

Review of the Reserve Bank Act

Release Document – Reserve Bank Act Review Phase 1: Committee decision-making rules, roles and remuneration

July 2018

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[2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.

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Treasury Report: Treasury Report: Reserve Bank Act Review Phase 1:
Committee decision-making rules, roles and
remuneration

Date:	2 May 2018	Report No:	T2018/1036
		File Number:	MC-1-7-2

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Agree to the recommendations in this report Refer this report to the Associate Ministers of Finance (Hon Parker, Hon Jones, Hon Shaw) for their joint agreement	Wednesday 9 May 2018

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Simon Duncan	Senior Analyst, Macroeconomic & Fiscal Policy	[2] (wk)	[1] (mob)	✓
Renee Philip	Manager, Reserve Bank Act Review	[2] (wk)	[1] (mob)	

Actions for the Minister's Office Staff (if required)

Subject to the Minister of Finance's decisions, **refer** this report to the Associate Ministers of Finance (Hon Parker, Hon Jones, and Hon Shaw) for their joint agreement by Wednesday 16 May 2018.

Return the signed reports from the Minister of Finance and Associate Ministers of Finance (Hon Parker, Hon Jones, and Hon Shaw) to the Treasury.

Note any
feedback on
the quality of
the report

Enclosure: No

Treasury Report: Treasury Report: Reserve Bank Act Review Phase 1: Committee decision-making rules, roles and remuneration

Executive Summary

On 19 March 2018, Cabinet agreed to reform the monetary policy framework as part of phase 1 of the Review of the Reserve Bank of New Zealand Act 1989 (the Act). These decisions included adding maximum sustainable employment to the monetary policy objective and instituting committee decision-making for monetary policy (through a monetary policy committee (MPC)) [CAB-MIN-18-0086 refers].

Finance Ministers (Hon Robertson, Hon Parker, Hon Jones and Hon Shaw) have been delegated authority to make second-order policy decisions to progress the drafting of the Bill. Following on from the Treasury Report you received on 12 April 2018 (T2018/998 refers), we now seek Ministerial agreement on some further second-order policy decisions in regards to the following:

- Monetary Policy Committee (MPC) decision-making rules covering quorum size, conditions for any quorum, and provisions for decision-making in emergencies. We recommend quorum rules that seek to maintain an appropriate mix of internal and external members, and very limited emergency rules to avoid the possibility of serious harm to the economy in the rare event when a quorum cannot be achieved.
- Limiting the number of Reserve Bank Deputy Governors to one (and removing the statutory role of Deputy Chief Executive). This would avoid having different Deputy Governors appointed through different processes (one appointed by the Minister of Finance and one appointed by the Reserve Bank Board).
- Clarifying the application of the Act to an acting Reserve Bank Governor to address potential ambiguity in the current Act.
- Determining who sets the remuneration of MPC external members. The State Services Commission note that the standard approach is for the Minister of Finance to set fees through the Cabinet appointments process and fees framework, which would give you more control over the level of remuneration. The other workable option is having the independent Remuneration Authority set remuneration, which would put a high weight on setting remuneration that is comparable with other roles. We seek your guidance on what option Ministers prefer.
- Considering whether there should be any changes to who determines the remuneration of the Reserve Bank Governor (currently set by the Minister) and Deputy Governor (currently set by the Board) as part of phase 2 of the Review of the Reserve Bank Act, where it can be more appropriately considered alongside the wider governance changes.

Following your decisions, we will instruct the Parliamentary Counsel Office (PCO) accordingly. We do not envisage seeking any further decisions from Finance Ministers in order to progress the drafting. The final Bill is expected to be ready for you to take through Cabinet in early July 2018 for agreement to introduce it into the House of Representatives by 20 July 2018.

Recommended Action

We recommend that you:

- a **note** that Cabinet has agreed to amend the Reserve Bank of New Zealand Act 1989 (the Act) such that a monetary policy committee (MPC) is established for the formulation of monetary policy and that maximum sustainable employment is included in the Reserve Bank's monetary policy objective [CAB-18-MIN-0086 refers];
- b **note** that a number of second-order decisions are required to be taken by Finance Ministers, as delegated by Cabinet, to enable a draft Bill to be prepared;

MPC decision-making rules

- c **agree** that the monetary policy committee (MPC) shall have a quorum if a majority of currently appointed members are present;

Agree/disagree.

