The Treasury

Reserve Bank Act Review Phase 2 Second Consultation Information Release

July 2019

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THE TREASURY
Kaitohutohu Kaupapa Rawa

RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

Review of the Reserve Bank Act

In principle decisions and further consultation topics

Ministerial workshop 9 April 2019

C2A Consultation Document

Outstanding in-principle decisions

- Should a Financial Policy Committee be established(FPC)?
- Should New Zealand have depositor protection?

Should a Financial Policy Committee be established?

Key Issues

- The Reserve Bank and Treasury do not see the need for a separate FPC for financial policy decisions, provided the new governance board is designed to be effective in financial policy decision making and provides robust oversight of the financial policy operations. Under this model, the new board would have formal responsibility for all the Bank's decisions (except monetary policy). The panel supports a governance board with accountability for strategic direction, with a majority supporting the board having responsibility for financial policy.
- The Review Team believes the Board model would be a significant improvement on existing governance arrangements for prudential policy, although it continues to see merit in the establishment of an FPC primarily on the basis of the expertise, focus and targeted external involvement inherent in the model (see T2019/80).

Potential way forward

- One way forward is to take an in-principle decision not to establish an FPC at this time and to communicate this decision in the June consultation (with the consultation focusing on the consequential elements of Board design). An FPC could be established in future should the Board not deliver on expectations.
- In the absence of an FPC, it would be important to ensure that the new Board is equipped and incentivised to take significant financial policy decisions and provide rigorous oversight of financial policy framework and the exercise of delegated powers. An effective board model will be dependent upon apolitical and highly competent appointees.

Should New Zealand have depositor protection?

Key Issues

- The Reserve Bank, Treasury and Review Team all recommend that a deposit insurance scheme be introduced in New Zealand. Views differ as to what objectives the scheme should have: a narrow focus on protecting depositors from loss (financial hardship objective) only, or a broader objective to promote financial stability by supporting depositor confidence and mitigating banks runs and contagion. A narrow focus may allow for a lower level of coverage.
- The Reserve Bank and Treasury favour a deposit insurance scheme with the primary objective of protecting depositors from hardship. The Reserve Bank is not convinced a higher limit would offer significant financial stability benefits.
- The Panel requested further work, which the Review Team has undertaken with further work underway to describe the economic impact of different options. This work outlines how deposit insurance could fit into New Zealand's broader financial safety net comprising prudential regulation, supervision, liquidity and crisis resolution arrangements. Strong prevention tools - like capital rules - may reduce the need to use failure management tools - like Deposit insurance. But, like any business, banks may still fail. When they do, failure management tools exist to limit the damage caused to society.
- The Review Team see merit in a narrowly focused scheme, although it believes a scheme with dual objectives of protecting depositors from financial hardship <u>and</u> promoting financial stability would be preferable and more in line with international practice (see T2019/80).

Should New Zealand have depositor protection?

Potential way forward

- The Treasury and Reserve Bank have indicated that they would support a deposit insurance scheme with coverage in an indicative range of $30,000- $50,000. A limit of $50,000 might fully protect more than 90% of individual depositors in New Zealand. The Panel continues to be uncertain with a range of views about what form of depositor protection will work best for New Zealanders.
- Given this range of views, one way forward is to take an in-principle decision to establish a deposit insurance scheme with dual objectives (of protecting financial hardship and financial stability) with a coverage limit in the indicative range suggested by the Reserve Bank and Treasury and comparing these with the economic impact of other options.
- Such a scheme would protect depositors from loss in the event of a bank failure (financial hardship) and contribute to financial stability (by narrowing a channel for contagion to spread through the system), albeit to a lesser extent than similar schemes overseas. Such a scheme would also allow the costs associated with failure to be better managed by decreasing pressures on the Minister to make ad hoc interventions to support failing firms with taxpayer funds.
- If an in-principle decision to establish such a scheme is made, the Review Team would look to consult on that proposal in the June consultation and consider arrangements to progress such a scheme.

C2B Consultation Document

The Reserve Bank’s role in financial policy: tools, powers and approach

- Macro-prudential policy
- New Zealand’s crisis management regime
- Supervision and enforcement
- Funding and resourcing

Macro-prudential policy

Key Issues

- It has become common since the GFC for central banks to use macro-prudential tools (such as LVRs) to lean against troubling credit booms.
- Some of these tools can generate distributional consequences that raise questions over whether central banks should have unfettered authority to use them. Internationally, practice varies as to whether consultation with government is required before taking macro-prudential decisions, but there is some evidence that they are used less when consultation is required.
- The next consultation will ask which macro-prudential tools the Reserve Bank should have and whether special governance arrangements are required.

Options for consultation

Options for reform include:

- Macro-prudential tools: The Reserve Bank could be restricted to only using capital and liquidity tools, it could retain the right to use LVRs as well, or it could be given more general powers to restrict lending if required.
- Governance: The Reserve Bank could retain unfettered authority to use macro-prudential tools, or could be required to consult with, or seek approval from other agencies (e.g. via CoFR) or the Minister for the use of at least some tools. Such governance arrangements could be specified in primary legislation or in a financial policy remit (and/or the Reserve Bank board charter).

New Zealand's crisis management regime

Key Issues

Potential issues with the existing crisis management regime to be consulted on:

- Lack of role clarity, resolution objectives and accountability for use of powers
- Role of Minister of Finance in influencing outcomes when taxpayer funds are at risk needs clarification – both before and after government intervention
- Some missing resolution tools; existing tools rely on some taxpayer support; legal provisions for taxpayer support are cumbersome
- No specific creditor safeguards
- Balancing risk of over-prescription with necessary flexibility in unknown circumstances

Options for consultation

Options to be consulted on include:

- Clarify the role of the Reserve Bank as resolution authority, provide resolution objectives, establish clear accountability requirements
- Enhance the set of existing resolution and stabilisation options and broaden the set of resolution tools; enhance the powers of the Reserve Bank as resolution authority
- Provide clarity over role of the Minister of Finance
- Introduce creditor safeguards

Supervision and enforcement

Key Issues

- The Reserve Bank has a largely 'low-intensity' approach to supervision
- Post-GFC: Internationally, risk appetite has changed – more 'assurance' has been sought through higher levels of supervision. Supervision should be "intrusive, sceptical, proactive and forward looking, comprehensive, adaptive and conclusive" (IMF)

Options for consultation

Options for reform include:

- More verification – 'on-site' inspections, deepening collaboration with APRA
- Enhancing enforcement regime – broader and more proportionate suite of tools
- Enhancing supervisory independence – remove the requirement for Ministerial consent for certain powers
- More resourcing to improve capability & capacity

Funding and resourcing

Key Issues

- The Reserve bank is currently funded through self-generated earnings, with a tight constraint on operating expenses via a five-year funding agreement between the Minister and the Reserve Bank.
- The next consultation will ask whether the role of the Minister in the Reserve Bank’s funding arrangements remains appropriate, and whether other sources of funding (such as an industry levy) should be explored.

Options for consultation

Potential options for reform:

- The appropriate degree of independence for budgetary decisions could vary across functions. For example, monetary policy may warrant a higher level of budgetary independence than prudential functions.
- Potential funding sources include self-generated earnings, fees, and industry levies to cost recover for prudential functions (this would be small and may not be worth the administrative cost).
- All funding options should be accompanied by enhanced accountability & transparency arrangements.