

# The Treasury

## Reserve Bank Act Review Phase 2 Second Consultation Information Release

July 2019

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# FINANCIAL POLICY OBJECTIVES

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

RECOMMENDATION: the Reserve Bank’s existing ‘soundness’ and efficiency’ objectives should be replaced with a single ‘financial stability’ objective. This high-level objective should then be complemented by a fuller set of objectives that includes both soundness and efficiency.

### HIGH-LEVEL OBJECTIVE

### TO PROTECT AND ENHANCE THE STABILITY OF NEW ZEALAND’S FINANCIAL SYSTEM

*Covered in the first consultation document. For decision now.*

- This high-level objective should be supported by additional detail and lower-level objectives, which would be specified in the Reserve Bank Act. This includes how efficiency could be picked up in the fuller set of objectives.
- The complete objective set doesn’t require a decision now. Lower order details of the objective set will be consulted on in the next public consultation in May, with a decision later in the Review process. We have set out the potential key elements of this additional detail below to help illustrate the choices if financial stability were the primary objective.

	Explanation	Examples of what could be included	
Additional elements in the objectives set	<b>DEFINITION OF HIGH-LEVEL OBJECTIVE</b>	This would define what is intended by the term ‘financial stability’ in order to provide the Reserve Bank with greater clarity in carrying out its role	The definition could be used to capture soundness, efficiency, and public confidence dimensions
	<b>SECONDARY OBJECTIVES</b>	These could be added to help guide the Reserve Bank’s behaviour when pursuing the high-level objective above	
	<b>REGULATORY PRINCIPLES</b>	These could be added to guide the Reserve Bank’s approach to prudential regulation	Otherwise, either secondary objectives or regulatory principles could be used to clarify how the Reserve Bank should support the efficiency of the financial system
	<b>FUNCTION-SPECIFIC OBJECTIVES</b>	These could be added to clarify the Reserve Bank’s goals for particular functions, such as specific resolution objectives	

Alongside primary legislation the government could also use a **Financial Policy Remit** or **Government Policy Statement** as a means to provide further guidance to the Reserve Bank on how to interpret its objectives (e.g. providing details on the Government’s economic objectives or a risk appetite statement setting out the broad risk tolerances under which the Reserve Bank should operate).

# GOVERNANCE

2) Should the Reserve Bank have a Governance Board?

3) Should the Reserve Bank have a separate Financial Policy Committee?

4) Who should monitor the Reserve Bank's performance?

RECOMMENDATION: YES

PREFERRED BY REVIEW TEAM

RECOMMENDATION: TREASURY

[2]

## STATUTORY RESPONSIBILITIES

### A MONETARY POLICY

- Monetary policy decisions
- Monetary Policy Statement

### B CORPORATE DECISIONS

- Organisational strategy
- Budget
- Risk & Audit, HR, etc.
- Annual Report

### C PRUDENTIAL POLICY

- Macro-prudential policy decisions
- Steady-state prudential settings (e.g. capital framework)
  - Supervisory intensity and supervisory framework
- Enforcement framework, significant firm-level decisions
- Financial Stability Reports & Stress Tests
- Crisis management framework

### D CRISIS MANAGEMENT (delegated to the Governor and other executives)

- Resolution decisions, Lender of Last Resort

### E OTHER POLICY FUNCTIONS

- Currency operations, reserves management

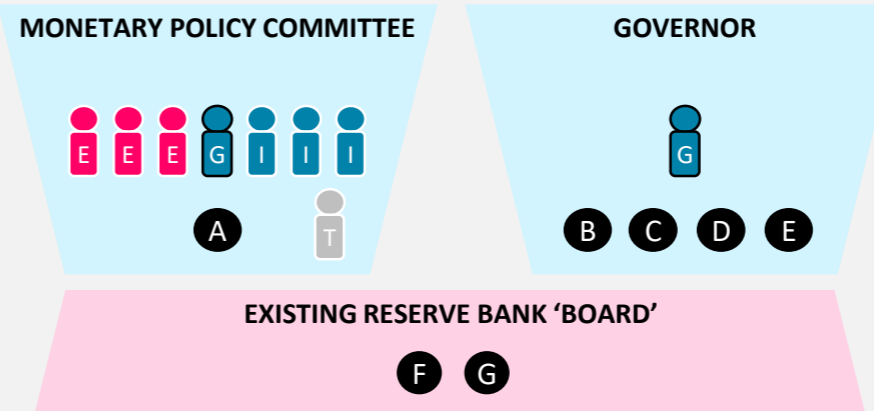
### F MONITORING RESERVE BANK MANAGEMENT