Agree/disagree.

(Minister of Finance)

(Associate Minister of Finance)

- d **agree** that the MPC's quorum must include:

- i. the Reserve Bank Governor or the Deputy Governor
- ii. one other internal member of the Reserve Bank (unless both the Governor and the Deputy Governor are present), and
- iii. at least one external member of the MPC;

Agree/disagree.

Agree/disagree.

- e **agree** to the following MPC emergency provisions which provide authority for the Governor and any other available member of the MPC to take action, if:

- i. unusual and exigent circumstances exist
- ii. action on the matter is necessary to prevent, correct, or mitigate serious harm to the economy
- iii. despite the use of all means available, other MPC members have not been able to be contacted on the matter, and
- iv. action on the matter is required before any other members of the MPC can be contacted;

Agree/disagree.

Agree/disagree.

- f **agree** that should action be taken under these emergency provisions, this action must be documented in writing by the available MPC members and copies be provided, as soon as practicable, to the other members of the MPC, the Reserve Bank Board and the Minister of Finance;

Agree/disagree.

Agree/disagree.

- g **note** that these emergency decision-making provisions are expected to be used very rarely, if at all;

Number of Deputy Governors

- h **agree** that the legislation provide for only one Reserve Bank Deputy Governor, appointed by the Minister of Finance, replacing the current dual Deputy Governor and Deputy Chief Executive position and restricting the Reserve Bank to one Deputy Governor;

Agree/disagree.

Agree/disagree.

- i **note** that *recommendation h* removes the role of the Reserve Bank Board in appointing a second Deputy Governor, as is currently the case;

- j **note** that the Reserve Bank Governor may also appoint any other Reserve Bank staff member to other internal senior roles, such as Assistant Governor, as he or she sees fit;

Acting Governor – clarification of the Act

- k **agree** to clarify in the Bill that where a person is appointed as an acting Reserve Bank Governor the Act applies as if that person were appointed as Governor, and that in all cases the person can be appointed for a period of up to 6 months;

Agree/disagree.

Agree/disagree.

MPC remuneration

I EITHER

agree that the remuneration of external members of the MPC be set by the Minister of Finance, through the Cabinet appointments process;

Agree/disagree.

Agree/disagree.

OR

agree that the remuneration of external members of the MPC be set by the independent Remuneration Authority;

Agree/disagree.

Agree/disagree.

- m **agree** that the issue of who sets remuneration for the Reserve Bank Governor and Deputy Governor be considered in phase 2 of the Reserve Bank Review so it can be more appropriately considered alongside the other potential Reserve Bank governance changes;

Agree/disagree.

Agree/disagree.

- n **agree** that there be no additional statutory remuneration for other internal Reserve Bank members of the MPC, as is standard practice across the public sector; and

Agree/disagree.

Agree/disagree.

- o **refer** this report to the Associate Ministers of Finance (Hon Parker, Hon Jones and Hon Shaw) for their joint agreement.

Refer/not referred.

Renee Philip
Manager, Reserve Bank Act Review

Hon David Parker
Associate Minister of Finance

Hon Grant Robertson
Minister of Finance

Hon Shane Jones
Associate Minister of Finance

Hon James Shaw
Associate Minister of Finance

Treasury Report: Treasury Report: Reserve Bank Act Review Phase 1: Committee decision-making rules, roles and remuneration

