The Treasury

Additional Documents Related to Phase 2 of the Reserve Bank Act Review - December 2019 to April 2021 - Proactive Release

June 2021

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Key to sections of the Act under which information has been withheld:

[7] 6(e)(ii) - to prevent serious damage to the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the regulation of banking or credit

[27] 9(2)(ba)(ii) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely otherwise to damage the public interest

[29] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment

[36] 9(2)(h) - to maintain legal professional privilege

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

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RESERVE BANK OF NEW ZEALAND
TE PŪTEA MATUA

TE TAI ŌHANGA
THE TREASURY

Report: Financial Policy Remit

Date:	20 February 2020	Report No:	T2020/88
		File Number:	MC-1-7-3-1-3

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance**	**Agree** to the recommendations **Note** the previous Cabinet decisions and the additional information provided **Indicate** whether you would like to refer the recommended changes to Cabinet	25 February 2020

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Elizabeth Bolton	Senior Analyst, Reserve Bank Act Review	[39]	[35]	✓
Tamiko Bayliss	Director, Reserve Bank Act Review, Reserve Bank Act Review		N/A	

Minister's Office actions (if required)

Return the signed report to Treasury.
Refer this briefing to the Associate Ministers of Finance

Note any feedback on the quality of the report	

Enclosure: Yes – Joint Report with sample Financial Policy Remit

Treasury Report: Financial Policy Remit

Executive Summary

As part of the development of a new Reserve Bank Institutional Act, Cabinet has agreed that the Minister will be required to issue a Financial Policy Remit (the Remit) [DEV-19-MIN-0345].

You have requested a sample Remit. The process of developing a sample Remit has resulted in further clarification regarding the scope of the Remit and when it will apply, in order to reach an agreed approach between the Treasury and the Reserve Bank. As a result, changes are recommended in relation to previously agreed decisions. The proposed changes relate to: the Remit's scope; when the Reserve Bank should have regard to the Remit; and procedural requirements. You may wish to seek further Cabinet decisions on these matters.

Additional commentary is also provided regarding: the role of the Remit; the scope of the Remit; how the Remit will influence the Reserve Bank's decision making; operational independence; the procedure for developing and issuing the Remit; and other relevant documents.

Recommended Action

We recommend that you:

a **note** the previous decision by Cabinet that the responsible Minister be required to issue a Remit which sets out the matters the Reserve Bank Board should have regard to when pursuing the financial stability objective

b **note** that in the course of developing the sample Remit, we have further clarified the role of the Remit and the circumstances under which the Board needs to consider it, resulting in some recommended changes to the original Cabinet decision

c **agree** that the Remit will set out the matters the Reserve Bank should have regard to when pursuing the financial stability objective, <u>as well as</u> the purposes of the Deposit Takers Act (DTA) and the Insurance (Prudential Supervision) Act 2010 (IPSA) Acts, and when applying the decision-making principles

Agree/disagree.

d **agree** that the Reserve Bank be required to have regard to the Remit when:

- formulating and implementing its strategic approach to advancing the financial stability objective and the purposes of the DTA and IPSA, and
- developing standards.

Agree/disagree.

e **note** the previous decision by Cabinet that the Remit be published in the *Gazette*

f **agree** that instead of publishing the Remit in the *Gazette* in its entirety, that the issue of a Remit will be notified in the *Gazette* and that the Remit itself will be published in a publically available location

Agree/disagree.

g **note** the previous decision by Cabinet that the Remit be reviewed at least every five years

h **agree** that instead, the Remit be reviewed not later than six months prior to the start of the financial year for which a new Statement of Intent (SoI) is required (it would need to be reviewed at least every three years)

Agree/disagree.

i **refer** this briefing to the Associate Ministers of Finance

Refer/not referred.

j **indicate** whether you would like to refer the changes to Cabinet
Yes/no.

