The Treasury

Reserve Bank Act Review Phase 2 Submission Information Release

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FINANCIAL SERVICES FEDERATION

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Thank you for the opportunity to comment on the consultation document "Safeguarding the future of our financial system: The role of the Reserve Bank and how it should be governed" as part of Phase 2 of the Reserve Bank Act Review. The FSF would like to congratulate the Treasury and the Reserve Bank on this consultation document which is in our view an excellent and thought-provoking paper which we believe will encourage some good discussion about regulatory parameters and who is responsible for which part of New Zealand's financial regulatory framework.

Background:

By way of background, the Financial Services Federation ("FSF") is the industry body representing the responsible and ethical finance, credit-related insurance and leasing providers of New Zealand. We have nearly sixty members and associates providing financing, leasing, and credit-related insurance products to more than 2 million New Zealanders. Our affiliate members are those organisations which provide services to the financial services sector and they include internationally recognised accounting, legal and consulting firms as well as credit reporting agencies, debt collection agencies and others. A list of our members is **attached** as Appendix A.

As such FSF members include some entities who are already regulated by the Reserve Bank – specifically, a very few Non-Bank Deposit Takers ("NBDTs") (currently only 3 FSF members take deposits from the public to fund their lending activities) and the credit-related insurance provider members. In addition, FSF's membership includes a number of Non-Deposit Taking Lending Institutions who provide consumer credit products, finance to commercial entities including asset and fleet leasing options or a mixture of both.

FSF members provide significant value to New Zealand's economy by providing access to consumer finance that is delivered responsibly and ethically and to commercial finance and leasing options for business to grow and thrive.

Before answering the questions posed in the consultation document, the FSF has some comments to make about some of the information contained in Chapter 1: Introduction to New Zealand's Financial System.

Introduction:

With regard to what New Zealand's financial system looks like (p.17), the FSF disputes the figure provided for the total assets of non-deposit taking lenders ("NDLIs"). FSF has 32 members that would be classed as NDLIs at the time of writing this report and they have close to $8.5 billion in total assets. The FSF believes that there are close to 2,000 finance companies which could be classed as being NDLIs that are supervised for Anti-Money Laundering and Countering Financing of Terrorism purposes by the Department of Internal Affairs. Whilst many of these will be small, their total assets added to those of FSF NDLI members would take the total assets held by this sector well beyond the $9.7 billion stated in the consultation document. Also to be added to that total would be the peer-to-peer lenders – the largest of which (Harmoney) reportedly has over $1 billion in assets.

The FSF believes that the NDLI sector is therefore a much more significant contributor to New Zealand society and its economy than the RBNZ's figures seem to suggest.

With regard to the statements made about who regulates New Zealand's financial system (p.18), the FSF believes that rather than a "twin peaks" model as the consultation document suggests, New Zealand in fact has a "triple peaks" model as the regulatory contribution made to the financial system by the Commerce Commission should not be separated out from that of the conduct and prudential regulation for which the RBNZ and the Financial Markets Authority ("FMA") are responsible.

As the regulator charged with enforcing competition, fair trading and consumer credit laws, the Commerce Commission has responsibility particularly for ensuring that banks and finance companies comply with the responsible lending obligations that are required of them through the Credit Contracts and Consumer Finance Act 2003 ("CCCFA"). Compliance with responsible lending obligations is, in the FSF's view, essential to the stability of New Zealand's financial system.

On that basis the FSF questions why the Commerce Commission is not a member of the Council of Financial Regulators ("CofFR") given this is the forum to address any financial markets regulatory issues, risks or gaps that arise or are being monitored. The FSF suggests that it would be hard to take a whole of government approach to managing regulatory risks for the financial system if the regulator charged with ensuring all lenders including banks, NBDTs, NDLIs and peer-to-peer platforms, are doing so responsibly is not part of the forum.

The FSF has at times been critical of the way in which the Commerce Commission has managed its mandate to enforce responsible lending practices. Where they have taken enforcement action against predatory lending practiced by high-cost, short-term lenders (payday lenders) and mobile traders (truck shops), their work has by and large been very effective in preventing the harm these entities do to New Zealand consumers, particularly those who are most vulnerable.

