

The Treasury

Reserve Bank Act Review Phase 2 Submission Information Release

October 2019

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SAFEGUARDING THE FUTURE OF OUR FINANCIAL SYSTEM

Submission form for consultation document 2B

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

To have your say on these important issues, please answer the questions below and send this form by email to rbnzactreview@treasury.govt.nz by 5pm on 16 August 2019.

To get more information on these topics and the wider Reserve Bank Act Review, see the full consultation document at treasury.govt.nz/rbnz-act-review.

Chapter 1

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

- 1.A Do you agree that the broader Reserve Bank Act model strikes an appropriate balance between primary legislation and delegated powers? If not, why not?
- 1.B Are there any areas of the Reserve Bank Act where changes to the model are required, such as the introduction of greater safeguards?
- 1.C Does the Chapter appropriately identify the key issues with the current framework for setting prudential rules? If not, what is missing?
- 1.D What are your views regarding the potential options proposed for setting the core prudential instrument? Are there any other changes to the rule-making framework that should be considered?
- 1.E What do you see as the costs and benefits of introducing enhanced process rights for administrative decisions? If you consider there is a case to introduce these rights, how should they be framed?
- 1.F Is there a case to change the breach reporting and liability models that apply to regulated entities in the Reserve Bank Act? If so, what models would be preferable?
- 1.G Is there a need to increase executive accountability?
- 1.H If so, which of these models would be most effective in doing so, and why?

1G - I support increased executive accountability (directors and senior managers). As well as determined prosecution of all apparent transgressions, there should be meaningful disincentives on both directors and the company.

The RBNZ should provide comprehensive courses to ensure individuals (directors and senior managers) fully understand the criticality of their role in ensuring financial stability of the New Zealand economy. Ignorance of regulations and law can be no excuse. Costs of enforcement should be applied to the banks, so as to incentivise them to have systems that can quickly and easily demonstrate their compliance to requirements.

What role should the Reserve Bank play in macro-prudential policy?

- 2.A Does the Reserve Bank's framework document (Ovenden, 2019) present its expected macro-prudential strategy in enough detail to allow monitors to ensure the Reserve Bank is following the strategy and predict future macro-prudential actions?
- 2.B What are your views on the conduct of macro-prudential policy in the past five years? It may be useful to read the recently released framework document (Lu, 2019) and the sub-questions below:
- Are there any lessons to be learned from New Zealand's experience with loan-to-value ratios (LVRs) to date?
 - Do you think LVR policies that have greater impacts on certain buyers (e.g. investors) or regions than on others are appropriate?
 - Has the Reserve Bank's 'speed limit' approach reduced risks without affecting too severely buyers who may need high LVR loans owing to special circumstances?
 - Would a greater use of macro-prudential tools other than LVRs have been appropriate during the recent housing boom?
- 2.C Is it appropriate to regulate lending standards (e.g. LVRs)? How broad should these powers be (should they include other tools such as debt-to-income restrictions)?
- Should lending standards apply only to deposit takers or to all lenders?
 - Should there be special governance arrangements for these tools?
 - Should the Reserve Bank reconsider its view that these tools should only be applied temporarily?
- 2.D Other than lending standards, when the Reserve Bank makes time-varying use of standard prudential tools such as capital ratios, are there any concerns or reasons for wider political oversight?

2B. (i) Yes. Initial efforts were weak applied to investors which severely disadvantaged first home buyers (FHBs). Only later did the RBNZ apply adequate LVR limits to investors. The RBNZ still does not adequately differentiate LVR limits between parties who buy with cash on hand (such as FHBs), versus other parties such as investors and home owners who use apply their equity position in their existing assets to secure loans from banks. The practice where banks give excessive weight to equity in property is not only a risk in the event of a shock, but is itself an endogenous cause of financial instability. Investors who frequently apply existing equity to acquire new loans are particularly dangerous for financial stability, and the RBNZ was correct to apply LVR limits of 60% to that group. Unfortunately, the RBNZ is winding back from that position so exposing New Zealand to financial instability arising from such lending.

2B (ii). Yes, the RBNZ was correct to apply more stringent LVR limits on investors (see previous paragraph).