Tamiko Bayliss
Director, Reserve Bank Act Review – Phase 2

Hon Grant Robertson
Minister of Finance

Report: Financial Policy Remit

Purpose of Report

1. The purpose of this report is to provide you with an example Financial Policy Remit (the Remit) as requested by your office. This is accompanied by explanatory material regarding: the role of the Remit; its scope; how the Remit will influence the Reserve Bank's decision making; preserving the Reserve Bank's operational independence while ensuring ongoing accountability; procedural requirements; and other relevant documents.

2. The report also asks you to make further decisions with regard to:
   - the scope of the Remit
   - how the Remit must be taken into account in the Reserve Bank's decision making, and
   - procedural requirements for the Remit.

Analysis

Background

3. Cabinet has previously agreed [DEV-19-MIN-0345] that under the Reserve Bank Institutional Act, the Minister will be required to issue a Remit. The Reserve Bank will be required to have regard to the Remit in the exercise of its financial regulatory powers in the sectoral Acts (the Deposit Takers Act (DTA) and the Insurance (Prudential Supervision) Act 2010 (IPSA)). The Remit will replace the direction powers in section 68B of the Reserve Bank of New Zealand Act 1989, section 13 of IPSA and section 9 of the Non-bank Deposit Takers Act 2013.

4. The Minister issues a separate Remit for the Monetary Policy Committee (MPC). This sets out the objectives of monetary policy. The MPC formulates monetary policy in accordance with these objectives.

Role of the Remit

5. The Phase 2 Review aims to create a fit for purpose prudential regime that is enabling and empowers the Reserve Bank to achieve its statutory mandate. It is intended to be able to adapt to the evolving nature of the financial system and its attendant risks. One part of the Review has been to re-specify the Reserve Bank's financial policy mandate more clearly (the 'what'). Another key aspect of the Review has been to ensure that the Reserve Bank has the requisite powers to fulfil its statutory role, and an appropriate degree of autonomy (operational independence) to decide how to use those powers (the 'how').

6. The Remit recognises that operational independence is different to, and should not be conflated with, 'goal independence'. While it is acknowledged that the Bank must have operational independence, it also needs to be accountable for achieving its goals. It is Parliament that sets the objectives for any agency that sits at arm's-length from Government. However, there are inherent limits on the degree of clarity or precision that can be given to financial policy objectives in legislation.

7. Financial stability, for example, is a multifaceted concept. It cannot be readily quantified into one or two intermediate objectives (unlike monetary policy). The subjective nature of financial stability is tied, in part, to the risk appetite that different stakeholders have for financial system outcomes. In crude terms, this might be expressed as the trade-off between: a very stable financial system with few institutional failures (with financial firms very constrained in their ability to take risks); and a more competitive and innovative financial system (perhaps complemented by a light touch approach to prudential regulation and supervision).

8. The proposed decision-making principles in the DTA provide some legislative clarity for the Reserve Bank regarding its statutory goals for the deposit taking sector (see Annex 2). The decision-making principles are designed to encourage the Reserve Bank to not pursue financial stability at all costs. Despite this, the legislative framework still requires a mechanism for society (through elected governments) to provide an ongoing interpretation of the financial policy goals for the Reserve Bank. This is ostensibly the role of the Remit.

9. In summary, the Remit should not create any <u>new</u> objectives for the Reserve Bank. Rather, it should provide clarity to the Reserve Bank regarding the Government's priorities and policies that the Reserve Bank must have regard to when pursuing the financial stability objective and statutory purposes.

10. Remit-type letters are also a feature of other prudential regimes (see Annex 3). The Australian Prudential Regulation Authority (APRA) is issued with a *Statement of Expectations* from the Government. The Bank of England's Financial Policy Committee (FPC) and Prudential Regulation Committee (PRC) are both issued letters from the Chancellor of the Exchequer (annually in the case of the FPC, and at least once in each Parliamentary term in relation to the PRC). In the case of the PRC, the letter allows the Government to make recommendations to the PRC about "aspects of economic policy" which it should have regard to when considering: how to advance the <u>objectives</u> of the Prudential Regulation Authority (PRA); and the application of <u>regulatory principles</u> that are set out in legislation.

