

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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- [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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Joint Report: Administration of Reserve Bank Legislation

Date:	16 September 2020	Report No:	T2020/444
		File Number:	MC-1-7-3-1-13 (Reports to Minister of Finance and Cabinet)

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	Agree to the recommendations	23 September 2020

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Tim Ng	Deputy Secretary, The Treasury	[39]	[35]
Geoff Bascand	Deputy Governor, Reserve Bank of New Zealand		

Minister's Office actions (if required)

Agree to the recommendations.
Return the signed report to the Treasury.

Note any feedback on the quality of the report

Enclosure: No

Joint Report: Administration of Reserve Bank Legislation

Executive Summary

You have decided that Treasury will be responsible for administration of the Reserve Bank of New Zealand Bill (RBNZ Bill). The Reserve Bank and the Treasury are seeking your decision on who should have responsibility for administration of the Deposit Takers Act and other prudential legislation for the financial sector. The Reserve Bank currently has this role.

Administering legislation involves acting as the lead adviser to the government on 'system strategy', including advising on the outcomes the regulatory system should deliver, designing the regulatory system, and working with other system leads to advise on the broader needs and trade-offs faced by government. Administering legislation is a function of a broader regulatory stewardship role.

This decision relates only to the administration of primary legislation. The Reserve Bank would retain responsibility for developing and maintaining legislative instruments that have been delegated to the Reserve Bank (such as prudential standards).

The existing arrangement (with the Reserve Bank administering the prudential legislation for banks, insurers, non-bank deposit takers, and now financial market infrastructures) was agreed by Cabinet in 2007, on the advice of a cross agency group.

The question of who should have responsibility for administration of legislation relating to the institutional arrangements for the Reserve Bank and the prudential regimes was included in the terms of reference for the Review, and consulted on in November 2018. The public consultation suggested three options: retaining the status quo, shifting responsibility to the Treasury, or a hybrid option (with the Treasury responsible for administration of legislation relating to the Reserve Bank's institutional arrangements and the Reserve Bank responsible for administering prudential legislation). Interested stakeholders largely supported shifting responsibility to the Treasury.

The Public Service Commission (PSC) supports the shift of responsibility to the Treasury. The Legislation Design and Advisory Committee's (LDAC's) view is that the issue in question here is not really about administration of legislation, but about who is best placed to be the Government's lead policy advisor and legislative designer. LDAC considers that the conventional approach (under which policy ministries administer legislation) is likely to lead to better regulatory design and compliance with the Legislation Guidelines.

This report uses the following criteria, including the government's outcomes for regulatory stewardship, as a framework for assessing the arguments for and against each agency having responsibility for administration of the primary legislation:

1. Regulatory systems are comprehensively monitored, reviewed and reported on	4. The needs of decision makers are met
2. Reform is supported by robust analysis	5. Effective and efficient use of resources
3. Operational independence is preserved	6. Reflects best practice

The Reserve Bank considers that the outcomes listed above would be best met by the Reserve Bank retaining administration of primary legislation for the reasons set out in this report. The Treasury considers that the outcomes listed above would be best met by shifting administration of primary legislation to the Treasury for the reasons set out in this report.

The Panel has considered this issue. Based on administration successfully achieving the outcomes as stated above, the Panel supports the proposal that the administration of the prudential legislation shifts to Treasury.

An important consideration in deciding which agency should have responsibility for administering prudential legislation will be whether the agency will have adequate standing resources, and robust processes in place, to discharge its stewardship responsibilities well. Irrespective of who is given responsibility for administration of primary legislation, a high level of cooperation and collaboration between the Reserve Bank and the Treasury will be required for effective regulatory stewardship across the financial sector.

Recommended Action

We recommend that you:

- a) **agree** that the Reserve Bank's current responsibilities for administering prudential legislation be retained (Reserve Bank preferred)

Agree/disagree

OR

agree that the Reserve Bank's current responsibilities for administering prudential legislation be transferred to the Treasury (Treasury preferred)

Agree/disagree

- b) **agree** that, if responsibility for administering prudential legislation is to be transferred to the Treasury, transfer of responsibilities for the Insurance (Prudential Supervision) Act (IPSA) would occur after the completion of the planned review of IPSA and the enactment of any legislative amendments arising out of that review

Agree/disagree

- c) **agree** that, if responsibility for administering prudential legislation is to be transferred to the Treasury, transfer of responsibilities for the Financial Market Infrastructures (FMI) Bill/Act would occur:

- a. after the enactment of the FMI Bill (Treasury preferred)

Agree/disagree

OR

- b. after the FMI Bill has been enacted, policy work on the report backs agreed by Cabinet in December 2018 has been completed, and any legislative amendments arising out of those report backs have been enacted (Reserve Bank preferred)

Agree/disagree

- d) **note** that irrespective of who has responsibility for administration of prudential legislation, effective regulatory stewardship in the financial sector will require a high level of cooperation and collaboration between the Treasury and the Reserve Bank

Noted

Tim Ng
The Treasury

Geoff Bascand
Reserve Bank of New Zealand

Hon Grant Robertson
Minister of Finance

Joint Report: Administration of Reserve Bank Legislation

Purpose of Report

1. This Report provides you with advice on who should be responsible for administering primary legislation governing prudential regulation of the financial sector.
2. Who administers the primary legislation would normally also determine who is formally responsible for issuing drafting instructions to the Parliamentary Counsel Office (PCO). The Review will need to have that agreed in the lead-up to Cabinet decisions on the Deposit Takers Bill.