2B(iii). Speed limits are likely to create winners and losers. Are bank employees the first to enjoy loans from the small pool of ungoverned lending? The better approach is a separate LVR limit applied to each group (e.g. FHBs, investors, existing home owners);

2B(iv). Yes, LVR limits should be applied alongside DTIs as there is an optimal mix, and if one is not specified it will mean that the other limit will have to be applied more stringently to achieve the same

effect. LVR and DTI limits should be permanently in place as preventative tools to prevent excessive credit growth and excessive levels of private debt.

2C (i) Yes, lending standards should apply to all lenders, but it is critical they are applied as permanent constraints to all deposit takers;

2C(ii). The lending standards and lending limits (LVR and DTI) should be applied permanently, with only adjustment of the levels being needed. This adjustment can be done by the RBNZ alone. However, I submit that because lending limits should be permanently in place, and set at levels to prevent excessive credit growth, any adjustment of the limits will only be infrequent (e.g. LVR limits would only need adjustment if the elasticity of supply of the housing market changed.)

2D. The timing of the application of tools such as capital ratios should not subject to be political approval. Rather, application of any such tools should be automatic, based on the breach of some metric, so as to eliminate any political impediment to implementation. It seems very apparent that there is no time that seems politically favourable to restrict credit growth, even if that credit growth is clearly dangerous. That is, for example:

- CCYB should be imposed automatically whenever the rate of credit growth exceeds the rate of growth in incomes.

- if not permanently in place, LVR and DTI limits should be imposed whenever banks are failing to voluntarily contain their lending standards substantially within such defined limits and tolerances.

(Note: I would be happy for the opportunity to support my strong assertions above that investors (and other homeowners) who seek to borrow using existing assets as collateral, and banks who agree to accept such nominal equity at high LVRs (> 60%), are together a primary cause of financial instability and danger for the economy).

How should the Reserve Bank supervise and enforce prudential regulation?

- 3.A What do you think are the strengths and weaknesses of the Reserve Bank's current approach to supervision and enforcement?
- 3.B Do you think that the Reserve Bank's planned approach to the supervision and management of climate change-related risks is appropriate and adequate? Do you think that the Reserve Bank's approach to climate change would be different if it was given a more explicit climate change objective, as considered in question 2B of Consultation Document 2A?
- 3.C In what areas do you think the Reserve Bank could improve its approach to supervision and enforcement? How could this be best achieved (e.g. through legislative change, resourcing, relationships with regulated entities)?
- 3.D Do you think the Reserve Bank should take a more intensive approach to verifying supervisory information? If so, which verification model do you favour?
- 3.E What are the appropriate enforcement tools for the Reserve Bank? Which tools in particular should be added to the toolkit?
- 3.F Is the Minister's role in issuing directions and deregistration appropriate?

No comment

How should the Reserve Bank's balance sheet functions be formulated?

- 4.A Should more detailed principles for the Reserve Bank's LoLR function be set out in legislation? Do the principles and governance considerations in Chapter 4 seem appropriate? Would you add others?
- 4.B If the Reserve Bank were to launch an asset purchase programme (quantitative easing), do you believe it should be able to make its own decisions to purchase government debt, but require ministerial consent to purchase other assets? Are there other implementation issues around asset purchase programmes that should be considered?
- 4.C How much power should the Minister have in determining the scope and objectives of the Reserve Bank's foreign exchange interventions? Should the current arrangements – which will give some decision-making power to the Minister, the MPC and the new Reserve Bank governance board – be broadly retained, or should the Reserve Bank's autonomy be increased?
- 4.D Do you have any other comments on the balance sheet functions described in Chapter 4?

4B. "Quantitative easing" as applied in recent years by central banks to reduce long term interest rates is proving to be a flawed and dangerous mechanism leading to egregious social inequality and market disruption. On no account should the RBNZ be allowed to apply this mechanism except by explicit approval at all levels of governance including the Minister of the Crown, and then only within prescribed limits and duration.

What features should New Zealand's bank crisis management regime have?