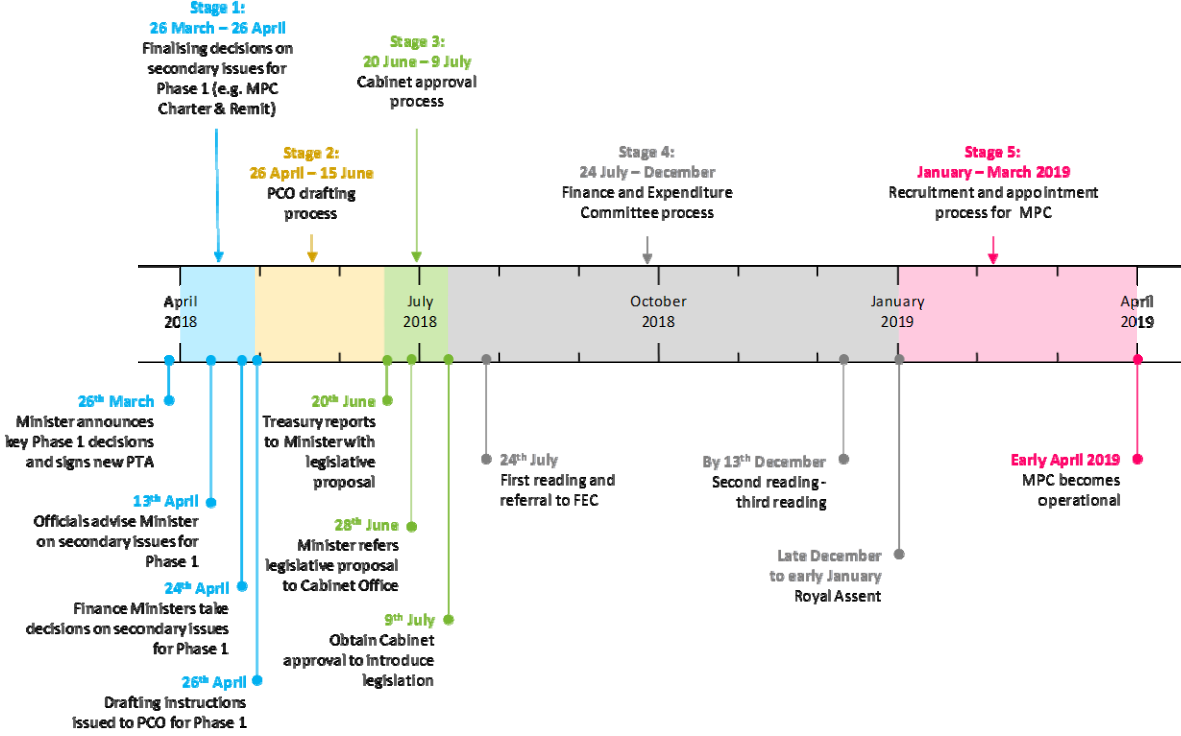
Purpose of Report

1. This report provides a further tranche of detailed policy decisions required to progress the drafting of the *Reserve Bank of New Zealand Amendment Bill* (the Bill) as part of phase 1 of the Review of the Reserve Bank Act (the Review). It follows on from the Treasury Report you received on 12 April 2018 which sought decisions on the operationalisation of a monetary policy committee (MPC), reporting on monetary policy and the role of the Reserve Bank Board (T2018/998 refers).
2. Cabinet has delegated authority to the Minister of Finance (the Minister) and the Associate Ministers of Finance (Hon Parker, Hon Jones and Hon Shaw) to take decisions on a range of such second order issues that are to be included in the draft Bill [CAB-18-MIN-0086 refers]. This report now seeks your decisions on:
 - monetary policy committee (MPC) decision-making rules (quorums and emergency provisions)
 - limiting the number of Reserve Bank Deputy Governors
 - clarifying the application of the Act to an Acting Governor, and
 - remuneration of MPC members.

Background

3. Currently, the Governor of the Reserve Bank (the Governor) is solely responsible for both the formulation and implementation of monetary policy. Cabinet has agreed that a MPC will be established by the amended Reserve Bank of New Zealand Act 1989 (the Act) and will be responsible for the formulation of monetary policy, and that the Reserve Bank's formulation of monetary policy will include consideration of maximum sustainable employment alongside price stability. The Governor will remain responsible for implementing monetary policy consistent with the decisions of the MPC.
4. The Parliamentary Counsel Office (PCO) is currently drafting the Bill. It will be ready for you to take to Cabinet on 9 July 2018 for approval to introduce the Bill by 20 July 2018. This timetable, which is set out in detail below, will enable legislation to be passed this year.