Background

3. The Reserve Bank has administered the Reserve Bank of New Zealand Act 1989 since it was enacted. On the advice of an interagency group,¹ Cabinet agreed in June 2007 to an allocation of policy responsibilities across agencies that included the Reserve Bank also being responsible for administering what would become the Insurance (Prudential Supervision) Act 2010 and the Non-bank Deposit Takers Act 2013. The June 2007 Cabinet paper described the proposed allocation of policy responsibilities as being based upon its fit with the “business and strategic direction” of each agency, and their capacity “to provide the advice needed, when requested by the responsible Minister”.
4. The Terms of Reference for Phase 2 of the Reserve Bank Act Review (the Review) provide for a comprehensive review of the financial policy responsibilities of the Reserve Bank. These include the Reserve Bank’s responsibility for regulatory stewardship in the financial sector. A key function of regulatory stewardship is administration of primary legislation.
5. The Review first considered who should administer the Reserve Bank’s primary legislation in the course of considering the Reserve Bank’s independence and how well that independence sat with regulatory stewardship responsibilities. In November 2018, the Review consulted publicly on who should have responsibility for administration of the Reserve Bank’s legislation. Stakeholders were asked if the administration of the Reserve Bank Act (and other prudential legislation) should remain with the Reserve Bank or transfer to the Treasury. It also set out a hybrid option, where stewardship of the Reserve Bank’s institutional arrangements would shift to the Treasury, but stewardship of prudential legislation would remain with the Reserve Bank.
6. On 14 February 2019 the Treasury and the Reserve Bank provided you with advice on administration of the Reserve Bank Act and other prudential legislation (T2019/80 refers). The Treasury recommended that responsibility for this role shift from the Reserve Bank to the Treasury. This recommendation was supported by the Review’s Independent Expert Advisory Panel and by most stakeholders that submitted on the issue. The Reserve Bank recommended that responsibility for the role remain with the Reserve Bank. You deferred a decision on this issue and noted that a decision would be made further into the consultation process.

¹ Including the Bank, Treasury, DMPC, SSC, and the then Ministry of Economic Development.
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7. On 11 December 2019 you notified the Cabinet Economic Development Committee of your decision that the Treasury would administer the RBNZ Bill creating the Reserve Bank and setting out the Reserve Bank's governance, objectives, powers and functions [DEV-19-MIN-0345]. The Reserve Bank supported the recommendation for this decision on the basis that administration of the RBNZ Bill accorded with the decision to appoint Treasury as monitor, while administration of prudential legislation accorded with the Reserve Bank's role as regulator.

Administration of legislation and regulatory stewardship

8. Your decision will determine who issues drafting instructions to PCO for the Deposit Takers Act. The relevant agency needs to make appropriate preparations in the lead-up to final Cabinet decisions during the first half of next year. Regardless of which agency has lead responsibility for this process, both agree that the other will be consulted in the development of drafting instructions and throughout the legislative process of the Deposit Takers Act.

Administration of legislation

9. We are seeking your decision on which agency should administer the following pieces of legislation (prudential legislation):
 - a) The Reserve Bank of New Zealand Act 1989, (RBNZ Act)
 - b) The Insurance (Prudential Supervision) Act 2010 (IPSA)
 - c) The Non-bank Deposit Takers Act 2013 (the NBDT Act)
 - d) The Deposit Takers Act (both through the legislative drafting process and when enacted)
 - e) The Financial Market Infrastructures Act (this Act will result from the Financial Market Infrastructures Bill, which is currently before the House).
10. The Reserve Bank administers the current legislation identified above, and under existing arrangements, will administer the proposed legislation when enacted.
11. Administering legislation involves acting as the lead adviser to the government on 'system strategy', including:
 - a) advising on the appropriate public policy purposes and objectives of the regulatory system (e.g. financial stability)
 - b) designing the regulatory system to deliver those outcomes, while balancing the different needs of system participants
 - c) working with other system leads to advise on the broader needs and trade-offs faced by government in other dimensions and in matters that affect other regulatory systems (e.g. capital markets development, market conduct and consumer protection, or productivity).
12. At a practical level, the role will also involve:
 - a) being the lead agency in legislative reviews
 - b) developing proposed changes to the legislation and managing the associated processes, including managing stakeholder and industry engagement in the policy development process

- c) instructing PCO in drafting legislation and supporting the Minister in taking the draft legislation through Parliament.

Regulatory stewardship

13. Administering legislation is a function of a broader regulatory stewardship role. Good regulatory stewardship involves adopting a whole-of-system view of regulation, and taking a proactive, collaborative approach to the care of a regulatory system across its lifecycle. Stewardship of regulatory systems is important because these systems are public 'assets' that should deliver a future stream of benefits in excess of their costs.
14. Regulatory stewardship involves a focus on the wider regulatory regime, not individual regulatory instruments. Regulatory systems and 'system strategy' need ongoing care and attention because technology, environmental conditions, behaviours, social values, and the wider machinery of government in which regulatory systems exist are all subject to change.
15. The financial system plays an important role in supporting the performance of the New Zealand economy, allowing households and businesses to make transactions, borrow and invest, access capital, and manage risks. Regulation of the sector is important to address market failures associated with externalities, asymmetric information and agency problems. Prudential regulation is part of this system, addressing risks to financial stability that would be created by the failure of firms such as banks and insurers.
16. A decision on administration of prudential legislation flows from a broader question: which agency is best placed to be the lead adviser to government on system strategy in the prudential regulatory system?