### G MONITORING RESERVE BANK AS ORGANISATION

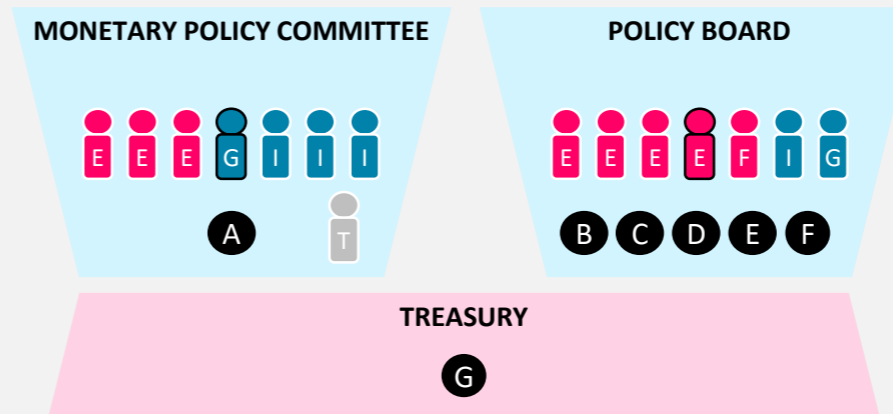
NOTE: All options presented here incorporate a substantial degree of delegation to the Governor as CEO. The Governor would oversee the day-to-day running of the Reserve Bank, including making time-critical policy decisions (e.g. during a crisis). But the options differ as to where that delegated authority comes from and which individuals have ultimate power to take decisions.

## GOVERNANCE MODELS

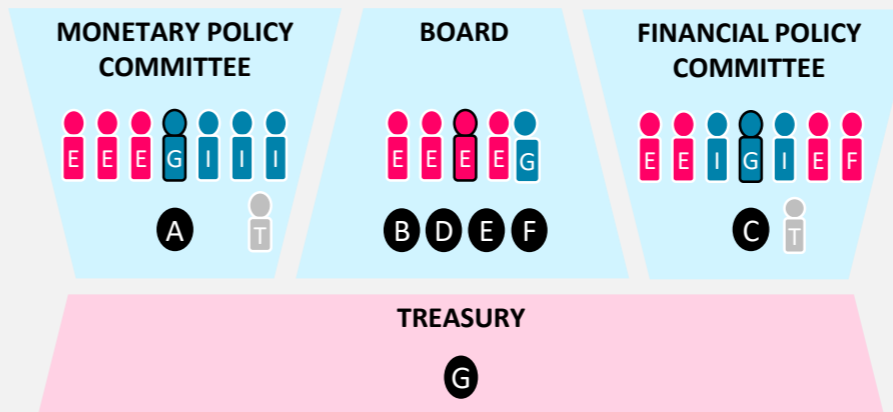
### STATUS QUO



### OPTION 1: 'POLICY BOARD'



### OPTION 2: BOARD + FPC PREFERRED



## KEY



RBNZ Decision Making Body

External Monitoring Agent

## KEY OPTIONALITY (FOR NEXT CONSULTATION)

Composition and size of the Board (e.g. non-exec board, executive board, or hybrid)

Whether to establish a statutory Executive Committee

Composition and size of the FPC (e.g. split between internals and externals)

