

Chair,

Cabinet Economic Development Committee

Phase 2 of the Reserve Bank Act Review - Release of first consultation document

Proposal

1. This paper seeks agreement to release the attached consultation paper titled 'Safeguarding the future of our financial system – the role of the Reserve Bank and how it should be governed'.

Background

2. A well-functioning and efficient financial system is important for improving the wellbeing and living standards of New Zealanders, and the regulatory framework is a key driver of the performance of the financial system.
3. Last year, the Government announced it would undertake a Review of the Reserve Bank of New Zealand Act 1989 (the Review) to modernise the monetary and financial stability policy frameworks and the Reserve Bank's governance and accountability settings. This Review is one of the Government's initiatives under the 'Grow and share more fairly New Zealand's prosperity' priority outcome, supporting the development of a productive, sustainable and inclusive economy.
4. The Review has been split into two phases.
 - a. Phase 1 focused on improving the Reserve Bank's monetary policy framework. Cabinet agreed policy changes in March 2018 [CAB-18-MIN-0086] and I announced the final decisions on 26 March 2018. These included a decision to add maximum sustainable employment to price stability as an objective of monetary policy. In addition, Phase 1 instituted a Monetary Policy Committee, which will make decisions on monetary policy and include a minority of external members. The legislative changes needed to deliver the outcomes of Phase 1 are now underway.
 - b. Phase 2 focuses mainly on the Reserve Bank's financial policy framework, which provides the basis for prudential regulation and supervision as well as matters such as the Reserve Bank's governance arrangements. Cabinet agreed the Terms of Reference for Phase 2 in May 2018 [DEV-18-MIN-0082], and I released these to the public on 7 June 2018.

5. A joint Review team comprising members of both the Treasury and the Reserve Bank is carrying out Phase 2 of the Review. The Review team has prepared the attached consultation paper.

The Consultation Document

6. Public consultation and engagement is a central feature of the Review. This is a once in thirty-year opportunity and requires a comprehensive approach. There will be three rounds of public consultation, during which we will seek feedback from a broad range of stakeholders. The Review team acknowledges that there are interdependencies between the topics in the Terms of Reference. The attached consultation paper covers topics that will be crucial in shaping the Review's overall outcome, and therefore form the basis of the first round of consultation. Further detail on the remaining consultation rounds is set out in paragraphs 15 – 18 below.
7. In preparing the consultation document the Review team has been mindful of the need for the consultation to be accessible to non-specialist audiences. An external editor has been used to ensure the readability of the document. Short summary material, that captures the key issues in this consultation, has also been developed to help increase overall engagement and accessibility. A draft of this summary material is provided alongside this Cabinet paper for information. The Review team have also engaged with the Commission for Financial Capability, and linked into recent experience from other agencies, in developing its programme of wider public engagement.
8. The attached consultation document is split into two parts. Part A asks what role the Reserve Bank should play in supporting New Zealand's financial system. Part B asks how the Reserve Bank should be governed. The key topics of the paper are briefly discussed in paragraphs 10 – 14 below.
9. Additional background papers will be published alongside this consultation paper to provide further technical background on some of the topics discussed.

What should the Bank's high-level objectives be?

10. The Reserve Bank's high-level financial policy objective to '*promote the maintenance of a sound and efficient financial system*' has been in place for almost 30 years and defines the Reserve Bank's role in financial regulatory policy. The key question for consultation is whether the existing objectives are still the most appropriate goals for the Reserve Bank, or whether they should be refreshed.

Should the Bank have a financial regulation role?

11. The Reserve Bank is currently the prudential regulator for New Zealand's financial system. This consultation considers whether the Reserve Bank should continue to have this prudential mandate, or whether this function should be moved to a separate agency. While I have expressed a current intention that current responsibilities should continue to sit with the Reserve Bank, I have tasked this Review with exploring this question further, and what underlies it, given interest from some external stakeholders.

Who should the Reserve Bank regulate?

12. The 'regulatory perimeter' refers to the firms or activities that the Reserve Bank regulates and how the boundary between regulated and unregulated firms is defined.