Out of scope

Prudential standards and regulations

17. The decision on administration responsibilities relates only to the prudential legislation (i.e. primary legislation). The Reserve Bank would retain responsibility for developing and maintaining legislative instruments (such as prudential standards), and imposing conditions through conditions of registration or licence. The Reserve Bank would also have the lead role on certain regulations, particularly where legislation specifies that regulations are to be made in accordance with the Reserve Bank's advice.

Current legislative work streams

18. The Reserve Bank is leading work on two significant pieces of legislative reform:
 - a) The FMI Bill – this Bill was reported back to the House by the Finance and Expenditure Committee on 4 August this year, and is currently awaiting its second reading
 - b) IPSA – the Reserve Bank has reinitiated its review of IPSA.
19. Any decision to change the current arrangements would require a decision on when Treasury should begin in its new role, should it be granted it (this is discussed further in both the Treasury and Reserve Bank's advice below).

Current regulatory stewardship arrangements and coordination in the Financial Sector

Policy setting and regulatory responsibilities are split between five agencies ...

20. The Reserve Bank currently has primary responsibility for the regulatory stewardship of prudential policy, and acts as your lead adviser in setting prudential policy.
21. The Reserve Bank is also the regulator responsible for supervision and enforcement of prudential regulation relating to banks, NBDTs, insurers and FMIs.
22. The Ministry of Business, Innovation and Employment (MBIE) is responsible for financial markets conduct policy, including stewardship for conduct legislation (such as the FMA Act and the Financial Markets Conduct Act), business law policy, and consumer and competition policy.
23. The Financial Markets Authority is the regulator responsible for market conduct supervision and enforcement of regulated entities. The Commerce Commission is the regulator responsible for market competition, fair trading, and responsible lending.
24. With respect to the financial sector, the Treasury advises the government on macroeconomic matters, advises on the long term economic strategy and productivity, and provides second opinion advice on prudential policy and conduct policy matters.

...and are supported by coordination through the Council of Financial Regulators

25. The primary mechanism for coordination across the public sector agencies with responsibility for the financial sector is the Council of Financial Regulators (CoFR). CoFR's primary focus is on system monitoring and operational coordination. All five agencies described above are members. CoFR's main objectives are to:
 - a) develop a collective view on longer-term strategic priorities for the financial system;
 - b) identify and monitor important issues, risks and gaps in the financial system that may impinge upon achievement of member agencies' regulatory objectives;
 - c) agree collaborative responses to issues that require cross-agency involvement and put in place appropriate mechanisms to deliver them.
26. CoFR's informal status will be formalised via the RBNZ Bill. Legislative backing is intended to enhance the status of CoFR by making it more durable and accountable for the performance of the financial sector.

Consideration of administration of primary legislation by the Review to date

Public consultation

27. In November 2018, the Review consulted on stewardship of legislation and the Reserve Bank's role in administering primary legislation. The consultation document included arguments in favour of the status quo, for shifting responsibility to the Treasury and for a hybrid model. The relevant section of the consultation material is reproduced in Annex 1.
28. Seventeen submissions were received on administration of primary legislation and 14 submitters favoured the Treasury administering legislation. Submissions that favoured moving administration of legislation to the Treasury tend to argue that it would enhance

the operational independence of the Reserve Bank by removing a conflict of interest. Some also argued that an agency administering its own legislation is unusual.

The Legislation Design and Advisory Committee

29. The Review sought LDAC's guidance on the appropriateness of the Reserve Bank retaining its role administering primary legislation. The Legislation Design and Advisory Committee's (LDAC's) view is that the issue in question here is not really about administration of legislation, but about who is best placed to be the Government's lead policy advisor and legislative designer. LDAC considers that the conventional approach (under which policy ministries administer legislation) is likely to lead to better regulatory design and compliance with the Legislation Guidelines. LDAC does not support a split approach to administration of primary legislation. LDAC's full advice is reproduced in Annex 2.

The Independent Expert Advisory Panel's view

30. In regard to the RBNZ Bill the Panel supported the recommendation to shift administration of primary legislation to the Treasury (T2019/80 refers). In its role of administering the primary legislation, the Panel notes its expectation that the Treasury would draw on Reserve Bank technical expertise where appropriate.
31. The Panel supports the proposal that responsibility for administration of the prudential legislation be shifted to Treasury. The Panel believes administration of legislation should be carried out by a separate agency than the one mandated. Through having another well-informed agency having independent oversight, the role of regulatory stewardship can be carried out efficiently and effectively. It considers that the agency with the most expertise to advise on the broader trade-offs (including monetary, fiscal and the broader economy) is the Treasury. The Treasury is well placed to administer the Act with a perspective across the financial system and its ability to work with other responsible government agencies, such as MBIE, where appropriate to address issues that support financial stability.
32. The Panel also notes that effective administration depends on both agencies being effectively resourced to address these key regulatory topics in a robust manner to ensure public trust and financial stability. Further, the panel recommends that an effective process for sharing information between the Reserve Bank and Treasury be implemented and maintained.

The Public Service Commission

33. The PSC supports a transfer of the Reserve Bank's current responsibilities for administering prudential legislation to the Treasury. The PSC considers that the activities involved in administering primary legislation, such as those summarised in paragraph 9, are more suitably located in a core department. Departments have a closer relationship with the responsible Minister and are better placed to provide more effectual support for the Minister's overall responsibilities to Parliament for legislation in the portfolio.

