

The Treasury

Reserve Bank Act Review Phase 2 Submission Information Release

March 2019

This document has been proactively released by the Treasury on the Treasury website at

<https://treasury.govt.nz/publications/information-release/reserve-bank-act-review-phase-2-proactive-release>

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people
- [2] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

Copyright and Licensing

Cabinet material and advice to Ministers from the Treasury and other public service departments are © **Crown copyright** but are licensed for re-use under **Creative Commons Attribution 4.0 International (CC BY 4.0)** [<https://creativecommons.org/licenses/by/4.0/>].

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.

SUBMISSION

TELEPHONE 0800 327 646 | WEBSITE WWW.FEDFARM.ORG.NZ



To: Phase 2 of the Reserve Bank Act Review
The Treasury
PO Box 3724
WELLINGTON 6140

By email: rbnzactreview@treasury.govt.nz

Submission on: Phase 2 of the Reserve Bank Act Review

From: Federated Farmers of New Zealand

Date: 25 January 2019

NICK CLARK
MANAGER GENERAL POLICY

Federated Farmers of New Zealand
PO Box 20448, Bishopdale
Christchurch 8543, New Zealand

[1]

www.fedfarm.org.nz

SUBMISSION TO THE REVIEW TEAM ON PHASE 2 OF THE RESERVE BANK ACT REVIEW

1. INTRODUCTION

- 1.1 Federated Farmers welcomes the opportunity to submit on Phase 2 of the Reserve Bank Act Review.
- 1.2 Phase 2 of the Review relates to financial policy and the Reserve Bank's role in safeguarding New Zealand's financial system. Phase 1 related to monetary policy.
- 1.3 Agriculture is a significant contributor to the economy:
 - For the year to June 2018 62.2 percent of the value of New Zealand's \$55.5 billion merchandise exports came from agricultural products¹.
 - Agriculture's direct contribution to GDP is around 5-6 percent but that does not include its indirect contribution through food processing and services used by farmers².
 - As at February 2018 53,500 agricultural businesses employed 84,400 people (excluding business owners)³.
 - Since 1978 productivity in the agricultural sector has grown faster than for the economy as a whole⁴.
- 1.4 Farmers are also important players in the financial system. As at November 2018 agricultural sector debt totalled \$62.5 billion⁵ and farmers will also have substantial financial assets, including bank deposits. Dairy farm debt, which makes up about two-thirds of total agricultural debt, is regarded by the Reserve Bank to be one of the key risks to the financial system (the others being the global economy and the housing market).
- 1.5 Federated Farmers takes a close interest in financial policy and we appreciated the opportunity to meet with the review team to discuss the issues canvassed in the Phase 2 consultation paper. We also commend the review team for a well-written and clear consultation document.
- 1.6 This submission makes general comments on banking and farming and comments specifically on the key questions raised in the consultation paper:
 - What high-level financial policy objectives should the Reserve Bank have?
 - Who does the Reserve Bank regulate and how should the regulatory perimeter be set?
 - Should there be depositor protection in New Zealand?
 - Should prudential regulation and supervision be separated from the Reserve Bank?
 - How should the Reserve Bank be governed?

¹ MPI's Situation & Outlook for Primary Industries for June 2018 and Statistics NZ's monthly Overseas Merchandise Trade Statistics for June 2018.

² Statistics NZ GDP quarterly statistics, September 2018 quarter.

³ Statistics NZ annual Business Demography Statistics (most recent is for 2018, as at February)

⁴ Statistics NZ annual Productivity Statistics (most recent is for 1978-2017)

⁵ Reserve Bank of NZ monthly Sector Credit Statistics (most recent is for November 2018)

2. RECOMMENDATIONS

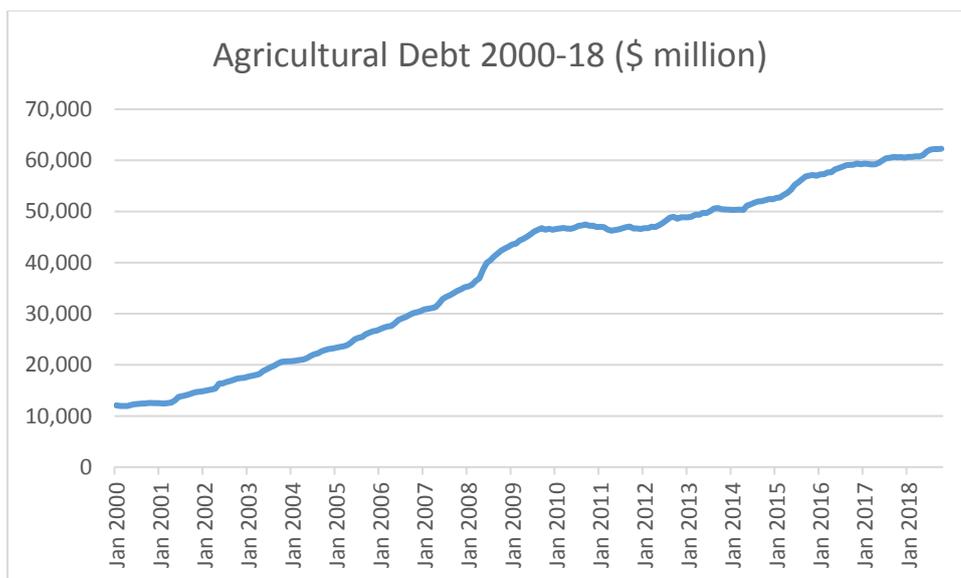
2.1 Federated Farmers recommends:

- (a) That the Reserve Bank's high-level financial policy objective should be to focus on regulatory efficiency;
- (b) That the regulation of banks, non-bank deposit takers and insurers should be flexible to enable differences between the types of entities regulated and their risk characteristics and that they should be able to respond to new innovations;
- (c) That there be more and better information and education to improve New Zealanders' financial literacy;
- (d) That depositor protection not proceed, especially if bank capital requirements are increased;
- (e) That if depositor protection is to proceed it be confined to lifting depositors in the hierarchy of creditors rather than imposing a costly insurance scheme;
- (f) That the Reserve Bank's efforts to improve its regulatory and supervisory performance should be given a chance to bear fruit before considering separation; and
- (g) That any changes to the Reserve Bank's governance and decision-making arrangements should not weaken its operational independence.

3. GENERAL COMMENTS ON BANKING AND FARMING

3.1 Federated Farmers takes a close interest in banking issues. Farming has been and will continue to be reliant on bank capital for investment to grow the business, become more productive and to respond to environmental requirements, for seasonal finance, and in some cases for survival. For some farmers, interest can be the largest single farm expense and with agricultural debt now exceeding \$62 billion, a 1 percent change in interest rates is worth over \$620 million per annum to farmers. Banks' decisions can have a huge impact on farm businesses and farming families' economic and social well-being.

3.2 Since 2000, agricultural debt has increased dramatically. Figure 1 below shows agricultural debt rising from \$12 billion in January 2000 to \$62.5 billion in November 2018, a five-fold increase. Other sectors have also seen increases over that period but not to the same extent – household and personal consumer debt has increased nearly four-fold and business debt has increased nearly three-fold.



Source: Reserve Bank of NZ Sector Credit Statistics

- 3.3 Dairy farmers hold more than \$40 billion of debt, around two-thirds of total agricultural debt. There was very rapid growth agricultural debt during the mid-late 2000s driven largely by expansion of dairying from new conversions but also investment in making existing dairy farms more productive and to meet environmental requirements. After a flat period in the years after the Global Financial Crisis, dairy debt increased again in 2014-16 as banks supported farmers through a prolonged downturn in dairy prices. Most recently growth in debt moderated with the recovery in dairy incomes. Annual growth in agricultural sector debt (currently 2.8%) is well below that for housing, personal consumer and business sectors.
- 3.4 For some time the Reserve Bank has included dairy sector indebtedness as one of the financial sector’s key vulnerabilities. Its November 2018 Financial Stability Report observed that:
- “Indebtedness remains high in the agriculture sector, particularly for dairy farms. While the sector is currently profitable, commodity prices are volatile, and the sector remains vulnerable to another downturn. In addition, there are a number of longer-term challenges facing the sector, including managing the risks of climate change. It remains important for the sector as a whole to continue to repair its balance sheets, to restore resilience to a future downturn and to allow farms to invest to adapt to medium-term challenges.”*
- 3.5 As well as climate change other medium-term challenges include *Mycoplasma bovis* and tighter regulation of freshwater management. The Reserve Bank considers the sector’s debt levels limit its capacity to withstand market downturns and invest to adapt over the longer term. So, it is keen for dairy farmers to pay down debt.
- 3.6 In our recent six-monthly Banking Surveys, Federated Farmers has detected a tightening of conditions faced by farmers, erosions in the levels of farmer satisfaction with banking relationships and with bank communication (both off high levels), and an increase in perceived pressure faced by farmers, especially for dairy farmers and even more so for sharemilkers. For more information please refer to the report from the November 2018 survey attached as an appendix.

4. SPECIFIC COMMENTS ON THE PAPER

- 4.1 The remainder of this submission provides Federated Farmers' views on the following key questions:
- What high-level financial policy objectives should the Reserve Bank have?
 - Who does the Reserve Bank regulate and how should the regulatory perimeter be set?
 - Should there be depositor protection in New Zealand?
 - Should prudential regulation and supervision be separated from the Reserve Bank?
 - How should the Reserve Bank be governed?

High-level financial policy objectives

- 4.2 In relation to financial policy, the Reserve Bank's role should be focused on regulatory efficiency, including minimising excessive compliance costs. The Reserve Bank should not be trying to promote competition or consumer protection or to grow particular sectors of the economy. These other objectives can be politically sensitive and are better addressed through existing legislation such as the Commerce Act (in the case of competition), the Fair Trading Act (in the case of consumer protection) and through wider government policies (especially in the case of promoting the growth of sectors).

