The Treasury

Reserve Bank Act Review Phase 2 Second Consultation Information Release

July 2019

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RESERVE BANK OF NEW ZEALAND
TE PŪTEA MATUA

THE TREASURY
Kaitohutohu Kaupapa Rawa

Report: Phase 2 of the Reserve Bank Act Review - Advice on In-Principle Decisions

Date:	14 February 2019	**Report No:**	T2019/80
		File Number:	MC-1-7-3-1

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Agree** to recommendations on in-principle decisions on Review topics set out in this report **Refer** a copy of this report, and attached material, to Associate Ministers of Finance and Hon Twyford.	28 February 2019 Ahead of the ministerial workshop due to be held on 25 February 2019

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Bernard Hodgetts	Director, Reserve Bank Act Review	[1] (wk)	[1] (mob)	✓

Actions for the Minister's Office Staff (if required)

Return the signed report to the Treasury.

Refer a copy of this report, and attached material, to Associate Ministers of Finance and Hon Twyford, following approval from the Minister of Finance

Note any feedback on the quality of the report	

Enclosure: Yes – Annex

Report: Phase 2 of the Reserve Bank Act Review - Advice on In-Principle Decisions

Executive summary

This report seeks your agreement to in-principle policy decisions for Phase 2 of the Reserve Bank Act Review. These in-principle decisions relate to the topics covered in the Review's first consultation, which closed on 25 January 2019.

These decisions are needed to confirm the direction of travel for the Review and enable the Review team to progress work on the remaining topics in time for the planned release of the next consultation document in May 2019. Final decisions will be sought on recommendations for these topics after the next consultation has concluded later in 2019.

The in-principle decisions are set out below along with a summary of the preliminary recommendations for each. The recommendations draw on stakeholder and agency feedback, along with input from the Independent Expert Advisory Panel (the Panel). Further advice around these recommendations is set out in the main body of this paper.

There is a broad alignment of views between the Review team, the Panel, Reserve Bank and Treasury on many of the in-principle decisions sought although there is a difference of views on the merits of a financial policy committee, [2] and the introduction of depositor protection.

<u>In-principle decision #1</u> - What high-level financial policy objectives should the Reserve Bank have? (paras 12-30)

The Review team recommends an in-principle decision to replace the Reserve Bank's existing 'soundness' and 'efficiency' financial policy objectives with a single over-arching 'financial stability' objective. This high-level objective should then be complemented by a fuller set of objectives that includes relevant aspects of both 'soundness' and 'efficiency'. The Panel, Reserve Bank and Treasury all support this recommendation.

Certainty around the Reserve Bank's high-level objective will enable us to further develop the objectives within the Act and allow us to include proposals for change in the next consultation document. Additional reforms could include:

- A definition of financial stability in primary legislation that captures the multiple dimensions of the term, including: system resilience, public confidence, and managing the financial cycle.
- A set of secondary objectives in primary legislation that the Reserve Bank should seek to achieve (subject to pursuing financial stability), such as an objective to facilitate competition.
- A financial policy 'remit' issued by the Minister of Finance, which provides additional guidance to the Reserve Bank on how to interpret its financial stability objectives (e.g. by specifying the Government's risk appetite for financial crises and guidance on macro-prudential policy).
- A set of 'regulatory principles' in primary legislation that clarify what factors the Reserve Bank should take into account when setting prudential regulation, including various principles aimed at supporting aspects of financial system efficiency.

- A set of function-specific objectives that apply to some of the Reserve Bank's specific financial policy areas. For example, the Reserve Bank Act could include objectives relating to prudential supervision, macro-prudential policy, and/or crisis management (resolution objectives).

The Panel agrees with expressing the primary objective of the Reserve Bank as 'financial stability' rather than 'soundness and efficiency'. In line with the Review team's recommendation, the Panel considers that this financial stability objective should be expressed in a way that recognises that financial stability should to be pursued as a means towards the purpose of the Reserve Bank Act.

The Panel considers that in pursuing the financial stability objective, the Reserve Bank should be required to take into account the effects of its policy settings on the efficiency of the financial system. This is in accordance with the Review team's recommendation to define financial stability, and investigate specifying lower tier objectives as part of the second stage of consultation.

***In-principle decision #2* - Should the Reserve Bank have a governance board? (paras 39-52)**

The Review team recommends an in-principle decision to establish a new board of directors, which is given statutory authority over all Reserve Bank decisions (except for those reserved for statutory policy committees like the MPC). This is similar to the Crown entity governance model, used for the FMA, and the model used for private sector companies. Under this model, the Governor as CEO would be given delegated authority to run the organisation on behalf of the board. The board would have responsibility for overseeing organisational matters (budget, risk and audit, strategy, performance of the executive), operational functions (currency and balance sheet management) and policy areas not reserved for statutory committees. If an FPC is not established (see in-principle decision #3), the board would also have responsibility for prudential policy. A fully non-executive board represents the cleanest split between governance and management roles and is consistent with the Crown Entities governance framework. However, if the board has prudential policy responsibilities, it may benefit from executive directors. We recommend consulting on the size and composition of the board in the next consultation document. The Panel, Reserve Bank and Treasury support the establishment of a governance board.

***In-principle decision #3* - Should the Reserve Bank have a separate Financial Policy Committee? (paras 53-73)**

The Review team also sees merit in establishing a separate statutory Financial Policy Committee (FPC) in addition to the governance board. If adopted, the FPC would be responsible for prudential policy rather than the governance board. The FPC would have statutory authority for making all prudential policy decisions, including: setting the prudential regulatory framework (capital and liquidity settings) and taking macro-prudential policy decisions. It would also oversee the supervision and enforcement regime.

The establishment of an FPC would in some ways appear consistent with policy decisions taken in phase 1 to establish an MPC, and would serve as a mechanism for ensuring group decision-making and for bringing external perspectives to the decision process. At the same time, there are some important differences between monetary and prudential policy and the optimal decision-making structures might not necessarily be the same for both. Most notably, prudential policy involves a more complex array of tools, supervisory and enforcement decisions and a less easily quantifiable objective.

The Review team sees both options as representing a significant advance over the status quo (single decision-maker model). While both models have pros and cons, on balance, the Review team considers the FPC offers an optimal decision-making model for prudential policy decisions on the basis of the expertise, focus and external involvement inherent in the FPC model.

The Reserve Bank and a majority of the Panel do not support the establishment of an FPC primarily on the basis that it would detract from the role of the board and introduce additional complexity.

The Treasury sees merit in both options. If the key issue is to enhance overall governance of the Reserve Bank, the board model without an FPC would be optimal. However, if the intention is to ensure focus on prudential regulation, then a separate FPC would have merit.

If you are in favour of an FPC, design details (including the split between internals and externals) would be consulted on in the next consultation document.

<u>In-principle decisions #4 and #5</u> - Who should monitor the Reserve Bank's performance [2]

Monitor

The Review team recommends an in-principle decision for the Treasury to be the external monitor of the Reserve Bank with a role similar to monitors under the Crown Entities Act. This will provide a clearer separation of the monitoring role from the Reserve Bank and will bring the Reserve's monitoring arrangement in to line with a Crown Entities style framework.

The Review team considers that the proposed recommendation will enhance the effectiveness of monitoring. With the establishment of a new governance board with stronger internal accountability, there will be less need for the bespoke external monitoring role currently performed by the Reserve Bank board.

The Panel, the Reserve Bank and the Treasury support Treasury becoming the external monitor for the Reserve Bank.

[2]

<u>In-principle decision #6</u> - Should there be depositor protection in New Zealand? (paras 111-164)

The Review team has examined the role that depositor protection can play in the wider safety net of the financial system, drawing on domestic and international experiences from before, during, and after the global financial crisis (GFC). This has shown that an appropriately-calibrated deposit protection scheme can do more than protect some depositors from loss if their bank fails. Deposit protection can also contribute to financial stability more broadly, by supporting depositors' confidence in the financial sector, reducing the propensity for depositors to join bank runs and spread contagion, and underpinning the feasibility of options to resolve failing firms in an orderly way without relying on taxpayer support. In doing so, depositor protection can sharpen the incentives of non-insured investors to discipline bank risk taking.

Accordingly, the Review team recommends an in-principle decision be taken to establish a permanent depositor protection regime in New Zealand. The form of protection would be an insurance scheme to protect depositors from loss up to a specified limit if a firm holding their deposit fails, possibly complemented by depositor preference.

The Review team recommends that the public policy objectives of the regime should be to protect depositors from loss, and to contribute to depositor confidence and financial stability. This approach is consistent with modern depositor protection regimes around the world.

The Review team is not yet seeking decisions on key design aspects of an insurance scheme, such as the scope of its coverage or the mechanisms to fund it. Proposals for these design aspects will be developed based on the agreed objectives for the scheme on which we seek your decision now. As an indication, the team anticipates the objectives we are recommending would require a level of coverage in line with international norms (e.g., $100,000 per depositor). At this level, international experience suggests depositors' incentives to join bank runs could be meaningfully mitigated, and options to resolve failing firms without relying on taxpayer support could be made more politically feasible.

The Reserve Bank is not convinced that deposit insurance can contribute to financial stability without extraordinarily high coverage levels, and in turn is concerned about the moral hazard that would be created by such a scheme. It favours narrower coverage (e.g., $10,000 per depositor) to advance a solo objective of protecting depositors from hardship.

The Treasury supports a deposit insurance scheme along the lines of the Review team's recommendations, as it offers a level of capped protection that mitigates the risk of emergency guarantees or bail-outs and so transforms an uncertain and hard-to-price implicit Crown exposure into one that is more transparent, and easier to manage.

The Independent Panel believes further work is required to situate the potential role of deposit insurance within New Zealand's broader policy context, including recent proposals to increase regulatory capital requirements. Accordingly, the Panel remains unconvinced about the merits of deposit insurance at this time, being concerned that the costs outweigh the benefits and the potential for other policies to be more effective in stabilising the financial system and protecting depositors.

<u>In-principle decision #7</u> - How should the regulatory perimeter be set? (paras 165-180)

The Review team recommends an in-principle decision to merge New Zealand's two existing prudential regimes for regulating banks and non-bank deposit takers (NBDTs) into a single deposit-taking regime (as is the case in Australia and the UK). This new regime should be based on a common set of minimum standards that apply across all deposit-taking firms, but should also allow the Reserve Bank to set tailored regulatory and supervisory requirements for classes of firms (or individual firms) based on the risks they pose to the system. The new regime should also include arrangements for appropriate flexibility of the perimeter, including a power to designate financial businesses as being subject to regulation.

The Panel, Reserve Bank and Treasury support this recommendation.

<u>In-principle decision #8</u> - Should prudential regulation remain with the Reserve Bank? (paras 181-197)

The Review team recommends that prudential regulation and supervision should remain a function of the Reserve Bank. Concerns among stakeholders around the Reserve Bank's lack of focus on its prudential role, insufficient capacity to deliver it, the Reserve Bank's relationship with regulated entities, and potential conflicts across different policy functions can largely be addressed within current institutional arrangements – this is the 'enhanced status quo' option. Enhancements include potential changes to the Reserve Bank's objectives, funding and governance structure. This option is the cost-effective choice, is in-keeping with the direction of international regulatory changes since the GFC, and would ensure that existing policy synergies between the Reserve Bank's prudential role and other functions are retained. Moreover, by taking an evolutionary approach to New Zealand's twin peaks model, rather than jumping to a more costly separate agency model, the Government retains the option to review its choice in the future if the Phase 2 reforms prove insufficient.

The Panel, Reserve Bank and the Treasury support this recommendation.

Next steps

You are meeting with the Review team on Monday 18 February to discuss this report ahead of the follow-on ministerial workshop on Monday 25 February with Associate Ministers of Finance and Hon Twyford. The purpose of this workshop is to discuss wider ministerial views on the in-principle decisions before confirming your decisions.

The report, along with supporting material in Annex 1, serves as the background and material for both these meetings. We recommend you refer a copy of this report, and attached material, to Associate Ministers of Finance and Hon Twyford ahead of the ministerial workshop.

Recommended Action

We recommend that you:

a **note** the first consultation for Phase 2 of the Review closed on 25 January 2019, and the Review team received 67 submissions.

b **note** a summary of submissions has been provided to you separately (T2019/306 refers) and the intention of the Review to publish it with the individual submissions on or around 1 March 2019 as previously agreed (T2018/3351 refers).

c **note** you are meeting the Review team on 18 February to discuss the in-principle decisions relating to topics from the first consultation, which are set out below.

d **note** timely in-principle decisions are important to confirm direction of travel for the Review, and enable the Review team to progress work for the next consultation document in time for the planned release in May 2019.

<u>In-principle decisions</u>

Objectives

e **agree** in principle to replace the Reserve Bank's existing 'soundness' and 'efficiency' financial policy objectives with a single over-arching 'financial stability' objective **(in-principle decision #1)**.

Agree/disagree

f **note** additional reforms will support this new objective (such as clearly defining financial stability in primary legislation and setting secondary objectives the Reserve Bank must have regard to) and these are currently being developed to include in the next consultation.

Governance

g **agree** in principle to establish a new board of directors, which is given statutory authority over all Reserve Bank decisions (except for those reserved for statutory policy committees) **(in-principle decision #2)**.

Agree/disagree

h **agree** in principle to either **(in-principle decision #3)**:

i. establish a new statutory financial policy committee which is given statutory authority for taking all prudential policy decisions (Review team preferred).

Agree/disagree

<u>OR</u>

ii. not establish a new financial policy committee, with the newly established board of directors retaining responsibility for prudential policy decisions.

Agree/disagree

i **agree** in principle to appoint the Treasury as external monitor of the Reserve Bank with a role similar to monitors under the Crown Entities Act **(in-principle decision #4)**.

Agree/disagree

j [2]

Agree/disagree

k **note** that the governance model recommended envisages a high degree of delegation to the Governor and other members of the executive at the Reserve Bank.

l **note** the design details around the establishment of a board and any financial policy committee will be included as part of the next consultation due in May 2019.

Depositor protection

m **agree** in principle to establish a permanent depositor protection regime in New Zealand **(in-principle decision #6).**

Agree/disagree

n **agree** in principle that the protection regime be in the form of a deposit insurance scheme that promptly reimburses depositors who suffer losses on their insured deposits, up to a pre-announced limit.

Agree/disagree

o **agree** in principle that the main public policy objectives of the protection regime be to contribute to depositor confidence and financial stability by mitigating run risk and contagion, and to protect depositors from loss in the event of a bank failure.

Agree/disagree

Regulatory perimeter

p **agree** in principle to merge New Zealand's two existing prudential regimes for regulating banks and non-bank deposit takers into a single deposit-taking regime **(in-principle decision #7).**

Agree/disagree

q **note** that further details around the design of the single deposit-taking regime will be included as part of the next consultation due in May 2019.