Outcomes to be achieved by the steward of the Reserve Bank's legislation

34. The Government has set out its expectations for good regulatory stewardship in the *Government Expectations for Good Regulatory Practice* (April, 2017). Meeting these expectations involves adopting a whole-of-system, lifecycle view of regulation, resulting in a regulatory system that remains fit for purpose over time. Based on these considerations, stewardship of the Reserve Bank's legislation should achieve the outcomes set out in the table below.

Outcomes for regulatory stewardship

Outcome	Description
<i>Regulatory systems are comprehensively monitored, reviewed and reported on</i>	The performance and condition of the regulatory system should be reviewed on an ongoing basis. Effective stewardship requires an understanding of how a regulatory system integrates with the broader environment in which it operates, the broader machinery of government, and the challenges faced by the government of the day. When reviewing and monitoring the system, consideration should be given to the views of parties affected by the regulatory system, and domestic and international best practice.
<i>Reform is supported by robust analysis</i>	Reform proposals should be supported by robust cost benefit analysis that clearly identify the underlying nature of the problem, of the alternative options considered, the importance of the issue in relation to the overall performance of the regulatory system, and risk analysis. Affected parties should have an opportunity to comment throughout the process, participate (where appropriate) in the regulatory design process, and be given sufficient time to transition to new requirements.
<i>Operational independence is preserved</i>	One of the guiding principles of the Review is that the ‘operational independence’ of the Reserve Bank “remains paramount and will be protected”. A key part of the Reserve Bank’s operational independence is being able to decide its own operational procedures, within a coherent legislative framework, supported by appropriate accountability and transparency.
<i>The needs of decision makers are met</i>	In New Zealand, Ministers are responsible to Parliament for the performance of regulatory systems. In this role, Ministers are also responsible for the performance of the independent regulators within those regulatory systems. An effective framework for system strategy needs to be oriented around the Minister, while ensuring an appropriate focus on long-term regulatory stewardship. In order to appropriately advise the Minister, it is important that agencies with stewardship responsibilities have the relevant experience, are able to provide impartial advice, and can avoid conflicts of interests.
<i>The effective and efficient use of resources</i>	Any arrangements for regulatory stewardship should provide for clear roles and responsibilities, lead to efficient outcomes, and maximise the expertise held by the agencies involved. The arrangements should best utilise the specialist expertise, broader policy capability, and stakeholder relationships held by the agencies involved.
<i>Reflect best practice</i>	Arrangements for regulatory stewardship should be informed by domestic and international best practice as applied to independent regulators.

Common features

35. Irrespective of who is given responsibility for administration of primary legislation, the following factors are critical to success:
 - a) a close and collaborative relationship between the Treasury and the Reserve Bank
 - b) appropriate experience and technical expertise
 - c) adequate resourcing and priority to the stewardship function.
36. Effective regulatory stewardship involves shared responsibility. Both the Treasury and the Reserve Bank have valuable roles to play in the stewardship of the prudential regulatory system. Regulation does not take place in a vacuum and it impacts a variety of stakeholders and systems. Good regulatory design and practice requires considerable attention, skill, and collaboration, leveraging off the relative expertise of those with stewardship responsibilities.
37. Good regulatory stewardship also requires long term investment and prioritisation within responsible organisations. There is a risk that long term stewardship responsibilities can get crowded out by more immediate or short term concerns. The Productivity Commission identified a number of issues concerning certain stewardship responsibilities, including inadequate capability and a lack of priority around legislative change. Ongoing stewardship arrangements must ensure adequate processes are in place to ensure stewardship responsibilities are not unduly compromised by competing priorities.

How to best deliver on good regulatory stewardship

The Reserve Bank's view

38. The Reserve Bank considers that the outcomes for regulatory stewardship listed above would be best met by the Reserve Bank retaining administration of primary legislation for the following reasons:

Background

39. The Reserve Bank has administered the RBNZ Act since it was enacted in 1989. On the advice of an interagency group,² Cabinet agreed in June 2007 to the Reserve Bank administering IPSA and the NBDT Act. The June 2007 Cabinet paper described the proposed allocation of policy responsibilities as being based upon its fit with the "business and strategic direction" of each agency, and their capacity "to provide the advice needed, when requested by the responsible Minister".

Analysis

40. The Reserve Bank has extensive experience in the administration of legislation, having been responsible for leading work on the following legislation since 2007:
 - a) The Reserve Bank of New Zealand Amendment Act 2008 (jointly with the Treasury)
 - b) IPSA
 - c) The NBDT Act

² Including the Bank, Treasury, DMPC, SSC, and the then Ministry of Economic Development.
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- d) The Reserve Bank of New Zealand (Covered Bond) Amendment Act 2013
 - e) The Financial Markets (Derivatives Margin and Benchmarking) Reform Amendment Act 2019 (jointly with the Ministry of Business, Innovation and Employment)
 - f) The Financial Market Infrastructures Bill (currently before the House).
41. There is no evidence to suggest that in carrying out its role in administering legislation, the Bank has failed to maintain the standard that would be expected of a comparable government department, or that shifting responsibility for administration of the prudential legislation would result in better outcomes.