The FSF has however been critical of the fact that there has not been enough of such enforcement action by the Commission and that predatory lending in vulnerable communities is still as prevalent as it has ever been – even since the introduction of Lender Responsibility Principles and the Responsible Lending Code as a result of the CCCFA review that was completed in 2014. What action the Commission does take appears to the FSF to be too slow to come to a conclusion and insufficient to provide the deterrent required to these types of lenders to prevent them from perpetuating the harm they are causing to vulnerable New Zealanders.

Having said that, however, the FSF believes that the review of the CCCFA that is currently under way will address not just the continued predatory lending practices of a certain sector of the NDLI market, but also the lack of resources for the Commerce Commission to adequately undertake their enforcement role.

With that in mind, therefore, the FSF believes that New Zealand's model for financial regulation is truly that of "triple peaks" comprising the RBNZ, the FMA and the Commerce Commission. Whilst it has not been suggested in the consultation document, the FSF believes that this an appropriate model to manage the risks associated with NDLIs not lending responsibly and, on that basis, the FSF would not agree with any suggestion that the RBNZ should take over responsibility for regulating or supervising these entities.

Beyond these introductory comments, the FSF is pleased to provide the following answers to the questions raised in the consultation document on behalf of its members.

What high-level financial policy objectives should the Reserve Bank have?

1. Are the Reserve Bank's existing high-level financial policy objectives still appropriate and fit for the future?

   (a) Should "soundness" remain a high-level financial policy objective of the Reserve Bank, or would a "financial stability" objective be more appropriate?

   The FSF has considered the difference between the definitions of the objectives of "soundness" versus "financial stability" and can see no reason why the soundness objective should be dropped in favour of a financial stability objective in terms of better achieving the purpose of the Reserve Bank Act ("RBA"). This purpose is to promote the prosperity and wellbeing of New Zealanders and contribute to a sustainable and productive economy.

   The FSF believes that the powers the Reserve Bank currently has to achieve financial soundness has served New Zealand well in most cases since its introduction in 1989. Introducing a financial stability objective that would allow the Reserve Bank to intervene to help dampen the financial cycle and hence minimise the incidence of costly financial booms and busts is not necessary in the FSF's view.

The FSF takes this view because it does not believe the Reserve Bank should be able to have too much power to influence financial cycles and what power it does have, for example to use macro-prudential tools where appropriate, has been used sparingly and effectively, for example, in the introduction of LVR restrictions for banks to take some of the heat out of the housing market.

Where the financial soundness objective did not prevent the failure of around 50 NBDTs as a result of the global financial crisis ("GFC"), this was not the fault of the objective itself but rather that the NBDT regime which saw the Reserve Bank take responsibility for the prudential supervision of these entities, was not in force at the time. Whereas the FSF notes that the banking sector which was being supervised for financial soundness before and throughout the GFC, was only moderately affected by the crisis (in contrast to banks in other parts of the world) as noted in the consultation document (p.23).

(b) What role should the Reserve Bank play in promoting "efficiency"? Should it have a narrow mandate (e.g. focused on regulatory efficiency) or a broad one (e.g. including allocative efficiency and promoting sustainable growth)?

The FSF strongly believes that the Reserve Bank should ensure regulatory efficiency by minimising the regulatory burden on firms under its supervision whilst at the same time, ensuring the resilience of the country's financial system through achieving its soundness objective. The FSF understands that this is sometimes a difficult balance to achieve as appropriate and effective regulation is absolutely necessary to ensure financial soundness but the FSF believes that the Reserve Bank on the whole has done a good job of achieving an appropriate balance in this respect.

The FSF agrees with the assertion in the consultation document (p.33, under "Potential arguments for retaining "efficiency" as a high-level objective) that taken together, soundness and efficiency are akin to the financial stability mandates of other central banks. The FSF also agrees that the Reserve Bank has been largely successful at ensuring that its regulatory interventions are targeted and a net benefit to society (particularly as previously mentioned, once NBDTs and insurers came under their supervisory mandate).

With regard to whether or not the Reserve Bank's efficiency mandate should be broadened to include other aspects such as competitive, dynamic and/or allocative efficiency, the FSF believes that the way in which the RB currently manages this mandate is working well and sees no reason for this to change. The fact that the Reserve Bank has the discretion to disregard efficiency in favour of safeguarding the system during a banking or financial crisis ensures that the mandate is exercised appropriately according to circumstance and the financial cycle.

(c) Should "efficiency" remain a high-level objective of the Reserve Bank, or should it be demoted to a lower tier of the legislation?