Figure 1: Indicative legislative timetable



MPC decision-making rules

5. To progress the drafting of the Bill, decisions are required on what specific rules will apply to the MPC for making decisions, in particular quorum size and conditions, and any emergency provisions.
6. We have surveyed international practices around committee decision-making in central banks. Key points are:
 - **Quorum size** – most central banks require at least half of appointed committee members to be present to constitute a quorum. For many central banks the bar is set higher (two thirds of members is fairly typical).
 - **Conditions of quorum** – a number of central banks include additional provisions when specifying a quorum. Many require either the Chair or a nominated alternate (usually the Deputy Chair) to be present in order to constitute a quorum. The Bank of England goes a little further in specifying that at least two internally-appointed Committee members must be present.
 - **Emergency rules** – a small number of central banks also specify conditions when quorum rules can be violated. The Federal Reserve and European Central Bank (ECB) are the clearest examples. In the ECB’s case, the ECB President can convene an extraordinary meeting at which decisions may be taken without regard to the quorum provisions. For the Federal Reserve, decisions can be made by a minimum of two Federal Reserve Governors in extreme circumstances where other members cannot be reached by other methods of communication, and where waiting for a quorum would risk harming the economy. Both the Federal Reserve and ECB are examples of central banks that have large committees whose constituents are spread across a wide geographic area and hence may be most vulnerable to members being temporarily unavailable during emergency periods.

7. On quorum size, we recommend the Bill include the following provision:

The MPC shall have a quorum if a majority of currently appointed members are present.

8. Given the size of the MPC is specified as a range in legislation (5 – 7 members), it seems more appropriate to specify a quorum in relation to that range rather than as an absolute number (such as 4 or 5 members, for example). Our suggested approach implies that for a committee of 5, a quorum would be three members, while for a committee of 6 or 7 a quorum would be four members. This model is recommended over other potential alternatives we explored because it is more common internationally for a quorum to contain more than half of the MPC members.
9. In terms of the MPC's quorum conditions, we recommend the Bill include the following provisions:

The quorum must include:

- a) the Governor or the Deputy Governor*
- b) unless both those mentioned in paragraph (a) are present, one other internal member of Bank staff must also be present, and*
- c) at least one external MPC member.*

10. The main reason to include these sorts of conditions is to minimise the chance that the MPC's structure can be manipulated. We consider these additional provisions help maintain an appropriate balance of internal and external members for a MPC quorum to be met.
11. Finally, we also consider it appropriate to include some emergency provisions in the very rare situation decisions might need to be taken without a quorum being present. To provide for this, we recommend the Bill include the following provisions:

Authority when sufficient number of MPC members are not in office or available:

Any action that the MPC is otherwise authorised to take may be taken by the Governor and any other available MPC members, if:

- a) unusual and exigent circumstances exist;*
- b) action on the matter is necessary to prevent, correct, or mitigate serious harm to the economy;*
- c) despite the use of all means available (including all available telephonic, telegraphic, and other electronic means), other MPC members have not been able to be contacted on the matter; and*
- d) action on the matter is required before the number of MPC members otherwise required to vote on the matter can be contacted through any available means (including all available telephonic, telegraphic, and other electronic means);*

The Governor and any other available MPC members should document in writing the determinations required by paragraph (b), and such written findings shall be included in the record of the action, and copies of such record shall be provided as soon as practicable to the members of the MPC who were not available to participate in the action and to the Reserve Bank Board and Minister of Finance.

12. It is relatively rare for central bank legislation to include specific emergency provisions to cover situations where the quorum conditions cannot be met.¹ However, we consider it useful to allow for decisions to be taken quickly, without a full quorum, in (limited) emergency circumstances (such as a large natural disaster that may trigger financial market disruption). This ensures that the new framework does not lead to a loss of decision-making capability in such emergency circumstances compared to the current situation where the Governor is able to respond quickly to these events to minimise harm to the economy, should they arise. Use of these emergency provisions is expected to be rare, if at all, given the low probability of an emergency event occurring alongside the unavailability of other MPC members.