- 5.A What are the most important objectives for New Zealand's resolution authority? Should they be ranked in order of importance? Would the objectives suggested above strike the right balance between providing guidance and accountability for the Reserve Bank and flexibility for the Reserve Bank to deal effectively with a crisis?
- 5.B Is the proposed resolution authority function for the Reserve Bank specified appropriately? Do you see any alternatives to the Reserve Bank as resolution authority??
- 5.C Should the current requirements for ministerial consent be replaced with an ability for the Minister to direct the Reserve Bank when public funds could be at risk? Are there additional circumstances in which the Minister should be able to direct the Reserve Bank on a resolution if public funds are not at risk?
- 5.D Should the Reserve Bank, as the resolution authority, have resolution powers (instead of only statutory managers having these powers)?
- 5.E In principle, should the Reserve Bank have the power to 'bail in' specified categories of unsecured liabilities (with details of eligible liabilities to be determined and subject to creditor property rights safeguards – see below) in order to recapitalise a failing large bank after its owners have absorbed maximum losses, and to minimise the need for taxpayer support? Alternatively (or in addition), should the recapitalisation of a failing large bank be funded through industry-wide levies?
- 5.F Do you agree with the proposal to allow continuous disclosure-to-market requirements to be suspended temporarily, subject to conditions and safeguards? Are the suggested conditions and safeguards appropriate, or should there be others?
- 5.G Should the resolution authority always be required to respect property rights (including the hierarchy of creditors in liquidation)? Or should it have discretion to override property rights as long as compensation is made available to creditors left worse off than they would have been in a liquidation? Or should no change be made to the protection of creditor property rights?
- 5.H Should an industry-funded resolution fund be established (alongside any deposit insurance scheme fund)?
- 5.I Do any other aspects of cross-border resolution need to be considered in the design of New Zealand's crisis management framework?

5.E Irrespective of any scheme of deposit insurance, the bail-in of ordinary depositors should be the last resort in all cases. No other bank creditors should have priority above ordinary depositors, especially those who do not have deposit insurance. Capital requirements of banks should be at a sufficient level to ensure that such the catastrophic and unjust bail-in mechanism should only be expected to be imposed on depositors at a very low frequency. i.e. bail-in of depositors should be only be expected to occur once in 500 years (much greater than the once in 200 years recently proposed by the RBNZ). This level of acceptable expected frequency of bail-in should be specified by the Crown to the RBNZ so as to assist the RBNZ to formulate its regulations for macroprudential protections.



How should the Reserve Bank coordinate with other agencies?

- 6.A What do you see as the main pros and cons of the existing coordination arrangements, and why?
- 6.B What would you change about current arrangements, and why?
- 6.C Which, if any, of the options above for enhancing support for status quo coordination arrangements do you consider would be desirable, and why?
- 6.D Do you think that a high-level coordination objective would be an appropriate way to ensure that the Reserve Bank is coordinating with non-financial sector agencies (for example on climate change)?
- 6.E Which is your preferred option for the structure of CoFR and why?
- 6.F Do you agree with the analysis of the pros and cons of the different options?
- 6.G Are there any other specific coordination mechanisms, bodies, or transparency requirements that the Review should consider?

No Comment

How should the Reserve Bank be funded and resourced?

- 7.A Do you agree with the potential issues identified in the current funding model? Are there any additional issues with the current funding model?
- 7.B How should the Reserve Bank report its funding and spending? Do you have any comments on the transparency of, or accountability for, the Reserve Bank's funding and spending, including the possible channels to strengthen arrangements?
- 7.C Given the in-principle decisions to change the Reserve Bank's governance framework as outlined in Consultation Document 2A, what role should the Minister have in the Reserve Bank's funding model? Should it be different for prudential and non-prudential functions?
- 7.D Should the Reserve Bank continue to be fully funded from revenue (seigniorage and investment income) and fees, or should other funding sources be considered? In particular, should the Reserve Bank have the option to introduce an industry levy to fund the Reserve Bank's prudential supervisory function?
- 7.E Do you have any comments on the illustrative options in Figure 7C and Table 7B? Are there other options, combinations, or additional design features that should be considered?

No comment.



Any other comments?

Click or tap here to enter your answer. Text box expands as you type

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