The FSF supports the retention of "efficiency" as an objective of the Reserve Bank and believes that the way in which the RB has interpreted this objective since its adoption in 1989 has been entirely appropriate for the reasons outlined above.

2. Should the Reserve Bank be given additional high-level financial policy objectives?

   (a) How many high-level financial policy objectives should the Reserve Bank have – are the gains of having multiple objectives worth the costs of lost focus?

   The FSF believes that the danger with having too many objectives is definitely a loss of focus on what is important. There is also a very real risk of regulatory cross-over and double-up between other agencies empowered with matters like managing competitive tensions and consumer protection (such as the FMA or the Commerce Commission). This can lead to regulatory arbitrage on the part of the entities being regulated with the real risk of entities taking a path of least resistance approach if they believe they can play one off against the other.

   The FSF therefore does not believe that having more than two – three clear objectives for any regulatory entity is helpful or conducive to achieving the regulator's purpose, allowing them to prioritise and establish boundaries for their work and providing the means for the public to hold the regulator to account.

   (b) Should "competition" be promoted to a high-level objective of the Reserve Bank, or should it remain as a lower-tier objective?

   As noted in the consultation document, competition policy is currently developed by the Ministry of Business, Innovation and Employment ("MBIE") and enforced by the Commerce Commission whilst the RB is also required to "maintain competition" as a regulatory principle for insurers and NBDTs by considering the competitive implications of its regulatory actions, rather than actively promoting competition. The FSF believes this is entirely appropriate and does not support the introduction of competition in and of itself as a high-level objective for the RB.

   The FSF agrees with the points made in the consultation document against the introduction of such an objective, in particular with the assertion that competition could create a trade-off with the soundness objective by reducing firms' profitability and therefore their resilience to financial shocks.

   The consultation document also asserts that the efficiency mandate could empower the RB to promote competition in the financial sector for example by reducing firms' barriers to entry by lowering initial capital requirements for new firms (p.33 under "Potential arguments for retaining "efficiency" as a high-level objective). In the FSF's view this would be a very dangerous argument for the promotion of competition as an objective for the RB

and would also be counter-productive to the achievement of the RB's financial soundness objective.

For these reasons, the FSF believes that "competition" should not form any part of the RB's high-level objectives.

(c) Should "consumer protection" be added to the Reserve Bank's objectives?

The arguments provided in the consultation document against the inclusion of an objective for "consumer protection" are, in the view of the FSF, all extremely valid. There are already regulators in New Zealand who are empowered to provide the appropriate consumer protections and potentially consumer redress where firms have failed in their obligations to consumers.

The FSF believes that regulators should concern themselves with the areas of their own expertise and certainly if they encounter issues which cross over into another regulator's jurisdiction in the course of their own work, should be empowered to report these to the appropriate regulator to take action. The FSF believes that the forum to do this is that of the CofFR.

As mentioned in the consultation document, the RB would need to increase their skills in this new area when these skills already exist in other regulatory entities particularly that of the Commerce Commission but also within the FMA (p.35). To replicate such skills could potentially reduce consumer incentives to manage their own risks and also by requiring skills different from those of prudential supervision, have the effect of watering down the RB's prudential supervision role.

For these reasons, the FSF believes that "consumer protection" should not form any part of the RB's high-level objectives.

(d) Should "public confidence (or trust)" be reinstated as a high-level financial policy objective of the Reserve Bank?

The FSF believes that by concentrating on the financial soundness and efficiency high-level objectives, the objective of public confidence or trust is already taken into account. Avoiding instability in the financial system is essential and as it says in the discussion paper, all RB financial policy decisions should take into account the need for public trust and confidence in the system (p.36). It is an implied objective that does not, in the FSF's view, need to be stated – it is an outcome of good financial policy, not an objective in its own right.

(e) Are there any other objectives you think the Reserve Bank should be given?

For the reasons stated above, the FSF believes that the RB's current objectives of achieving financial soundness and efficiency are sufficient and that other objectives such as those of achieving public confidence or trust are achieved as a natural by-product of the RB achieving those two high-level objectives so no other objectives are required.

Who does the Reserve Bank regulate and how should the regulatory perimeter be set?

3. What are your views on the costs and benefits of moving from the current perimeter to an ADI (authorised deposit-taking institution) type of framework? Based on your views, is this an issue worth pursuing?