Separation

r **agree** to retain the prudential regulation and supervision function as part of the Reserve Bank **(in-principle decision #8).**

Agree/disagree

s **refer** a copy of this report, and attached material, to Associate Ministers of Finance and Hon Twyford ahead of the ministerial workshop due to be held on 25 February 2019.

Referred/not referred

Bernard Hodgetts
Director, Reserve Bank Act Review

Hon Grant Robertson
Minister of Finance

Report: Phase 2 of the Reserve Bank Act Review - Advice on In-Principle Decisions

Purpose

1. This report seeks your agreement to in-principle policy decisions for Phase 2 of the Reserve Bank Act Review. These in-principle decisions relate to the topics covered in the Review's first consultation, which closed on 25 January 2019.

2. These decisions are needed to confirm the direction of travel for the Review and enable the Review team to progress work on the remaining topics in time for the planned release of the next consultation document in May 2019. Final decisions will be sought on recommendations for these topics after the next consultation has concluded later in 2019.

3. The report, along with supporting material in Annex 1, serves as the background and material for your meeting with the Review team on Monday 18 February and for the follow-on ministerial workshop on Monday 25 February with Associate Ministers of Finance and Hon Twyford. We have also provided you with a summary of submissions to the consultation along with this report.

Summary of first consultation

4. The first consultation document for Phase 2 was released on 1 November 2018 and the consultation period closed on 25 January 2019.

5. We had received a total of 67 formal submissions (with around 40% of these being from individuals/members of the public). The Review team also met with a range stakeholders through a series of meetings, workshops and interviews since the consultation document was launched.

6. Key themes from stakeholder feedback relevant to each of the in-principle decisions are set out in the advice below.

7. A separate report has also been provided to you with a draft of a Summary of Stakeholder Submissions document (T2019/306 refers) and the Review team intends to publish it with the individual submissions on or around 1 March 2019 as previously agreed (T2018/3351 refers).

List of in-principle decisions sought

8. Following the first consultation, the in-principle decisions that we are seeking from you are:

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

    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?

5. [2]

6. Should there be depositor protection in New Zealand?

7. How should the regulatory perimeter be set?

8. Should the prudential regulation and supervision functions remain with the Reserve Bank?

9. In-principle decisions are needed from you to confirm the direction of travel for the topics above. This is a key gateway point in the Review. Timely decisions are important to enable the Review to progress work for the next consultation document in time for the planned release in May 2019. This is because work on the second group of topics depends on these in-principle decisions – for example, it will be difficult to progress work on the crisis management framework without a steer from you on whether to pursue depositor protection or not.

10. It is important to emphasise that each of the areas covered in this paper are interdependent. The Review team has taken these interdependencies into account and considers that the recommendations work well as a package. For example, the introduction of a depositor protection regime recommended in the paper would be greatly assisted by the unification of the regulatory regimes for bank and non-bank deposit takers that we are also recommending. Decisions not to proceed with some recommendations may require us to revisit the overall package of suggested changes.

11. The remainder of the report sets out the Review team's advice and preliminary recommendations on each of these in-principle decisions. The Panel met on 7 February to discuss the advice around these decisions. Their views been included in the advice below.

In-principle decision #1 - What high-level financial policy objectives should the Reserve Bank have?

Context and Problem Definition

12. The purpose of the Reserve Bank Act (the Act) is to “promote the prosperity and well-being of New Zealanders and contribute to a productive and sustainable economy”. Financial policy currently contributes to this purpose via the high-level objectives of ‘promoting the maintenance of a <u>sound</u> and <u>efficient</u> financial system’. There are a number of potential issues with the way these objectives are currently formulated:

- **Clarity**: neither ‘soundness’ nor ‘efficiency’ are defined in the current Act. The meaning of ‘efficiency’ is particularly ambiguous and it is clear that stakeholders have different views on what it is intended to cover. Some concepts of efficiency complement promotion of financial soundness, while others conflict with it. Thus, in its current form, the efficiency objective lacks clarity.
- **Relevance:** the existing objectives are 30 years old, but the nature and tools of financial policy have changed significantly since 1989. Internationally, ‘soundness’ has become a dated concept. It is regarded as too narrow to describe best practice regulation, which has multiple dimensions, including a macro-prudential focus. Efficiency rarely features as a high-level objective of other central banks.
- **Weighting:** under the current Act, soundness and efficiency are effectively dual objectives of equal importance. In practice, the instruments of prudential regulation have been exercised chiefly to influence prudential outcomes, with less emphasis on efficiency. A dual objective is therefore problematic at least in the absence of further guidance on the relative importance of the two objectives.
- **Coverage:** some stakeholders argue that there are gaps in New Zealand’s financial regulatory architecture, such as a lack of competition, consumer protection or public confidence in the financial system. There is an open question as to whether the Reserve Bank should be given additional objectives to plug those gaps.

Recommendation

13. The Review team recommends an in-principle decision to replace the Reserve Bank’s existing responsibility to promote the ‘soundness’ and ‘efficiency’ of the financial system with a single financial policy objective to promote ‘financial stability’. This would be consistent with the recently amended purpose of the Act and set a clear expectation of the outcomes the Reserve Bank is expected to achieve.

14. Using the term ‘financial stability’ would also capture the concepts of both soundness and efficiency that are relevant for prudential regulators. While the Review team does not believe ‘efficiency’ should be a high level objective for the Reserve Bank, it considers the relevant efficiency considerations should be included at lower levels of the objective set contained within the Act. Doing so would provide scope to be clearer about which aspects of efficiency the Reserve Bank could feasibly be expected to focus on.

15. For context, the Review team intends to consult on the complete set of objectives for the Reserve Bank in its consultation in May, including a range of lower level objectives and regulatory principles. We are not seeking decisions on these lower level objectives and regulatory principles at this stage. The key point is that they will provide more specification of the Reserve Bank’s financial policy role, including within specific financial policy areas. Aspects to be covered include:

- A definition of financial stability in primary legislation that captures its multiple dimensions, including: system resilience, public confidence, and managing the financial cycle.
- A set of secondary objectives in primary legislation that the Reserve Bank should seek to achieve (subject to pursuing financial stability), such as an objective to facilitate competition.
- A financial policy 'remit' issued by the Minister of Finance to provide additional guidance to the Reserve Bank on how to interpret its financial stability objectives (e.g. by specifying the Government's risk appetite for financial crises and guidance on macro-prudential policy).
- A set of 'regulatory principles' that clarify what factors the Reserve Bank must take into account when setting prudential regulation (for example, minimising compliance costs, and supporting financial sector innovation where possible).
- A set of function-specific objectives relating to various financial policy areas. For example, the Act could include objectives relating prudential supervision, macro-prudential policy, or crisis management. These functional areas will be included as detailed topics in the next consultation document to be released in May.

Rationale for recommendation

16. The purpose of the Act is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy. The biggest contribution the Reserve Bank can make to the prosperity and well-being of New Zealanders as the prudential regulator is to minimise the likelihood of financial crises – which is akin to promoting financial stability. The Reserve Bank's financial policy objectives should be set to reflect the areas in which the Reserve Bank can most effectively reduce market failures in the financial system. Replacing the Reserve Bank's high-level objective to promote the 'soundness and efficiency' of the financial system with an objective to promote 'financial stability' would be more consistent with the way the Reserve Bank already interprets its responsibilities.[1] The Review team considers that retaining the current wording would be problematic because it creates ambiguity about the role and mandate of the Reserve Bank in certain policy areas.

17. Firstly, 'soundness' is often interpreted as being limited to promoting the resilience of the financial system, and is not dynamic in nature. The objectives of other central banks tend to focus on the broader and more dynamic term 'financial stability', which captures the need to adjust regulatory settings through the financial cycle and consider how the financial sector can affect the real economy.

18. The term 'efficiency' is very broad and is also poorly defined. It can be taken to add the dynamic element lacking in the term 'soundness', because a highly cyclical financial system would not be very efficient. However, it can also be taken as a counterweight to 'soundness' so that the Reserve Bank does not stifle economic activity in its pursuit of 'soundness'. The current objective set does not guide the Reserve Bank on how to manage these trade-offs.

19. 'Efficiency' also potentially captures many concepts that central banks typically have little or no ability to influence, and these concepts can even conflict with each other. For example, an efficiency objective could be taken to mean primarily promoting

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[1] The Reserve Bank has published a *Financial Stability Report* since 2004.

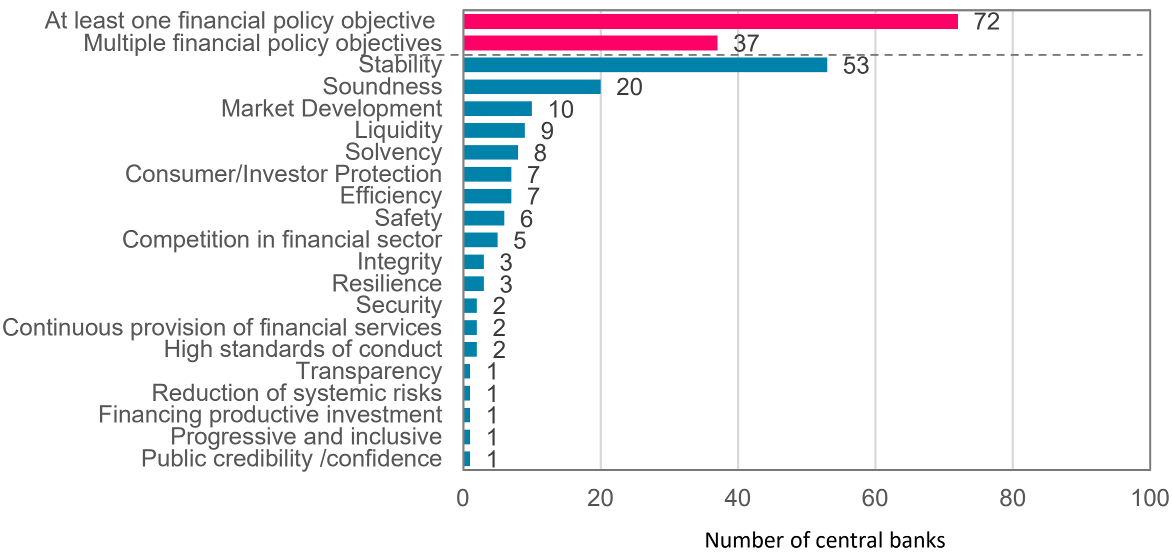
competition in financial markets, which is the responsibility of the Commerce Commission.

20. The Reserve Bank's existing objectives are not aligned with the OECD's best-practice guidelines, which note the importance of giving regulators clear guidance over how to interpret their objectives and to avoid multiple objectives that can conflict with one another. Giving the Reserve Bank only one, clearly defined high-level financial policy objective that provides a focus to its work would address some of these issues. The Reserve Bank will still have to make difficult trade-offs when formulating policy. However, guidance on how to manage these trade-offs can be embedded by other means, such as lower-tier objectives. A tiered objectives model would enhance role clarity.

21. A financial stability objective is also directly tied to the purpose of *prudential* regulation, which is to ensure that financial firms conduct their business 'prudently'. The GFC highlighted the enormous cost that a lack of effective prudential regulation can have on the real economy.

22. Financial stability is now the main goal of prudential regulators overseas, and is becoming the internationally accepted term. Based on a survey of 100 central banks, financial stability is by far the most common financial policy objective in legislation (Chart 1). Of the 72 central banks that have a financial policy objective, 52 have a financial stability objective. By contrast, 20 central banks have a soundness objective and only 7 have a system-wide efficiency objective (including New Zealand). Switching to a financial stability objective would be consistent with how international agencies such as the Financial Stability Board, International Monetary Fund and Bank for International Settlements commonly discuss the policy area.

Chart 1: Financial system policy objectives for 100 central banks



Sources: IMF Central Bank Legislative Database, BIS, National legislation

Notes: The chart shows the results of a survey of 100 central banks' primary legislation. Any such survey requires a degree of judgement as to what constitutes an 'objective'. The above definition captures objectives that apply to the financial system as a whole but excludes those objectives that apply to a narrow part of the system (such as payment systems only). This survey may miss some objectives that are specified in sectoral or secondary legislation.

Feedback from stakeholders

23. Two thirds of stakeholders were in favour of replacing 'soundness' with 'financial stability' on the grounds that it was a broader, more systemic objective, that provided a clearer mandate for the use of macro-prudential tools and was already the de facto way the Reserve Bank interprets its objective. There was near unanimous support for retaining some form of soundness/stability objective as a high-level financial policy objective of the Reserve Bank.

24. Around half of stakeholders supported retaining 'efficiency' as a high level objective, often as part of a general view that the status quo objectives were working well and did not need changing. However, an equal number supported making efficiency at most a secondary objective. Those arguing for making efficiency a secondary objective mainly saw it as best conceived narrowly: as a useful constraint on prudential policy that would avoid onerous regulation.

25. Most stakeholders preferred to have one objective (soundness or stability) or at most two high level objectives. Besides efficiency, there was some support for public confidence as a primary objective. Some respondents argued this would reinforce the need for: a strong communications function; close collaboration with the FMA and other regulators; and increased emphasis on improving public understanding of the financial system which is low in New Zealand.

26. A number of stakeholders suggested it would be useful to include further objectives in the Act for specific functions, for example, for macro-prudential policy or crisis management. There was also some support for additional secondary objectives to sit just below the high-level objectives. Besides efficiency and public confidence, potential secondary objectives included promoting financial sector competition (some support) and consumer protection (majority against). Finally, some stakeholders suggested that legislation should provide for objectives to be specified in more detail (and additional considerations added) via a government policy statement or 'remit'.

Panel and agency views

27. The Panel, Reserve Bank and Treasury all support the recommendation to make 'financial stability' the primary objective of the Reserve Bank. The Panel emphasises:

- The importance of couching the financial stability objective with reference to the broader purpose of the Act to promote the prosperity and well-being of New Zealanders, and

- That the Reserve Bank should be required to take into account the effects of policy settings on the efficiency of the financial system. The Review will consult on how to achieve this as part of the broader objective hierarchy in the second consultation document.

Other options considered and incorporated elsewhere

28. The first consultation document put forward a number of other options for the Reserve Bank's high-level objectives, including retaining soundness and efficiency, and whether to add one of more of competition, public confidence or protecting consumers.

29. Competition, consumer protection and public confidence rarely feature as financial policy objectives of central banks. The Review team considers that while some of these alternative objectives are important considerations, they should not feature in the highest level of the objective hierarchy. By contrast, 'financial stability' is a multi-dimensional objective that incorporates a number of intermediate goals (such as protecting the resilience of the financial system, maintaining public confidence in the

system, and minimising the amplitude of the financial cycle). ‘Financial stability’ is also the only objective in the set that is broad enough to span all of the Reserve Bank’s financial policy functions, including prudential, macro-prudential, and crisis management policy.

