

The Treasury

Reserve Bank Act Review Phase 2 Second Consultation Information Release

July 2019

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**Independent Expert Panel for the Reserve Bank Act Review
Meeting Minutes – 14 December 2018, 9:00am- 5:00pm
Select Committee Room 2, Bowen House**

Attendees

Panel: Suzanne Snively (Chair), Barbara Chapman, Dr Girol Karacaoglu, Dr Malcolm Edey, Belinda Moffat, John Sproat.

RBNZ: Geoff Bascand, Toby Fiennes

The Treasury: Bryan Chapple

RBNZ Act Review team (some on a topic by topic basis): Bernard Hodgetts, David Hargreaves, Victor Kuipers, Chris Hunt, Nick Mulligan, Kaja Stojkov, Tom Smith, Alistair Birchall, James Haughton, Patricia Wright.

Sessions I: *Introductions and update on the Review*

The Review Director provided an update on Consultation 1 feedback to date and the timeline for the Review.

Session II: *Crisis management*

The Review Team presented an overview of the crisis management regime in New Zealand. The Review Team also considered a series of international models, including Australia, Singapore, and the UK. It was noted that the international models selected were not intended to be an exhaustive summary.

The discussion was framed around the FSB's 'Key Attributes of Effective Resolution Regimes' (KAs). It was noted that crisis management was a policy area that had seen significant change since the GFC. A number of countries had significantly reframed their crisis management regimes, and sought to increase the set of tools available to deal with the non-viability of systemically significant banks.

Some jurisdictions such as the UK had closely modelled their regimes on the FSB KAs. Others had chosen to diverge in specific areas, most commonly in relation to bail-in powers (e.g. Australia with a focus on TLAC, or Singapore excluding senior debt).

The Panel and the Review Team discussed New Zealand's current crisis management framework. For systemically important banks the framework was oriented around statutory management, which allowed for the application of OBR. It was noted that the IMF had observed several shortcomings in New Zealand relative to the KAs as part of the 2017 FSAP. Many of these shortcomings related to the clarity of the regime, and the degree to which tools and safeguards were specifically empowered.

The Panel and the Review Team discussed the proposed approach to the topic. The Panel considered the overarching questions being considered were the right ones. The Panel nonetheless indicated a particular interest in understanding the trans-Tasman dimension, and how any change to the crisis management in New Zealand would integrate with Australia.

Both the Review Team and the Panel agreed it would be value to consider a broad set of international regimes as part of the topic – particularly those that had direct experience of using resolution tools since the GFC.

Session III: *Macro-prudential policy*

The Review Team presented an overview of macro-prudential policy development in New Zealand, along with some international approaches.

The panel discussed the governance arrangements for macro-prudential policy. A panel member noted the importance of the various governance options presented in Consultation 1 and the relevance of these to the decision rights for macro-prudential policy. If there was a governance board, then independent macro-prudential policy would be less controversial than under a single decision-maker model. A panel member noted there is an important trade-off between strong governance arrangements versus the level of specificity or constraints placed on macro-prudential policy use.

The panel and the Review Team discussed whether the time-varying nature of macro-prudential policy or the distributional impacts are the key reason that some macro-prudential policies may need additional governance arrangements.

The panel discussed the broader impact and role of macro-prudential tools. A panel member noted that macro-prudential policies could be applied to a broader range of lending. A panel member questioned what work had been done looking at the distributional effects of the LVR policy (for example, the impact on rents and first-home buyers). The lessons learned from the use of macro-prudential tools to date should be explored. A Panel member questioned whether a comparative study could be done comparing the housing market downturn in Australia and the less pronounced slowdown in New Zealand. Has the macro-prudential policy insulated New Zealand?

A panel member suggested considering how debt-to-income ratios might affect different regions in New Zealand.

A panel member noted that the broader regulatory philosophy of the financial system should be considered. As part of that, macro-prudential tools might be able to be used to achieve wider government objectives (e.g. influence credit allocation). The risks of this and the advantages of keeping a clear separation between prudential and fiscal policies were discussed.

Session IV: *Update/overview on remaining topics for C2 consultation*

The Review Team's provided verbal updates on the work plans for regulatory powers and instruments, supervision and enforcement, funding and resourcing, trans-Tasman cooperation and domestic cooperation, and climate change.