Scope of the Remit

11. Cabinet agreed that the Minister will be required to issue a Remit setting out matters the Reserve Bank should have regard to when pursuing the financial stability objective [see DEV-19-MIN-0345]. The financial stability objective will be directed at "protecting and promoting the stability of New Zealand's financial system". This objective will be located in the Institutional Act and is the primary objective of the Bank when exercising its financial regulatory powers under the sectoral Acts.[1]

[1] The application of the Remit to the Financial Markets Infrastructure Act (currently a Bill) will need to be further considered, to ensure that it is compatible with the co-regulator model (certain payment systems will be jointly regulated by the Reserve Bank and the Financial Markets Authority).

12. The intention is that the Reserve Bank will have regard to the matters set out in the Remit when pursuing the financial stability objective and the purposes of the sectoral Acts. The Reserve Bank has been delegated significant policy making powers. Enabling the Minister to set out matters the Reserve Bank must have regard to when exercising those powers will ensure that the Reserve Bank considers the priorities and policies of the democratically elected government of the day.

13. Further consideration has been given to how the purpose statement for the DTA will be specified. While it was previously thought that the purpose statement for the DTA would sit under the overarching financial stability objective, it is now recommended that the DTA have four purposes, in addition to the financial stability objective in the DTA. The revised purposes will recognise the Reserve Bank's role in regulating individual entities, even when there is not a system-wide financial stability reason for doing so. The revised specification of the purposes in the DTA is as follows:

    The purpose of the Deposit Takers Act is to

    - promote the safety and soundness of deposit takers
    - promote public confidence in the financial system
    - mitigate the risks that arise from the financial system, and
    - in doing so, contribute to protecting and promoting the stability of New Zealand's financial system.

14. We recommend that the Remit provide matters that the Reserve Bank must have regard to in the pursuit of both the financial stability objective and the purposes in the sectoral Acts.

15. In addition, we recommend that the Remit provide matters the Reserve Bank must have regard to when considering the decision making principles in the sectoral Acts. As noted above, this aligns with the approach taken in the UK to the Chancellor's letter of recommendations to the PRC.

16. The decision-making principles that will sit in the new DTA, and those that currently sit in IPSA, are 'unweighted'. That is, legislation is silent on the relative importance of the individual principles that the Reserve Bank must have regard to when pursuing its statutory purposes. The Remit will enable the Government to emphasise or implicitly 'weight' a principle or set of principles. For example, a government which was particularly concerned with the cost of doing business, could choose to draw a link between a relevant government policy and the first decision-making principle in the DTA that requires the Reserve Bank to consider the compliance costs imposed on deposit takers in the course of any regulatory action. Similarly, a link could be made between the principle tied to the desirability of competition in the financial sector, and any specific government policies in this area.

How the Remit will influence the Reserve Bank's decision-making

17. The Board will make a range of financial policy decisions under the new governance arrangements. This includes formulating and overseeing the implementation of the strategic approach of the Bank. It also includes setting prudential requirements through secondary legislation and conditions of licence, and taking action in relation to individual entities.

18. Further clarity is required regarding when the Reserve Bank would have an obligation to consider the matters in the Remit. We recommend that the Bank be required to have regard to the Remit when:

- formulating and implementing its strategic approach to advancing the financial stability objective and the purposes of the DTA and IPSA ; and

- when developing standards under the DTA and IPSA.

19. Requiring the Reserve Bank to have regard to the Remit when undertaking these activities recognises that the Reserve Bank has been given responsibility for the oversight of the financial system, along with significant financial policy functions.

20. Like a Crown entity, the Bank will be required to set out the entity's strategic intentions and medium-term undertakings in a Statement of Intent (SoI). Financial policy does not operate in a vacuum and the strategic direction of the organisation should take into account the wider economic and social context. The Remit is a mechanism for the Government to communicate relevant policies and priorities that reflect the wider economic and social context. It will also help align the Bank's strategic direction with wider societal expectations. For this reason we recommend that the Reserve Bank be required to take account of the Remit when formulating and implementing these strategic intentions. This is an ongoing high level and strategic obligation, rather than a detailed operational obligation, that does not end with the publication of a SoI.