Regulatory systems are comprehensively monitored, reviewed and reported on

42. The existing allocation of responsibilities (with the Treasury administering the RBNZ Bill and the Reserve Bank administering the prudential legislation) better aligns with Treasury's role of monitor (and expertise in public sector governance frameworks) and the Bank's role as regulator (and expertise in licensing and supervisory frameworks, and regulated sectors). This is one of the main reasons why the Bank supported the recommendation for Treasury to administer the RBNZ Bill.
43. Given the breadth of portfolios overseen by the Treasury as the Government's lead adviser on economic and financial policy, it may not give the same consistent priority and resources to prudential issues as the Bank does and would do.
44. The Bank's supervision and technical knowledge of the sectors it regulates are important in informing the administration of the prudential legislation, and ensuring that it is well designed. The Bank's closer proximity to industry also means that the Bank is well informed and more likely to be a responsive administrator of the legislation.

Reform is supported by robust technical analysis

45. The Reserve Bank's expertise in the regulated sectors, and knowledge of those sectors and relevant international standards, means that it is best placed to conduct rigorous cost benefit analysis, consider alternative policy options, and formulate recommendations on changes to primary legislation.

Operational independence is preserved

46. An argument raised in favour of Treasury administering the prudential legislation is that it would clarify the Bank's independence. This argument may have some merit in regards to the RBNZ Bill, where the Treasury is advising the government on the governance of the Reserve Bank and the Bank's objectives. It is unclear why it is material for the prudential legislation or would change stakeholder perceptions of the Bank's independence, if the legislation is already clear about which aspects of the Bank's functions are exercised independently. Other regulatory agencies are also operationally independent in some functions and administer their own legislation (e.g. IRD, Statistics NZ, and Customs).
47. In administering prudential legislation there are potential conflicts for both the Bank and Treasury. For the Bank, the risk of regulatory capture or prioritising financial system soundness over efficiency, and for the Treasury, of prioritising the management of fiscal risks over financial stability, or not sufficiently prioritising this area due to its broader economic and fiscal responsibilities.
48. The potential conflicts faced by the Bank are dealt with at the moment through a robust policy development process, and Treasury providing an important "contestable advice" role, where they provide their own advice on our recommendations to the Minister of Finance where they think this is necessary.

49. We consider that the Reserve Bank's operational independence is best maintained by its continued administration of the prudential legislation. This allows the Reserve Bank to ensure that prudential supervision is underpinned by an effective regulatory regime.

The needs of decision makers are met

50. Treasury's contestable advice role is an important part of the current arrangements, and helps ensure a high level of quality assurance around our recommendations for legislative changes (as it does in tax and other policy areas). It would be a rather extraordinary change in role and expectation for Treasury to become the prime advisor on multiple, complex policy areas. Shifting the administration of the prudential legislation to Treasury would mean that either the Reserve Bank would have to take on this type of contestable advice role, or that it would no longer be part of the process (weakening policy development around changes to primary legislation in this area).

The effective and efficient use of resources

51. There is a small pool of technical expertise available on the regulation of banks, insurers, and FMI's. Treasury would likely have to develop the resources and capability to effectively administer the prudential legislation (including potentially by reallocating them from other parts of the Treasury), whereas the Bank is already able to carry out this role without the need for additional resources. The Bank's existing expertise in this area would also not be easily replaced by Treasury (it would not be possible to simply shift the resource from the Bank to Treasury, as the Bank would still need to maintain the necessary in-house capability to provide feedback on proposed changes to legislation and administer standards).
52. The Bank works closely with Treasury, MBIE and the FMA in the policy development process at the moment to ensure effective co-ordination. In administering primary legislation, the Bank uses the same policy development processes as a department, and engages with other agencies in the same way a department would. It is not clear why shifting responsibility for the administration of the prudential legislation would improve the already high level of consistency and coordination in policy development in respect of the conduct and prudential regulatory regimes.

Reflects best practice

53. One of the common arguments for change is that the Bank is unusual in being an independent agency that administers its own legislation rather than a government department. However, this is a difference of form rather than substance. There are a significant number of government departments that administer legislation under which they operate (e.g. IRD, Customs, Stats NZ), and the Bank operates exactly as a department would when administering legislation - both in terms of its interactions with Ministers, and the processes it follows around changes to primary legislation.
54. Other jurisdictions generally have different entities administering prudential legislation and acting as prudential regulator. However, this reflects the fact that these jurisdictions are coming at this issue from different starting points - i.e. their institutional arrangements have generally always taken this form, and in the case of larger jurisdictions they have a bigger pool of domestic expertise to draw on (making it easier to resource separate policy and regulatory agencies).

Alternative options

55. We note that the decision around who should administer the prudential legislation is often presented in a binary fashion as a choice between either the Bank or the Treasury. While our preference is to remain administrator of the prudential legislation,

other options are also available. For example, as part of the current process the Bank consults and/or works closely with the Treasury on the development of proposed changes to primary legislation. It would be possible to formalise this process. For example, by the Bank formally being the administering agency, but the Bank and Treasury jointly advising on significant legislative changes (or the Bank and Treasury jointly administering the prudential legislation). How the Inland Revenue and the Treasury work together on tax policy is one example of how this type of model could work.