Number of Deputy Governors

13. Currently, the Act provides for the following statutory Reserve Bank positions:
- Reserve Bank Governor (s40), appointed by the Minister of Finance
 - up to two Reserve Bank Deputy Governors (s43), appointed by the Reserve Bank Board
 - if two Deputy Governors are appointed, one shall be the Reserve Bank Deputy Chief Executive (s43), and
 - the ability to appoint an acting Governor (s48).
14. Without further changes, the amended Act would provide for two different classes of Deputy Governor – one appointed by the Minister of Finance (the Deputy Chief Executive and Deputy Governor) and one appointed by the Reserve Bank Board (the “other” Deputy Governor). The latter, but not the former, would be an employee of the Reserve Bank. We do not consider this distinction to be desirable. Instead, we suggest limiting the statutory positions in the Act to one Deputy Governor, appointed by the Minister of Finance on recommendation of the Reserve Bank Board. The concept of a “Deputy Chief Executive” will not be necessary. This would make for simpler legislation than providing two classes of Deputy Governor of materially different status. However, it does remove the Reserve Bank Board’s role in the appointment of the “other” Deputy Governor as this role would no longer exist.
15. Such a change would not preclude other Reserve Bank staff members from being promoted to other senior roles, such as an Assistant Governor, however, this would be an internal employment decision of the Governor.

Acting Governor – clarification of the Act

16. As mentioned in paragraph 13, the Act (section 48) currently provides for an acting (or interim) Governor to be appointed for a period not exceeding six months if there is a vacancy in the office of Governor (such as if the Governor leaves early). There is some ambiguity as to the provisions that apply to a Governor appointed under section 48 (eg, who determines their pay). It has led to inconsistent practices in 2002 and 2017 during periods where the office of the Governor has been vacant. In addition, the 2017 acting Governor appointment led some commentators to question the legality of the appointment made by the previous Minister of Finance.

¹ The European Central Bank and the Federal Reserve are the two notable exceptions.

17. We recommend amending the Act to put beyond doubt that where a person is appointed to the position of acting Governor under section 48, the Act applies in the same manner as if that person had been appointed as Governor. In addition, we recommend that the legislation provide for an acting Governor to be appointed for a period of up to six months in all cases. This would remove the current legislative requirement for an acting Governor to be appointed for less than six months if the remainder of the previous Governors' term was less than six months. We do not consider that these legislative clarifications are a change to the original policy intent.

MPC remuneration

Remuneration of the external MPC members

18. The Minister of Finance will appoint all external MPC members following recommendation from the Reserve Bank Board. One issue that needs to be addressed is how external MPC members' remuneration will be set. We highlight two main options, both of which we believe are workable:
 - i. Remuneration is set by the Minister of Finance through the Cabinet appointments process, or
 - ii. Remuneration is set by the independent Remuneration Authority.
19. Option (i) would see the Minister setting the remuneration under the Cabinet Office fees framework (CO (12) 6 refers), similar to how fees are set by the Minister for members of the Reserve Bank Board. The Cabinet Fees Framework is the default fee setting mechanism for bodies in which the Crown has an interest and is used to set fees for a wide variety of positions across the public sector. You may prefer this model because it gives Ministers control over the fees paid to the external MPC members.
20. We note that fees for external MPC members will likely require the Minister of State Services' support for exceptional fees (above the ranges allowed under the Framework) given the expertise required, the function of the MPC and the public interest in MPC decisions. This is particularly the case because external MPC members are likely to be relatively limited in their ability to perform outside roles given the need to avoid conflicts of interest. This exemption would need to be sought each time the level of remuneration is changed.
21. Option (ii) would be consistent with how remuneration is set for independent decision-makers across the public sector. For example, the Remuneration Authority currently sets remuneration for Independent Crown Entities such as the Commerce Commissioners and the Takeovers Panel, who have similar, important decision-making powers. The framework used by the Remuneration Authority does not contain a 'maximum rate'. This approach is likely to put a high weight on ensuring remuneration is consistent with comparable roles and is fair and reasonable, therefore helping to attract high quality candidates. The Remuneration Authority also has significant expertise in setting of remuneration across a number of different positions and roles in the public service and wider public sector.
22. Both options are workable and we seek your guidance as to what option Ministers prefer.