21. It is proposed that the Reserve Bank be delegated significant law making powers in the DTA. This is uncommon in the New Zealand regulatory context (although less so by international comparison). In addition, the Reserve Bank currently has the ability to make standards under the IPSA.

22. Given this significant delegation of law-making power, we recommend that the Reserve Bank be required to consider the Remit when developing standards. This will ensure that the Reserve Bank considers the policies and priorities of the democratically elected Government when exercising its law making function. The Remit will provide the Government with a formal mechanism for communicating relevant policies and priorities. This is preferred relative to informal communication mechanisms which may lack transparency. It may also provide more certainty by providing an alternative to frequent changes to the primary legislation. As the Remit cannot require a particular outcome, the need for independence in setting standards will be preserved.

23. While we recommend that the Remit must be taken into account in the formulation and implementation of the Bank's strategic approach and in the setting of standards, it will not absolve the Reserve Bank of ultimate responsibility for identifying and managing risks relevant to its financial policy functions. The Remit is not a substitute for good governance practices and policy analysis. The Reserve Bank still retains responsibility for determining priorities and resource allocation.

24. We do not intend that the Reserve Bank will have regard to the Remit when making decisions relating to licencing, setting licence conditions or enforcement activity for individual entities or classes of entities. As noted, the Remit should not impinge on the operational independence of the Reserve Bank.

Protecting operational independence

25. The following characteristics of the Remit will protect the operational independence of the Reserve Bank:

    - The Remit is not intended to be an extensive list of the Government's policies, priorities and objectives. The subject matter will be limited by the fact that it must relate to the financial stability objective, the purposes in the sectoral legislation, and the decision-making principles. It should not reference wider policy matters that are difficult or unreasonable for the Reserve Bank to have regard to.

    - The Remit should not link the Government's policy priorities to specific outcomes in the SoI or standards. The Remit should not, for example, be the vehicle for a Government to specify minimum capital requirements.

    - The Remit should not attempt to quantify financial system outcomes in the same way the Monetary Policy Remit does for price stability. While a 'risk appetite' statement may be appropriate and legitimate content for the Remit, this should be specified qualitatively and at a fairly high level of generality. This will ensure that it does not give the appearance of locking the Reserve Bank into (possibly unachievable) 'targets' for financial policy.

    - The Remit cannot be used to require the performance or non-performance of a particular act, or the bringing about of a particular result, in respect of a person or persons. This will preserve the Reserve Bank's autonomy around supervisory and enforcement-related decisions. For example, the Remit cannot state that action should be taken in relation to a particular entity.

26. In addition to the constraints around the scope of the Remit, operational independence is ultimately protected by the 'have regard to' quality of the Remit's content. The Remit cannot direct the Reserve Bank to perform its statutory functions in a particular way or to achieve specific outcomes.

Procedural requirements

27. Cabinet agreed that the following procedural requirements would apply to the Remit:

    - the responsible Minister will be required to consult with the Reserve Bank before issuing the Remit

    - the Remit will be published in the *Gazette* and tabled in the House

    - the Remit will be reviewed at least every five years, and

    - the Reserve Bank will be required to report back in its SoI on how it has taken the Remit into account.

28. Following further discussion and analysis, we recommend that some slight amendments are made to the procedural requirements for the Remit.

29. Instead of publishing the Remit itself in the *Gazette*, the issue of a Remit will be notified in the *Gazette* and published in a publicly available location (for example, the Remit could be published on the Reserve Bank's website).

30. We recommend that the requirement that the Remit be reviewed at least every five years be changed to a requirement that the Remit be reviewed not later than six months prior to the start of the financial year for which a new SoI is required. This aligns with the recommendation above that the Remit be an input into the formulation and implementation of the Reserve Bank's strategic approach. It would allow the Remit to be taken into account in the development of each new SoI. In addition, it would ensure that a new Remit does not require the revision of the SoI at a time it would not otherwise be required.