Transitional issues if Treasury were to administer the prudential legislation

56. We note that should administration of the prudential legislation be shifted to Treasury, we support the Reserve Bank completing all foreseen legislative work on the FMI Bill, and the IPSA review. Not adopting that approach would create significant risks to the progress of both of these projects.
57. In the case of the FMI Bill, the Bank and Treasury agree that, should administration of the prudential legislation be shifted to Treasury, the Bank should still be responsible for supporting the passage of the FMI Bill through its remaining Parliamentary stages. The area of disagreement relates to which agency should then lead the work on the report backs agreed by Cabinet in December 2018. In light of the conclusions of Phase 2, these report backs will consider:
 - whether the requirement for Ministerial consent for directions should be retained
 - whether specific aspects of the statutory management regime should be changed, including creditor safeguards in statutory management and the statutory manager's powers to act contrary to the interests of creditors on financial stability grounds
 - whether the statutory management regime could be better tailored to FMIs
 - whether any other aspects of crisis planning could be improved based on any implementation experience to date.
58. We recommend that the Bank lead this work so that it can be completed as soon as possible after the Deposit Takers Bill is enacted. In particular, we note that this work will require detailed knowledge of the context in which FMIs operate (as well as familiarity with the approach taken in the Deposit Takers Bill). As a result, we consider that the Bank not leading this work could create a serious risk of a delay in it being completed.
59. We understand that the Bank and the Treasury both agree that the Bank should lead work on the IPSA review and progressing any legislative changes arising out of that review (including through the issuing of drafting instructions to PCO and supporting the passage of amending legislation through Parliament). The Reserve Bank has invited Treasury to join a cross agency steering group which will review, and have an opportunity to input on, proposed recommendations arising out of the IPSA review (although the Bank will retain final decision making responsibility). That approach and the timeline for the IPSA review would have to be revisited if Treasury had a more formal decision making role in the process.

The Treasury's view

60. The Treasury considers that the outcomes for regulatory stewardship listed above would be best met by shifting administration of primary legislation to the Treasury for the following reasons:

The current model does not serve the Minister's interests because of the Reserve Bank's natural conflict of interest

61. Primary legislation is the responsible Minister's legislation. The Minister is responsible for the quality of the legislation and the effectiveness of any regulatory regimes that the legislation establishes. An independent regulator operates at arm's length of its Minister and its responsibilities and objectives are determined by its empowering legislation, not its Minister.
62. The responsible Minister's interests are generally wider than those of the regulator, especially in the case of a Minister of Finance and a prudential regulator. At times, those interests are naturally not aligned. For example, an independent regulator may have a preference for legislative flexibility over regulatory powers while the Minister needs to manage fiscal risks and wider system coherence and performance. The Minister needs to ensure that the extent of any powers are proportionate to the problems identified and subject to appropriate checks and balances.
63. The Reserve Bank has extensive experience in prudential regulation. Regardless of who administers the legislation, it is critical that the Reserve Bank continues to be seen as the lead and centre of excellence in this area. However, the Treasury knows of no other comparable central bank or prudential regulator that administers its own primary legislation.
64. The Treasury agrees with LDAC in that, while a regulatory agency has subject matter expertise and understands the detailed context and what will work in practice, it will tend to design a regime from its own perspective and interests. On key judgments, such as powers, processes, checks and balances, a regulatory agency is more likely to lean in favour of its interests, potentially at the expense of the Minister's interests or the wider system stewardship interest.
65. The potential conflicts and more limited perspective of a regulatory agency could result in lesser quality legislation in the future if it was administered by the regulator.
66. A responsible Minister's interests should prevail when there is a natural non-alignment, but this can be difficult to achieve when the Minister's policy department (in this case, the Treasury) has limited ability to influence a legislative drafting process that is controlled by the regulator.
67. As the Minister's policy department, the Treasury is constitutionally better-positioned to design legislative frameworks that balance the Minister's interests against the interests of an arm's length regulator.

Role of the Government in system strategy and design

68. Administering legislation is a function of a broader regulatory stewardship role and the government needs to have ownership of system strategy and design. Government policy departments are generally better positioned to balance the need for government to control system strategy against the need for an independent prudential regulator to maintain a strong policy voice and capability. This is particularly the case with the Treasury representing the Minister of Finance's stewardship interest.
69. As the lead adviser to the Government on economic and financial policy, the Treasury is best placed to focus on the wider regulatory regime. The Reserve Bank is not as well placed to make policy judgements on broader trade-offs that affect public policy matters outside its own regulatory mandate. The Treasury believes that these policy trade-offs are required to be made in all prudential legislation covered in the advice.

The majority of stakeholders support the Treasury administering the Reserve Bank's legislation

70. There was wide stakeholder support for transferring administration of Reserve Bank legislation to the Treasury. A key concern voiced by industry stakeholders has been the perceived lack of independence that exists when any review of the performance of a regulator's legislative framework is led by the regulator itself. Legislative review is an important function of legislative administration, and good practice is that an independent regulator should not be in charge of reviewing the legislation for its own regulatory powers and accountabilities.

The Treasury does not support a hybrid option

71. A hybrid option was floated in the first round of consultation where the stewardship of the elements of legislation relating to the Reserve Bank's governance, objectives, and functions shifted to the Treasury (through the RBNZ Bill), but the Reserve Bank remained the steward for legislation covering the regulatory regimes themselves. This option was supported by only one submitter.
72. Neither the Treasury nor LDAC supports the idea of splitting administration responsibilities in this way. Split administration sometimes occurs, but this is usually only where an Act straddles two or more regulatory systems, so different agencies (eg, the Treasury and Inland Revenue) are system leads for different parts.
73. Treasury administration of primary legislation does not, however, mean that the Reserve Bank cannot administer secondary legislation where appropriate (for example, standards or technical regulations). Other than where the secondary legislation regulates the regulator itself, a primary-secondary division of responsibilities is consistent with the LDAC guidelines, which direct matters of policy to primary legislation and matters of technical detail to secondary legislation. If administration responsibilities shift, the Reserve Bank would need to remain closely involved in the administration of the legislation.