Session V: *Wrap up/Conclusion of Meeting*

After reconfirming the Review timeline for the next few months.

**Independent Expert Panel for the Reserve Bank Act Review
Meeting Minutes – 7 February 2019, 9:00am- 5:00pm
Select Committee Room 2, Bowen House**

Attendees

Panel: Suzanne Snively (Chair), Barbara Chapman, Dr Girol Karacaoglu, Dr Malcolm Edey, Belinda Moffat, John Sproat.

RBNZ: Adrian Orr (sessions III-V), Geoff Bascand, Toby Fiennes

The Treasury: Bryan Chapple (until midday)

RBNZ Act Review team (some on a topic by topic basis): Bernard Hodgetts, David Hargreaves, Victor Kuipers, Chris Hunt, Nick Mulligan, Kaja Stojkov, Tom Smith, Alistair Birchall, James Haughton, Patricia Wright.

Sessions I-II: *Coffee and Panel-only session*

The Panel met from 9.00am-9.45am to discuss the issues for discussion.

Session III: *Introductions and Update*

At the request of the Chair, the Review Director ran through the timetable and process for providing written advice to the Minister on the in-principle decisions sought following the Consultation 1 (C1).

Session IV: *Reserve Bank Governor – Reserve Bank Board Governance Proposal*

Reserve Bank Governor Adrian Orr offered some comments on the Review Team's initial recommendations for in-principle decisions following C1. The Governor described the Reserve Bank's preferred governance model and the Reserve Bank's preferences around how it should be funded. The Governor's speaking notes are appended to this minute.

Discussion centred on the following points:

- It was noted that the Reserve Bank supported the Treasury taking the monitoring role, as this would broadly reflect the current relationship with the Treasury.
- There was discussion on the potential role of a Treasury observer on a Financial Policy Committee (FPC). It was noted that the objective switching that occurs in a crisis from financial stability to fiscal risk needs to be adequately accounted for.
- A Panel member questioned how the Bank's Capital Review Proposal affected the case for Deposit Insurance. A concern was noted that with multiple decision-making bodies (such as a board and FPC) the Reserve Bank wouldn't be able to attract quality individuals for the board. It was also noted that good corporate boards will always request external expert advice to inform decisions, even if that advice could be critical of management, as they are less emotionally invested.
- A Panel member urged the group to consider why a Monetary Policy Committee (MPC) had been established and whether the same reasoning would also point to establishment

of an FPC. The Panel member asked: why is financial policy different? It was suggested that the case for an FPC may be different given the timing and specialisation of issues and decisions is more variable than with monetary policy. There may be more effective ways to earn the 'social license' such as using the Statement of Intent or employing experts. It was noted that while the legitimacy argument may mirror that for an MPC, the effectiveness and efficiency argument is not the same.

- Another Panel member questioned how policy coordination between monetary policy and financial policy would be achieved in the Reserve Bank's governance model. How would the minister influence the Reserve Bank's financial policy and what mechanism would be used? It was noted that in Australia, the Murray Inquiry led to APRA being told to ensure the Australian banks' capital ratios were in the top quartile in the world.
- A Panel member asked whether any responsibilities would not be allowed to be delegated by the board. The Governor said that there would need to be a very high hurdle rate for such a requirement.
- A Panel member commented that, given the range of skills that an FPC would require in order to cover the areas of prudential regulation and supervision, too many experts would be required to make an FPC feasible.

Session V: Governance

The Review Team's recommendations for in-principle decisions on the Reserve Bank's governance arrangements were briefly summarised:

- The establishment of a governance board;
- The establishment of a Financial Policy Committee with statutory responsibility for prudential policy and supervision
- Treasury to become the Reserve Bank's monitor.

It was noted that that the Review Team considered that both the FPC and policy board (under which the board would also have responsibility for prudential policy) represented a significant improvement on the status quo. However, the Review team considered the FPC model as optimal due on the basis of the targeted expertise, focus on financial policy, and external involvement inherent in the FPC model.

There was discussion of how the governance model adopted by the Bank of England had improved the quality of financial policy.