31. The SoI sets out the strategic objectives of the entity. It must also cover the nature and scope of the entity's functions and its intended operations for the period covered by the SoI. The SoI is also prepared by the entity. Under the CEA framework, the Minister can direct amendments to the SoI. The Minister will not be able to amend the Bank's SoI. The Board will be required to have regard to the Remit when implementing the strategic direction as set out in the SoI, and more broadly when performing its strategic oversight function.

32. The review period provides an element of certainty for the Reserve Bank. It is not fixed, however, meaning that a new Government could issue a Remit or that it can be amended to reflect changes in priorities. The Remit is an ongoing requirement and where a Government chooses not to amend the content, the existing Remit will remain in force.

Other relevant documents

33. A range of other accountability documents will provide mechanisms for addressing expectations outside of the financial stability objective and the Reserve Bank's policy making activities. While it will not be a legislative requirement, the Minister will retain the ability to issue a Letter of Expectations. The Letter of Expectations could, as has previously been the case, include expectations with regard to consultation with the Minister. It could also include ministerial expectations regarding how the Reserve Bank should engage with other government agencies or international counterparts.

34. The Reserve Bank will be required to produce a Statement of Performance Expectations (SoPE) on an annual basis. The SoPE must identify reportable classes of outputs for each financial year, along with measures against which performance can be assessed. This will include measures and targets relating to the Reserve Bank's operations. The Financial Market Authority's (FMA's) SoPE, for example, includes measures relating to the number of industry or business presentations undertaken, timeframes for processing licence applications, and timeframes and standards for investigation and enforcement activities. SoPEs are prepared by the entity and presented to the House of Representatives.

Risks

35. There are some potential risks associated with the Remit. These could include:

[36]

ii The inclusion of matters that are too broad or ill-defined, resulting in a more complex decision-making framework.

iii The inclusion of matters that are loosely related or unrelated to the Reserve Bank's functions which divert the Bank's focus from its main objectives and purposes.

iv The possibility of tension between the Minister and the Reserve Bank if the Minister feels the Reserve Bank did not pay sufficient regard to matters included in the Remit.

36. The following features of the Remit should mitigate these risks:

- The requirement to consult with the Reserve Bank will ensure that it has the ability to provide advice and comment on the proposed content of the Remit.
- It is does not direct the Reserve Bank to undertake a specific action or deliver a specific outcome. Rather, the Reserve Bank will be required to have regard to the Remit.
- Notification in the *Gazette* and tabling in the House will deliver transparency by providing the public and elected representatives with visibility of the content.

Next Steps

37. Cabinet gave you delegated authority to make policy decisions consistent with the December Cabinet decisions. As the Remit is a significant new instrument and we are proposing some changes to the original decisions, you may wish to seek further Cabinet agreement on these matters.

38. The Review Team will consider the application of the Remit to the Financial Markets Infrastructure Act (currently a Bill) in order to address potential complications associated with the co-regulator model.

39. The Review Team will further consider the formal report back requirements and the consequences for non-compliance.

Annex 1

Sample Financial Policy Remit

The Reserve Bank of New Zealand Act 2021 requires me to issue the Reserve Bank with a Financial Policy Remit. This sets out matters the Reserve Bank must have regard to when pursuing the financial stability objective, and when applying the purpose statements and decision making principles in the Deposit Takers Act (DTA) and the Insurance (Prudential Supervision) Act 2010 (IPSA).

The Reserve Bank's role

The Government recognises the important role the Reserve Bank plays in regulating and supervising deposit takers and insurers, and the overarching goal of the prudential framework to protect and promote a stable New Zealand financial system. A stable financial system with sound and strong regulated entities is an important prerequisite for sustainable economic growth.

The Government also recognises that risk-taking is essential to well-functioning markets, and ultimately the efficiency and growth of the New Zealand economy. The prudential regime cannot and should not seek to guarantee a zero rate of failure for regulated financial institutions. The Government expects the prudential regime to contribute to a low incident of failure of regulated entities, while fostering a competitive, innovative and inclusive financial system. Where failures do occur, the Government expects these to be managed in a way that minimises the disruption to depositors, policyholders, the financial sector and broader economy.