The Treasury supports a sustainable model despite the short-term cost

74. The Treasury understands the transitional challenges associated with changing the responsibility for administering the legislation, which will involve building the Treasury's capability. We think that this cost is justified as it will result in a more resilient, responsive and sustainable model.
75. As part of the process for transitioning responsibility for administering the legislation to the Treasury, the Treasury will need to continue to prioritise building the necessary capability to service this new function, working closely with experts from the Reserve Bank. The Treasury has progressively built up its expertise in the prudential regulation area throughout the process of reviewing the Reserve Bank Act. Some further effort will be required to expand this and bed it in but the Treasury is well-placed to do this.
76. In total we expect the Treasury would need to dedicate 10 FTE to properly administer the RBNZ Act, Deposit Takers Act, IPSA and FMI Act, to take on monitoring functions, and provide advice on broader issues financial system performance (e.g. competition, innovation). These are important roles providing stewardship for the financial system and would be a top Treasury priority alongside Treasury's core economic performance and macro policy functions.
77. The Treasury currently has approximately 1 FTE dedicated to Reserve Bank monitoring functions. The Treasury resource currently deployed to reviewing the Reserve Bank Act (7 FTE) could also be redeployed at the conclusion of the review to administer the various pieces of legislation. This resource would need to be supplemented by approximately 2 FTE to deliver the financial system performance work, which would need additional funding or trade-off against other work the Treasury might undertake. Redeployment of resource from the Reserve Bank Act review or from

other parts of the Treasury would have an opportunity cost for other work you would like the Treasury to prioritise.

78. The Treasury's proposed model still requires substantial involvement of the Reserve Bank. The Reserve Bank has significant technical experience and capability which has been developed over a number of years. Harnessing this expertise will be critical to achieve the ongoing stewardship and administration of the regime.
79. Regardless of who is given responsibility for the administration of primary legislation, a high level of cooperation and collaboration between the Reserve Bank and the Treasury will be required.

Transitional Arrangements

80. The Treasury recommends that the Reserve Bank continue to lead on the Financial Markets Infrastructures Bill (FMI Bill) until it is enacted. Cabinet agreed in 2018 that following the conclusion of Phase 2 of the Reserve Bank Act Review, the FMI Bill be reviewed. This review will consider whether the Ministerial direction model and the statutory management regime is right going forward, given the new framework in the RBNZ Bill and the Deposit Takers Act. The Treasury believes that the task of reviewing the FMI Act should be led by whichever agency has responsibility for the administration of the RBNZ Bill and the Deposit Taker Act, as it involves carefully considering how the whole accountability and regulatory regime for the Reserve Bank should fit together and apply to financial markets infrastructure. The Treasury would work closely with the Reserve Bank on this review (and on any subsequent legislative reform of any of the relevant legislation).
81. The Reserve Bank is leading the Insurance Prudential Supervision Act (IPSA) review. If you decide that the Treasury should administer IPSA in the future, the Treasury believes the RBNZ should continue to lead the review but with the Treasury being invited to join the Reserve Bank's steering group for this process.
82. Collaboration between the Reserve Bank and the Treasury on an ongoing basis will be critical. Whatever happens, the two agencies need to have a relationship of respect for each other's roles in the system, to recognise that challenge is an important part of the process, and that system-wide and technical considerations need to be given equal weight in policy development.

Stewardship of primary legislation

Regulatory stewardship is a responsibility of government regulatory agencies.³ It involves adopting a whole-of-system, lifecycle view of regulation and is designed to ensure that the regulatory system remains fit for purpose.

The Reserve Bank currently has primary responsibility for the regulatory stewardship of financial policy, and acts as the lead adviser to the Minister. Regulatory stewards are expected to act collaboratively and enable other interested agencies to contribute to system oversight. The Treasury's role in relation to financial policy is acknowledged in a 2012 Memorandum of Understanding with the Reserve Bank.

As part of its current stewardship role, the Reserve Bank is responsible for administering the Reserve Bank Act, IPSA 2010, and the NBDT Act.⁴

Administering an Act involves:

- being the lead policy agency in reviewing the legislation
- developing proposed changes to the legislation and managing the associated processes, including:
 - managing stakeholder and industry engagement in the policy development process
 - instructing the Parliamentary Counsel Office in drafting legislation
 - supporting the Minister in taking the draft legislation through the House of Representatives.

It is unusual, both in New Zealand and internationally, for an independent agency to administer primary legislation, particularly when it specifies its own powers. It is also inconsistent with OECD best-practice guidance (see Box 7B).

Box 7B: OECD best-practice guidance

The responsibility for setting or advising on Government policy, particularly relating to the nature and scope of the regulator's powers and functions, should not principally sit only with the regulator even though the regulator has the most up-to-date knowledge of the issues in the regulated sector. The principal responsibility for assisting the executive to develop Government policy should sit with the responsible executive agency and the regulator should have a formal advisory role in this task. In all cases such policy should be advanced in close dialogue with affected regulatory and other agencies, and there should be specified mechanisms for regulators to contribute to the policy-making process.

OECD (2014), *The Governance of Regulators: OECD Best Practice Principles for Regulatory Policy*

The usual approach to the stewardship of legislation is for the responsible Minister's policy department (the Treasury in this case) to exercise the role on behalf of the Minister as part of a broader role overseeing the regulatory regime. This makes the independence of the regulator clearer and reduces potential conflicts of interest. However, there are also

³ More information about regulatory stewardship can be found at <https://treasury.govt.nz/information-and-services/regulation/regulatory-stewardship>.

