The Treasury

Phase 1 RBNZ Act Review Information Release

December 2018

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Panel Paper 4

THE TREASURY

Kaitohutohu Kaupapa Rawa

Governance at the Reserve Bank of New Zealand

Contents

Background

The Reserve Bank's Current Governance Structure

- Consistent with the single decision-maker model, the Reserve Bank's powers are vested in the Governor, who is responsible for all elements of governance.
- The Reserve Bank Board does not have a full set of management powers. Instead, the Board is better thought of as a monitoring agent for the Minister of Finance.
- The Board's monitoring role includes a specific role evaluating each monetary policy statement and is linked to the Board's role in appointment and dismissal.
- The Board's role in appointment and dismissal is intended to reduce the risk of Ministerial influence over policy decisions arising from direct appointments by the Minister.
- The Board also has an advisory role, and can advise the Governor on any matter relating to the performance of the Bank.

The Reserve Bank’s Current Structure

Monitoring and Oversight

Board

- Monitors the performance of the Governor and the Bank
- Reports annually on Bank performance
- Assesses each Monetary Policy Statement
- Can advise the Governor on the Bank’s performance
- Key roles in appointment and dismissal

The Treasury

- Advises the Minister on matters relating to the Bank’s performance and operation, including:
  - the Policy Targets Agreement
  - legislative frameworks
  - the funding agreement

Governance

Governor

Legally responsible for:

- Setting strategic direction and the SOI
- Performance reporting, including financial statements
- Resource use and allocation
- Risk management and audit
- Signing the funding agreement (with the Minister)

Operations

Governor

Legally responsible for:

- All policy and regulatory decisions of the Bank
- Management and operation of the Bank
- Agreeing the Policy Targets Agreement (with the Minister)

Potential Phase 2 Changes

- A committee-based decision-making model for the Bank’s financial sector responsibilities is likely to be looked at in phase 2 of the Review, although no decision on that has been made yet.

- While different committee arrangements could exist for financial policy decisions, there would be benefits from aligning processes and structures for different committees where possible.

- Officials’ intention is for any governance changes recommended in phase 1 to be able to stand alone, while also being consistent with changes that may follow from phase 2.

- Further changes to the governance model could be recommended as part of phase 2 if required to better reflect the Bank’s eventual decision-making structure.

Implications of Codifying a Committee Model

Implications from Codifying an MPC

- As noted in panel paper 3, officials' initial view is that the Monetary Policy Committee (MPC) should assume overall legal responsibility for the conduct of monetary policy.
- Practically, the Governor would be responsible for executing the Committee's decisions. Legal responsibility for monetary policy would give the MPC the authority to take such action as is necessary to ensure effect is given by the Governor to the Committee's policy decision. This ensures the committee can be held responsible for outcomes.
- Such a change is also consistent with the Bank's independence in the choice of instrument. If the MPC is to be responsible for significant decisions, any decision to change the instrument should be taken by the committee rather than the Governor.
- The approach would also clearly delineate between the responsibilities of the Committee and the Governor.
- Such a model can be incorporated into the Bank's current structure with change limited to the "operations" level, as shown on slide 9.
- A further implication of introducing the Committee is that the Governor can no longer be held personally accountable for monetary policy decisions. Accountability provisions for the Governor, including dismissal criteria, will need to be updated accordingly.

Implications from Codifying an MPC: Current Structure with Minimal Changes

Monitoring and Oversight

Board
- Monitors the performance of the Governor and the Bank and the MPC
- Reports annually on Bank performance
- Assesses each Monetary Policy Statement
- Can advise the Governor on the Bank's performance
- Key roles in appointment and dismissal

Treasury
- Advises the Minister on matters relating to the Bank's governance, performance and operation, including:
  - the Policy Targets Agreement
  - legislative frameworks
  - the funding agreement.