   As mentioned previously, the FSF has only 3 members who are NBDTs licensed by the Reserve Bank. These are Asset Finance, Gold Band Finance and Mutual Credit Finance. They are all small, niche deposit-takers and two of them (Gold Band and Mutual Credit) are so small as to not require a credit rating. Of the 22 other licensed NBDTs, 17 are building societies or credit unions and there are 5 NBDTs which are not members of the FSF (these are Christian Savings Limited, FE Investments Limited, Finance Direct Limited, General Finance Limited and UDC). As such the FSF is only able to answer these questions on behalf of its NBDT members.

   Before doing so, however, the FSF believes that in some ways the public of New Zealand has not entirely benefited from the introduction of the NBDT regime post the GFC which in the FSF's view was done hastily and which has therefore resulted in some unfortunate unintended consequences. Whilst it is a fact that the finance company sector and in particular that which attracted deposits from the public, bore the brunt of the effects of the GFC, those Non-Bank Deposit Taking finance companies that did survive the crisis did so because their lending policies were responsible, and they were able to therefore meet their commitments to their depositors.

   The FSF believes that the most unfortunate unintended consequence of the NBDT regime is that many deposit-taking finance companies which survived the effects of the GFC made the decision to find other ways of funding their lending activities rather than meet the requirements of the regime because the costs of compliance with it wer seen by them to be prohibitive and would, in their view, increase the cost of credit to their borrowing customers. Some others (SBS Bank, the Co-operative Bank and Heartland Bank) moved from being finance companies to becoming registered banks.

   The effect of this for the New Zealand public was that options for placing their deposits became restricted mostly to registered banks and for those people, for example those in retirement, this had the effect of significantly reducing the income they were able to make from their deposits.

The FSF makes this point as a warning that it needs to be kept in mind that appropriate and safe alternatives for deposits other than those options provided by registered banks are just as important to the public of New Zealand as safe and appropriate non-bank finance options.

A further point to consider when considering the scope of the current perimeter for deposit-taking institutions, is where the peer-to-peer lending sector sits within this regime. Box 3 on p. 45 of the consultation document discusses the need for perimeter flexibility to allow for innovations such as FinTech. From a public confidence and trust and consumer protection perspective, the FSF would strongly agree that this is appropriate so suggests that consideration be given to the inclusion of the peer-to-peer lending sector within the RB's regulatory perimeter.

As Mark Carney (Bank of England, 2017) is quoted as saying in the consultation document (p.23), "Our starting point is that there is nothing new under the sun. We need to be disciplined about consistent approaches to similar activities undertaken by different institutions that give rise to the same financial stability risks."

Peer-to-peer lenders take deposits from the public to lend to people seeking finance in the same way as an NBDT and therefore should be subject to the same regulatory regime as banks and NBDTs – in the view of the FSF.

In May 2018 the New Zealand High Court determined that the fees charged to borrowers by New Zealand's largest peer-to-peer lender, Harmoney, amounted to a credit fee and were therefore subject to the CCCFA in the same way as they are for any other consumer credit provider. The FSF believes that this gives credence to the assertion that such lenders should be treated in the same way for prudential regulation and supervision as they would if they were an NBDT.

The FSF is also concerned at the potential for reputational damage to the entire Non-Bank finance sector of not imposing the same regulatory framework on other non-bank participants such as peer-to-peer lenders as those which apply to NBDTs. An article which appeared in the National Business Review on 22 April 2016- (NBR Article) quoted the Harmoney CEO as saying that, due to a spate of fraudulent loans, investors who were usually small had lost money. FSF lending members also experience fraud from time to time but view this as an unfortunate cost of doing business and certainly would not pass on the losses from any such loans to their depositors. The FSF believes that the same should apply to any lender which takes deposits from the public regardless of whether they are a peer-to-peer platform or however they actually raise their deposit funds.

This is in part why the FSF supports in principle the suggestion of a framework where all deposit taking lenders are regulated as "authorised deposit-taking institutions" ("ADIs") particularly if the intention was genuinely for all deposit taking lenders including peer-to-peer or any other form of fintech innovation to be included in the regime.

Whilst the FSF believes that the suggestion that the Reserve Bank applies the same regulatory and supervisory functions to all ADIs (which as stated above should include banks, NBDTs and peer-to-peer lenders) is a desirable objective, the framework to achieve this needs careful thought to ensure it is workable and that it does not create a prohibitive structure that would deter business from continuing to take deposits.

