

The Treasury

Reserve Bank Act Review – In-principle decisions and the release of the third consultation document

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Chair,
Cabinet Economic Development Committee

Reserve Bank Act Review – In-principle decisions and the release of the third consultation document

Proposal

1. This paper seeks agreement to release a third consultation paper on prudential regulation and related matters as part of the Reserve Bank Act Review.

Executive Summary

2. Phase 2 of the Reserve Bank Act Review (the Review) is developing recommendations on a new legislative framework for the prudential regulation of banks and other deposit takers (the Deposit Takers Act), alongside the development of a new governance framework for the Reserve Bank (the Institutional Act). In December 2019, Cabinet took a series of in-principle decisions related to prudential regulation and related matters such as deposit insurance [DEV-19-MIN-0346 refers].
3. I am seeking Cabinet approval to release the attached consultation document for the third round of public consultation on the Review, covering the detailed design elements of the Deposit Takers Act, including the design of the new deposit insurance scheme. Key issues examined in the consultation document include:
 - 3.1. the definition of a deposit taker and the treatment of different types of entities within the regulatory perimeter
 - 3.2. the permitted scope and process requirements for prudential standards

- 3.3. the liability and accountability framework for deposit takers and their directors, and the supervision and enforcement tools available to the Reserve Bank
- 3.4. the design of some key elements of the new crisis management and resolution framework, including the triggers for resolution, the framework for implementation of the new bail-in powers and the application to deposit takers of CIMA statutory management, and
- 3.5. the scope of the deposit insurance scheme, along with the functions and governance of the insurer and how the deposit insurer will be funded.
4. Consultation with the public, regulated entities and other interested stakeholders on the design of the legislation is critical to the delivery of an effective prudential framework for deposit takers. There will be around six weeks for consultation following the public release of the consultation document.
5. I intend to report back to Cabinet with final policy decisions for the Deposit Takers Act in early August 2020, with a view to introducing legislation to Parliament in the first half of 2021.

Background

6. In 2017, the Government announced it would undertake a Review of the Reserve Bank of New Zealand Act 1989 (the Review) to modernise the monetary and financial stability policy frameworks and the Reserve Bank's governance and accountability settings. This Review is one of the Government's initiatives under the 'grow and share more fairly New Zealand's prosperity' priority outcome, supporting the development of a productive, sustainable and inclusive economy. Phase 1 of the Review, which dealt with monetary policy arrangements, is now complete.
7. Phase 2 of the Review considers the Reserve Bank's financial policy framework, which provides the basis for prudential regulation and supervision, as well as the Reserve Bank's broader governance and accountability arrangements. Cabinet agreed the Terms of Reference for Phase 2 in May 2018 [DEV-18-MIN-0082 refers], and I released these to the public on 7 June 2018.
8. A joint Review team comprising members of the Treasury and the Reserve Bank is carrying out Phase 2 of the Review. The team is supported by an Independent Expert Advisory Panel (the Panel). The Panel also provides advice directly to me, as appropriate. For Phase 2, the Panel consists of Suzanne Snively (Chair), Malcolm Edey, Girol Karacaoglu, Barbara Chapman, Belinda Moffat, and John Sproat¹.

¹ Mr Sproat resigned in January 2020 due to other commitments.

Development of the Deposit Takers Act

9. Deposit takers play a critical role in enabling borrowing and saving in the economy. The prudential regulation of deposit takers aims to protect society from the damage to the financial system and wider economy that could be caused by excessive risk taking by this sector, and the failure of individual deposit takers.
10. The Review aims to reform the prudential framework for deposit takers to deliver:
 - 10.1. An **independent, transparent and accountable regulator**.
 - 10.2. A regime that promotes **financial stability** while supporting sustainable growth.
 - 10.3. A **flexible and empowering** regulatory framework.
 - 10.4. A **well-understood and credible** framework for financial regulation.
11. Following the first round of consultation on Phase 2 of the Review, Cabinet made an initial set of in-principle decisions in June 2019 to:
 - 11.1. retain prudential regulation and supervision functions as part of the Reserve Bank's responsibilities
 - 11.2. merge New Zealand's two existing prudential regimes for regulating banks and non-bank deposit takers into a single deposit-taking regime, and
 - 11.3. establish a deposit insurance scheme.
12. A second consultation paper was released in June 2019, following up on the initial in-principle decisions and examining the Reserve Bank's regulatory tools, powers and approach.
13. In December 2019, Cabinet agreed to replace the current Reserve Bank of New Zealand Act 1989 with two pieces of legislation [DEV-19-MIN-0345 refers]:
 - 13.1. the first will provide for the institutional form and governance of the Bank ('the Institutional Act')
 - 13.2. the second will set out the Bank's prudential functions and powers in relation to deposit taking institutions ('the Deposit Takers Act').
14. Cabinet also made a number of further in-principle decisions on the Deposit Takers Act framework [DEV-19-MIN-0346 refers], including:
 - 14.1. that standards set by the Reserve Bank would be the primary tool for imposing regulatory requirements on deposit takers