Governance

Governor
Legally responsible for:
- Setting strategic direction and the SOI
- Performance reporting, including financial statements
- Resource use and allocation
- Risk management and audit
- Signing the funding agreement (with the Minister)

Operations

Monetary Policy Committee
Legally responsible for:
- All monetary policy decisions/achievement of the monetary policy objective
- The Bank's role in setting intermediate monetary policy objectives (e.g. currently the Policy Targets Agreement)

Governor
Legally responsible for:
- All other policy and regulatory decisions of the Bank
- Management and operation of the Bank, including implementation of monetary policy decisions by the MPC

Potential Changes to Governance

Potential Changes to Governance

- The updated model on page 9 is limited to changes at the “operations” level, with no change to Governor’s current governance responsibilities:
  - Setting strategic direction and the SOI
  - Performance reporting, including financial statements
  - Resource use and allocation
  - Risk management and audit
  - Signing the funding agreement (with the Minister)

- This model is unusual in New Zealand. In phase 2 consideration could be given to whether legal responsibility for any or all of these functions better sit with the Board, rather than the Governor.

- Making the Board responsible for any or all of these functions may be desirable if:
  - the introduction of a committee decision-making model introduces coordination challenges between the Bank’s policy functions – for example by creating competing demands for resources.
  - the Board is better placed to perform any of these functions – for example because the Board has greater expertise in performing the function, or because the function is more consistent with the other roles of the Board than the role of the Governor.

Potential Changes to Governance

- Officials' initial view is that the Governor should continue performing the governance functions after phase 1 of the Review. This is because:
  - Except for monetary policy, the Governor will remain the single decision-maker (at least until phase 2 changes are made, and perhaps indefinitely). The Governor continuing to perform the governance functions would be consistent with the Governor's wider role.
  - No significant coordination challenges are expected to arise as a result of the MPC taking legal responsibility for monetary policy outcomes but the Governor retaining all other responsibilities.

- The Governor continuing to perform the governance functions would also minimise the changes from phase 1 of the Review.

- If the decision-making model for the financial policy is considered as part of phase 2, officials would recommend reconsidering the governance model then.

The Role of the Board

The Role of the Board

- The updated model on page 9 also does not recommend any substantive changes to the role of the Board

<u>Board</u>
- Monitors the performance of the Governor and the Bank
- Reports annually on Bank performance
- Assesses each Monetary Policy Statement
- Can advise the Governor on the Bank's performance
- Key roles in appointment and dismissal

- An MPC with external members has direct implications for the Board, including:
  - The Board's monitoring role would expand to cover individual committee members and the committee as a whole.
  - Assuming it retains a role in appointment and dismissal, the Board would have a potentially significant increase in the number of appointments it makes.
  - There is scope for the Board's role to evolve to adapt to the presence of external members.

- As with the governance functions, consideration should be given to whether the introduction of an MPC means monitoring and oversight should be done differently.

The Role of the Board: Performance Monitoring

- The Board’s current monitoring responsibilities include:
  - The requirement to keep the Bank’s performance under constant review.
  - The assessment of each MPS, to ensure it is consistent with the PTA.
  - Publication of an annual performance report (included in the Bank’s annual report).
  - Quarterly reporting to the Minister of Finance (not a statutory requirement).

- Officials’ initial view is that the introduction of an MPC does not remove the need for a monitoring agent. This is because the Minister will still benefit from an independent assessment of the Bank’s overall performance.

- The Board’s role could evolve in light of the inclusion of external members however. For example, the Board could focus its attention on the appropriateness of overall processes and procedures followed by members in reaching quality decisions, rather than decisions *per se*.

- Such a change could mean that the Board no longer needs to explicitly evaluate each MPS for consistency with the PTA, instead taking a higher-level approach to monitoring.

The Role of the Board: Performance Monitoring Powers

- In addition to considering the Board's performance monitoring role, it is worth considering the Board's monitoring powers.

- The Board's powers are largely informal.
  - After each decision the Board has access to the materials provided to the Governing Committee, and access to the Governors themselves.
  - The Board does not have independent resources, and relies on the Governor to fund any external advice (legal opinions for example).