- 4.3 Recommendation: That the Reserve Bank's high-level financial policy objective should be to focus on regulatory efficiency.**

The regulatory perimeter

- 4.4 Banks, non-bank deposit takers (NBDTs), and insurers are regulated by the Reserve Bank and they each have their own regulatory regimes. While Federated Farmers is not an expert in the regulation of banks and NBDTs, the apparent similarities and interlinkages between banks and NBDTs means there might be value in consolidating their two regimes into one. There should be flexibility within any resulting regime(s) to take account of the differences between the types of entities regulated and their risk characteristics. We also agree that there should be scope for 'flex' to future-proof the regulatory regimes so they can adapt to new innovations, such as 'FinTech'.

- 4.5 Recommendation: That the regulation of banks, non-bank deposit takers and insurers should be flexible to enable differences between the types of entities regulated and their risk characteristics and that they should be able to respond to new innovations.**

Depositor protection

- 4.6 The discussion paper does a good job outlining the pros and cons of depositor protection. On balance Federated Farmers is not convinced that there is a significant enough problem in New Zealand to warrant depositor protection. We are concerned that it would run up against the need for individuals to take responsibility for their investment decisions and more practically it would likely result in higher costs which would be passed on to consumers, including those that are aware of risks and are not in need of protection.

- 4.7 Federated Farmers acknowledges that New Zealand is unusual in that it does not have a formal scheme for depositor protection, but that does not mean we are in the wrong. New Zealand has other tools that are intended to help protect depositors such as open

bank resolution and bank capital requirements. It is worth noting that the Reserve Bank is separately consulting on proposals to substantially increase bank capital requirements with the intention of further reducing the risk (already small) of bank failure. This ought to reduce the need for a depositor protection scheme.

- 4.8 It is well known that the standard of financial literacy in New Zealand is poor and that many people do not understand that bank deposits are not 'as safe as houses'. Federated Farmers believes a better solution to this problem would be more and better information and education to improve financial literacy.
- 4.9 If some form of depositor protection is considered necessary it might be better to confine it to lifting depositors in the hierarchy of creditors rather than putting in place a costly insurance scheme.
- 4.10 Recommendation: That there be more and better information and education to improve New Zealanders' financial literacy.**
- 4.11 Recommendation: That depositor protection not proceed, especially if bank capital requirements are increased.**
- 4.12 Recommendation: That if depositor protection is to proceed it be confined to lifting depositors in the hierarchy of creditors rather than imposing a costly insurance scheme.**

Separation of prudential regulation and supervision

- 4.13 Federated Farmers is aware of concerns about the performance of the Reserve Bank's prudential regulatory and supervisory responsibilities. These have been expressed in the IMF's 2017 report *New Zealand Financial System Stability Assessment* and the New Zealand Initiative's 2018 report *Who Guards the Guards?*
- 4.14 Although the latter report was unflattering about the Reserve Bank's performance, at least in comparison with the highly-regarded Financial Markets Authority, Federated Farmers is not convinced that separating prudential regulation and supervision from the Reserve Bank and giving it to another agency (such as the FMA) is necessarily the solution. We understand that the Reserve Bank is working to improve its regulatory performance, including through consideration of the IMF's recommendations, its recent announcement that it is establishing a Relationship Charter for working with banks, and its recent acknowledgement that it needs more resources. As the discussion paper acknowledges there would also be costs associated with separation that would need to be carefully assessed against the benefits.
- 4.15 Federated Farmers is open-minded on future arrangements for prudential regulation and supervision, but we believe that in the first instance the Reserve Bank's efforts to improve its regulatory and supervisory performance should be given a chance to bear fruit.
- 4.16 Recommendation: That the Reserve Bank's efforts to improve its regulatory and supervisory performance should be given a chance to bear fruit before considering separation.**

Governance of the Reserve Bank

- 4.17 As discussed in our submission on Stage 1 of this Review and in our subsequent submission to the Reserve Bank of New Zealand (Monetary Policy) Amendment Bill,

Federated Farmers is a strong supporter of the Reserve Bank's operational independence. We believe it has served New Zealand very well, especially for monetary policy.

4.18 As discussed in our submission on Stage 1 of this review (in relation to monetary policy), Federated Farmers is open-minded about the Reserve Bank's governance and decision-making arrangements, provided that its operational independence is maintained. *Who Guards the Guards* was critical of the Reserve Bank's governance and decision-making arrangements for financial policy, especially the single decision-maker. We would not be averse to change from a sole decision-maker to a committee approach, but our strong preference would be for any financial policy committee to be appointed by the Reserve Bank Board rather than the Minister. Otherwise we fear this would weaken the Bank's operational independence.

4.19 Recommendation: That any changes to the Reserve Bank's governance and decision-making arrangements should not weaken its operational independence.

5. ABOUT FEDERATED FARMERS

5.1 Federated Farmers is a member-based organisation that represents farmers and other rural businesses. Federated Farmers has a long and proud history of representing the needs and interests of New Zealand's farmers.

5.2 The Federation aims to add value to its members' business. Our key strategic outcomes include the need for New Zealand to provide an economic and social environment within which:

- Our members may operate their business in a fair and flexible commercial environment;
- Our members' families and their staff have access to services essential to the needs of the rural community; and
- Our members adopt responsible management and environmental practices.