Remuneration of the Governor

23. Currently, the remuneration for the Reserve Bank Governor is determined by agreement between the Minister of Finance and the Governor after consultation with the Reserve Bank Board (section 42). In recent years, the Governor's remuneration

has been set at the beginning of the Governor's term and then reviewed annually by the Board. This has required the Minister to take decisions on remuneration increases based on the Board's recommendations. In practice, the Minister has generally sought second-opinion advice from the State Services Commissioner on appropriate remuneration increases. This process has previously led to a significant gap between the final increase agreed by the Minister and what was recommended by the Board.

24. When considering remuneration, we consider the following objectives to be important:
- Providing fair and reasonable conditions of employment that meets the public's expectations of the public sector.
 - Ensuring the independence, and the perception of independence, of key decision-makers.
25. We also consider that any remuneration process should draw on appropriate expertise. There are a number of different approaches to setting remuneration for the Governor, for example:
- i. the Minister of Finance sets (status quo)
 - ii. the Reserve Bank Board sets
 - iii. the Reserve Bank Board sets with veto by the State Services Commissioner (as proposed in the State Sector and Crown Entities Reform Bill currently before select committee), or
 - iv. the independent Remuneration Authority sets.²
26. We are also mindful of the work being undertaken in phase 2 of the Review on the roles and functions of the Reserve Bank Board. In particular, the possibility of moving towards a more traditional independent Crown entity model where the Board becomes a true governance board instead of a more limited role focused on monitoring. In this model we would see the Board playing a greater role in the performance oversight of the Governor/Chief Executive, and setting the Governor's remuneration would be an important performance lever for such a Board. Given there is no urgency to amend the way the current Governor's remuneration is set, we recommend that this issue be considered as part of phase 2 of the Review where it can be more appropriately considered in light of potential changes to the Reserve Bank Board and Governor's roles.

Remuneration of the Deputy Governor

27. The appointment process for the Deputy Governor is changing from the Reserve Bank Board appointing the role to the Minister of Finance. Currently the Reserve Bank Board sets the remuneration for the Deputy Governor. For the same reasons as for the Governor's remuneration, we recommend leaving the setting of remuneration with the Board and considering the question of who should set the Deputy Governor's remuneration as part of phase 2 of the Review where it can be more appropriately considered in light of the other potential governance changes. Note that this will mean the remuneration of the Governor and Deputy Governor are set differently despite both being appointed by the Minister of Finance.

² As noted in the Cabinet Office circular Role of the Remuneration Authority in Setting Remuneration for Individuals Appointed to Statutory Bodies and Other Positions (CO (11) 7 refers), the Remuneration Authority is responsible for determining the remuneration of specified statutory officers, whose roles require them to exercise, and be seen to exercise, a high degree of independence.

Remuneration of other internal MPC members

28. Except in exceptional circumstances, public servants do not receive additional compensation for other work they may do in their role (such as sitting on a Board or a policy-making committee). We therefore recommend there is no statutory pay for internal MPC members. Whether or not internal MPC members receive a higher salary for being members of the MPC is an internal matter for the Reserve Bank.

Consultation

29. This report has been developed with the Reserve Bank, who agree with the Treasury's recommendations.
30. The State Services Commission and the Remuneration Authority have been consulted on the issue of setting the MPC's remuneration.

Next steps

31. We do not envisage seeking any further decisions from Finance Ministers to progress the drafting of the Bill. We will provide a draft LEG Cabinet paper, Regulatory Impact Statement, Departmental Disclosure Statement and final version of the Bill to you in mid-June. The Bill will incorporate the decisions taken in this report and the previous phase 1 detailed decisions report [T2018/998 refers]. The LEG Cabinet paper, which will seek Cabinet's approval to introduce the Bill, can then be submitted for consideration at the LEG meeting on 5 July 2018. Following Cabinet's decisions, the Bill can be introduced into the House of Representatives.
32. We are also planning to report to you on some non-legislative but related issues in due course. These include the process for appointing MPC members and other mechanisms to help support effective monetary and fiscal coordination.