From the perspective of its NBDT members, the FSF believes that having the RB take on the supervisory functions which are currently carried out by private sector companies (financial markets supervisors or "FMSs") should be at least cost neutral in respect to their current supervisory costs. At the very least bringing the supervisory function as well as the licensing and prudential regulation functions under the umbrella of the RB would mean that the NBDT would have only one supervisor or regulator to whom they must report rather than the two supervisors at present – the RB and the FMS – with often differing reporting standards and requirements.

4. Is new legislation the most appropriate way to adjust the prudential perimeter, or could a timelier mechanism be better? What accountability processes would be necessary to accompany any new mechanism?

   The FSF is supportive of the suggestion to allow a timelier option to amend the regulatory perimeter such as allowing for the Minister of Finance to "designate" entities or activities within the perimeter as suggested on p.45 of the consultation document. The FSF also supports the suggestion that an avenue for discussion on these matters could be through the CofFR provided the opportunity is afforded to affected parties to participate in consultation on any proposed changes. However, as the FSF has previously noted in the introduction to this submission, the CofFR consists of the FMA, the RBNZ, the Treasury and MBIE and the FSF suggests that, where ADIs are concerned, the Commerce Commission as the regulator in charge of ensuring credit providers are behaving responsibly and enforcing the CCCFA, should also be a member of the CofFR.

Should there be depositor protection in New Zealand?

5. Have the key benefits of the status quo and the identified depositor protection options been correctly identified?

   The FSF believes the consultation document expresses the key benefits of the status quo and the identified depositor protection options extremely well.

6. Is the high-level assessment of the risks and costs under the status quo and the identified depositor protection options reasonable?

   The FSF believes the way in which the high-level assessment of the risks and costs under the status quo and the identified depositor protection options have been expressed in the consultation document is entirely reasonable.

7. On balance, do the arguments support a case to progress work on depositor protection in New Zealand? Why or why not? If yes, which protection approach do you prefer and why? Given the fact that the FSF has only 3 members who take deposits from the public, the FSF does not hold extremely strong views on this matter. However, the FSF's preference would be for the status quo.

   As the discussion paper quite rightly points out, (p.23) New Zealand's banks were only moderately affected by the GFC from a financial soundness perspective (in fact they were barely affected at all). This was because they were soundly managed and their lending activities were conducted responsibly so they were not subject to significant or unsustainable losses as a result of poor lending decisions that might then cause depositors to lose their money.

   By contrast, some finance companies took excessive risk and failed to manage their cash flow prudently in the run-up to the GFC (p.15). In other words, their lending activities were much more speculative and, in the case of many of those 50 NBDTs that did collapse causing the loss of their depositors' funds, their lending activities were often irresponsible.

   The increased scrutiny on all lenders as a result of New Zealand's experience of the GFC and the accompanying massive "once in a lifetime" legislative and regulatory reform that has taken place to protect New Zealand consumers and financial institutions since then will, in the FSF's view, provide the protection required to ensure that institutional collapses on such a scale will not happen again.

   The key platforms of this legislative framework that, in the FSF's view, make the status quo the best option include (but is not limited to):

   - The NBDT Act 2013 which required NBDTs to be licensed and for their prudential management to be supervised by the RBNZ and for them to be supervised by a licensed supervisor;
   - The establishment of the FMA in 2011 with their overarching objective to promote and facilitate the development of fair, efficient, and transparent financial markets;
   - The Financial Markets Conduct Act 2013 which has the purposes to promote the confident and informed participation of businesses, investors, and consumers in the financial markets and to promote and facilitate the development of fair, efficient, and transparent financial markets;
   - The 2014 review of the CCCFA (as previously mentioned) which introduced Lender Responsibility Principles and a Responsible Lending Code and which applies to all lenders whether they are banks, non-banks, payday lenders, etc.

   The FSF believes this last piece of legislation in particular is the reason why the situation for lending institutions taking deposits from the public is now quite different to the

circumstances prevailing leading up to the GFC. As a result of the CCCFA there is now much greater scrutiny on lenders' responsible lending practices and therefore the potential for bad lending decisions to lead to loss of depositor funds is much less than it was then.

It should be noted that the CCCFA is once again under review as the current Minister of Commerce and Consumer Affairs, the Hon. Kris Faafoi, is of the belief that vulnerable consumers are still being harmed by predatory lending practices. The review is expected to provide further prescription for lenders as to how to ensure their loan affordability assessment processes are sufficient to ensure that borrowers are not being lent money they cannot afford to repay. Whilst this is a consumer protection mechanism for borrowers it is also a protection mechanism for depositors lending money to these credit providers to ensure that their deposits can be repaid at maturity.

