The Treasury

Reserve Bank Act Review Phase 2 Submission Information Release

October 2019

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RESERVE BANK
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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?

Macroprudential policy – should require a level of government oversight or consultation. Macroprudential policies are intrinsically political and there should be coordination with Treasury. The independence of the RBNZ is important when it comes to financial stability issues but macroprudential tools can and should be used for more than just strict financial stability issues.

The very definition of ‘financial stability’ comes with many assumptions. It does not take into account climate change and ‘stranded asset’ risks; the extent that property and property related businesses (excluding farming); regional disparities and issues of productivity in the economy. These are all bigger risks to banks not addressed by the RBNZ. The RBNZ takes these factors as a given and only can respond to such risks retroactively. The extent of these risks are significant and the RBNZ and Government must work together in steering the economy on to a better and more sustainable path.

We would like to see a more competitive environment for the banking sector and supporting of non-bank lending institutions. The RBNZ and Treasury could look toward the development of ‘challenger banks in the United Kingdom. Non-bank deposit-takers (NBDT) should be supported with more specific remits and conditionalities around support of regions; Maori; those with limited access to banking and small and medium sized enterprises.

We see the NBDT’s as playing a key role in widening access to finance in the regions. Monetary policy actions when required should be steered towards funding NBDTs rather than just banks. Conditionalities should still be applied. There should be efforts to level the playing field for access to funds at a regulatory level as part of aims to stimulate regional growth.

Core-prudential rule-making instruments should therefore be through a system of regulations to allow for greater input by Government to achieve economic aims in addition to prudential regulation and monetary policy.

We would want to see consultation specifically on proposals that affect NBDTs. Proportionality should be a significant factor in the regulation of NBDTs. NBDTs are not systemically important which is where the financial stability regulations should be focussed. We want to see simpler and more effective regulation that support NBDTs to increase competition and for engaging in markets. NBDTs often play an important role in their communities, reaching sectors the banks have forgone.

Chapter 2

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?

The RBNZ should reframe its view of macro-prudential policy as just being about financial system risk. There are long-run risks to the economy that are inextricably tied into financing of the economy.

We are in full agreement with the various post GFC macro-prudential tools such as LVR, and the various capital buffers. We want to see more analysis by RBNZ with Treasury on measures to tackle the build up of risks: high household debt levels, high level of property and property related lending vis a vis productive lending to the business (services and manufacturing) sector. Services firms and new economy businesses - some, the very firms that wealth create and support productivity – are not supported by our banking sector. – This is New Zealand's' financial stability risk – relative economic decline. We understand that Government economic policies are the means in how economic development issues should be addressed, but the banking sector is the main driver of financing the economy and the RBNZ (with Government regulations) can play a role in steering banks to support productive investment and get ahead of climate change risks.

The RBNZ's mandate should be widened (by Government) to account for such risks (some of which are becoming more immediate) but yet not accounted for by Basel III or RBNZs rules).

We would like to see the RBNZ having a broad power to use macro-prudential tools in consultation with the Minister of Finance and Treasury.

Chapter 3

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?

Light touch regulation has worked in New Zealand in the past because there has been little financial innovation. With the lending books of banks dominated by housing loans and farm loans the risks are around house and farm property valuations, the analysis of risks are more simple than what is the case with banks in the USA, Europe and the UK. But the ANZ Bank (in New Zealand) and its 'miscalculation' of regulatory capital risk highlights failure by the regulator to catch this much earlier and then to apply tougher enforcement. Such a fundamental breach over an extended period should be of great concern to the public. There should be higher level of public transparency as to how this occurred, who was responsible and appropriate fines, as we would see elsewhere in the UK, EU and USA.

The ANZ had an unfair advantage over its competitors by holding less regulatory capital for its business operations in New Zealand. Gaming regulatory capital is not new; the incentives are great. The ANZ could have saved millions of dollars. Directors bonuses still got paid and there was not even a mention of claw-backs of their bonuses which would happen in the UK and EU.

The Australian Banking inquiry too highlights the risk of light touch regulation and the complacency it engendered. A more comprehensive approach to supervision should be taken. The RBNZ should be given powers to carry out spot-check inspections and regular on-site inspections. Continuous monitoring should be an available power to be used when appropriate issues of concern require it.

In terms of enforcement, the RBNZ should have a full suite of powers to enforce criminal and civil fines against banks, their directors and key staff. The Australian banks based in New Zealand are all systemically important to New Zealand. New Zealand has the additional risk with governance of the banks. Questions of major credit risks, funding and liquidity are ultimately decided by Australian based boards, whose ultimate aim is to protect the parent entity.

The RBNZ should consider looking at enforcement rules in the EU and UK that shift responsibilities to directors and the most senior members of a bank through the Senior Managers & Certification Regime. A proportionate approach is used for less systemically important financial institutions.

Chapter 4

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?

Lender of last resort

There have been lessons learned from the GFC. The UK bank rescue worked but not nearly as well as how the USA handled the matter. The lending of any public finances for a bank rescue must go to Government for approval. We think your option for RBNZ to decide this with ministerial approval is not sufficient. It should be a full cabinet decision. The back drop to this is the incredible fall-out since the GFC and the high debt to GDP ratio in the UK. Austerity measures in the UK have lead to - poverty – weakened government institutions – populism – low productivity – a banking sector even less interested in productive lending. Conditionalities must be put in place on any rescue packages to ensure that lending is pro-business growth.