30. There are a number of elements of these alternative objectives that could be included in the full objective set below financial stability:

- **Financial Soundness:** this is a core part of the concept of financial stability, focusing on the resilience of the financial system. Soundness should be included in the definition of financial stability in primary legislation.

- **Efficiency:** while the current term is unclear and unusually high in the legislative hierarchy compared with other central banks, efficiency is nevertheless a critical consideration. The Review team recommends that the definition of efficiency be clarified, and that its inclusion in the lower levels of the objective hierarchy be considered in the second consultation document.

- **Competition:** competition is one aspect of efficiency, and its place in the objective hierarchy will be considered in the second consultation. However, based on its current powers, the Reserve Bank can only play a supporting role in promoting competition in the financial sector by setting prudential regulations in a way that facilitates, or does not unduly undermine competition. Responsibility for competition policy rests with the Ministry of Business, Innovation and Employment. The Commerce Commission is the primary competition regulator, but its actions are limited to mergers that would generate substantial pricing power, the regulation of natural monopolies, and anti-competitive behaviour.

- **Public confidence:** maintaining public confidence in the financial system is a necessary condition for financial stability. This should therefore be included in the definition of financial stability in primary legislation.

- **Protecting consumers:** the Reserve Bank should only play a limited role in this area to avoid blurring its role with that of the FMA. However, one element of this objective could feature in the resolution objectives for crisis management, which we will consult on in May. For example, it would not be uncommon to require a central bank to consider the interests of depositors when resolving a failing firm. This also links to ‘in-principle decision #6’, which recommends New Zealand should introduce a form of depositor protection, and aligns with the current purpose of the Act to promote the prosperity and well-being of New Zealanders.

Governance arrangements

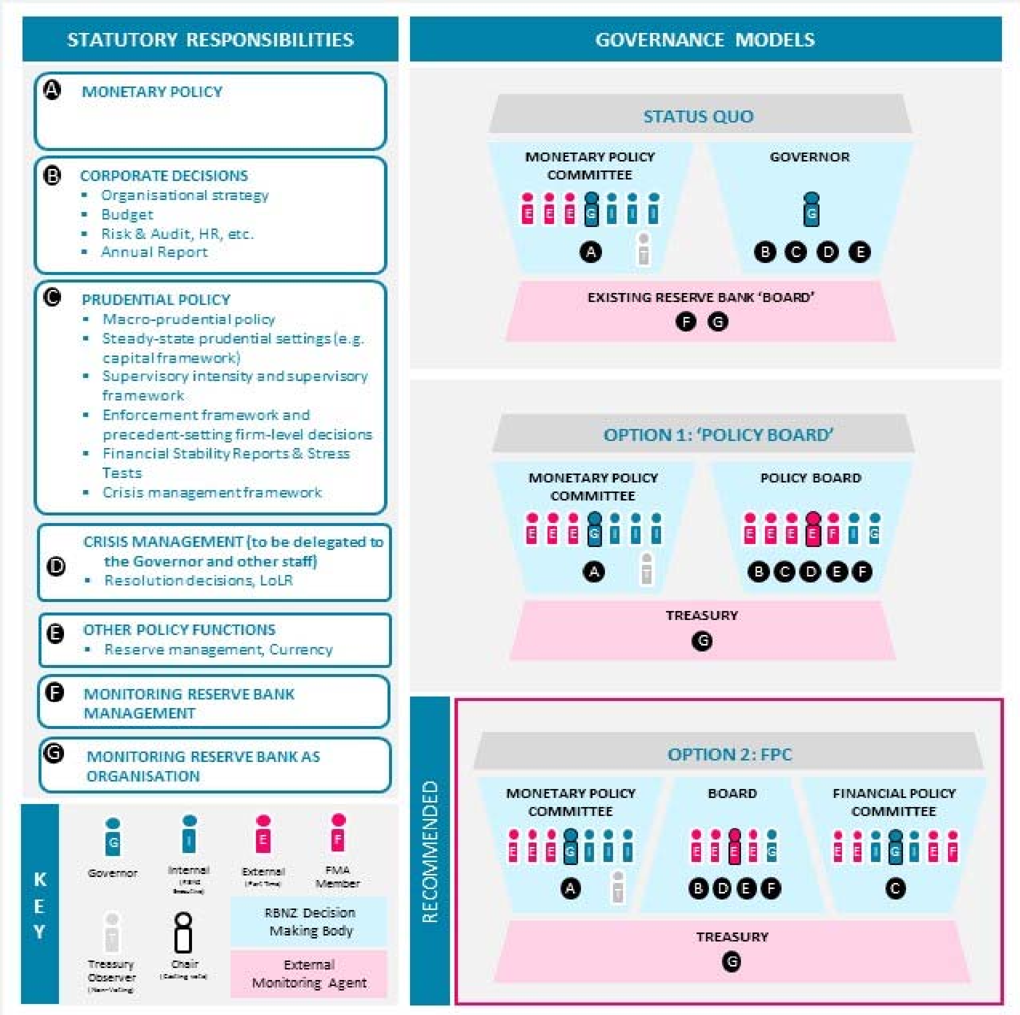
Context and Problem Definition

31. The Reserve Bank's governance arrangements for financial policy were established in the Act in 1989. Other than the changes associated with the recent establishment of the Monetary Policy Committee (MPC), these arrangements have remained largely unchanged. Their design largely reflected the Reserve Bank's then primary function of monetary policy, alongside a relatively narrow prudential role. Since 1989 the Reserve Bank's role in the financial system has expanded substantially, and the financial system itself has evolved.

32. The primary reason for reviewing the governance arrangements is to ensure that the governance framework empowers the Reserve Bank to carry out its responsibilities for financial policy in the most effective and efficient way. In addition, many stakeholders have engaged on governance for financial policy suggesting that this area is a priority for review. Arguments for change often centre around the perception that the role of the Governor is too big/powerful and that group decision-making is more appropriate. Concerns were also raised around overall Reserve Bank effectiveness in financial policy and supervision, the role of the current board and a lack of accountability. The review of the governance arrangements should help to ensure legitimacy and durability by dealing with these perceived shortcomings.

Governance models considered

33. The November consultation document considered whether the Reserve Bank's governance arrangements for financial policy should move from a single decision-maker model (the status quo) to a more typical board structure, with or without a statutory Financial Policy Committee (FPC). These models are set out in the diagram below:



34. Both governance options considered envisage extensive delegation from the board or FPC to the Governor as is standard practice in any effective governance model. Delegations are not envisaged as statutory delegations as the latter would undermine the accountability of the FPC or Board (the governing body) and the accountability of the executive to the governing body. While the Governor's key day-to-day powers would be derived by delegation from the board or FPC, in practice the Governor would remain at the centre of the institution. The Governor would be the key public face of the Reserve Bank, a highly influential member of the FPC and board, and appointed by the minister.

Statutory responsibilities

35. Both governance options recommend the establishment of a board with responsibility for corporate and operational decisions. The key question is whether the board should also take responsibility for prudential policy. Under option 1 (Policy Board), the Board has responsibility for all prudential policy. However, a board tasked with prudential policy, in addition to its other responsibilities, may struggle with the breadth of functions and decisions. Option 2 (FPC) seeks to address these issues by establishing an FPC comprising of financial policy experts focused on prudential policy decisions.

36. The establishment of an FPC would in some ways appear consistent with policy decisions taken in phase 1 to establish an MPC, and would serve as a mechanism for ensuring group decision-making and for bringing external perspectives to the decision process. The new FPC would include a significant number of external financial policy experts, to provide a cross-check on the Reserve Bank's internal decision-makers. An

FPC might also be able to bring in external members with more specialist expertise than might be possible for a board with wider responsibilities.

37. At the same time, the establishment of an MPC does not of itself establish the case for an FPC, because the nature of the decisions required for financial policy are different from those required for monetary policy and the optimal decision-making structures might not necessarily be the same for both. Most notably, prudential policy involves a more complex array of tools, supervisory and enforcement decisions and a less easily quantifiable objective. Due to prudential monitoring and supervision of financial institutions, prudential policy decisions are required more frequently than monetary policy decisions. As a result, it may be more difficult to delineate the separate responsibilities and coordinate meetings than is the case for monetary policy.

38. Further analysis of the governance options for financial policy is provided in the sections analysing **In-principle decisions #2 and #3**.

In-principle decision #2 - Should the Reserve Bank have a governance board?

Recommendation

39. The Review team recommends an in-principle decision to establish a new board, which is given statutory authority over all Reserve Bank decisions (except those reserved for statutory policy committees like the MPC).

40. The Panel, the Reserve Bank and the Treasury all support this option.

Rationale for recommendation

41. The rationale for the Reserve Bank's single decision-maker model is less compelling today than it was in 1989 in light of the Reserve Bank's current responsibilities. In 1989 the Reserve Bank's organisational structure was designed with one primary function in mind – monetary policy. To overcome the time inconsistency of monetary policy decisions at the political level, a single individual – the Governor – was made publicly responsible and accountable for getting inflation under control. An explicit inflation target made it clear whether the Governor was meeting his brief or not, and the governance model proved effective in taming inflation in the early 1990s.

42. However, over time, the focus of the Reserve Bank's work has broadened. The Reserve Bank's financial policy role is now larger than envisaged in 1989. Financial policy is an area where it is much harder to write down an explicit target to hold a single decision-maker to account. Decisions are multi-faceted, and can have pervasive distributional effects on society. Financial policy decisions are more complex and uncertain than monetary policy decisions, and the decision-making framework is still evolving. In addition, in both the public and private sector, it is the norm for organisations to be overseen by groups not individuals.

43. Given these complexities and the breadth of the financial policy and other roles, there is a clear rationale that the Reserve Bank's decisions should be made by a group and not a single individual. The Reserve Bank itself recognises these issues and has long-relied on a number of non-statutory committees to advise on policy decisions although the Governor retains statutory responsibility.

44. A board would provide an effective governance framework that is well understood. A typical board provides for robust accountability with a clear split between governance and management functions. There is strong support from stakeholders for a new governance board to be established. The establishment of the recommended board would shift the function of the current board from a monitoring agent to a more conventional governing board. At a minimum, this board would have responsibility for overseeing the Reserve Bank's management and for various corporate and operational decisions (such as determining organisational strategy, and overseeing HR policy, budget, risk and audit, management of reserves, overseeing the performance of management). The board would delegate extensively to the Governor and Reserve Bank staff but maintain oversight and statutory responsibility for all decisions. The board could also have responsibility for prudential policy (see *In-principle decision #3*).

45. Some advantages of the board model over the single decision-maker model are:

- **Group decision-making**: a board embeds group decision-making at the highest level of the Reserve Bank, which is consistent with the direction of reforms from Phase 1. Group decision-making offers a number of advantages over single decision-makers including:

- A diversity of perspectives and experience from inside and outside the organisation, which is likely to enhance credibility in the decision-making process.
- If every group member exerts effort to become informed, groups can gather more information than individual decision-makers. Better information can lead to better decisions.
- Even if all group members have identical information, they need not reach the same (individual) conclusion. This is because group members typically have different skills, backgrounds and preferences, and different abilities to process data and extract useful information.
- A group is more likely to identify errors in information and analysis. Groups can also provide 'insurance' against extreme preferences by individuals.

- **Robust accountability:** establishing the board would have another key benefit over the status quo – it would provide a clearer line of accountability between governance and management. A conventional board has responsibility for all an organisation's functions and will delegate extensively to management while maintaining oversight over the actions of management and holding them to account. This accountability is not a feature of the current governance model because the Governor is also the CEO responsible for both governance and management and the existing Reserve Bank board's statutory powers are as a monitoring agent only.

- **Simplicity and credibility:** a board structure is seen as providing an effective governance model and is well regarded. A board model is used across a wide range of private and public sector organisations and provides a clear allocation of roles. A board relies extensively on delegations to management for the efficient running of the organisation.

46. A switch to a governance board would not come without costs and potential risks. The speed and efficiency of a single decision-making model is hard to match, although well planned internal management policies and delegations can provide for an efficient board structure and provide for rapid decision-making and execution when it is required. Risks commonly identified with group decision-making structures, such as group think and social loafing, could undermine the potential benefits of a board. However, the prevalence of boards in the public and private sector, both in New Zealand and overseas, suggests these potential costs and risks are manageable.

Feedback from stakeholders

47. In addition to receiving feedback on governance via formal submissions, the Review team conducted a series of interviews with individuals from the public and private sector in New Zealand, as well as a few individuals from Australia, Canada and the UK who have particular governance or financial policy expertise.

48. There was a clear consensus that the Reserve Bank's legislative governance model should be modernised to embed group decision-making.

49. A number of stakeholders questioned the effectiveness of the existing Reserve Bank board. Although the board is supposed to be the Minister's monitoring agent, stakeholders considered that in practice the board has become more like a de facto corporate board – advising the Governor on matters such as budget, strategy, risk and audit. Despite taking on this more conventional governance role, the board has few

statutory powers in that area. Without decision-making rights, the board's ability to challenge and influence the Governor are limited.

50. There was a broad consensus that a new governance board should be created to oversee the Reserve Bank. Most stakeholders thought such a board would be particularly effective in determining the Reserve Bank's strategy, risk appetite, budget, and overseeing management's decisions. Some stakeholders noted that this change was not risk free, particularly if board members were appointed on political grounds and switched to an advocacy role, if they lacked sufficient expertise to make decisions, or if they failed to delegate to the CEO effectively.

51. We encountered a range of views on the composition of the board and what its responsibilities should be:

- Many stakeholders thought that the calibre of the directors is critical to success and supported having externals on the basis that externals bring a diversity of views, independent challenge and accountability to the structure. Several stakeholders noted the importance of an effective board chairperson to encourage productive debate and the importance of hiring high-quality board members with CEO experience to hold the Governor to account.

- There was broad agreement that a board would be well-placed to oversee corporate and organisational decisions. But views were divided as to whether a board would be the most appropriate body for making financial policy decisions.

Options not recommended

Continuation of the single decision-maker model

52. The Review team has considered whether the current arrangements be retained (whereby the Governor retains statutory responsibility for all corporate and policy decisions outside of monetary policy). The Review team does not support this option given the limitations posed by a single decision-maker model and the advantages of group decision-making embedded in a board structure highlighted above. The single decision-maker model comes well short of dealing with concerns expressed by stakeholders that the current prudential regime gives too much discretion to Reserve Bank staff and lacks external challenge and expertise. The existing board is unable to act as an effective check on the Governor because it does not have responsibility for the Governor's decisions. Criticisms about the current board's lack of effectiveness and visibility would continue under the status quo.