⁴ It is also intended that the Reserve Bank administer the legislation relating to FMI, once this has been finalised.

important advantages of the Reserve Bank acting as steward. These arguments are noted in the boxes below.

Benefits of the Reserve Bank continuing as the Reserve Bank Act administrator

- **Aligning technical expertise with policy development** – the Reserve Bank’s extensive technical expertise makes it well placed to contribute to regulatory framework development.
- **Synergies** – Reserve Bank staff can operate across both primary and delegated legislation.
- **Transition costs** – shifting the function to the Treasury would require it to reallocate or seek additional resources, assuming that no resources move from the Reserve Bank.

Benefits of the Treasury becoming the Act administrator

- **Closer constitutional relationship with the Minister** – as the Minister of Finance’s policy department, the Treasury is constitutionally an extension of the Minister and is therefore best placed to serve the Minister’s interests.
- **Avoids conflict of interest** – the Reserve Bank has a conflict of interest in acting as the principal adviser on primary legislation. At both an overarching level and within the regulatory regimes it oversees, the Reserve Bank is required to assess the appropriateness of its objectives, functions, and powers. In assessing the effectiveness of regulatory regimes, the Reserve Bank must also make judgements about its own performance as regulator. This can be perceived as reducing accountability.
- **Protects independence** – having the Reserve Bank as principal adviser to the Minister on primary legislation risks blurring the boundaries of its independence.

Shifting the administration of the Reserve Bank’s legislation to the Treasury would move a notable stewardship responsibility from the Reserve Bank to the Treasury. This would give the Treasury an increased responsibility for ensuring that the financial policy framework is fit for purpose, and clarify that MBIE and the Treasury share an oversight role for the financial system more broadly. The Reserve Bank would retain an important advisory role, including providing independent advice where appropriate. A decision regarding the stewardship of primary legislation would not affect the role of the Reserve Bank in administering delegated instruments (e.g. conditions of registration).

A hybrid option could also be considered where the stewardship of those elements of the Act relating to the Reserve Bank’s governance, objectives, and functions shifted to the Treasury (by creating a separate institutional Act for the Reserve Bank, similar to the FMA Act 2011), but the Reserve Bank remained the steward for legislation covering the regulatory regimes themselves.

Annex 2: LDAC advice on administration of primary legislation (received 10 May 2019)

You have sought guidance from LDAC on the appropriateness of the Reserve Bank retaining its role administering the primary legislation in the prudential regulatory system and also LDAC's views on good practice in relation to administration of primary legislation, as well as how LDAC would apply those views translating to the specific context of the Review and the Reserve Bank. LDAC has considered your questions and has the following thoughts.

LDAC's view is that the issue in question here is not really about administration of legislation, but about who is best placed to be the Government's lead policy advisor and legislative designer. Concerns are not so much raised by reference to specific principles within the Legislation Guidelines but around who is best placed to ensure that the principles in the Legislation Guidelines are being appropriately applied. In order for the Guidelines to be able to be appropriately applied, the right person needs to be applying them. Who the right person is requires consideration of matters such as who is best-placed to advise the Minister, maintain an appropriate free and frank relationship with the Minister and other government departments, meet the obligations of stewardship of legislation, and ensure that the collective Crown position is not undermined.

The Legislation Guidelines articulate principles of good legislation that require judgment. A regulatory agency is more likely to be the subject matter expert and to understand the detailed context and what will work in practice, but will tend to design a regime from its own perspective and interests, and, therefore, on key guidelines judgments such as powers, processes, checks and balances is more likely to lean in favour of administrative convenience (see, for example, Legislation Guidelines chapters 2, 14, 18, 22). It is also not well-placed to make policy judgements on broader trade-offs that affect public policy matters outside its own regulatory mandate. The potential conflicts and more limited perspective of a regulatory agency is more likely to result in lesser quality legislation.

A system lead is more likely to focus on the public policy purpose, and as part of that, balance the interests of the system participants and the regulator to achieve the outcomes of the system. It is used to, and has responsibility for, working with other system leads to advise on broad public policy trade-offs on matters that affect other systems (providing a collective Crown view). It is separate from the day to day operations, so is more able to apply the guidelines on an objective basis. However, it will have less subject matter expertise than the regulator and, being separated from the day to day, is more prone to discounting administrative complexity. To mitigate this, it is important for a system lead to ensure it maintains appropriate expertise within its agency and, importantly, works in a close and consultative manner with regulatory agencies during policy development.

These considerations have led to the conventional approach, under which policy ministries act as system leads, and as part of that lead the development of primary legislation (signalled by being named as the administrator of the Act). However, it is important that the system lead has excellent relationships with the regulator, or the system will be suboptimal.

The position with secondary legislation is more mixed. Technical secondary regulation is sometimes administered by regulators, and often where the regulation is not made by Order in Council. However, regulations are often administered by the system lead, particularly if there is significant policy content. This split largely reflects the Guidelines, which directs matters of policy to primary legislation, and matters of technical detail to secondary legislation (Legislation Guidelines, chapter 14.1).

LDAC considers that the conventional approach outlined above is likely to lead to better regulatory design and compliance with the Guidelines.

LDAC does not support the idea of splitting administration in the way suggested. This misconceives the rationale for the system lead having the role of leading policy development. Split administration sometimes occurs, but this is usually only where an Act straddles two or more regulatory systems, so different agencies are system leads for different parts.