This perimeter could be redrawn to create a more unified, simple and future-proofed regulatory regime. The key question is whether the potential benefits of redrawing the perimeter are worth the transition costs.

Should there be depositor protection in New Zealand?

- 13. Unlike most OECD countries, New Zealand does not currently have a formal depositor protection regime, so customer deposits are potentially at risk if a bank fails. The consultation paper sets out the potential costs and benefits of a depositor protection regime and invites views on whether the arguments support a case to progress work on developing depositor protection.

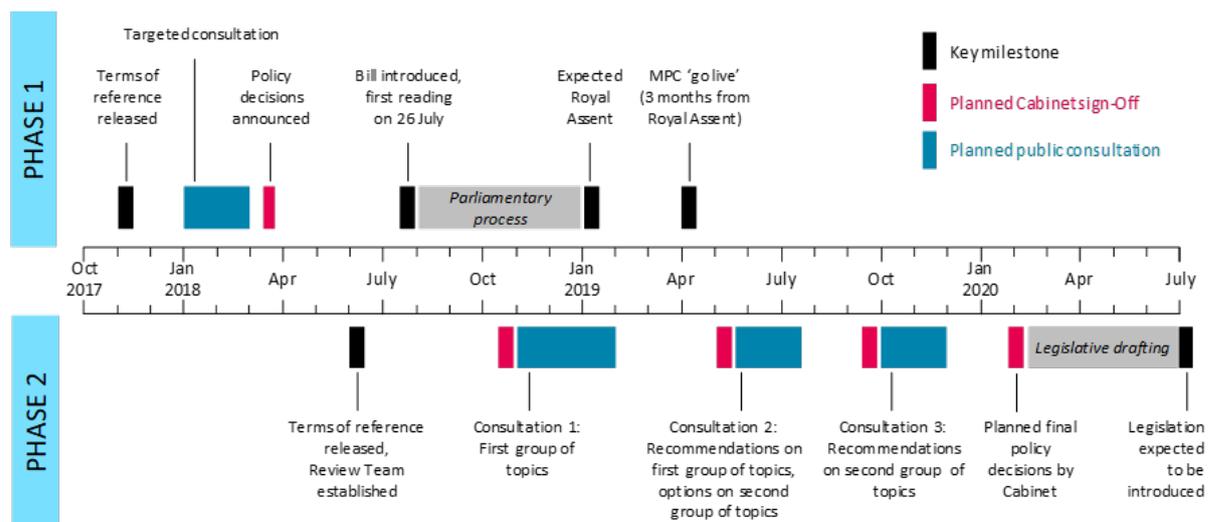
How should the Reserve Bank be governed?

- 14. The governance arrangements of the Reserve Bank play an important role in determining how the Reserve Bank pursues its policy objectives. The focus of this part is on whether any of the Reserve Bank’s governance arrangements could be enhanced. The key questions for consultation are whether the governing body of the Reserve Bank should be a single decision maker or a board; and whether a Financial Policy Committee should be introduced alongside the new Monetary Policy Committee being established from Phase 1.

Consultation Timeline

- 15. The first consultation is planned to run for 12 weeks, from early November 2018 to late January 2019 (see Figure A below). The longer consultation period is to accommodate the holiday period over Christmas and New Year. Following completion of the consultation process, a summary report will be published outlining key messages and themes emerging from public submissions. At this stage, I expect the Review Team to present me with recommendations for ‘in-principle’ decisions, where required, to help shape the remainder of the Review.

Figure A: Illustrative timeline of the Review



Future Consultations

16. Once the first round of consultation is complete – and using the information and feedback it provides – a second round of consultation planned for 2019 will consider other issues covered by the Terms of Reference, such as the:
 - legal basis for bank regulation,
 - approach to supervision and enforcement of bank regulation,
 - macro-prudential policy,
 - crisis management, and
 - the Reserve Bank’s resourcing and funding.
17. This second consultation will also seek feedback on the preferred options developed as a result of this first consultation. A third and final consultation later in 2019 will seek feedback on the preferred options developed from the second consultation. After that, final recommendations will be developed.