In-principle decision #3 - Should the Reserve Bank have a separate Financial Policy Committee?

Recommendation

53. Agree in-principle to either:

- establish a new statutory financial policy committee which is given statutory authority for taking all prudential policy decisions (Review team preferred).

  OR

- not establish a new financial policy committee with the newly established board of directors retaining responsibility for prudential policy decisions.

54. The Review team and a minority of the Panel support the establishment of an FPC. The Reserve Bank and a majority of the Panel do not support the establishment of an FPC. The Treasury see merit in both options depending on the key objectives of the reform. Further analysis of the Panel and agency views is included below.

Rationale for recommendation

55. The creation of a statutory FPC to sit alongside the new MPC takes a symmetric approach to governing the Reserve Bank's core policy areas. As with the MPC, decision-making rights for prudential policy decisions would rest with a group that includes a mixture of Reserve Bank officials and external policy experts. The FPC would be responsible for all prudential policy decisions, including setting the prudential regulatory framework (capital and liquidity settings), taking macro-prudential policy decisions, and overseeing the supervision and enforcement regime. The FPC and MPC would be complemented by the proposed new board that would oversee the Reserve Bank's management, ensure that the decisions of both policy committees are implemented, take corporate decisions, and oversee some residual policy areas (such as balance sheet management or currency) that are not allocated to either statutory committee. This model is akin to a simplified version of the Bank of England model, where the responsibilities of the UK's two financial committees (the Prudential Regulation Committee and the Financial Policy Committee) have been combined into one. This model was generally favoured by stakeholders with central banking experience.

56. The FPC has many of the benefits of a board including embedding group decision-making and external challenge into decision-making. An FPC has the following key benefits over a board only model:

  - **Expertise and specialisation on financial policy matters:** a statutory committee with a financial policy mandate only would attract specialists in the areas of financial policy. Financial policy decisions are complex and quality decisions require specialist expertise and financial sector experience. In a board only model, a broad range of expertise will be required to make decisions across a range of functions with less focus on prudential expertise.

  - **Prominence and focus given to financial policy:** stakeholders have criticised the Reserve Bank for a lack of focus on financial policy and internationally there is a perception that prudential policy is the 'poor cousin' to monetary policy. Having a separate statutory FPC, with financial policy experts, provides a prominence and focus to the Reserve Bank's financial policy functions.

- **Better suited to external members:** a role targeted at financial policy is likely to be more attractive to part-time external members and allow them to focus on financial policy responsibilities. A board only model would require external members to take responsibility for corporate, organisational and other policy decisions which could be a drain on their time and resources.

- **Better protects operational independence:** appointments to the FPC would be made on recommendation of the board, better insulating the FPC from politically motivated appointments.

- **Consistency with phase 1 decisions:** an FPC would adopt the same governance structure for financial policy creating a consistent approach across the Reserve Bank's two main policy functions. However, as noted above, there are some important differences between monetary and prudential policy and the optimal decision-making structures might not necessarily be the same for both.

57. The introduction of an FPC would have some disadvantages when compared to a board only model. Some of the key disadvantages include:

- **Complexity of set-up:** an FPC would introduce additional complexity and cost. The MPC model is supported by a number of administrative requirements including: appointments; provisions around the relationship with the Minister the board, the MPC and the governor; requirements around duties and conduct and other procedures. The MPC arrangements are unique when compared to Crown entities and other corporate models. While monetary policy committees are relatively common, statutory financial policy committees are rare - with the Bank of England being a notable exception. Replicating this structure for an FPC, with the necessary adaptations, would compound the cost.

- **Complexity of operation:** prudential policy involves a more complex array of tools, supervisory and enforcement decisions and a less easily quantifiable objective. Decisions relate to several industries (insurance, banking, settlement systems), which are distinct and complex in their own right. Due to prudential monitoring and supervision of financial institutions, prudential policy decisions are required more frequently than monetary policy decisions. As a result, it may be more difficult to delineate the separate responsibilities and manage administrative requirements such as coordinating meetings than is the case for monetary policy.

- **Lack of role clarity:** role allocation could be difficult to specify with an FPC. Role clarity is critical to accountability and performance but splitting roles and responsibilities between an FPC, board and governor could be difficult.

- **Difficulty in securing suitable appointments:** there may also be difficulties in recruiting suitably qualified and non-conflicted members to both the FPC and board given New Zealand's small labour market and the expectation that the external members will be financial policy experts. The board may not be an attractive proposition if it has no policy responsibilities and limited influence over the policy committees.

58. The Review team considers that the advantages of an FPC focused on the financial policy decisions of the Reserve Bank would outweigh the complexity and cost associated with the model. Some of the complexity will be transitional as the framework is established and individuals adapt to it. Cross membership will enable efficient coordination and information sharing and conflicts can often be dealt with.

Decisions on financial policy are multi-faceted, involve complex analysis and the decision-making framework is still evolving. The GFC showed that the implications of an insufficient focus on financial policy are serious and pervasive. In these circumstances, the Review team considers the FPC would provide the optimal governance model to take decisions on financial policy.

A Policy Board as an alternative option (Option 1)

59. Under this model, no FPC is established and the board would have statutory responsibility for all Reserve Bank organisational and policy decisions (other than those reserved for the MPC). Option 1 is preferred by the Reserve Bank and a majority of the Panel.

60. A Policy Board represents a simpler and conventional governance structure based on the model used widely in the public and private sector. Some of the key advantages of a Policy Board include:

- **Coherency and credibility:** a board structure provides an efficient, robust and well regarded governance structure. All Crown Entities use a single board structure and a board structure is common across the private and public sectors internationally.

- **Simplicity**: the concerns around role clarity in the FPC structure would not feature with a Policy Board. The board would simply have responsibility for all the Reserve Bank's functions outside of monetary policy and delegate to management. A more conventional model may be more appropriate for New Zealand reflecting the size of New Zealand's financial system.

- **Flexibility:** the use of delegations, divisions and internal committees could provide focus and expertise necessary to provide for quality prudential policy decisions and efficient functioning. The board would be free to create a non-statutory advisory FPC with external appointees if it saw fit.

61. Concerns around a Policy Board centre around the breadth of its responsibility and include:

- **Broadness of mandate and lack of focus:** a Policy Board on its own may struggle with the range of functions and decisions. A broad range of expertise will be required at the board level to make decisions for all the Reserve Bank's functions and this may result in less focus on prudential policy expertise.

- **Quality of decisions:** there will need to be a spread of experience at the board level with less expertise on prudential policy. Decision-making power on financial policy would be vested in some board members who are less well-qualified to take prudential decisions or contribute to robust debate.

- **External (non-executive) members could struggle:** non-executive members are generally part time. The breadth of responsibilities may not fit with a part time role even with effective delegations and internal policies. Non-executive members may struggle to get up to speed to make informed decisions on all the Reserve Bank's functions that they are responsible for. If a non-executive member has responsibility for organisational decisions and is required to spend more time in their directorship role, there is a higher risk they will become more internalised and part of the corporate culture and less likely to dissent.

62. While a Policy Board would be a viable option and a significant advance over the status quo, the Review team considers the FPC offers an optimal decision-making model for

prudential policy decisions. With no FPC, the responsibilities of the Board would be broad including all prudential policy, corporate matters, operational functions and other policy areas. Prudential policy is complex and a wide range of responsibilities risks overburdening the board. The FPC model avoids some of the risks associated with a Policy Board, by avoiding over-burdening board members, and enabling external expertise to be brought in on financial matters. The inclusion of an FPC facilitates specialisation – with board members being recruited for their corporate governance expertise and FPC members for their financial policy expertise.

Feedback from stakeholders

63. Stakeholders had mixed views on whether to establish a statutory FPC. In the governance interviews conducted, those with policymaking experience tended to favour establishing an FPC, while those with more of a corporate background were sceptical as to whether a statutory committee should take on such a role. In the written submissions received, a majority favoured a Policy Board over an FPC.

64. Those that were more sceptical of an FPC tended to favour the Policy Board model as it was seen to provide more flexibility to operate in divisions and to establish expert committees as needed. Some stakeholders also argued that it would be difficult to draw the dividing line between the board's responsibilities and those of the FPC, which could create a complex legislative and organisational structure. Interactions between the board and FPC would need to be carefully delineated. In addition, some stakeholders worried there would not be a sufficiently large pool of financial policy experts in New Zealand from which to draw FPC members who were free from conflicts of interest.

65. Stakeholders favouring an FPC noted that the main reason to establish a statutory committee was to provide for specialisation, focus and give decision-making rights to externals as an accountability check on the Reserve Bank's prudential decision-making. To make this check credible, some stakeholders argued there should be a majority of externals on the FPC. Some stakeholders also noted that an FPC would establish a clear body, with a public profile that the financial industry and wider public would know is accountable for financial policy decisions – something that may be lacking at present. The same stakeholders argued that it might be inconsistent to stop at the point of establishing an MPC only, given that many of the arguments for establishing statutory committees (embedding group-decision-making and external accountability) also apply to financial policy. Some stakeholders noted that there would be greater risk of political interference with a board only model due to direct appointments by the Minister of Finance.

66. Stakeholders in favour of an FPC also noted that by separating the financial policy role from the board's corporate responsibilities, it would avoid over-burdening board members, avoid them becoming full-time, and would allow individuals to be recruited to each body based on their expertise. This would bring in specialist advice at the appropriate point and guard against the risk that policy decisions fall to a board with little policy experience.

67. Many stakeholders thought that the calibre of the members is critical to success and supported having externals on the basis that externals bring a diversity of views, independent challenge and accountability to the structure. A number of stakeholders noted the importance of delegations, particularly with decisions involving firms. These stakeholders thought delegations for monitoring, supervision and enforcement should flow from the body responsible for setting the prudential framework. The board or committee should have good oversight and familiarity of supervisory matters and the institutions they are regulating.

68. Stakeholders generally agreed it was not necessary, particularly in a small concentrated financial system like New Zealand, to have separate statutory micro-prudential and macro-prudential committees.

Panel and agency views

69. A majority of the Panel do not support the establishment of an FPC primarily on the basis that it would detract from the role of the board and introduce additional complexity. These members think that a well-designed board structure with high quality appointments would provide a robust governance structure for prudential policy.

70. A minority of the Panel supports the introduction of an FPC primarily on the basis of the prominence and focus that an FPC would bring to prudential policy decisions. These members think prudential policy decisions would benefit from an FPC on the basis of the expertise, focus and external involvement inherent in the FPC model. These members think there would be benefit providing further details of the board and FPC's mandate and carrying out further consultation.

71. The Reserve Bank do not support the establishment of an FPC on the same basis as the majority of the Panel.

72. The Treasury sees merit in both options. If the key issue is to enhance overall governance of the Reserve Bank, the board model without an FPC would be optimal. However, if the intention is to focus on prudential regulation, then a separate FPC would have merit.

Other features of the Board and FPC to be consulted on in May

73. Once decisions have been taken on the structural features of the Reserve Bank's governance model, decisions will also be needed on several important design features and other aspects. In particular, there are options around where responsibility for crisis-management functions is best placed. The FPC may have better qualified decision makers but there could be a conflict if crisis-management decisions are made by the same group making decisions on the prudential regulatory framework. Also of importance is the composition and expertise required of Board and FPC members, which will contribute to the overall effectiveness of the governance structure. Other features include appointments, size, decision-making process, and approach to communications and transparency. The Review team intends to consult on these design features in May. Many of these features are similar to those consulted on for the MPC in phase 1.

In-principle decisions #4 and #5 - Who should monitor the Reserve Bank's performance, [2]

Context and Problem Definition

Monitoring

74. The Reserve Bank board currently serves as the Minister's monitor. The Reserve Bank board has a statutory duty to keep the performance of both the Reserve Bank and the Governor under "constant review."

75. In the view of the Review Team, this arrangement has placed an unrealistic expectation on the Reserve Bank board.

    - The Reserve Bank board is poorly placed to monitor and assess the operational performance of the Reserve Bank. Beyond its role in appointments the Reserve Bank board has no formal decision rights. The Reserve Bank board therefore only provides a weak form of accountability in relation to the performance of management.

    - At a more strategic level, there are challenges for the Reserve Bank board in operating as a 'friendly critic' of the Reserve Bank. Several stakeholders have suggested that this shortcoming reflects a lack of independent resourcing and specific financial policy expertise, as well as the practical challenge the Reserve Bank board faces in balancing its duties to the Minister and its relationship with the Reserve Bank itself.

[2]

[2]

[2]

Recommendation

Monitoring

85. The Review team recommends an in-principle decision be taken to align the monitoring framework for the Reserve Bank with a Crown Entities style model. The Treasury would be designated as the Reserve Bank's 'monitor'.

86. As the monitor, the Treasury would be responsible for assisting the Minister in relation to the three main monitoring functions:

    - appointing and maintaining both an effective board, and statutory committees
    - setting direction and performance expectations for the Reserve Bank, and
    - monitoring performance.

[2]

Rationale for recommendation

Monitoring

89. The Review team considers that the shortcomings identified in operational monitoring are best addressed through the creation of a more empowered governance board (see in-principle decision #2). Alongside a shift to a governance board, the Review team recommends aligning monitoring arrangements for the Reserve Bank with the Crown Entities framework. Under this framework, the strategic monitoring function would sit with the Minister's policy department (in this case Treasury). The strategic monitoring role cannot sit internally, given an enhanced governance board will play a lead role in setting the Reserve Bank's strategy.

90. In the view of the Review team, shifting to a Crown Entity style monitoring framework will create a clearer delineation of roles than is currently the case. It would also help to address one of the structural shortcomings of the status quo: in contrast to the Treasury, the Reserve Bank board has a more limited ongoing relationship with the Minister, and is therefore more constrained in its ability to engage on monitoring issues.

[2]

[2]

Panel and agency views

Monitoring

94. The Panel, the Treasury and the Reserve Bank support shifting to a Crown Entity style monitor. Treasury would act as the monitor.

[2]

Feedback from stakeholders

Monitoring

100. Stakeholders tended to agree that the establishment of a new governance board would provide more of an internal crosscheck on the Reserve Bank's executive, meaning there was less of a need for an independent external monitoring agent. Stakeholders therefore suggested that the Treasury should monitor the Reserve Bank. No stakeholders advocated for a new 'regulator of the regulators' to be created, but several thought the Treasury should be given additional monitoring powers to fulfil its new role.

[2]

[2]

Options not recommended

Monitoring

102. The Review team considered alternative options for the Reserve Bank's monitor, including assigning the function to MBIE rather than the Treasury. The Review team dismissed this option on the grounds that assigning the monitoring role to MBIE would involve changes to ministerial portfolio responsibilities.