- 14.2. increased accountability requirements for directors of deposit takers
- 14.3. the introduction of a more graduated enforcement and penalty framework for breaches of the Deposit Takers Act
- 14.4. that the deposit insurance scheme will be funded by levies on deposit takers, with a maximum coverage of \$50,000 per depositor per institution
- 14.5. the designation of the Reserve Bank as the resolution authority for deposit takers, with clear statutory functions and objectives and the ability to restore to solvency or to recapitalise a failed deposit taker using statutory bail-in.

Consultation approach

- 15. The Review team has prepared the attached document for the third round of consultation on the Deposit Takers Act. The consultation document's purpose is to test many of the proposed details of the prudential framework for banks and other deposit takers, building on the previous two rounds of more general consultation and Cabinet's in-principle decisions to date.
- 16. Consultation with the public, regulated entities and other interested stakeholders on the design of the legislation is critical to the delivery of an effective prudential framework for deposit takers. While many of the issues canvassed in the consultation document are relatively detailed compared to previous rounds of consultation, it is important that they are tested with stakeholders in order to inform final policy decisions for the legislation.
- 17. Issues that are likely to be of most interest to stakeholders include:
 - 17.1. the regulatory approach to finance companies and wholesale-funded lenders
 - 17.2. the scope of the Reserve Bank's standard-setting power, including in relation to macro-prudential standards such as loan-to-value ratios
 - 17.3. the specification of new accountability duties on directors
 - 17.4. the products that would be covered by deposit insurance
 - 17.5. the implications for depositors, other creditors and industry of deposit preference and future funding arrangements for deposit insurance.
- 18. In preparing the consultation document the Review team has been mindful of the need for the consultation to be accessible to non-specialist audiences. An external editor has been engaged to ensure the readability of the document. The executive summary includes some visual summaries of the work.
- 19. I also note that a number of more technical aspects of the proposed crisis management and resolution framework, such as the relationship between a statutory manager of a distressed bank and the Reserve Bank as resolution authority, are being developed by the Review team with relevant experts in

parallel with the public consultation process. The Review team also plans to test certain technical aspects of this proposed framework directly with relevant experts.

Consultation document – structure and content

20. The consultation document is divided into eight chapters. The first chapter provides context about the overall Phase 2 Review and in-principle decisions to date, while the other chapters cover:
 - 20.1. The purposes of the Deposit Takers Act – the proposed purposes of the legislation and the specification of the Reserve Bank’s decision-making principles.
 - 20.2. The regulatory perimeter – the definition of a ‘deposit-taker’ and the consequential treatment of entities that sit on the boundary of that definition.
 - 20.3. Standards and licensing – the permitted scope and process requirements for prudential standards and the licensing requirements for deposit takers.
 - 20.4. Liability and accountability – the liability of entities and individuals for breaches of the Deposit Takers Act and the proposed accountability framework for the directors of deposit takers.
 - 20.5. Supervision and enforcement powers – the supervision powers of the Reserve Bank and the enforcement tools available to it to effect corrective action.
 - 20.6. Resolution and crisis management - the design of some key elements of the new framework, the framework for implementation of the new bail-in powers and the application to deposit takers of CIMA statutory management.
 - 20.7. Depositor protection – the design of the deposit insurance scheme, including: the scope of insured products; the functions and governance of the insurer and how the deposit insurer will be funded. The chapter also discusses the option of giving depositors preference, or priority, over other unsecured creditors.
21. The Independent Panel has provided detailed feedback on the Consultation 3 document and considers it now covers the ground for consultation. The Panel has emphasised the importance of meeting with groups of depositors around the country to achieve wider feedback from them.