Panel discussion centred on the potential complexity created by an FPC and whether the functions of an FPC could adequately be handled by a board. There was also a focus on consistency given that Phase 1 of the Review has resulted in the creation of a Monetary Policy Committee. There was a discussion on delegations and whether statutory delegations/carve outs would be sought. It was noted that the board would have responsibility and would delegate. For example, the Reserve Bank would do the work to determine the appropriate bank capital requirements, but the board would approve these. Another concern expressed was whether an FPC would degrade the role of the board making the latter less attractive to new members.

Session VI: Objectives

A summary was provided of the Review Team's recommendation for an in-principle decision to adopt 'financial stability' as the Reserve Bank's high-level objective for financial policy.

The Panel noted 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 was in accordance with the Review Team's recommendation to define financial stability, and, to investigate specifying lower-tier objectives as part of the second stage of consultation.

Session VII: Depositor Protection

An outline was provided of the reasons for the Review Team's recommendation for an in-principle decision to establish a permanent depositor protection regime for New Zealand.

The Panel questioned how the case for depositor protection in New Zealand could be rationalised in light of other key regulatory policies, including recent proposals to significantly increase bank regulatory capital. Several Panel members said the case for depositor protection thus needed to be contextualised against this broader policy background.

Session VIII: Regulatory Perimeter

An outline was provided of the recommendation to merge New Zealand's existing prudential regimes for banks and non-bank deposit takers into a single (ADI style) deposit-taking regime.

The Panel reiterated the need to ensure any changes to the prudential regime took into account future potential changes in the structure of the financial system, that may pose a challenge for prudential regulation (such as the advent of entities such as Paypal).

Session IX: Separation

The group discussed the Review Team's recommendation that the prudential regulation and supervision function remain with the Reserve Bank.

The Panel asked about feedback received on this issue during consultation. There was discussion of a proposal by one or two submitters that prudential regulation and supervision of insurers could be carved-off to another agency with regulation and supervision of banks and non-bank deposit takers remaining with the Reserve Bank.

Conclusion of Meeting

After reconfirming the process for providing advice to the Minister of Finance, the main meeting was concluded around 4pm and the Panel met privately to discuss the day's issues. The Chair undertook to provide the Panel's comments to the Review Team Director by Sunday night for incorporation into the report for the Minister.

**Independent Expert Panel for the Reserve Bank Act Review
Meeting Minutes – 1 April 2019, 9:00am- 5:00pm
The Treasury Room 3.30**

Attendees

Panel: Suzanne Snively (Chair), Barbara Chapman, Dr Girol Karacaoglu, Dr Malcolm Edey, Belinda Moffat, John Sproat.

RBNZ: Geoff Bascand, Toby Fiennes

The Treasury: Tim Ng

RBNZ Act Review team: Bernard Hodgetts, Bronwyn Kenna, David Hargreaves, Victor Kuipers, Chris Hunt, Nick Mulligan, Kaja Stojkov, Tom Smith, Alistair Birchall, James Haughton.

Panel-only session

The Panel met from 9.00am -9.45am to discuss the issues for the day.

Session I: Process and Timeline Update

The Review Director ran through the timetable and process in the lead-up to the release of the Consultation 2 (C2). It was noted that the Minister of Finance has agreed to extend the release date for C2 until 18 June. The Panel were updated with the decisions that the Minister had made in relation to the Consultation 1, noting a further workshop will take place with the Minister and his associates on 9 April. This will cover the issues on which the Minister has deferred a decision (including the possible creation of a Financial Policy Committee, depositor protection, and administration of the Act) and briefly preview the remaining issues for C2.

Session II: What prudential regulatory tools and powers should the Reserve Bank have?

The Review Team briefly presented on New Zealand's framework for setting prudential rules. The focus of this section in C2 would be on ensuring the model appropriately balances the need for Reserve Bank flexibility and regulatory independence against other characteristics (legitimacy, transparency, and accountability).

The Panel and Steering Committee members raised and discussed the following issues:

- The nature of rule-making. It was noted that the nature of prudential rule-making had changed since the Reserve Bank Act had been drafted. Rule-making had increased in depth and breadth (including new areas such as macro-prudential policy), and the impact of Reserve Bank regulatory discretion had increased. Rules were now more of a legislative tool, rather than an administrative tool. This suggested there was a case to shift to a legislative instrument, to preserve appropriate accountability.
- It was noted that it was important to preserve discretions in rule-making (e.g. to approve instruments, or vary capital requirements). It was noted that this could be potentially achieved by either allowing for some flexibility in the legislative instrument itself, or using an administrative instrument for individual entity rules.