103. The establishment of a central external monitoring agent as some stakeholders have suggested is a possibility but the Review team considers this option to go well beyond the terms of reference for the review. Such an option would also involve significant cost.

[2]

[2]

In-principle decision #6 - Should there be depositor protection in New Zealand?

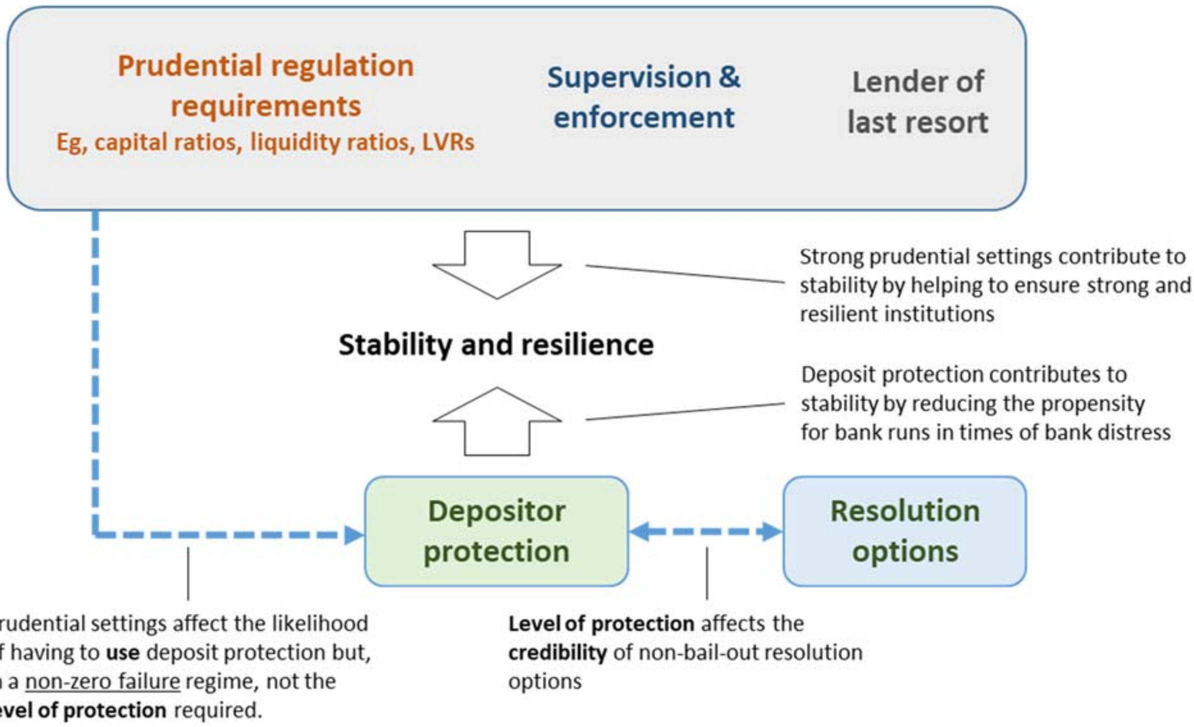
Context and Problem Definition

111. Like all countries around the world, New Zealand aims to operate a non-zero-failure banking regime: banks may fail, and may be allowed to fail. There is an international consensus that an effective regime to manage bank failures should:
    - ensure that non-viable firms can exit the market in an orderly way (i.e., maintaining continuity of vital banking services; avoiding disruption spreading to the system)
    - allocate losses to the failing firm's owners and uninsured and unsecured creditors in a manner that respects the hierarchy of creditor claims in liquidation
    - provide speed, transparency and predictability through legal and procedural clarity
    - not expose taxpayers to loss, not rely on taxpayer support, and not create an expectation that such support will be available

112. There are a number of tools accepted as fundamental to an effective failure management regime, and a number of settings for each tool essential to making the overall failure management regime credible. Depositor protection is one of those fundamental tools, and the scope of protections offered are key to its credibility.

113. Failure management tools do not exist in isolation. They are part of a wider regulatory framework, known as the 'financial safety net', comprising five functions that work together to help to support a strong, stable and resilient financial system. Figure 1 illustrates the wider financial safety net within which depositor protection sits.

Figure 1: Depositor protection within the wider financial safety net



114. Figure 1 shows the five elements of the financial safety net. Business as Usual (BAU) prudential regulation and supervision functions are supported by the central bank's lender of last resort role, plus the two failure management functions (depositor protection and special bank resolution).

115. Each financial safety net function is mutually supportive. The GFC showed an absence of any one of the five functions cannot be compensated by the others, as they all serve different roles. Prudential settings, which have been strengthened around the world since the GFC, seek to make it less likely that failure management functions will be called on (and here the Review team note the Reserve Bank's capital proposals that seek to reduce the likelihood of a systemic crisis to one in 200 years[2]). However, prudential regulations do not remove *all* banking sector risks. Stress and failure will still happen no matter how strong are the preventions at the 'top of the cliff'. When it does, a robust framework of resolution options and depositor protections should be there at the bottom of the cliff. Recognising this, failure management regimes around the world have also been made considerably stronger since the GFC.

116. New Zealand's regulatory framework, however, lacks one of the five safety net functions: it does not look to protect depositors from loss. This, in turn, could undermining the credibility of resolution options that do not rely on public funds. Certainly, feedback to the consultation has shown a high level of scepticism around the Reserve Bank's 'Open Bank Resolution' (OBR) policy and the way it treats depositors[3].

117. Since the end of the ad hoc Crown Deposit Guarantee Scheme (CDGS) in 2010, the prevailing thinking amongst policy makers has been that depositor protection in New Zealand is neither required nor desirable. All depositors have been expected to 'discipline' banks' risk taking (supported by regulatory and self-discipline), and it has been thought that shielding depositors from the risk of loss could blunt that discipline.

118. The Review team finds limited evidence that depositors play a material role in disciplining bank risk taking for any but the most financially sophisticated and large-scale depositors. As such, we find that exposing depositors to loss in order to encourage depositor discipline is no longer a credible proposition, and that the conditions for an effective failure management regime outlined in paragraph 110 are not met by New Zealand's current approach to the treatment of depositors. Box 1 sets out the key findings to support that conclusion.

119. The Review team also note that depositor protection schemes exist in all other advanced countries because of the recognised impediments to depositor discipline and the adverse consequences that can come with relying on it. Reflecting this, various international organisations have repeatedly recommended New Zealand adopt depositor protection (most recently the IMF in its 2016/17 FSAP).

[2] Individual firm failures would be expected more frequently.

[3] Advice on crisis management options are being prepared as part of the second round of consultation.

Box 1: The Review team's key findings on depositor discipline and protection

- Market discipline depends on the ability of market participants to identify, assess, and manage risks at the banks they invest in. Given banks' complex operating models and balance sheets, it is widely recognised that depositors are generally not in a position to do this (and indeed, the GFC demonstrated that even the world's best-resourced bank supervisors can sometimes struggle to truly understand bank risks.) If prudential supervision functions properly, depositors will struggle during BAU to distinguish meaningfully one bank's risk profile from another.

- Deposit accounts are not normally pure investments. Rather, deposits are a transactional utility essential for participating in a modern economy, and New Zealanders have little choice but to use banks (or 'non-bank deposit takers') to receive, store, and transfer their money.

- Although many depositors are poor at exerting discipline in BAU, evidence shows depositors are prone to losing confidence rapidly and at once – for example, following news of a significant bank distress event. Market discipline that depositors exert *en masse* is called a 'bank run', and can quickly turn a liquid bank into an illiquid one and lead to wider financial system contagion. International standard-setting bodies have noted that 'experience over the last twenty years—and especially during the global financial crises—suggests that … most depositors, if not adequately protected, will indiscriminately run from both sound and weak banks.'[4] It is not clear New Zealand's current arrangements do enough to mitigate the risk of bank runs.[5] Disorderly bank runs destroy economic value, and a bank failure that might see individual depositors lose some of their money can cause damage that goes far wider and deeper for the financial sector and the real economy.

- Without depositor protection, stress at any deposit taker - no matter how small - will always force governments into a hard decision of whether to impose losses on depositors, or expose taxpayers to loss in order to avoid it. The revealed preference of past governments in New Zealand and abroad is to protect bank depositors from losing their savings, and in the absence of adequate deposit protections ad hoc guarantees have been put in place at short notice (or institutions have been bailed out) to shore up the banking system and avoid losses for depositors. Unsurprisingly then, expectations in New Zealand - not only of an 'implicit guarantee' of bank deposits, but an implicit guarantee of 100% of bank deposits - are widespread.[6] This undermines market discipline, and gives rise to moral hazards far greater than under a formal depositor protection scheme with a limited coverage level.

- Deposit insurance could replace a large and uncertain implicit exposure on the Crown balance sheet with a capped explicit one that can be better managed and priced.

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[4] IADI, *Enhanced guidance for effective deposit insurance systems: deposit insurance coverage,* March 2013.

[5] The OECD noted in its 2013 economic survey that existing arrangements in New Zealand 'may not be enough to prevent bank runs in all circumstances as, once OBR is applied to one bank, depositors may fear contagion to the others'.

[6] In a survey of 1000 New Zealanders commissioned by the Review Team, more people believed bank deposits were already insured or guaranteed than those who didn't think they were already insured or guaranteed. The implicit guarantee issue was also referred to in several written submissions. As one submitter (a former Reserve Bank special advisor on financial stability) noted, 'if you have no deposit protection, you really have 100% deposit protection.' The OECD similarly noted in its 2013 economic survey of New Zealand that some moral hazard exists already: the fact that deposit insurance was adopted under urgency in 2008 … may lead to the expectation that a similar policy would be implemented in a future crisis.'

Recommendations

120. The Review team recommends that you agree in principle to the development of an explicit and permanent depositor protection regime in New Zealand. In line with modern international best practice, a deposit protection regime should form a part of a crisis management framework for dealing with distressed or failing deposit takers. As a part of an effective financial safety net, the depositor protection regime should advance the objectives of:

    - contributing to depositor confidence and financial stability by mitigating run risk and contagion
    - protecting depositors from loss in the event of a bank failure.

    In advancing these objectives and clarifying where losses will fall in a failure event, deposit insurance could support the feasibility of a range of orderly resolution options - especially options that do not rely on taxpayer support - and remove the expectation that such support will be made available through 'ad hoc' guarantees going forward.

121. The Review team recommends that depositors be protected through an insurance scheme that guarantees to promptly repay depositors in failed deposit-taking institutions up to a pre-announced limit, possibly supported by a preference for depositors and the scheme that insures them. The scheme would be mandatory for all deposit-taking institutions and pre-funded from levies on those institutions. In this way, depositor protection would clarify the treatment of depositors in failure event, allowing existing risks to be made more transparent and better managed.

122. We are not seeking further decisions on the specific design features of a protection regime at this stage. However, the design would have to be consistent with the objectives on which we are seeking your agreement now. Your in-principle decisions will thus be important in shaping the regime's ultimate design.

123. To advance the objectives that the Review team recommend, most (c95%) individual depositors would need to be fully protected from the risk of loss in order to mitigate incentives to join bank runs, whilst a meaningful amount of deposit balances (c50%) would need to remain at risk to encourage incentives to discipline banks. Based on preliminary analysis, this implies an insured limit of around $100,000.

124. The Review team believe this level of coverage would be politically robust, reducing the risk of governments - when faced with a failing deposit taker - feeling pressured into using taxpayer funds to bail-out the institution or its depositors.

125. The Review team understands that the Reserve Bank favours a narrower, 'avoiding hardship' objective which they argue would imply a lower coverage limit – e.g., $10,000 – on the grounds that a financial stability objective would be unachievable without almost full coverage of deposit balances.

126. The Review team recommend that a separate work programme be set-up to develop the details of the insurance scheme. This would work alongside the Review team, and draw on international best practice guidance, and outreach and development programmes that international bodies have available. The work programme would be guided by a Terms of Reference that would be included in the next consultation document. The Terms of Reference would set out in more detail a framework for the design principles for the scheme, including:

    - mandates and powers
    - governance and decision-making structure

- coordination arrangements with existing safety net providers
- membership and coverage arrangements
- funding and payout mechanics, and
- design features to mitigate moral hazard.

127. The Review team's discussions with the international standards-setting and coordinating body for deposit insurers, IADI[7], indicate the path from policy recommendation to regime implementation would take a minimum of two years and require a team of three dedicated staff. There is also an option of outsourcing technical tasks to consultancy firms whom have offered to assist.

Options considered:

Status quo

128. There are no formal or permanent protections for depositors at failed New Zealand banks. An option to protect depositors from loss is embedded in the Reserve Bank's OBR policy through its '*de minimis*' limit, which envisages a carve out for some unspecified (but low, i.e. around $500-$1,000) value of prepositioned deposits from the OBR's general freeze of creditor claims. This carve out would be achieved through statutory powers to interfere with the established hierarchy of creditor claims, shifting losses from 'de minimis' deposits onto other general claims. Whether or how the OBR policy would be applied is determined in the event, on a case-by-case basis.

129. *Review team's assessment:* The Review team does not recommend the status quo, as it does not protect depositors in a transparent, predictable, or consistent way. It also exposes creditors and taxpayers to risks that are uncertain and difficult to plan for ahead of time by potentially interfering with the hierarchy of creditor claims, and assuming a Crown guarantee of 'de minimis' (and all other unfrozen) creditor claims in OBR. Depositors at failed banks that do not meet statutory thresholds for entry into OBR, or are not pre-positioned for it, could face disruption and hardship during a lengthy insolvency process, giving rise to the risk that decision makers will prefer to 'bail-out' a bank or guarantee its depositors rather than exposing them to loss. This was the Government's choice during the GFC when the $1m per depositor Crown Deposit Guarantee Scheme was implemented.

Enhancing the OBR de minimis

130. By legislating the *de minimis* limit to an amount around $10,000, many depositors at OBR-prepositioned banks would be protected from loss and would have continued access to their 'unfrozen' funds.

131. *Review team's assessment:* The Review team advises against repurposing resolution tools like OBR that *assign* losses in a failure event to be depositor protection tools that *compensate* for losses in a failure event. Conflating or merging these different tools risks creating confusion, as demonstrated by various sophisticated stakeholders to the consultation (banks, academics, investors) who have suggested that OBR is 'incompatible' with depositor protection. While the Review team recognise that OBR *is* compatible with a depositor protection policy (and arguably wouldn't be politically credible without one), we believe that depositor protection tools should be stand alone and independent from the particular tool used to resolve a failing bank. Deposit protection should work in conjunction with OBR (or any other resolution option) rather than be embedded within a particular resolution option.