Whether to include a Treasury observer on the FPC or Board

The role of the Board, Treasury and Minister in appointments and dismissals

Degree of delegation to RBNZ Executive and Staff

## DEPOSITOR PROTECTION

### 6. Should there be depositor protection in New Zealand?

**RECOMMENDATION:** YES. A formal regime to protect depositors should be established, with primary objectives of contributing to financial stability and depositor confidence, and protecting depositors from loss

#### CONTEXT

New Zealand is an international outlier in having no formal or permanent arrangements to protect depositors if their bank fails. This stance may leave New Zealand vulnerable to bank runs and contagion and reduces the credibility of non-taxpayer funded resolution options. The IMF's FSAP also recommended that New Zealand's stance on depositor protection be reconsidered. The November Consultation document asked whether it was appropriate to treat depositors in New Zealand banks as ordinary creditors, or whether a special treatment to protect them from losses would be more appropriate. It laid out the common ways that depositors are protected internationally:

- **Insurance**, protecting depositors' money up to a pre-announced limit
- **Preference**, moving depositors to the front of the queue of creditors in a wind-up process

#### FEEDBACK FROM CONSULTATION

There was strong support for **formal depositor protection**, including general agreement that a well-designed protection scheme could protect depositors from loss and hardship. Many respondents agreed that depositor protection could support depositor confidence and mitigate the risk of disorderly bank runs. However, some respondents doubted whether protecting depositors would contribute to financial stability. There were widespread concerns about the risks of a poorly designed protection scheme. Depositor insurance was the preferred protection approach. There was less support for depositor preference and doubt about its efficacy as a standalone tool.

## REGULATORY PERIMETER

### 7. How should the regulatory perimeter be set?

**RECOMMENDATION:** The banking and NBDT regimes should be brought together into a single 'licensed deposit-taker' framework

#### CONTEXT

New Zealand currently has two parallel regimes that regulate entities that are 'deposit takers':

- A name-based 'banking' regime, regulated and supervised by the Reserve Bank
- A 'non-bank deposit taker' (NBDT) regime that applies to firms that borrow from retail investors and then lend, such as credit unions and finance companies

As both the banking regime and the NBDT regime seek to address the same risks, the November Consultation Paper asked whether it would improve the efficiency and coherence of the current perimeter to **regulate both sectors under a single 'licensed deposit taker' framework**. This would be consistent with the approach in a number of other jurisdictions.

#### FEEDBACK FROM CONSULTATION

There was strong support for a **licensed deposit-taker framework**. Submitters noted that the current approach added unnecessary complexity. Submitters considered that the regulatory framework was not well-placed to adapt to new risks that might emerge, for example through FinTech business models.

Consistent with the discussion in the November Consultation document, submitters emphasised the need for the framework to allow for differences in both regulation and intensity of supervision between firms.

Submitters also broadly supported the need to ensure sufficient flexibility in the perimeter, condition on the design of appropriate governance and safeguards.

## SEPARATION

### 8. Should prudential regulation remain with the Reserve Bank?

**RECOMMENDATION:** YES, but the existing RBNZ prudential model should be 'enhanced' through changes to governance, objectives and funding

#### CONTEXT

Prior to the launch of the Phase 2 Review, some stakeholders expressed a view that responsibility for prudential regulation and supervision should be carved out from the RBNZ and sit with another agency. The November Consultation document laid out three potential options for reform:

- An **'enhanced' status quo**, where prudential regulation and supervision remains at the RBNZ but is improved through changes to the RBNZ's objectives, governance and resourcing
- A separate **New Zealand Prudential Regulation Authority (NZPRA)** similar to Australia
- A separate **New Zealand Financial Services Authority (NZFSA)** – covering the FMA and RBNZ's prudential and market conduct roles.

#### FEEDBACK FROM CONSULTATION

There was strong support for an **'enhanced' status quo**.

Submitters noted that the extra costs from creating a new agency significantly reduced any potential benefits from separation in a small country like New Zealand. Additional resourcing and governance changes could be made to give greater focus to the RBNZ's prudential responsibilities within the status quo. In addition, some stakeholders noted continuing to situate prudential regulation with the RBNZ's other functions (e.g. monetary policy) improved policy co-ordination and exploited useful synergies.