- The enforceability of the current rule-setting model (Conditions). It was noted that Conditions were enforceable (e.g. through directions). A breach of a Condition could also result in enforcement action against a registered bank. While many substantive rules sat in the Banking Supervision Handbook, and were incorporated by reference into Conditions, this did not impact on their enforceability.
- There was discussion around the scope of the Reserve Bank's rule-making powers. Should these be guided solely by the Reserve Bank's objectives, or should there be more guidance? It was noted that accepted New Zealand model was to strike a balance: providing a list of areas in which rules could be set. A useful additional option was to provide the ability for this list to expand by way of Regulation. This list should give the Reserve Bank clear scope to act in areas that were seen as appropriate for a prudential regulator (not unnecessarily restrictive), but provide an accountability check should rule-making expand into new areas that had a sharper edge in terms of policy. Macro-prudential policy was a good example of the risks where there was a lack of clarity – the limits of rule-making would not tend to be tested by a Court, but where rule-making was not very clearly empowered there were risks around other forms of intervention (e.g. the 2013 MoU).
- The Panel recommended more clearly integrating the Regulation chapter with supervision and enforcement, and spell out the potential use of regulatory tools that would follow a breach of rules. For example, what types of responses were considered appropriate for a breach of capital requirements, or for governance issues within a bank?

Session III: *What role should the Reserve Bank play in macro-prudential policy?*

The Review Team briefly presented on New Zealand's macro-prudential policy experience and options for enhancing the macro-prudential framework.

The Panel and steering committee members raised and discussed the following issues:

- The issue of whether more formal prescription is required around the process under which instruments are deployed. It was noted that the Reserve Bank already has prudential policy powers but the use of macro-prudential instruments in a time-varying or more activist fashion may warrant more accountabilities, checks and balances.
 - The difficulty of delineating particular instruments as macro-prudential (or not) was noted. For example, the case to treat capital and loan-to-value (LTV) requirements as fundamentally different was not immediately apparent.
 - One Panel member noted that the systemic element and redistributive effects associated with macro-prudential policy necessitates consultation between agencies and consultation with politicians. Could the Board be instructed via a letter of expectation to be aware of systemic consequences and take these into account?
 - One Panel member asked whether deployment of some macro-prudential instruments could be reserved for the Reserve Bank board – it was noted that a remit could also require the board to focus on the use of these instruments. It was agreed that this issue be addressed in the consultation chapter.
 - The issue of how incentives on banks to exercise self-discipline may have changed over the period following the introduction of the macro-prudential framework was raised. There was also discussion of graduated powers in the macro-prudential
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arena – from data collection to soft powers (like moral suasion) which could mean formal powers (deployment of an instrument) could be used as a last resort.

- A Panel member noted that applying LTVs to all institutions, not just banks, would be desirable for competitive neutrality reasons. How this could be accommodated through objectives was discussed.
- It was noted that it would be important not to create too much bureaucracy around macro-prudential instruments and tie the Reserve Bank's hands.
- One Panel member suggested that it would be best to keep the macro-prudential decision-making framework with officials with no special governance even for LTVs/debt-to-income (DTI) restrictions.
- It was noted that if the Reserve Bank were to become an Independent Crown Entity, the Minister of Finance would be able to ask the Reserve Bank to consider certain things as part of the consultation and decision-making process for macro-prudential policy.
- It was suggested that if the Council of Financial Regulators were to have a role in macro-prudential policy, this should not be hardwired. The need and obligation for consultation was important, but flexibility (including who the Reserve Bank consulted with) was needed, particularly as the focus of macro-prudential policy could shift over time.
- It was noted that the Murray Inquiry had decided against recommending a formal role for the Australian Council of Financial Regulators.
- A Panel member suggested the macro-prudential chapter needs reference to any governance changes planned; needs more generalisation around the process for adding instruments like LTVs and DTIs as new instruments may come up over time. A remit might provide more flexibility in this regard than legislation (but the chapter would need to explain why/how).