The Government's economic plan

This Government is focused on addressing long term economic challenges to New Zealand. This is with a view to building an economy that is more:

- productive;
- sustainable; and
- inclusive.

The Government's economic plan sets out four priorities and the eight key economic shifts that are required to transition the economy. The Reserve Bank must have regard to the relevant aspects of Economic Plan and specific priorities as set out below.

Building a more productive economy

Open banking

I note the work currently being undertaken by the Ministry of Business, Innovation and Employment (MBIE) on open banking. This Government considers that open banking can deliver competition, efficiency and innovation across the financial services sector. The Reserve Bank must have regard to ongoing developments in this area and the Government's desire to see this work progress when pursing the financial stability objective.

Housing affordability

This Government is working towards improving housing affordability and supply. This includes a commitment to ensuring that more low and middle income New Zealanders are able to buy a home. A comprehensive programme of work is taking place designed to deliver improved housing affordability. The Reserve Bank must have regard to the Government's priorities in this area, along with the associated policy programme, when considering the adoption and implementation of macro-prudential tools to achieve financial stability.

Small business

The Government supports continuing access to finance for small to medium enterprises. When pursuing the financial stability objective, the Reserve Bank must have regard to the impact on small business finance. This includes taking into account the New Zealand Small Business Strategy and related initiatives. I note in particular the principles relating to competition and avoiding unnecessary compliance costs, and request that the Reserve Bank take into account this Government's desire to enable the development of the small business sector in New Zealand.

Building a more sustainable economy

Climate change

I acknowledge the work the Reserve Bank has undertaken to identify and manage the financial stability risks associated with climate change. I note the Government's continued focus on transitioning to a climate resilient, sustainable and low-emissions economy.

The Reserve Bank must continue to take into account the risks to financial stability associated with climate change. The Reserve Bank must also take into account the risks associated with climate change when giving effect to the legislative purposes requiring the promotion of public confidence in the financial system, and the maintenance of a sound and efficient insurance sector.

More generally, the Reserve Bank must also have regard to New Zealand's climate change programme. In particular, the Reserve Bank should take into account the work currently being undertaken by the Ministry for the Environment and MBIE on the design of a climate related financial disclosure regime. In particular, the extent to which this may contribute to promoting public confidence in the financial system and the insurance sector.

Affordable and available property insurance contributes to resilience

The Government supports measures that promote a sound and efficient insurance industry that contributes to New Zealanders' resilience to unforeseen events. In particular, this Government has an interest in ensuring that property insurance appropriately contributes to New Zealanders' long-term resilience to all natural disasters, including earthquakes. The extent to which property insurance contributes to resilience will change if the number of underinsured or uninsured properties materially changes. Accordingly, this government is looking to pursue policies that ensure that property insurance is affordable and available. The Reserve Bank must have regard to these government policies when carrying out its functions, including the impact of insurer solvency standards on competition dynamics and compliance costs in the insurance sector, and the implications for the affordability and availability of building insurance generally.

New Zealand's emergency management plan

The National Disaster Resilience Strategy was published in April 2019. I note that the strategy highlights the importance of the ability of infrastructure to function in adverse conditions and to quickly recover after an event. This includes banking and financial services.

The Reserve Bank must have regard to continuing work on developing New Zealand's resilience and ability to respond to emergencies. This includes building the resilience of critical infrastructure and managing insurance risks. This must be taken into account when pursing the legislative purposes in the DTA and IPSA.

Conduct and culture review

This government continues to support measures that ensure the public can have confidence in our financial system and insurance sector. I acknowledge the work done by the Reserve Bank and the Financial Markets Authority on the review of the conduct and culture in New Zealand's retail banks and life insurers. The Reserve Bank must continue to have regard to work being undertaken across government to strengthen public confidence in New Zealand's financial system and insurance sector. This includes an in-principle decision to strengthen director and executive accountability, following recent reforms in Australia.