The FSF is also in agreement with the potential reasons to not protect deposits outlined on ps. 54, 55 and 56 of the discussion document, in particular that banks shielded from deposit runs may have less incentive to act prudently; depositors might be saved by a depositor protection scheme, but everyone pays in the long run; and protecting depositors could add to everyday operating and funding costs.

With regard to the other two potential options, the FSF is not in favour of either of these for the following key reasons:

- A depositor preference regime could increase the risk of a single bank's distress being spread throughout the wider market via wholesale participants (p.58) and also because other creditors would bear increased costs;
- A deposit insurance scheme such as the sector-wide guarantee the Government put in place in New Zealand during the GFC (the Crown Deposit Guarantee Scheme ("CDGS") did not prevent the firms covered by it from taking on even more risk at significant cost to the New Zealand taxpayer.

8. (To the extent possible) what are the potential implications of your preferred approach to depositor protection, for depositors, other bank creditors and investors, banks and other financial firms, taxpayers, and the operation of the New Zealand financial system?

The FSF believes that the status quo requires all the players in the New Zealand financial system to act responsibly and to fulfil their obligations to New Zealand consumers and taxpayers. This means that financial institutions need to act responsibly, regulators need to do their job properly and enforce the excellent legislative framework that exists to protect depositors, other bank creditors, investors, and borrowers and to ensure the efficient and sound running of New Zealand's financial system. Depositors need to understand the fact that with every investment there is a certain amount of risk and to feel comfortable with the trade-off they make when setting the risk against the return when investing in one particular institution as compared to another.

9. Are there any alternative protection options, design principles, or complementary policies that could improve outcomes for the stakeholders identified above?

   The FSF is unable to suggest any alternative protection options.

Should prudential regulation and supervision be separated from the Reserve Bank?

10. In your view, have the key conceptual arguments both **for and against** assigning a prudential role to a central bank been considered? If not, what other important arguments are there?

    Once again, the FSF congratulates the writers of the consultation document on how well-written it is and for the way in which the key arguments for and against all the questions posed within it have been presented. The FSF does not believe that any relevant arguments have been missed from the consultation document.

11. In the New Zealand context, are there any significant problems associated with locating monetary and prudential policy within the Reserve Bank (i.e. the status quo)? If so, how would "separation" address these problems?

    The FSF believes that the Reserve Bank does a very good job of managing the competing tensions of its monetary and prudential policy roles currently and can see no reason for changing the status quo.

12. Do you agree that the three alternative models for institutional arrangements (a New Zealand Prudential Regulation Authority, a New Zealand Financial Services Authority and an "enhanced status quo") are the correct options to consider? If not, please suggest any alternative options of institutional arrangements not discussed here. Please indicate your preferred option, and your reasons for preferring it.

    The FSF does not support the establishment of a New Zealand Prudential Regulation Authority ("NZPRA") or a New Zealand Financial Services Authority ("NZFSA"). The FSF believes the public of New Zealand and the soundness and efficiency of New Zealand's financial system are well served by the role currently carried out by the RBNZ.

    The FSF notes that the RBNZ has appealed to Parliament's Finance and Expenditure Select Committee for more resources (Wednesday 12 December 2018) to allow it to carry out its existing functions and supports this request. It is certainly true that the RB's mandate is already wide but their functions are highly important to the overall stability of New Zealand's financial system, and the FSF believes they should be resourced accordingly to achieve these.

    The FSF believes that establishing further regulatory agencies such as an NZPRA or an NZFSA will only add to the cost of prudential regulation and supervision not detract from it. Each

agency would require separate resourcing including individual overheads and it would therefore seem much more effective to provide the RB with more resource to do their job properly than to establish more agencies with accompanying cost structures.

13. What do you consider would be the main impact on relevant stakeholders (industry, ordinary depositors, etc.) arising from each option?

    As for the answer to the previous question, the establishment of new Authorities would lead to higher costs to achieve the same result the RB is currently achieving. Providing more resources to the RBNZ to achieve its mandate has to be more cost-effective than establishing two new agencies with all the accompanying overheads.

    The FSF is also not in favour of diffusing regulatory responsibility across a number of agencies. The potential for serious issues to fall through the cracks when the regulatory landscape becomes too broad is something that should, in the FSF's view, be avoided at all cost.