Monetary policy implementation

The MPC should have the ultimate decision on monetary policy implementation but must consult with the Minister of Finance. We see a role whereby the Minister can make recommendations through guidance so that any actions are also net positive for other strategic goals of government. For example both the Bank of England and the European Central Bank undertook purchases of asset backed securities, corporate bonds and government bonds. Some impacted certain markets which was not supportive of wider aims and crowded out other investors. The banks conservatism meant they did not support other parts of the economy that needed financing for fear of taking on too much risk, instead they squewed safe markets, driving down the yields.

With a more measured and holistic approach and in coordination with government, the RBNZ should take the opportunity to support areas of investment where we can 'crowd in' private sector investment and boost growth which is the ultimate purpose of the unconventional tools.

The provision of cheap financing to banks by the Bank of England did not achieve its aims. The RBNZ should consider other means of ensuring that its policy aims are able to be met.

Chapter 5

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?

Objectives of the resolution regime

This is an important question which need a series of objectives some of which may or may not apply depending on the context of a systemic bank failure.
Financial stability should always be the primary objective and in addition pro-cyclical action may need to be taken if there has been a macro economic shock and banks are conserving capital limiting flow of credit to the economy. Inevitably a banking crisis is a macro economic crisis. Both need to be resolved.

Coordination by RBNZ and Government is there for necessary to ensure the economy gets back on track. Box 5C highlights the risk that liquidity played in the collapse of Northern Rock. The risk is was not the assets of the northern Rock, but is mode of funding - too much was in short term debt funding. As debt markets in the UK and globally dried up because of the GFC firms such as Northern Rock ran out of cash. This was a fundamental flaw in the banks core business with which light touch regulation allowed to happen.

We fully support Special Bank resolution tools. We support the regulations such as the European Union's Bank Recovery and Resolution Directive (BRRD). The transposition of these rules in the UK through the Special Resolution Regime (SRR) have since increased powers to the Bank of England which we welcome.

We would support a full overhaul of New Zealand's Bank resolution rules in light of lessons learnt by other central banks. We also agree with the IMF that the statutory management regime for a bank is a significant weakness with a statutory manager unlikely to have a power to act in the interests of financial stability for the banking system but rather only in relation to the bank in question. The resolution authority must be the RBNZ as part of its overall mandate for financial stability.

The Minister of Finance and Treasury department should be involved early in discussions where there is a risk of systemic risk. The RBNZ has limited capability and a government should be made aware of the risk of potential fiscal and macroeconomic issues. Government must play a role in the responses by RBNZ in the use of public funds.

We do not believe that in New Zealand, as in the UK, that there is sufficient capability within the central bank alone to take such significant measures and understand the ramifications on markets and the wider economy. The various actions for the bail-out of banks in the UK required Government to act and the co-opting of bankers from the private sector to assist in the financial rescue. Without doubt the macroprudential actions were a success in the UK, but there were clear failures and high costs borne by the public.
New Zealand has limited experience in banking crises and bail-outs. The skills and understanding should be wider than just the RBNZ. We recommend that the Government should take ultimate responsibility for use of public funds because of their wider remit to society.

Bank Run

Banking sector should be directed early on in a bank run crisis where there is good evidence that a Bank's management are losing public confidence and a bank run is escalating. The RBNZ should have powers to require the other systemically important banks to shore up the particular bank that is at risk on a fully collateralised basis. A bank run will entail funds going out of one bank and into the other 4 main banks. A package of securitised prime mortgages with appropriate 'haircuts' would allow for the 4 stable banks through inter-bank lending to support the ailing bank on a fully collateralised basis. This would be overseen by the RBNZ. It would go a long way to ensuring liquidity and assist in the stabilisation of the bank. These actions should be taken before any form of public funding or statutory management should take place. We strongly agree with the Consultation paper 2b section 4 at page 120. Statutory management should be a last resort. The mere act of putting a bank into statutory management will halt all means of additional funding from deposits, debt or equity. The bank will be effectively cast adrift from markets. We would like to see wider powers for RBNZ prior direct and manage a bank before any statutory management is imposed. We favour bail-in rights while the entity remains operational.

We are fully in agreement with the FSB comments around putting public funds at risk. We agree that debt and equity owners of a bank should bear the losses for failed or rescued bank. The rigours of the market should bear on debt and equity holders. The fire-power of public funds can be better used as a more direct stimulus if the economy is under pressure.

Chapter 6

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?

We support deposit insurance as a cheap and effective means of protecting the public from bank failures. It has systemic importance and should be put in place. New Zealand is an outlier in not having deposit insurance. If RBNZ has appropriate rules in place there is no loss of moral hazard for depositors opting to choose a weaker bank. There should be a minimum set of operating standard that banks must meet or risk loosing their licence. Moral hazard is not a strong argument for a utility function of deposit taking by a bank.

Chapter 7

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?

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

Any other comments?

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

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