To: The Treasury

On: Reserve Bank of New Zealand Act Review

12 March 2018

INTRODUCTION

This submission is from Chapman Tripp, PO Box 993, Wellington 6140.

We would be happy to meet with The Treasury to discuss our submission. Our contacts are:

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ABOUT CHAPMAN TRIPP

Chapman Tripp is a leading law firm with a strong practice in banking and finance law. We have advised a range of banks and other stakeholders on a wide range of issues in connection with the Reserve Bank of New Zealand Act 1989 and the Reserve Bank's prudential regulatory framework.

The proposal to review the Reserve Bank of New Zealand Act is of direct interest to us as legal practitioners and to our clients, and we welcome the opportunity to make a submission on the list of issues for consideration as part of Phase 2 of the review of the Reserve Bank of New Zealand Act.

SUBMISSION STRUCTURE

Our submission mainly focuses on the question as to whether the current structure of the Reserve Bank remains appropriate, and whether this issue should be considered as part of Phase 2 of the review.

We have also briefly commented on some other topics that we consider could be usefully included in the review.

SUBMISSION

Appropriateness of the Reserve Bank's current structure

We consider that a key issue that should be considered as part of the Phase 2 review of the Reserve Bank of New Zealand Act is whether the current structure of the Reserve Bank remains appropriate or whether it should be change to a structure that is better suited to deal with the dual functions that the Reserve Bank has, namely the formulation and implementation of monetary policy on the one hand and the setting and implementation of prudential regulation on the other hand.

We believe that the current structure, with a single Governor, who acts as chief executive, and a single board of directors of the Reserve Bank, that cover both of these functions is no longer the most appropriate way in which the Reserve Bank should operate.

We consider that the operational oversight in respect of these two functions should be split, with separate governance structures applying to each. This could be achieved by having each of these functions carried out by separate organisations (along the lines of the position in Australia with the Reserve Bank of Australia implementing monetary policy and the Australian Prudential Regulatory Authority (APRA) being responsible for prudential supervision) or having both functions carried out under a single legal structure but subject to separate governance and oversight regimes (similar to the position in the United Kingdom where the prudential regulation function is carried out by the Prudential Regulation Authority which is a separate part of the Bank of England).

We do not have a particularly strong view as to which approach would be best. Rather we suggest that the structure which fits best for most efficiently achieving the separation of the two functions, after identifying the desired outcomes, should drive any such decision.

We are concerned that the current single governance and operating structure does not adequately take account of the fact that the Reserve Bank has two distinct roles.

In carrying out the function of implementing monetary policy the Reserve Bank needs a high degree of independence. There needs to be some distance between itself and the stakeholders that the Reserve Bank's decisions can affect. By contrast, in its role as prudential supervisor and regulator of banks, reflecting best practice, the Reserve Bank needs to have a less arms' length relationship with the stakeholders that it regulates. This requires not only a different skill set, but a fundamentally different approach to how it interacts with its stakeholders.

We consider that achieving these different outcomes requires the Reserve Bank to have separate governance and oversight structures, with the corresponding oversight boards/committees having the requisite skill sets and expertise for each role. In our view the oversight board/committee in respect of the prudential function needs to have a range of experience and expertise in the financial services area that allows it to balance up the regulatory aspects of the prudential supervisor's role with "real world" understandings. This includes the need to take account of the international perspective and to build and maintain market confidence in the decisions and actions of the regulator.

In this context we suggest that the composition of board of the Financial Markets Authority is a good illustration of the cross-section of stakeholder representation that would be appropriate.

There is a question as to whether such a board or committee should also have a broader governance role in relation to the day-to-day operation and management of the regulator and the performance of the governor/chief executive in their capacity as the head of the prudential regulatory function.

We consider there are good arguments that this governance and performance oversight function should sit separately from the role of the board/committee that oversees the formulation and direction of the prudential policies proposed by the regulator. Such a separation would avoid the risk of conflict issues arising, which could be the case if a single board/committee both gave directions to the governor in relation to the way in which the regulatory function was to be managed and reviewed the performance of the governor in relation to that management. In any event, this should be a specific issue to be considered as part of the Phase 2 review.

It is also relevant to consider what the prudential regulator has oversight of. For example, we question whether it is appropriate that the prudential regulator is also the regulator in respect of the anti-money laundering regime that applies to banks. We see this regulatory function as being "conduct regulation" function, more suited to, say, the Financial Markets Authority than the Reserve Bank as prudential regulator.

There is also a question as to whether the regulation of non-bank deposit takers, not seen as being systemically significant to the financial system, should fall under the prudential regulator's oversight. Equally, is it appropriate for the prudential regulator to have oversight of insurance companies? On the basis that the core purpose of the prudential regulator is to promote the maintenance of a sound and efficient financial system we question whether the regulation of insurance companies falls within this ambit.

We consider a case can be made that the prudential regulator's role should be limited to the oversight of banks and other aspects of the financial system that are systemically important, such as financial market infrastructures (e.g. payment and settlement systems).

Other comments

We consider that the following issues should also be taken into account as part of the Phase 2 review.

We are concerned that the Reserve Bank currently has insufficient resources to operate effectively and efficiently as the prudential supervisor. We note that this is something the Reserve Bank has acknowledged itself. Our sense is that there is a concern that the lack of resource means the Reserve Bank tends to take a more thematic approach to matters that could benefit from more detailed direction. This results, at times, in approaches or decisions which lack clarity for both banks and other stakeholders affected by such actions.

Separately, we consider that the approach taken to the conditions of registration should be considered as part of the Phase 2 review. Given that the conditions of registration are a critical part of the regulatory regime that applies to banks, it is important that there is no misunderstanding between the Reserve Bank and the banks as to how these are to operate. We question whether the current approach of drafting conditions of registration in a somewhat abbreviated form is the best approach. Consideration should be given to whether it would be more appropriate for the conditions to be drafted within a more formal framework, for example more in the style of regulations with, if applicable, explanatory notes. This would help to provide more clarity as to how they are to apply and the extent of their breadth.

This is need for clarity is also relevant to the broader legislative regime that applies to the supervision of banks. Thematic approaches are useful to provide a policy backdrop, but banks are other stakeholders need to implement such policies at a granular level. So it is important that the general legislative framework (including elements of the banking supervision handbook) has sufficient precision and direction to allow banks and other stakeholders to clearly understand the breadth of the regulatory framework.

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