14. Do you agree with the evaluative criteria and the assessment of the three options? If not, please suggest any evaluative criteria and/or alternative assessment you think should be included here.

    The criteria of focus, synergies, conflicts of interest and cost to assess the three options seem to the FSF to be entirely appropriate and the FSF cannot think of any alternative criteria that could be applied.

15. If the "enhanced status quo" is your preferred option, what features of this option are likely to be most important in addressing any problems you might see with current arrangements?

    The FSF supports the enhanced status quo option as the preferred one and believes that all the proposed changes – developing clearer objectives for the RB, changing governance and accountability arrangements, and increasing resourcing to enable a greater focus on the RB's financial system responsibilities – should be given serious consideration.

What should be the scope of the Reserve Bank's operational independence?

16. Do you consider there is a case for a Ministerial role in clarifying the Reserve Bank's financial policy objectives?

    The FSF agrees with the statement in the consultation document (p.80) that "additional Government influence on policy objectives could potentially enhance the resilience of the Reserve Bank's operational independence." Further, the consultation document states (also p.80) that The Minister has an existing power to direct the RB to have regard to

Government policy in discharging its financial stability functions. The direction is not structured explicitly around the RB's objectives, as it is for autonomous Crown entities and the FSF agrees that this potentially limits its effectiveness, particularly as stated the provision has never been used.

The consultation document (p.81) suggests ways in which a different balance could be addressed by using one or more of the options to specify additional detail in primary legislation with weightings prescribed using a legislative hierarchy; empowering or requiring the Minister to issue a risk appetite statement or remit and setting weightings in respect to each objective; and requiring the RB to issue its strategy in advance in more detail.

The FSF is in favour of the use of all or some of these options particularly that of the final one – requiring the RB to issue its strategy in advance in more detail.

17. If the Reserve Bank's objectives are to be clarified:
    (a) What should the Minister of Finance's role be?

    The FSF agrees with the suggestion that the Minister's role in approving bank directions and cancelling bank registrations should be reduced to provide a more consistent approach across the banking, NBDT and insurance regimes. That this is consistent with the IMF's 2016/17 Financial Sector Assessment Programme ("FSAP"), seems to the FSF to be a significant reason to do so, particularly if mitigated by the other changes suggestion in the consultation document (p.82) – being more guidance on goals to be provided; additional due process to be put in place around the development of designated policy; greater external monitoring and stewardship of the RB to be put in place; and enhancements made to the governance of the RB.

    (b) What other mechanisms could be used to clarify the Reserve Bank's objectives?

    The FSF believes that the suggestions made in the consultation paper to clarify the RB's objectives are sound and can think of no other mechanisms that could be used.

18. Do you think there is a case for making the Reserve Bank's operational independence more explicit, for example by removing the requirement for Ministerial consent for certain policy instruments and direction powers? If so, will this require any process or governance changes?

    Please refer to the answer provided to the question above.

19. Should the administration of the Reserve Bank Act (and other Acts creating regulatory regimes operated by the Reserve Bank) remain with the Reserve Bank or transfer to the Treasury?

The FSF agrees with the proposal to transfer the role of Act administrator to the Treasury for the reasons provided on p.84 of the consultation document. The FSF believes that this is also consistent with the usual approach taken to the stewardship of legislation to make the independence of the regulator clear and to reduce potential conflicts of interest. The FSF notes that as this approach applies to other regulatory agencies in New Zealand (for example the FMA or the Commerce Commission), these agencies are provided with the opportunity to have input and submission into the process of developing legislation along with other interested stakeholders so any unintended consequences they might identify that have been overlooked by the responsible policy department can be taken into consideration and mitigated.

How should the Reserve Bank be structured?

20. Should the governing body of the Reserve Bank be a single decision-maker or a board? What are the key considerations in support of your view?

    As stated in chapter 6 of the consultation document (p.75), a lot of evidence exists to suggest that more effective governance of organisations is achieved through a board structure rather than via a single decision-maker. Whilst the consultation document very clearly outlines the pros and cons of both models, the FSF believes the advantages of a board structure outweigh any of the disadvantages and perceived advantages of a single decision-maker model.