[7] International Association of Deposit Insurers

132. The Review team considers an OBR-only depositor protection option would be:

- ***Inefficient***: This approach would require extending OBR to *all* deposit takers. Beyond the operational and legal challenges this would give rise to (for example, statutory thresholds for using OBR would have to be relaxed), OBR is a novel and untested tool specifically designed to deal with systemic banks by keeping them 'open for business' during resolution. In contrast, closed-bank insolvency or receivership is the current default mechanism for smaller banks not pre-positioned for OBR. Keeping non-viable banks open for business is costly, so enshrining OBR as a one-size-fits-all failure management tool could be inefficient, especially if other resolution options (like insolvency) would be more suitable.

- ***Ineffective***: Depositor protection has to be trusted and well understood to be effective. The Review team's stakeholder engagement has shown OBR is misunderstood by market practitioners and is mistrusted by the general public, amongst whom it is synonymous with depositor haircuts and loss. IADI have advised an enhanced *de minimis* would be an unnecessarily complicated and difficult-to-message way to protect depositors.

- ***Incompatible with a credible and independent resolution regime:*** Depositor protection affects the integrity and credibility of bank resolution arrangements. An effective resolution regime should offer a range of resolution tools, which will be considered as part of the Review's crisis management and resolution workstream. Attaching depositor protection to just one of those resolution tools (like OBR) offers little certainty of protection to depositors. Any meaningful depositor protections must apply consistently across *all* resolution options.

133. The Review team notes the similarities between this option and the UK's experience with deposit protection during the retail run on Northern Rock in 2007. Both feature relatively low protection limits (the Reserve Bank's proposed $10,000 for OBR versus £2,000 in the UK) and loss sharing (or 'haircutting') for depositors above those limits. Loss sharing above a relatively low protection limit proved disastrous for Northern Rock[8], and has been eliminated from modern deposit insurance best practice.

Stand-alone depositor preference

134. Depositors would be moved up in the queue of creditors in an insolvency or wind up, maximising recoveries and mitigating the possibility of loss. There would be no accompanying insurance scheme.

135. *Review team's assessment:* A preference is not recommended as a stand-alone protection tool as it would not give depositors at failed banks access to their money with speed or certainty. Insolvency practitioners have advised the Review team that a preference would not let them distribute realised assets to depositors any faster than the status quo, and have advised against this option.

136. A depositor preference could, however, usefully support deposit insurance by encouraging market-based discipline from non-preferred bank investors and reducing insurance costs. Risks ordinarily borne by depositors (and any scheme that protects them) would be shifted onto the holders of sophisticated wholesale instruments like bonds and commercial paper where they can be made more transparent and better

[8] Concurrent to the run on Northern Rock, and in similarly stressed conditions, a US bank with a similar sized balance sheet and business model (Countrywide) was closed in an orderly way, supported by a deposit insurance system that offered material protection for depositors and successfully mitigated a run. An initial flurry of several dozen deposit withdrawals from Countrywide dissipated, at the same time as Northern Rock was losing 10% of its funding each day in retail withdrawals.

managed. The Review team recommends that further analysis of a supporting depositor preference be included in the design work of an insurance scheme.

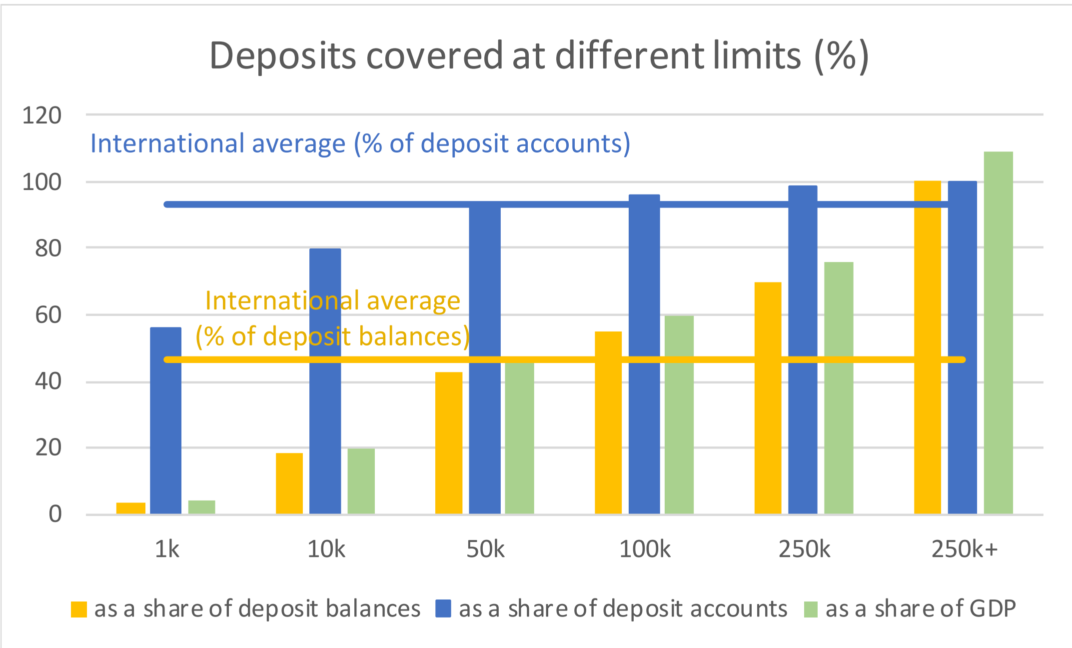
Deposit insurance (Review team recommendation)

137. Depositors at failed (closed) banks would be promptly paid out by an insurance fund and so protected from loss up to a pre-announced limit. The scheme would be mandatory for all deposit-taking institutions and pre-funded from levies on them.

138. *Review team's assessment:* A well-designed[9] insurance system can protect depositors from risks beyond their control, and increase their personal resilience to financial shock. This, in turn, can raise public confidence, reduce the likelihood and severity of bank runs and disorderly bank failures, and contribute to financial stability. A well-calibrated insurance scheme also provides critical credibility to resolution tools that avoid using taxpayer support by imposing losses on the owners and non-insured creditors of failed firms. Also, by providing a mechanism to promptly repay customers and recover costs from industry, insurance could support the orderly closure of small deposit takers in a way that protects customers without needing Crown intervention.

139. A deposit insurance scheme's coverage limit should be calibrated to the scheme's public policy objectives. The Review team's recommended dual objectives for a deposit protection regime align with international best practice, and in turn imply an insurance coverage limit comparable with international norms - which reflect extensive experience around what level of coverage works, and what doesn't, in advancing those objectives.

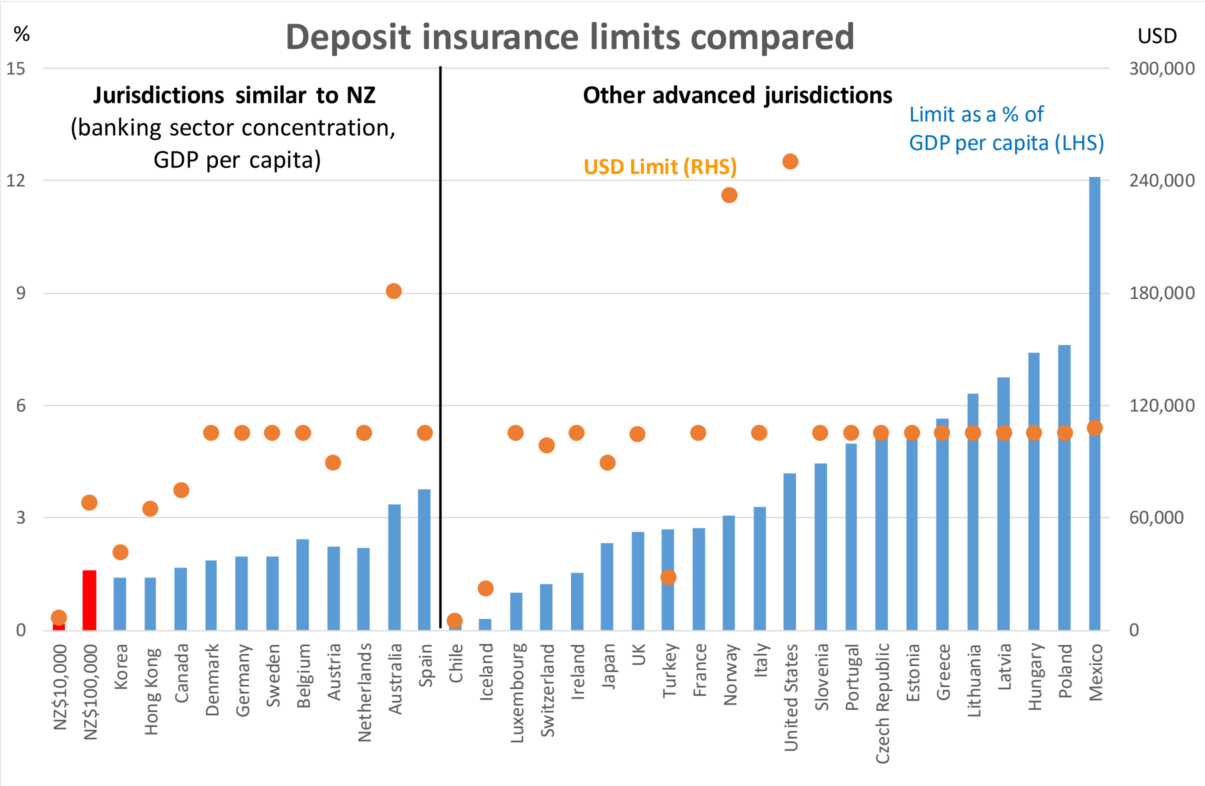
Figure 2



140. For New Zealand, as an indication only, this could roughly equate to a $100,000 insured limit (figure 2). Based on current data, this would fully protect 96% of individual deposit accounts - meaningfully mitigating their incentives to join runs - whilst leaving 55% of the *value* of deposits exposed to risk - preserving an important market-based channel to discipline bank risk-taking and absorb losses in a failure. This limit is also broadly in the region of the approaches seen in advanced countries with similarly concentrated banking sectors as New Zealand's (Figure 3).

[9] A 'well-designed' insurance system would accord with modern best practice adapted for local conditions.

Figure 3



141. Alternatively, a deposit insurance scheme could be designed with the solo aim of preventing financial hardship for those with relatively low bank balances. The Reserve Bank suggests that such a scheme would probably imply a lower coverage limit (e.g. $10,000) than would be the case under the Review team's recommendation. A $10,000 insured limit would protect 80% of deposit accounts and leave c80% of the value of deposit balances exposed to risk.

142. The Review team appreciate there is uncertainty around the efficacy of deposit insurance in mitigating bank runs and contributing to financial stability, especially given the experiences of the GFC. However, we note that, since the highly publicised failures of a few deposit insurance systems in the GFC, there have been numerous instances of the stronger systems that have replaced them working successfully.

143. For example, the UK insurance limit has been raised to £85,000 (fully covering 98% of depositors), and the scheme has managed the orderly closure of 50 failed credit unions and one small bank with no signs of panic or contagion since the run on Northern Rock. Closer to home, deposit insurance systems have recently supported the orderly resolution of failed firms in Japan, Korea, Hong Kong, and Malaysia. Hong Kong and the UK also provide examples of outflows from high-value (uninsured) deposits at banks under stress – but only down to the insured limit. In these instances, deposit outflows stayed orderly and well managed.

144. The Review team considers a deposit insurance scheme focused only on protecting low value deposits may not be politically feasible, leaving the Government with the hard choice in any failure event of whether to intervene, or whether to stay on the side-lines and allow depositors to face potentially considerable losses. The revealed preference (through bail-outs and guarantees) of past governments in New Zealand and abroad is

that insufficient insurance does not avoid costly taxpayer-funded interventions, possibly exposing the Crown to a hard-to-price implicit guarantee.

145. One way of considering the issue is to ask what level of economic activity is a government prepared to have disrupted through depositors absorbing a failed bank's losses. A limit of $10,000 would ensure depositors are still able to meet pressing needs such as purchasing food and fuel, paying rent and power bills, etc. Economic activity that is crucial to the confidence and smooth-running of the economy, however, goes well beyond paying for food and power bills. Ultimately, insurance coverage limits, and the types of deposits that should be covered, will be a judgement call for Ministers.

The costs of depositor protection

In BAU

146. Almost all modern deposit insurance systems are privately funded by industry levies, with access to temporary public funding liquidity backstops. Determining an appropriate insurance fund size (and the levies to build it up) would be a task for the separate work programme the Review team are recommending.

147. As a rough guide, though, the fund size would be a function of the covered deposit base, the probability of failure at a deposit taker, and the loss given failure. Importantly, this means that an insurance fund would not need to match - or be anywhere near as big as – the covered deposit base. This is firstly because other financial safety net features like regulatory capital and liquidity requirements make the probability of failure low; and then, in the rare event, other safety net features like resolution tools would lessen the impact of a failure on depositors, and any scheme that insures them.

148. Comparable economies to New Zealand have insurance fund targets of less than 2% of the insured deposit base. It is likely that, if the capital requirements the Reserve Bank is consulting on are adopted, an appropriate fund size for New Zealand would be below 1% of covered deposits, given the reduced probability of default. Applying a (generous) 2% target to a $100,000 insurance limit implies a steady state target fund of $3.5 billion. This could be built up within 9 years through a levy of 5% of the banking sector's annual profits, or in 11 years through a 10bps premium on insured deposits.[10] We note that this is similar to deposit insurance premiums in other advanced economies, that average around 5bps.

149. A depositor preference could also create costs for banks, increasing non-deposit funding rates by around 10-30bps, as an upper estimate. Any increase in non-deposit funding rates would appropriately reflecting a reallocation of risks away from depositors towards sophisticated investors better able to price them.

150. Whether or not these costs would be passed on to bank customers depends on the contestability of the New Zealand banking sector. Given the sector's high level of competition, we would expect a meaningful portion of costs to be absorbed by banks' own margins and retained earnings, rather than passed on to customers.

