evolve rapidly. Effective regulation requires in-depth market knowledge, vigilance and appropriate resourcing. One of the advantages of Twin Peaks is said to be that it can help regulators keep pace with developments, which may carry new forms of risk. In order for the model to work effectively, however, the internal apparatus of regulators must be constructed to enable them to fulfil statutory obligations.”
- “The only way prudent way forward is for New Zealand to conduct a full review of the legislative and structural framework for prudential regulation. [...] New Zealand benefits from the high quality of the RBNZ staff, and personnel with the requisite skills are a scarce resource. Having said that, a review is prudent in the light of the IMF findings. If New Zealand genuinely wishes to fix the shortcomings of the past, two things are required: open, informed debate on what is the best model for prudential regulation for New Zealand and a willingness from government to redraft the 1989 Act from scratch.”

# Background Paper G: Reserve Bank Prudential Regulation of Banks

## Author: Dr James Every-Palmer QC

### Issues with the current framework

- “These observations are not intended to be critical of the Reserve Bank. Rather, the divergence between the statutory framework and the current practice of prudential regulation that has arisen over 30 years indicates that it is an appropriate time for a stocktake to assess the robustness of the statutory framework”
- “[...]an accountability deficit has arisen as [...] prudential requirements operate as laws imposed by administrative decision-making without sufficient parliamentary oversight”
- “The prudential regulation regime has evolved from a light-handed approach based on self-discipline [...] to a much greater prescription about how registered banks are to behave [...] In this narrow sense, much regulation is ‘opt-in’ [although] in practice it is not really practical for large banks to opt out of the prudential regulation regime by deciding not to register as banks”
- The report emphasises the need for regulatory certainty and the importance of technical expertise and concludes that the Reserve Bank should continue to have a high degree of autonomy when setting prudential requirements. “However, Every-Palmer considers that the quid pro quo should be more tightly prescribing the range of matters in relation to which the Reserve Bank may impose prudential requirements and providing the Minister of Finance with a clear mandate to advise the Reserve Bank of policy matters to have regard to in operating the prudential regulatory regime.”

# Background Paper G: Reserve Bank Prudential Regulation of Banks

## Author: Dr James Every-Palmer QC

### Issues with the current framework (cont)

- The report considers the following potential legal/regulatory issues:
  - The main prudential rules sit outside the conditions of registration [and therefore legislation];
  - There is limited or no Ministerial or Parliamentary scrutiny of the rules;
  - There is no express process for the general rules to be tailored to the circumstances of a particular bank;
  - The Reserve Bank has retained an ongoing administrative decision-making function through the “notice of non-objection” process;
  - The macro-prudential MOU is not envisaged by the RBNZ Act and may operate in practice to constrain the Reserve Bank’s powers;
  - The regulatory perimeter presently evolves in an ad hoc function; and
  - The accessibility of the prudential requirements.

# Background Paper G: Reserve Bank Prudential Regulation of Banks

## Recommendations: prudential framework

1. Retain conditions of registration and give statutory recognition to the Banking Supervision Handbook
2. The prudential requirements should be drafted and made by RBNZ
3. Oversight by way of judicial review rather than the Regulations Review Committee or appeals
4. Changes should require public consultation and the process should be set out in the Act
5. The Government should be able to issue a Government Policy Statement that the Reserve Bank is required to have regard to in setting and updating the Banking Supervision Handbook
6. The Reserve Bank should have an express power to grant exemptions or otherwise modify the application of the standard prudential requirements to a particular bank and to maintain an ongoing administrative decision-making function
7. The Act should set out the process for decision-making around exemptions, other modifications to the standard prudential requirements and ongoing administrative decision-making
8. A bank should have the right to appeal a decision relating to an exemption, other modifications to the standard prudential requirements and ongoing administrative decision-making
9. The Act should set out a core set of areas for prudential regulation, but new areas would require regulation, for example by Order in Council
10. The Act should impose new disclosure requirements on the Reserve Bank so that the prudential requirements applying to a particular bank are as accessible and transparent as possible.