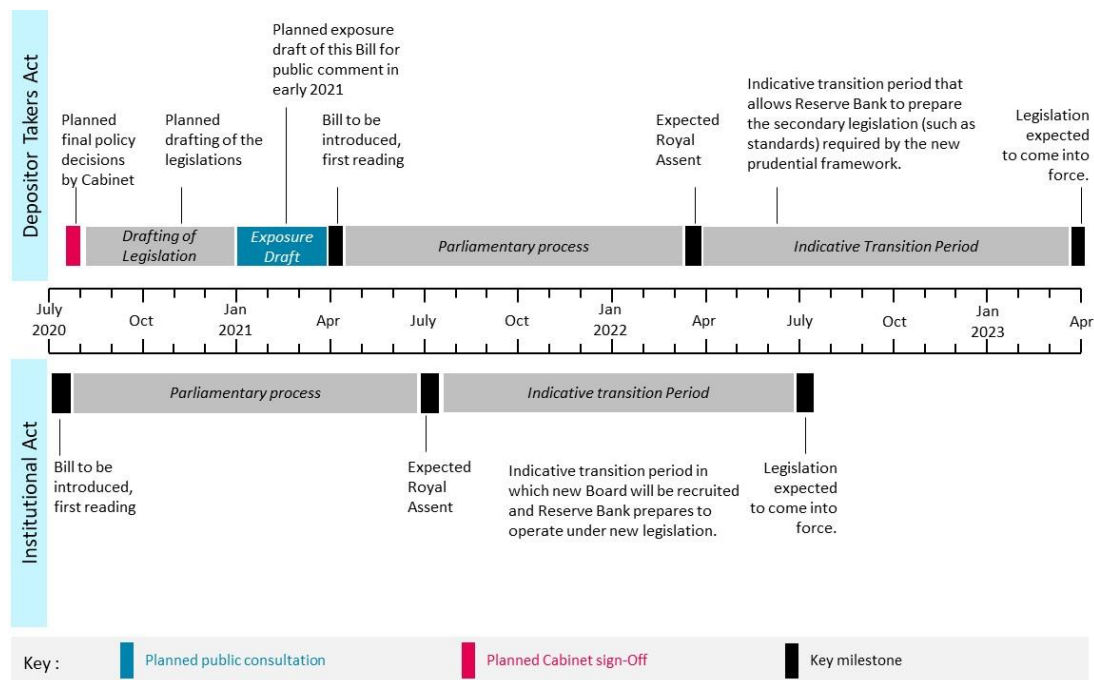
Next steps

22. There will be around six weeks for consultation following the public release of the consultation document, through to late April 2020. This timeframe is necessary to allow for policy decisions on the Deposit Takers Act to be made

prior to the election. To facilitate engagement, officials will meet with key stakeholders and hold workshops with stakeholder groups.

23. I intend to report back to Cabinet with final policy decisions for the Deposit Takers Act in early August 2020, with a view to releasing an exposure draft of the legislation in early 2021 and introducing legislation to Parliament in the first half of 2021. Based on this timing the Deposit Takers Act would be likely to be enacted in 2022. A transition period would also be required for the Reserve Bank to finalise its prudential standards and for deposit takers to come into compliance and go through the necessary licensing processes.
24. An indicative timeframe showing key milestones for both the Deposit Takers Act and the Institutional Act is below.

Indicative timeframe for legislative process



Interagency consultation

25. The joint Review team, comprising staff from the Treasury and the Reserve Bank, prepared the attached consultation documents. The following agencies were consulted: the Ministry of Business, Innovation and Employment, the Financial Markets Authority, the Commerce Commission, the Ministry of Justice, and the State Services Commission.
26. The Department of the Prime Minister and Cabinet was informed.

Financial Implications

27. This paper has no direct financial implications.

Human Rights

28. There are no human rights implications arising from this paper.

Legislative Implications

29. There are no legislative implications arising directly from this paper. Final policy decisions made later in the Review will be implemented through a new piece of legislation (the Deposit Takers Act).

Regulatory Impact Analysis

30. A regulatory impact statement is not required at this stage. The consultation document incorporates elements of regulatory impact analysis, and a regulatory impact statement will be prepared when final policy decisions are sought.

Gender Implications

31. There are no gender implications arising from this paper.

Disability Perspective

32. There are no disability implications arising from this paper.

Publicity

33. The consultation documents will be made available on the Review section of the Treasury website. A media release will be issued when the consultation documents are released. A programme of stakeholder engagement is planned to follow the release.

Proactive Release

34. I propose to proactively release this Cabinet paper, in full, as part of a wider proactive release of material (such as policy advice reports) relating to the development of the set of second consultation documents.

Recommendations

35. I recommend the Committee:

- 1 note the focus of the attached consultation paper is to seek further feedback on the detailed design of the Deposit Takers Act, including the establishment of formal deposit insurance and other protections for depositors
- 2 agree that the Minister of Finance release the attached consultation document
- 3 authorise the Minister of Finance to approve minor amendments and refinements to the consultation documents
- 4 note the consultation period will run for 6 weeks commencing on or around 9 March
- 5 agree that Cabinet's decisions and this paper be publically released
- 6 note that the Minister of Finance expects to report back to Cabinet on the outcome of this consultation in early August 2020.

Authorised for lodgement

Hon Grant Robertson
Minister of Finance