- The Board's monitoring powers could be enhanced by giving:
  - the Board independent control of some resources, which could be used to commission external reviews.
  - Board members the ability to observe MPC meetings.

The Role of the Board: Appointment and Dismissal

- A “double veto” arrangement is currently used for appointments. The Board nominates the Governor (Minister appoints) and appoints the Deputy Governors (on recommendation of the Governor).

- The Board cannot remove the Governor directly but can recommend it. The Board can remove a Deputy Governor on the recommendation of the Governor, or recommend the removal of a Deputy Governor to the Minister.

- As noted in panel paper 3, our initial view is that the Board should retain a role in recommending appointment and dismissals.

- This is because officials support the retention of the “double veto” to limit the risk of politicisation of Ministerial appointees, and because the appointment and dismissal function is consistent with the Board’s monitoring function.

The Role of the Board: Advice

- The Board may give advice to the Governor on any matter relating to the performance of the Bank's functions and the exercise of its powers.

- The advisory function risks creating a tension, given that the Board is evaluating decisions they are advising on. The Board's advisory powers could be removed to avoid this tension and to simplify the role of the Board.

- There is value in having the option of giving advice as a lesser intervention than reporting to the Minister though, especially given the typical collective experience of the Board.

- Official's initial view is that the advisory function should be retained but what the Board can advise on should be clarified to clearly delineate the role of the Board from external committee members and to make the role consistent with the monitoring function.

- For example, with respect to monetary policy the Board's advisory role could focus on the overall processes and the performance of individuals in reaching decisions. External committee members could be relied on to advise and challenge particular policy decisions.

The Role of the Board: Other Duties

- At its December meeting, the Panel highlighted the need to think about other changes that should be made to the Bank’s governance arrangements and the role of the Board, to ensure that the governance model is modern and best practice.

- The papers provided here have focused on issues that would be fixed in legislation, rather than through secondary documents (such as a Board Code of Conduct).

- Does the Panel have a view on whether legislation should cover any other issues beyond what is covered in these papers? This could include a legislative requirement for the Board’s code of conduct to address particular issues.

- An list of the legislative governance provisions included in the Crown Entities Act have been provided in a separate background paper.

The Composition of the Board

The Composition of the Board

- The Board’s composition is determined by the Reserve Bank of New Zealand Act 1989 (the Act) as follows:
  - There must be between 5 and 7 non-executive directors
  - The Governor is a member of the Board
  - The non-executive directors appoint their own Chair (and by convention a Deputy)
  - Non-executive directors are appointed by the Minister, with regard to their knowledge, skill and experience
- If the Board’s role is limited to monitoring the Governor’s performance, officials’ initial view is that the Governor should no longer be a member of the Board. However, officials recommend waiting to see the outcome of any governance changes arising in Phase 2 before changes are made to the Governor’s role on the Board.
- It is unusual for the Board to elect their own Chair rather than being appointed by the Minister. This was intended to reduce the risk of politicisation, but the effect seems to have been to distance the Minister from the Board and lessen Ministerial engagement. Accordingly, consideration should be given to having the Chair appointed by the Minister.
- If the role of the Board changes, the skills required by the Board will also change, although the current specification of the Act provides for such a change.

Discussion Questions

Discussion Questions

- Should the MPC have legal responsibility for all monetary policy decisions?
- Are any conflicts or significant coordination challenges expected to arise if the Governor retains responsibility for “governance”?
- Do you foresee any conflicts or significant coordination challenges emerging if a Financial Policy Committee is progressed as part of Phase 2? If so, should these be pre-empted?
- How should the Board’s monitoring role evolve in response to the codification of a committee with external members?
- Should the Board’s monitoring powers be enhanced?
- Should the Board retain a role in appointment and dismissal processes?
- Should the Board retain an advisory function? If so, should it be narrowed?
- Should the composition of the Board change?
- Does the Panel have a view on whether legislation should cover any other issues beyond what is covered in these papers? This could include a legislative requirement for the Board’s code of conduct to address particular issues.