Building a more inclusive economy

Financial inclusion

I recognise the work the Reserve Bank has been doing with the finance sector and the Council of Financial Regulators on financial inclusion. Increased competition in the retail and commercial banking sectors supports the Government's desire to create a more inclusive economy. The Reserve Bank must have regard to this Government's focus on improving financial inclusion, particularly among low income and rural communities. When assessing regulatory interventions and the relative risk posed by small deposit-takers, the Reserve Bank must have regard to this Government's willingness to tolerate a degree of regulatory risk in order to ensure the ongoing viability of these institutions.

Regional Economic Development

The Government is committed to supporting thriving and sustainable regions. This includes ensuring that regional communities have access to banking and insurance facilities. The Reserve Bank should have regard to the Government's aim to enhance economic development opportunities in the regions, improve social inclusion and participation, and to build resilient communities. In this context, the need to avoid unnecessary compliance costs is noted, including compliance costs that may have an impact on regional services.

Annex 2: Decision-making principles

Proposed for inclusion in the DTA	FMI Bill (clause 13 (2))	IPSA (section 4)
The desirability of minimising unnecessary costs from regulatory actions, taking into account the benefits of the outcomes to be delivered.	(a) The importance of recognising that FMIs can have a key role in maintaining a sound and efficient financial system.	(a) The importance of insurance to members of the public in terms of their personal or business risk management.
The desirability of taking a proportionate approach to regulation and supervision, and ensuring consistency of treatment of similar institutions.	(b) The importance of recognising that primary responsibility for ensuring that an FMI is sound and efficient rests with its operators, participants, and indirect participants and those who own or control its operators, participants, and indirect participants.	(b) The importance of maintaining the sustainability of the New Zealand insurance market.
The desirability that sectors regulated by the Reserve Bank are competitive, taking account of the size of the market.	(c) The need for an FMI's rules to provide, to the extent possible, certainty and predictability about the rights and obligations of its participants and indirect participants, especially in the event of a participant default.	(c) The importance of dealing with an insurer in financial distress or other difficulties in a manner that aims to— (i) adequately protect the interests of its policyholders and the public interest; and (ii) ensure that any failure, or possible failure, of the insurer does not have the potential to significantly damage the financial system or the economy of New Zealand.
The value of transparency and public understanding of the Reserve Bank's objectives and how the Reserve Bank's functions are exercised.	(d) The importance of regulating FMIs in a way that is consistent with international standards for their regulation where those standards are appropriate for conditions in New Zealand.	(d) The importance of recognising— (i) that it is not a purpose of this Act to eliminate all risk of insurer failure; and (ii) that members of the public are responsible for their own decisions relating to insurance.
Consideration of the practice by relevant international counterparts carrying out similar functions, as well as guidance and standards from international bodies.	(e) The need to avoid unnecessary compliance costs and unnecessary constraints on innovation.	(e) The desirability of providing to the public adequate information to enable members of the public to make those decisions.
The desirability of taking into account long term risks to financial stability.	(f) The importance of timely, accurate, and understandable information being available to participants, indirect participants, and potential participants or indirect participants, of an FMI to assist them in making informed decisions about their interaction, or potential interaction, with the FMI.	(f) The desirability of consistency in the treatment of similar institutions (while recognising that the New Zealand insurance market comprises a diversity of institutions).
	(g) The importance of avoiding financial risk to the Crown resulting from a distressed FMI, other than financial risk associated with the Crown being a participant or indirect participant of the FMI.	(g) The need to maintain competition within the insurance sector.
		(h) The need to avoid unnecessary compliance costs.
		(i) The desirability of sound governance of insurers.
		(j) The desirability of effective risk management by insurers.

Annex 3
Remits – the international context

Australia

The Australian Prudential Regulation Authority (APRA) is an independent statutory agency established by the Australian Parliament under the APRA Act 1998. APRA's website details a number of accountability mechanisms. With respect to the executive branch of government this includes a *Statement of Expectations* which sets out the "Government's expectations for how APRA fulfils its role, balances its objectives and responds to changing circumstances in the context of the Government's policy priorities. It also outlines expectations for how APRA manages its relationship with the Government, other agencies and regulators, and issues of transparency and accountability".