In a failure

151. In the event of a failure, an insurance scheme would pay out covered depositors from its available resources - if necessary, borrowing temporarily from the Government to fill

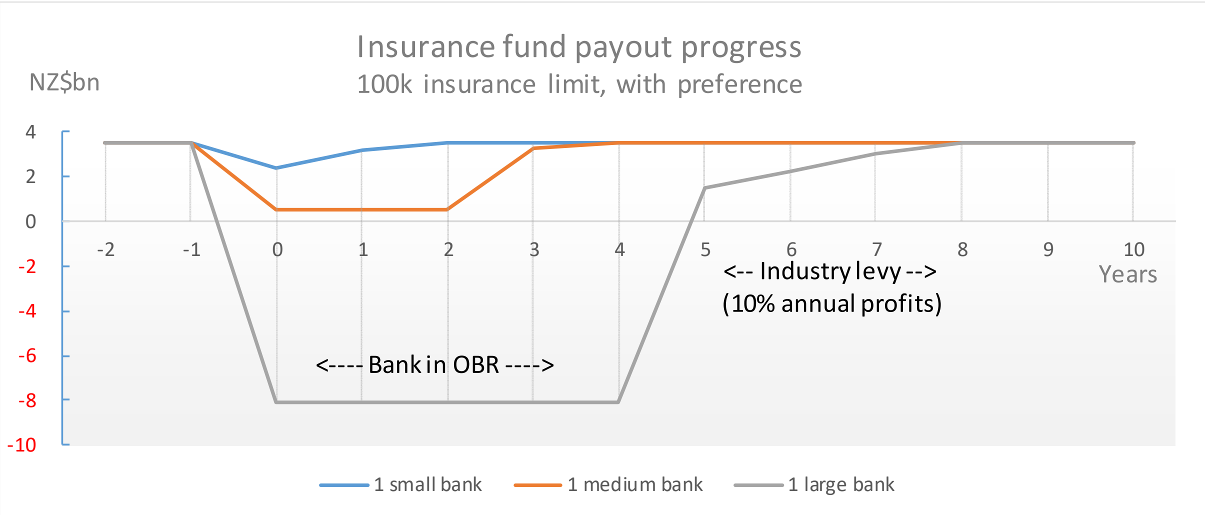
[10] A $10,000 insurance limit would require a target fund of $1.1bn.

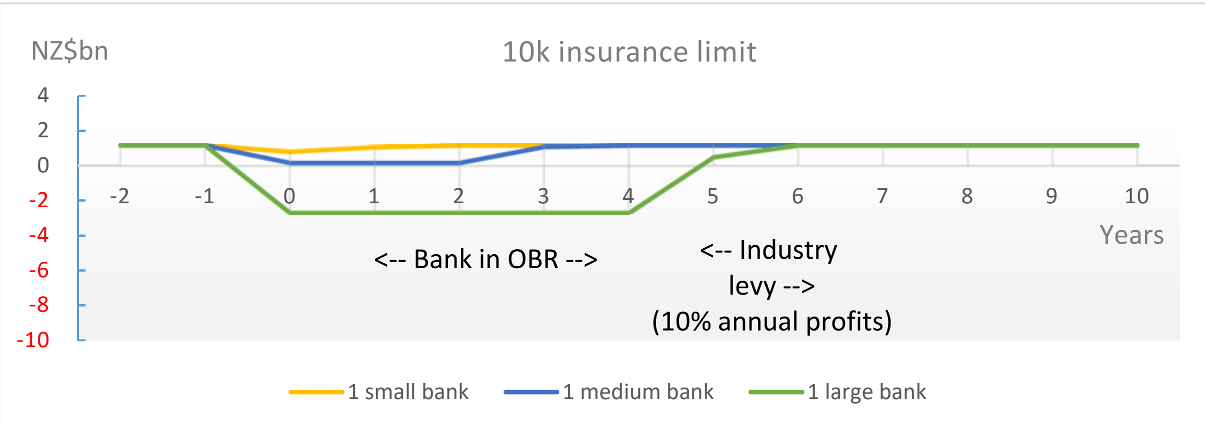
any shortfall - and recoup those payout costs firstly from recoveries from the failed bank, and then any remaining balance from industry through 'extraordinary levies'[11].

152. The method of recovering costs following a payout would depend on the type of resolution option employed. Providing that a full set of resolution options are available, deposit insurance should have no permanent impact on taxpayer funds.

153. By way of illustration, we estimate that, with an insurance limit of $100,000, the scheme would have to borrow NZ$8bn from Government to fund a payout for a Big 4 bank. It would recover all of its costs and repay all of its borrowings (and return to its steady state target) within 8 years. With a lower limit of $10,000, neither the amount that the fund would have to borrow from the government nor the time to recover payout costs and restore the fund to its steady state target are considerably less (Figure 4). In other words, the costs of having a larger limit do not appear to be prohibitively large.

Figure 4:





Moral hazard risks

154. The Review team recognise that comprehensive deposit protection reduces incentives for covered depositors to exercise discipline and might lead to greater risk-taking at covered deposit takers. Extending a Crown retail deposit guarantee to unregulated and unsupervised finance companies in the GFC allowed depositors to risklessly

[11] Recoveries from the failed estate would be determined by the insurance funds position in the creditor hierarchy; with a preference for depositors and the fund that insures them, we estimate a recovery rate of 90-100%. Without a preference, we estimate a recover rate of 70- 95% for the fund, depending on the funding structure of the failed bank.

search for yield, shifting money from banks to finance companies and providing 'guaranteed funding' for their risky investment activities.

155. But deposit insurance, like any insurance system, can be designed to mitigate the impact of moral hazard on the behaviour of shareholders, bank management and depositors. The success of these mitigation techniques will be a function of the overall design of the insurance system, and the financial safety net more broadly, and would be a key focus of the work programme established to develop the protection regime. Some key design features that can mitigate moral hazard include:

- limited coverage levels and scope
- higher premiums for riskier institutions, and
- timely intervention and resolution arrangements.

156. The moral hazards of formal deposit insurance should also not be overstated. For banks and their owners, there is less moral hazard if deposit protection is only triggered when banks are closed and/or losses have been imposed on shareholders through 'bail-in' resolution. For depositors, the moral hazards of formalising deposit protection are limited because:

- *There is moral hazard without formal deposit protection.* There may be an expectation of ad hoc Crown support, like the CDGS, in a failure event. Large or unlimited implicit guarantees, or the expectation of them, can distort incentives to manage risks more than credibly capped explicit insurance.

- *There is limited moral hazard from protecting depositors:* There is little empirical evidence to suggest retail depositors impose much discipline on banks. The Review team's survey of 1,000 New Zealanders showed only 8% regularly consider the riskiness of their bank, and less than half understood they stood to lose money if their bank failed. Bank switching is difficult and (anecdotally) limited for retail customers, and literature assigning a causal relationship between deposit protection and bank failures has not been borne out in practice, at least in advanced economies similar to New Zealand with robust institutional frameworks.

- *Other safeguards can counteract any moral hazard increase:* A robust regulatory and supervisory regime can address the risk that deposit protection incentivises unsound risk management practices or riskier institutions.

- *Formal deposit protection can strengthen market discipline:* If protected claims are defined clearly and credibly, the holders of unprotected claims (like bondholders) will be less incentivised to gamble on being bailed out and will have greater incentive to monitor bank risks. Deposit insurance could make market discipline from uninsured creditors a more powerful force on banks.

Feedback from stakeholders

157. Deposit protection was an important issue for many stakeholders, with 70% of consultation submissions addressing the issue. Those submitters strongly supported protecting depositors: two thirds of those were in favour of strengthening New Zealand's depositor protection framework, against one in six (or 10% of all submitters) that were opposed to stronger protections. This breakdown accords with a survey of 1,000 New Zealanders commissioned as part of the Review engagement process.

158. Around 10% of submitters preferred depositor protection options not put forward in the consultation paper, including narrow banking or adopting of a formal *de minimis* limit as part of OBR. In general, though, there was some scepticism about OBR as a way to protect depositors. Of the respondents that opined on the depositor protection options

proposed in the consultation, half favoured deposit insurance; one in six a legal preference; and one in three both insurance and preference.

159. Of the consultation respondents opposed to formal depositor protection:

- one third thought individual incentives to manage risks prudently were already well supported
- one third thought that capital and regulatory requirements that reduced the probability and severity of bank failures provided depositors with sufficient protection against the risk of loss
- one third thought ad hoc guarantees for failed banks would be less costly than introducing a formal insurance scheme

160. Submitters were split on why they supported depositor protection, across:

- protecting depositors from hardship, including by protecting their access to critical banking services
- addressing information asymmetries by protecting less sophisticated consumers with limited tools to manage deposit risks
- avoiding bank runs and contagion to other banks and the payments system (contributing to financial stability)
- promoting consistency with international practices
- supporting fair outcomes, trust and public confidence

161. Almost all submitters in favour of depositor protection agreed that protection from hardship was important. Whether or not it could help to protect against bank runs and contagion, or was an appropriate tool to address information asymmetries, was more contentious. Most respondents thought that the assessment of the benefits and costs of the various options were reasonable, although some thought ‘financial stability’ benefits, or risks related to ‘moral hazard’, were overstated.

162. In general, there was a good understanding that formal deposit protection would come with costs. Risk-based industry levies was the preferred funding mechanism, although most submitters expected these would ultimately be passed on to depositors.

163. The consultation intentionally did not delve into design specifics. Nonetheless, some submitters identified preferred coverage limits, shaped by where they fell on the objectives of deposit protection. Those who supported aligning with international practices identified Australia’s $250,000 limit; those who thought depositor protection could help disincentivise bank runs favoured high limits (c$100,000); those who preferred an objective of protecting depositors from hardship favoured a low limit, (c$10,000-$20,000).

Independent Panel views

164. The Independent Expert Advisory Panel is of the view that the potential role and design of a deposit protection scheme cannot be considered in isolation from New Zealand’s broader policy context and other aspects of the review that are yet to be completed. In particular, the Panel considers the case for protection should be considered in light of decisions about the role of OBR, the level of stringency in capital standards, and the trans-Tasman dimension (whether there is a need for some degree of consistency with Australian arrangements). The Review Team would be happy to further explain the contextual setting for depositor protection ahead of the May consultation.

In-principle decision #7 - How should the regulatory perimeter be set?

Context and Problem definition

165. The regulatory perimeter for prudential regulation is the boundary between the regulated and non-regulated sectors of New Zealand's financial system.

166. A well-specified perimeter has two characteristics:

- *Appropriate coverage:* the perimeter must capture the right types of firms to enable the Reserve Bank to deliver against its financial stability objectives.
- *Efficiency:* the perimeter is one of the key building blocks of any regulatory system. The way in which firms are brought into the perimeter, and the manner in which regulation is applied, can have a meaningful impact on the ability of a system to satisfy the key attributes of best practice regulation: growth compatibility, proportionality, flexibility, certainty and transparency.

167. The current regulatory perimeter captures the right types of firms: deposit takers, insurers and FMIs. There are nonetheless two problems with existing arrangements:

- *The deposit taking framework is inefficient:* New Zealand has two parallel regimes that regulate firms that are 'deposit takers': a banking regime and a non-bank deposit taking (NBDTs) regime that applies to finance companies, credit unions and building societies. While it remains workable to retain both regimes, the current framework is complex and lacks a degree of coherency. There are potentially meaningful efficiency benefits to both the Reserve Bank and the deposit taking sector in bringing the banking and NBDT regimes together.
- *There is insufficient flexibility in the regulatory perimeter:* The Reserve Bank currently has a mandate that extends beyond the specific sectors it regulates to the stability of the financial system as a whole. However, the tools available to address risks to financial stability can only be applied to firms operating within the prudential perimeter. This can create risks: a key learning from the GFC was that threats to financial stability can emerge from outside the traditional perimeter, often driven by innovation or regulatory arbitrage. Amending the perimeter currently requires change to primary legislation which, while ensuring strong democratic accountability, may mean regulatory responses occur after risks have crystallised.

Recommendations

168. The Review team recommends that an in-principle decision be taken to bring the banking and NBDT regimes together, into a single 'licensed deposit taker' framework. In line with the approach taken in Australia and the United Kingdom, this single framework would:

- Be based around an activities-based definition of deposit-taking, capturing firms that are in the business of borrowing and lending.
- Provide for a licensing and regulatory framework that aligned the risk and scale of activities carried on by entities with their compliance requirements. A move to an integrated deposit taking framework would not mean that the same rules would apply to all entities. There is a need to support tailored approaches for institutions of different scale or with specific business models.

- Be regulated and supervised by the Reserve Bank.

- Retain restrictions on the use of certain words such as ‘bank’ and ‘banking’.

169. The Review team is not seeking an in-principle decision in relation to perimeter flexibility at this point. There was strong appetite from stakeholders for the introduction of potential tools such as exemptions or designations. Stakeholders considered that such tools were required to allow the regulatory system to address new risks and adapt to new innovations, such as financial technology innovation (FinTech).

170. The proposals included in the first consultation paper were nonetheless relatively high-level. Perimeter tools require clear governance arrangements, activation thresholds and accountability processes. In order to settle more detailed design options, further consultation is required, with the option set closely linked to other elements of the May consultation paper (most notably regulatory instruments and governance). Decisions will be sought once that round of consultation has been completed.

Rationale for recommendations

171. New Zealand currently has two parallel regimes that regulate entities that are ‘deposit takers’:

- A ‘names-based’ banking regime. Firms that undertake financial services and want to use certain restricted words in their name or advertisements (e.g. ‘bank’ or ‘banking’) must register with the Reserve Bank. Entering into this registration process is essentially a voluntary choice on the part of applicants. There is no compulsion for firms that operate in New Zealand to become ‘banks’. Other firms may carry on bank-like activities (activities tied to borrowing and lending) as long as they do not call themselves ‘banks’. Once registered, banks are regulated and supervised by the Reserve Bank.

- NBDT regime linked to securities law. Broadly speaking, non-bank firms must become licensed as NBDTs if they want to carry on the business of borrowing and lending, and they are seeking to fund those activities (at least in part) by offering debt securities to retail investors. Once licensed, NBDTs are regulated by the Reserve Bank, and supervised by private sector entities known as trustees.

172. When compared to the status quo set out above, the Review team considers that a single licensed deposit taking framework has four key advantages:

- *Clearer alignment with objectives:* neither the ‘names-based’ banking regime nor the NBDT regime are clearly framed around the Reserve Bank’s financial stability objective. As a result, the banking and NBDT regimes do not capture all deposit takers that could potentially threaten the Reserve Bank’s prudential objectives (for example, wholesale lenders sit outside the regime).

- *Increased regulatory efficiency:* maintaining two regulatory regimes adds complexity to the regulatory system. It also has a resourcing impact on the Reserve Bank. A number of divergences have emerged between the bank and NBDT regimes that are more reflective of regulatory complexity than underlying differences between the two sectors. Examples include the application of macro-prudential policy and crisis management tools.

- *Regulatory neutrality:* current arrangements do not provide for clear regulatory neutrality. NBDTs do not have access to the same disclosure and governance exemptions as banks. This can create the perception that NBDTs are ‘second-class’ firms, reducing their ability to compete. While NBDTs are subject to less prescriptive capital and operational requirements, the difference in treatment between banks and NBDTs cannot be seen as explicitly risk-based.