    In the FSF's view the RB has been reasonably well served by the single decision-maker model as its governance model since the Reserve Bank Act 1989 came into force. However, during that time, the strengths and skills of the individuals concerned have tended to dictate the RB's direction and perception by stakeholders – which the FSF believes is only natural under such a model. The FSF believes that vesting all the responsibility for an organisation's powers and functions in one individual, even with that individual having the authority to delegate to employees of the organisation or to take advice from internal committees is a huge mandate for one person – possibly too large in the FSF's view.

    The collective responsibility for all an organisation's powers and functions of the board model allows for more diversity of thought and experience. As board members are free from managerial responsibilities, they can focus on governance matters as the consultation document rightly points out and can therefore be more objective in their judgements particularly on management's performance which enhances internal accountability.

    The FSF believes there are more advantages (pros) of a board model and less disadvantages (cons) than for the single decision-maker model and therefore fully supports a move towards this model for the Reserve Bank.

21. Should there be a Financial Policy Committee, and if so, what should it do? What are the key considerations in support of your view?

The nature of the multiple decisions and judgements covering a broad range of areas over different timeframes in relation to financial policy should in the FSF's view be formalised into a wide-ranging "financial policy board" as suggested in option D of the consultation document (p.90). As the option points out, the Financial Policy Committee ("FPC") would have the responsibility for decisions, the assumption would be that day-to-day decision-making ability would be delegated to the Governor and employees of the RB which seems to be entirely sensible in the FSF's view. The complexity and nature of decisions of a financial policy nature are such that the higher-level approach of an FPC is preferable to devolving all responsibility for financial policy decisions on one person.

22. Are there any other legislative structures for the governance of the Reserve Bank's powers and functions that you think should be considered?

    The FSF has no further suggestions with respect to any other legislative structures that could be considered for the governance of the RB's powers and functions.

How should the Reserve Bank be monitored and held to account?

23. Who should monitor the Reserve Bank? What do you see as the key considerations in determining who the monitoring agent should be?

    Given the FSF's answer to question 20 above supporting the introduction of a board as the governance model for the RB, the FSF supports the case for having the Treasury as the monitoring agent.

24. If the existing Board is retained as a monitoring agent only (e.g. in the form of a supervisory council), what changes do you see as necessary to improve its effectiveness?

    Please see the answer to question 23 above.

25. Are existing statutory accountability and transparency requirements sufficient? If not, in what areas would you like to see more?

    The FSF believes existing statutory accountability and transparency requirements appear to be sufficient but does have a concern with the fact that the Auditor-General has limited ability to initiate a performance audit of the RB (p.97) given that the consultation document states that no other public entity is excluded from the Auditor-General's scope in this way.

Appendix A- FSF Membership List as at 1 August 2018

Debenture Issuers - (NBDT) Non-Bank Deposit Takers	Vehicle Lenders	Finance Company Diversified Lenders	Credit Reporting Other	Insurance	Affiliate Members
<u>Rated</u> Asset Finance (B) <u>Non-Rated</u> Mutual Credit Finance Gold Band Finance ➢ Loan Co	BMW Financial Services ➢ Mini ➢ Alphera Financial Services Branded Financial Services Community Financial Services European Financial Services Go Car Finance Ltd Honda Financial Services Mercedes-Benz Financial Motor Trade Finance Nissan Financial Services NZ Ltd ➢ Mitsubishi Motors Financial Services ➢ Skyline Car Finance Onyx Finance Limited Toyota Finance NZ Yamaha Motor Finance <u>Leasing Providers</u> Custom Fleet Fleet Partners NZ Ltd ORIX NZ SG Fleet Lease Plan	L & F Ltd ➢ Speirs Finance ➢ YooGo Avanti Finance Caterpillar Financial Services NZ Ltd CentraCorp Finance 2000 Finance Now ➢ The Warehouse Financial Services Flexi Cards Future Finance Geneva Finance Home Direct Instant Finance ➢ Fair City ➢ My Finance John Deere Financial Latitude Financial Pioneer Finance ➢ Personal Finance South Pacific Loans Thorn Group Financial Services Ltd Turners Automotive Group	Equifax (prev Veda) Centrix <u>Debt Collection Agencies</u> Baycorp (NZ) Illion (prev Dun & Bradstreet (NZ) Limited	Autosure Protecta Insurance Provident Insurance Corporation Ltd Southsure Assurance	American Express International (NZ) Ltd AML Solutions Buddle Findlay Chapman Tripp EY Finzsoft KPMG Paul Davies Law Ltd PWC Simpson Western FinTech NZ HPD Software Ltd Receivables Management Experian Total 58 members