The last Statement of Expectations was issued in 2018. The *Statement* outlines the Government's policy priorities for the financial system including a number of legislative and policy initiatives tied directly to APRA's prudential role (such as the implementation of the banking executive accountability regime, higher capital ratios in response to the 2014 Financial System Inquiry, and new crisis management powers).

The *Statement* also outlines the broader regulatory reform programme including reducing red tape and compliance costs for business as part of efforts to encourage innovation and competition. The Government "expects APRA to facilitate an environment where innovation and competition are encouraged and barriers to entry are minimised".

There is a high-level 'risk appetite statement' where prudential regulation should not seek to guarantee 'zero failures' of regulated institutions, but rather "maintain a low incidence of failure of regulated entities while not unnecessarily hindering efficiency, competition, or otherwise impeding the competitive neutrality or contestability of the financial system".

The *Statement* includes expectations around APRA's relationship with the regulated sectors and industry stakeholders, with Government and responsible Ministers, and with the Treasury. The importance of transparency and accountability are also emphasised throughout the *Statement*.

The UK

The Bank of England's Financial Policy Committee (FPC) and Prudential Regulation Committee (PRC) are the decision-making bodies for macro-prudential and micro-prudential policy respectively. The Bank of England Act 1998 provides for letters from the Chancellor of the Exchequer to both bodies (termed 'Recommendations from the Treasury') – annually in the case of the FPC, and at least once in each Parliamentary term for the PRC.

In the case of the FPC letter, the Chancellor is able to specify what the economic policy of the Government is taken to be, and make recommendations about:

- matters the FPC should regard as relevant to its understanding of the BoE's financial stability objective;
- the responsibility of the FPC in relation to the achievement of that objective;
- the responsibility of the FPC in relation to support for the Government's economic policy, and
- matters to which the Committee should have regard to in exercising its functions.

The Governor, as Chair of the FPC, is required to write a formal response to the Chancellor's letter.

The Financial Services and Markets Act 2000 sets out the objectives of the Prudential Regulation Authority (PRA), and 8 regulatory principles the PRA must have regard to when discharging its functions. The PRA's 'general objective' is to promote the safety and soundness of PRA-regulated entities. The PRA also has a specific insurance objective (policyholder protection) and a general 'secondary objective' to facilitate effective competition in the markets for financial services.

The 8 regulatory principles (which also apply to the Financial Conduct Authority) are:

1. the need to use the resources of each regulator in the most efficient and economic way;
2. the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;
3. the desirability of sustainable growth in the economy of the United Kingdom in the medium or long term;
4. the general principle that consumers should take responsibility for their decisions;
5. the responsibilities of the senior management of persons subject to requirements imposed by or under this Act, including those affecting consumers, in relation to compliance with those requirements;

6. the desirability where appropriate of each regulator exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons subject to requirements imposed by or under this Act;

7. the desirability in appropriate cases of each regulator publishing information relating to persons on whom requirements are imposed by or under this Act, or requiring such persons to publish information, as a means of contributing to the advancement by each regulator of its objectives;

8. the principle that the regulators should exercise their functions as transparently as possible.

The Chancellor's letter to the PRC may make recommendations to the PRC about aspects of the Government's economic policy the Committee should have regard to when:

- considering how to advance the objectives of the PRA, and
- when considering the application of the regulatory principles.

Both recent letters state that the UK Government's economic policy objective is strong, sustainable and balanced growth, with price and financial stability as prerequisites. Both letters outline the more specific economic strategy of the Government which includes strengthening the financial system by reducing risks to the taxpayer and building resilience. The PRC letter also detail 6 specific matters the PRC should have regard to when advancing the objectives and considering the regulatory principles. These matters are: competition; growth; competitiveness; innovation; trade, and; better outcomes for consumers.