- *Growth compatibility:* the NBDT regime is the likely location for challenger or new entrant 'deposit takers', given lower minimum capital requirements. Some stakeholders consider that the trustee based supervisory model adds cost and complexity to the business models of NBDTs. These issues are likely to be further heightened as the deposit taking industry changes with the introduction of innovative business models.

173. Beyond the immediate impacts, developing a more simple framework will make it easier to future proof the regulatory framework and empower a number of the regulatory changes currently under consideration:

- *Deposit protection:* one of the core principles behind any deposit protection scheme has typically been competitive neutrality. In Australia, the UK, and most other markets, deposit protection schemes are extended to all deposit takers on the basis that they are subject to broadly similar requirements. Introducing deposit protection would be more complicated under the current regulatory framework given that, with their different supervisory arrangements, the banking and NBDT regimes cannot be seen as directly comparable. Further consultation on the deposit taking framework will be included in the second consultation paper.

- *Future proofing and innovation:* as noted, a strong theme of stakeholder submissions has been the need for the perimeter to capable of responding to new risks, while supporting a degree of innovation. Establishing tools that support perimeter flexibility and proportionality places a premium on clear and simple regime design, and supports a shift towards a single deposit taking framework. It is not possible, for example, to design a meaningful designation or recommendation power under the existing 'names-based' banking regime.

174. If an in-principle decision was made to create a single deposit-taking framework, further consultation would be required on a number of technical issues. In addition to determining an appropriate definition for 'borrowing and lending', areas for particular consideration would likely include the definition of 'deposit', the appropriate treatment of wholesale-funded financial firms and whether there is preference for a tiered regime or a single regime.

175. There would be costs to the Reserve Bank directly and to government more generally in designing and implementing any new framework. The Review team considers these costs to be primarily transitional. Depending on the design of the framework, there may be some increase in costs on NBDTs associated with prudential supervision by the Reserve Bank. These costs would be offset to some degree by the removal of trustee supervision, including the costs of trustee fees and the compliance burden associated with trustee supervision. If initial regulatory requirements were substantively similar to the existing NBDT regime, this could potentially allow for some degree of transitional or grandfathered licensing of existing NBDT licensees.

Feedback from stakeholders

176. Stakeholders have been broadly supportive of shifting to a single deposit taking framework. Stakeholders have emphasised the high degree of change that is occurring in the financial system at present, including FinTech. They consider these changes place a premium on a well-designed activities-based framework that can support regulatory neutrality and provide a degree of flexibility for the perimeter to

change over time. Stakeholders note that there are important issues related to setting the final boundaries of the perimeter that require further consultation. This issue particularly relates to firms that sit outside the current deposit-taking perimeter, such as wholesale-funded lenders.

177. Stakeholders emphasised the need for any framework to allow for differences in both regulation and intensity of supervision between firms. Stakeholders consider there is a need to support tailored approaches for firms of different scale or with specific business models.

178. A number of stakeholders have also expressed the view that the Reserve Bank's objectives and funding should ensure they invest sufficient resource and focus on smaller deposit takers, including placing appropriate weight on competition and regulatory efficiency.

Panel and agency views

179. The Panel, the Reserve Bank and the Treasury support the recommendation to move to a single licensed depositor framework. The Panel emphasised the need to ensure the new framework is resilient to future changes in the shape of the financial system.

Options not recommended

180. We are not recommending retaining the current banking and NBDT regimes in the longer-term.

In-principle decision #8 - Should the prudential regulation and supervision functions remain with the Reserve Bank?

Context and Problem Definition

181. During the scoping for the terms of reference for Phase 2 of the Review, a number of stakeholders suggested that the Reserve Bank's current prudential responsibilities should be carved out and sit with another (new) agency. The most commonly raised reasons for promoting 'separation' included:

- Actual or perceived conflicts of interest across the Reserve Bank's policy functions (e.g. between monetary policy and prudential policy), that might not be adequately managed within current governance arrangements.
- A perception that separation would lead to a better-resourced, efficient and responsive prudential authority. In addition, some stakeholders thought that a specialist agency would have a more appropriate mix of skills in prudential regulation and supervision.
- Perceptions that culture within the Reserve Bank, coupled with a lack of resourcing, has led to a lack of focus on prudential regulation.
- A sense that the Reserve Bank's current financial system objectives are unclear, and that separation would provide an opportunity for greater clarity.

182. Given these concerns, the November consultation document asked stakeholders to consider whether prudential regulation and supervision should be separated from the Reserve Bank. Chapter 5 of the document (supported by a detailed background paper), laid out three options and considered the merits of each one:

- **An enhanced status quo** – this option would take the current 'twin peaks' model as a given, but could include a number of changes to arrangements within the Reserve Bank (stemming from the wider Phase 2 Review) that would address some of the concerns of stakeholders who are advocates for separation. Changes include developing clearer objectives for the Reserve Bank, changing the governance and accountability arrangements, and increasing resourcing to enable a greater focus on the Reserve Bank's financial system responsibilities.
- **A New Zealand Prudential Regulation Authority (NZPRA)** – this option would loosely resemble the twin peaks arrangements in Australia. The Reserve Bank would still be responsible for monetary policy and the lender of last resort (LoLR) role.
- **A New Zealand Financial Services Authority (NZFSA)** – this separate agency (a 'mega-regulator') would assume responsibility for the Reserve Bank's prudential role and the FMA's financial market conduct mandate. The Reserve Bank would still be responsible for monetary policy and LoLR.

Recommendation

183. The Review team recommends that the Reserve Bank continue in its current role as the integrated prudential authority responsible for banks, non-bank deposit-takers, insurers and financial market infrastructure (FMIs). The team believes enhancements to the current Reserve Bank model will help address many of the perceived shortcomings that have led some stakeholders to argue for the establishment of a

separate agency to carry out prudential regulation and supervision functions. This is the 'enhanced status quo' option.

184. These enhancements to the status quo include:

- Establishing clearer financial system-related objectives (see in-principle decision #1). Well-specified objectives are the building block for an organisation's activities, providing both a clear focus and ultimately a marker for assessing the performance of the regulator. Vaguely specified primary objectives or too many objectives can dilute the focus of the regulator and make accountability more challenging (particularly where it is unclear how the Reserve Bank should manage any conflicts between objectives).

- Shifting to a collective form of decision-making for financial policy (see in-principle decisions #2 and #3). The recommendation for a statutory FPC, for example, would provide a formal focal point for the Reserve Bank's financial system-related responsibilities. By contrast, the current single decision-maker model runs the risk that a Governor may not be able to devote sufficient attention to the full range of policy (and corporate) responsibilities.

- Greater resourcing for the Reserve Bank's prudential responsibilities. The second consultation document in May will consider the Reserve Bank's approach to regulation and supervision, which emphasises self and market discipline, and is lightly resourced. A lack of resources has been a consistent theme in stakeholder feedback. The Review team will examine whether the current funding model gives the Reserve Bank the necessary degree of 'budgetary independence' to underpin the broader concept of 'operational independence'. The aim will be to develop options to enhance the Reserve Bank's capability as a prudential regulator.

Rationale for recommendation

185. An 'enhanced status quo' would preserve the strong complementarity that exists between a prudential mandate and the Reserve Bank's other functions, including monetary policy, lender of last resort, and systemic oversight. The co-location of these functions enables the exploitation of synergies across functions (although this is never a given since silos can exist in any organisation tasked with a number of functions). The benefits of policy coordination would be particularly evident in times of stress.

186. This is also the most cost-effective option of the alternatives – notwithstanding that greater funding and resourcing for the Reserve Bank's prudential function may be a consequence of the Review (note, more funding for prudential regulation is compatible with all three options considered in the consultation document, relative to the baseline). Transition costs would be kept to a minimum (since a new agency isn't being established) and there would be no duplication of certain functions (such as HR and IT services), relative to the other options.

187. As noted above, enhancements to the current model arising from other aspects of the Review would further support and improve the current institutional arrangements. The Review team believe these enhancements could go a long way to addressing most, if not all, of the concerns of stakeholders who initially expressed a preference for separation. Indeed, this has been borne out by the nature of the stakeholder feedback, with overwhelming support for the enhanced status quo option (see below).

188. Two further points support the Review team's recommendations.

- First, separation of the nature considered here would be against the general direction of travel internationally. Since the GFC central banks are generally gaining more financial system responsibilities, not less.
- Second, an enhanced status quo would preserve a degree of optionality for changes in the future. Good regulatory stewardship would dictate that changes arising from this Review be evaluated at some future interval, perhaps in five years. Were such a review to conclude that the proposed Review changes have not addressed the perceived shortcomings of the current approach, then institutional separation could become a more viable and compelling option for future governments to consider. By contrast, pursuing separation as an outcome of Phase 2 – setting up a New Zealand Prudential Regulation Authority, for example – presents potentially less optionality in the future if this new institutional arrangement ultimately proved inadequate. Unwinding such arrangements, perhaps by re-integrating a prudential mandate back within the Reserve Bank, would prove equally costly and disruptive.

Feedback from stakeholders

189. Feedback from stakeholders has been overwhelmingly supportive of the (enhanced) status quo. Of the 41 formal submissions received on this issue (out of 67 in total), only 4 have argued the case for separation.

190. Those in favour of current institutional settings emphasised, in particular, the way in which the co-location of different functions within the central bank can be beneficial for policy coordination, based on the exploitation of synergies. Lessons from the GFC in terms of crisis management were noted in this regard by some (i.e. the link between prudential supervision and the central bank's role as the provider of emergency liquidity). Relatedly, some noted that separation required robust external coordination mechanisms between the Reserve Bank and any newly created agency, but there was always the risk of such mechanisms proving inadequate or for 'turf wars' to ensue.

191. Other area of focus for stakeholders was on the cost dimension for the system as whole, and that for a small country like New Zealand, the net benefits from separation did not seem very compelling – in terms of setting up another institution and the duplication of various functions (corporate and IT, information gathering etc.). Some thought New Zealand did not have the scale and capability to support two agencies tasked, in their own way, with ensuring financial stability.

192. Most stakeholders considered that enhancements to current arrangements could potentially address any concerns around a lack of focus on prudential policy (the perception amongst some that the Reserve Bank privileges monetary policy at the expense of its financial system related responsibilities). Almost all thought greater resourcing was key in this regard. In addition, clearer objectives and governance changes associated with some form of collective decision-making body were also identified as helping to ensure this focus on the Reserve Bank's prudential responsibilities

193. A small number of submitters (4 out of 41) argued that the creation of a new agency was the only way to fundamentally change the current approach to prudential supervision.[12] Two of the four were from individuals who stated their preference for separation without specific supporting arguments.

[12] Note, the Review team also received support for separation from several individuals that were engaged through stakeholder meetings following publication of the C1 consultation document in November. They have not followed up with formal

194. The other two proponents of separation were Westpac and Tower Insurance. Both Westpac and Tower supported the **NZPRA option**. Westpac argued that there was little or no synergy between the Reserve Bank's prudential mandate and its other functions. They also thought co-location significantly complicates the construction of optimal governance arrangements for the Reserve Bank. A separate NZPRA effectively solves this governance question, while creating an agency whose sole focus is on its prudential role, staffed and resourced accordingly. Tower believes an NZPRA model would afford a greater focus on the insurance sector.

195. Finally, there was also a view from two submitters that the insurance supervision function of the Reserve Bank should sit with a separate agency, leaving other prudential functions with the Reserve Bank. Proponents of this view emphasised that insurers are not systemically important and insurer issues can potentially distract Reserve Bank management and decision-makers. This view was not supported by the two insurance industry bodies that made submissions – the Insurance Council of New Zealand (ICNZ) and the Financial Services Council. These submitters supported current arrangements, but wanted greater focus given to the insurance industry by the Reserve Bank, via more funding for the Reserve Bank's prudential responsibilities.

Panel and agency views

196. The Panel, the Reserve Bank and the Treasury support the Review team's recommendation that responsibility for prudential regulation and supervision remains with the Reserve Bank. Further, the Panel supports enhancements to current arrangements that will ensure the Reserve Bank's prudential functions are adequately resourced, and that the Reserve Bank has an internal culture that values its prudential mandate.

Options not recommended

197. Two options considered in the consultation paper that we are **not** recommending be pursued are:

- *Creation of a New Zealand Prudential Regulation Authority (NZPRA)***.** This option would increase the ongoing costs of financial sector regulation in New Zealand by creating a separate agency and duplicating some functions across this new agency and the Reserve Bank (even assuming this new agency was better resourced relative to current baseline funding). Transition costs in setting up the new agency would also be significant.

- *Creation of a New Zealand Financial Services Authority (NZFSA)***.** This option would incur significant transition costs and would involve disruption to both the Reserve Bank and the FMA (and likely MBIE). While there would be some economies of scale from integrating the Reserve Bank's prudential functions with that of the FMA, there would likely be some duplication of effort across the NZFSA and the Reserve Bank in some areas. This option is unlikely to address the perceived lack of focus on prudential policy raised by some stakeholders. The NZFSA would have a broad mandate cutting across prudential and financial market conduct issues.

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submissions. That said, many of the arguments the Review heard from these individuals align with those presented by Westpac and Tower.

Next Steps

198. The Review team are due to meet you on Monday 18 February to discuss this report ahead of the ministerial workshop due to be held on Monday 25 February.

199. We recommend your refer a copy of this report, and attached material, to Associate Ministers of Finance and Hon Twyford, who will be attending this workshop, ahead of 25 February 2019. The purpose of this workshop is to discuss wider ministerial views on the in-principle decisions before confirming your decisions.

200. Suzanne Snively, Chair of the Panel, is also due to attend both of these meetings on behalf of the Panel.

201. Once in-principle decisions are made, these will feed into the development of the second consultation document, which is currently planned for release at the end of May 2019. This consultation document will cover:

- Recommended options for the topics covered in the first consultation (noted above) as well as seeking further feedback on some aspects of these topics, and

- Material on the remaining topics covered by the Review's terms of reference, including:

    iv The legislative basis for bank regulation,

    v The approach to supervision and enforcement of bank regulation,

    vi Macro-prudential policy,

    vii Crisis management, and

    viii The Reserve Bank's resourcing and funding.

202. The table below sets out the key upcoming dates for delivering the next consultation document.

Date	Milestone
18 February	Meeting with Review team to discuss advice on in-principle decisions relating to the first consultation
25 February	Ministerial workshop on in-principle decisions
28 February	Decisions due from you on the recommendations set out in this report
1 April	Panel meet to discuss material on remaining Review topics
9 April	Ministerial workshop on remaining Review topics
18 April	Draft of the next consultation document circulated to you for your comment
May	Ministerial and coalition consultation, followed by Cabinet sign-off for the release of the next consultation document
End May	Planned release of the next consultation document

Annex 1: Summary material for meeting