Session IV: *How should the Reserve Bank supervise and enforce prudential regulation?*

The Review Team provided a presentation for this session to explain the Reserve Bank's current approach to supervision and enforcement and contextualise some of the options for potential improvement.

The Panel and steering committee members raised and discussed the following issues:

- Several Panel members suggested the definition of supervision and enforcement in the draft C2 chapter needed to be clarified along with the description of how the two activities inter-relate.
- Several Panel members suggested the chapter needed to give a sense of the Reserve Bank's vision for supervision and enforcement including how the Reserve Bank wishes to be perceived by stakeholders and the nature of the relationship with banks.
- The Panel were in favour of boosting discussion of resourcing in the chapter, which would have a bearing on supervision and enforcement activities that the Reserve Bank would or would not be able to undertake.

- The possibility of more active engagement with APRA with their on-site inspections of New Zealand subsidiaries was discussed and could be brought into the C2 chapter.
- One Panel member noted the additional costs imposed on the NZ subsidiaries that would arise from any dual-inspection regime
- The Panel enquired whether more comparative context could be provided setting out what other countries do in the supervision and enforcement space and the resources devoted to these tasks.
- One Panel member asked about the role of auditors in verification and compliance space and it was suggested that more discussion on this point could be included in the chapter.

Session V: *What features should New Zealand's Crisis Management Regime Have?*

The Review Team briefly presented a high-level overview of how New Zealand's crisis management framework might be aligned with international best practice in order to support financial stability and address potential shortfalls with the existing framework.

The Panel and steering committee members raised and discussed the following issues:

- A Panel member asked about the interaction and flow of information across the crisis management, supervision, and early intervention functions.
 - Clarification was sought on the conflict of interest between resolution and supervision.
 - A Panel member sought clarification on whether the role of the statutory manager was diminished in the framework presented. The Review Team confirmed that the statutory manager's role has changed, but they would be more accountable to the Reserve Bank.
 - A Panel member asked whether deposit insurance was being assumed in the framework presented. The Review Team noted that deposit insurance was still being considered by the Minister, and it was presented for completeness to show the optionality of the bank failure management process.
 - A Panel member asked about the protection of property rights, noting that NZ would struggle to raise foreign funding if this was not clear (they also asked a related question about the idea of levying to support 'No Creditor Worse Off'). The same Panel member wondered about an interaction between the Reserve Bank's capital proposals and the issue of property rights.
 - A Panel member asked whether concerns around property rights and the Open Bank Resolution were the main issues preventing compatibility between the New Zealand and Australian frameworks and suggested the issue should have more focus. Another member raised the question of whether there needs to be compatibility between the two crisis management regimes.
 - It was noted that Australian parent banks' view their NZ subsidiaries as brand-critical.
 - The Panel suggested clarifying how supervision and resolution fit together, particularly the sequencing or escalation from supervision to resolution.
 - It was suggested that the consultation document draw out what forms industry-funded resolution financing might take and how it might operate.
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- It was suggested that governance arrangements be given more prominence in the chapter – i.e. could a governance board delegate crisis management and resolution functions?
- It was suggested that the chapter acknowledge the complexity of the area and talk about what the next steps and implementation timeframes might be.

Session VI: *Remaining issues and residual discussion*

During this discussion, the following points were raised:

- A Panel member suggested changes to the ordering of the chapters. The balance sheet chapter could be placed later in the document and the crisis management chapter could come earlier, given it could be considered another one of the ‘safety net’ set of chapters.
- It was noted that links between potential Reserve Bank governance changes and other chapters should be highlighted where appropriate (e.g. in the macro-prudential chapter).
- It was noted that the Review Team had done work to contextualise deposit insurance within the broader financial system safety net. A Panel Member also noted that some analysis on the broader economic impact of deposit insurance would also be desirable. Another Panel member observed that generous deposit insurance could be quite a cheap protector of the financial system.
- The Panel also raised the issue of the Reserve Bank’s review of bank capital and noted that this poses challenges for the Phase 2 Review and could confuse stakeholders who may view bank capital as fundamental and therefore within the purview of the phase 2 review. They asked for the consultation documents to clarify the relationship between decisions on capital with the review of the Reserve Bank’s legislation.

Conclusion of Meeting

The meeting concluded at 4.45pm.