Climate Change

18. The risks that climate change poses to financial stability over the long term is a growing question internationally and is increasingly receiving central bank attention in other jurisdictions. The Review presents a timely opportunity to consider the role of the Reserve Bank (in its role as prudential regulator and supervisor) in assessing and responding to the risks to New Zealand’s financial stability posed by climate change. Options in this area will be included in the second consultation.

The Independent Expert Advisory Panel

19. Under Phase 1 of the Review, an Independent Expert Advisory Panel played an important role in providing advice and making critical judgements on key issues. This role will continue under Phase 2. The Panel will also provide advice directly to me, as appropriate.
20. For Phase 2, the Panel consists of Suzanne Snively (Chair), Malcolm Edey, and Girol Karacaoglu (the original members of the Phase 1 panel) along with Barbara Chapman, Belinda Moffat, and John Sproat (Cabinet agreed in August to add these three members to broaden expertise on the Panel [APH-18-MIN-0155]).
21. The Panel considered that overall the document is suitable for consultation. The Panel’s main feedback included:
 - a. Ensuring that consultation material is accessible to a wide range of stakeholders. The consultation document itself has also been reviewed by an external editor to improve its readability. As noted in paragraph 6 above, a summary document has also been prepared that captures the key issues in this consultation and will help increase overall engagement and accessibility. A draft of this summary document is attached for information.

- b. The Panel considers that the subject of the administration of the Reserve Bank Act should be in the consultation document, as it is a topic where there are different perspectives that require resolution. The Treasury also share this view, but the Reserve Bank consider it to be an issue to be resolved by ministers, and that public consultation would be unusual. As recommended by the Panel, discussion on the administration of the Act has been included in the consultation document.
- c. The Panel suggested that by moving the governance chapters (Chapters 6-9) earlier in the consultation document, the discussion would flow better. The Review team did not incorporate this feedback and have structured the document to first address what the Reserve Bank does, followed by how it does it, which the team considers is the way to ensure flow for the reader.

Consultation

- 22. The joint Review team, comprising staff from the Treasury and the Reserve Bank, prepared the attached consultation paper. The following agencies were consulted: the Ministry of Business, Innovation and Employment, the Financial Markets Authority, the Commerce Commission, the State Services Commission, the Reserve Bank, and the Treasury. The Reserve Bank Board has also been engaged.
- 23. The Department of Prime Minister and Cabinet was informed.

Financial Implications

- 24. This paper has no direct fiscal implications.

Human Rights

- 25. There are no human rights implications arising from this paper.

Legislative Implications

- 26. There are no legislative implications arising directly from this paper.

Regulatory Impact Analysis

- 27. Regulatory impact analysis is not required at this stage. The consultation document incorporates elements of regulatory impact analysis. A regulatory impact statement will be prepared when policy decisions are sought.

Publicity

- 28. The consultation document will be made available on the Review page on the Treasury website. A media release will be issued when the consultation document is released. A programme of stakeholder engagement is planned to follow the release.
- 29. The Review team will also release additional material, including a summary document and a short survey, to enhance accessibility and stakeholder engagement.

Recommendations

30. I recommend the Committee:
1. **note** that Phase 2 of the Reserve Bank Act Review was announced in June 2018 and is focusing on reviewing the financial policy provisions of the Reserve Bank Act 1989 as well as broader governance arrangements for the Reserve Bank
 2. **note** this Review follows Phase 1 of the Reserve Bank Act Review, which focused on changes around the Reserve Bank's monetary policy function
 3. **note** the consultation is seeking views on five of the nine key topics set out in the Terms of Reference for the Review, and is not seeking views on recommendations at this stage
 4. **note** this is the first consultation for Phase 2 of the Reserve Bank Act Review and subsequent consultations on recommendations, and on the remaining topics, will take place in 2019
 5. **agree** that the Minister of Finance release the attached consultation document
 6. **authorise** the Minister of Finance to approve minor amendments and refinements to the final consultation document
 7. **note** the consultation period will run for 12 weeks commencing early November and concluding end January
 8. **note** that the Minister of Finance will report back to Cabinet on the outcome of this first consultation in April 2019 ahead of the next consultation for Phase 2 of the Reserve Bank Act Review.

Authorised for lodgement

Hon Grant Robertson
Minister for Finance