

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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Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

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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Reference: T2020/3578 MC-1-7-3-1-13

Date: 26 November 2020

To: Minister of Finance (Hon Grant Robertson)

Deadline: None
(if any)

Aide Memoire: Background information on the financial policy remit

You recently asked for an overview of the way that the financial policy remit (the Remit) will function in the Reserve Bank of New Zealand Bill (RBNZ Bill), which is currently awaiting its first reading.

The RBNZ Bill provides the Reserve Bank with a clearer mandate for protecting and promoting financial stability

The RBNZ Bill replaces the Reserve Bank's existing 'soundness and efficiency' objective for prudential regulation with an objective of "protecting and promoting the stability of New Zealand's financial system". This objective provides greater goal clarity to the Reserve Bank and is more consistent with international practice. A clear and well-defined objective is particularly important given the level of operational and policy independence that the Reserve Bank exercises in relation to prudential matters.

While the new objective will improve role clarity for the Reserve Bank, financial stability is a multifaceted concept that cannot be easily quantified into intermediate objectives (unlike monetary policy). In general terms, there can be a trade-off between a very high level of stability and the level of competition and innovation in the financial system. The pursuit of financial stability can also have implications for other government policy objectives, such as housing affordability and credit availability more generally.

The Remit enables the broader policy interests of the Government to be taken into account

The RBNZ Bill requires the Minister of Finance, after consulting the Bank, to issue a Remit, setting out matters that the new Reserve Bank board must have regard to when pursuing financial stability. The Remit must be reviewed by the Treasury at least every five years and can be amended or replaced at any time at the Minister's discretion. We provided you with an indicative sample Remit as part of our earlier advice on this topic – this is attached as **Annex 1**.

The Remit provides a mechanism for the elected Government of the day to influence the way in which the Reserve Bank interprets its financial stability objective, while respecting the independence of the Bank in setting prudential policy. This will allow the Government to provide an indication of its risk appetite in relation to financial stability matters and to highlight areas of Government policy that the Reserve Bank should have regard to in pursuing financial stability. The matters contained in the Remit will be in addition to any decision-making principles provided for in the relevant prudential legislation.

The Remit will not create any new 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. It is not a direction power and cannot require the performance or non-performance of a particular act, safeguarding the ongoing independence of the Bank.

The Remit is given effect via a duty on board members

Under the RBNZ Bill, the new Reserve Bank board will have a duty to have regard to the financial policy remit when:

- setting its strategic objectives in relation to financial stability in the Bank's statement of intent
- making significant policy decisions about how to achieve those objectives
- monitoring and reporting on the Bank's performance in achieving those objectives
- issuing and reviewing prudential standards.

The Reserve Bank is required explain how the board has complied with this duty in its annual report and as part of its regulatory impact assessments in relation to individual policy decisions. The board's ongoing compliance with the Remit would be considered as part of the Treasury's monitoring of the Bank and board members could ultimately be removed from office if they do not comply with this duty.

James Campbell, Principal Advisor, Reserve Bank Act Review, [39]

James Haughton, Programme Manager, RBNZ Act Review, Reserve Bank Act Review, [39]

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 pursuing 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 pursuing 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.