The Treasury

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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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Paper for the Minister of Finance

From the Independent Experts Advisory Panel for the Reserve Bank Act Review

10 December 2020

In early March this year, the Independent Experts Advisory Panel (Panel) for the Reserve Bank Act Review met with you to discuss 5 key topics relevant to the success of the Review going forward.

This paper has been prepared to provide an update on those 5 topics and to bring your attention to 3 more.

The Panel is delighted with the progress of the Institutional Bill and the priority it has been given. Its dual objectives and enabling approach to the RBNZ's approach to monetary policy, supported by robust governance, provides a basis for the central bank to be fit-for-purpose for the modern continuously changing financial system.

Below is an update of the Panel's perspective on the 5 topics raised with you in March.

(1) Trans-Tasman Perspective on Supervision and Crisis Management

The Panel is pleased with progress that has been made in the collection of evidence, analysis, and the contribution of the Review Team to the development of advice to frame the legislation covering banking supervision and crisis management.

Previously, the Panel raised concerns that Consultation Three, the C3 document, failed to explain how OBR and statutory management fitted together. How the legislation covers this has significant implications for the trans-Tasman relationship.

During its meeting with the Review Team on 4 December, the Panel saw that there has been progress by the Review Team, RBNZ and Treasury. The Panel was also told that a side benefit of Covid-19 has been more frequent, focused online conversations between the New Zealand and Australian regulators to discuss specific topics.

Regarding the trans-Tasman perspective, the no-creditor worse off provision is particularly important. In our most recent discussions, the Review team has indicated that OBR and statutory bail-in are considered to be alternative tools for resolving a distressed bank, and that both of these tools would be subject to the no-creditor worse off provision. If we have understood this point correctly, this would be likely to allay some longstanding concerns of the trans-Tasman banking groups regarding uncertainties about what could happen under OBR. Clarification of this point will help to provide reassurance and hence reduce the banks' cost of doing business in normal times.

To ensure that the legislation is sufficiently enabling and clear about decision-making, the Panel is still keen to understand that the legislation is clear how OBR and other resolution tools would work in times of crisis.

The Crisis Resolution Manuals on both sides of the Tasman are helpful. It is important to financial organisations on both sides, though, that the New Zealand side is clearer about the use of discretion regarding the use of public funds. The Panel notes that an experience of the GFC was that even when government funding is not a preferred outcome, there were cases where some governments were pressured to do it.

The Panel notes that Australian legislation provides a standing appropriation for emergency financial support at the discretion of the Minister and wonders whether something of that nature should be considered in New Zealand.

(2) Engagement Plan

In both 2019 and in March this year, the Panel has emphasised to the Review Team its view that the importance of this once in 30 years review, that an engagement plan be implemented that engages directly with consumers about how changes in policy impact on them. The Review Team's ambitions for the C3 consultations were delayed by the Covid-19 lock downs and then by the change in the date of the election. A Survey Monkey process did gain some consumer feedback and the Team did have several workshops with stakeholders that deepened the feedback beyond the small number of submissions received.

Looking forward to progressing the Deposit Takers Bill, the Panel remains adamant about the deepening of public trust that will occur with an engagement plan that is designed to be inclusive in engaging directly with those who will be directly affected. While understanding that there will be ongoing distractions generated by Covid–19, the Panel notes that more depositor involvement during the design stage and then the select committee discussion of the DT Bill can play a strong role in building public trust during these unprecedented uncertain times.

(3) Role of RBNZ in 2020 context

The Panel acknowledges progress by the Review Team on the development of enabling legislation. The reasoning for this seems is reflected in the way that the legislation to date has been drafted.

In particular, the Panel notes that it is important to ensure that that provisions regarding the perimeter are both clear and flexible, considering, amongst other things, the role of technology and the rapid growth in innovation in the financial sector.

This is another reason to give consideration of CoFR's role and whether it might include horizon scanning of the innovation landscape. Given that prescriptive legislation is unlikely to keep pace with technology and innovation, the Panel wonders if the current

Government's approach to new entrants and perimeter issues might be covered in the Letter of Expectation content.

(4) Comprehensive impact review (customers, key players, regulators)

In previous meetings with the Review Team and the Minister, the Panel has described the value of a comprehensive impact review of the Institutional Bill.

An implicit finding this year regarding the progress with the C3 engagement plan is that the public has little understanding of how the financial system works, including limited understanding of how it is regulated. Given the pressure of time for the Review Team, a comprehensive impact review, that is both more accessible to and engaging of the public, is unlikely to happen unless the Minister specifically asks for it. As all members of the Review Team are fully occupied addressing some 25 topics so that the DTA can be passed into law in 2023, such a request would require additional resources.

The Panel wonders if a comprehensive impact study could be seen in conjunction to the Government's broader wellbeing framework.

Through applying the Treasury's wellbeing analysis in this broader direction, the public discussion would be better informed about systemic impacts of the financial sector, the role of public trust and the opportunity for more forward thinking compared to the methodology applied to carry out a regulatory impact statement. For example, there is potential for a wellbeing approach to identify the ways that financial stability supports positive technological change and climate change.

(5) Role of the Panel/Finance Minister's Perspective

Discussion of the Panel's role until April is clear, based on the Review Team's processes until then.
The Panel would like to understand it role after April 2021.
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As a result of its 4 December meeting with the Review Team, the Panel has identified three more topics for comment to the Minister.

(6) Role of the Minister

An important attribute of robust crisis management is that there is a plan that outlines how the process works. The Reserve Bank has led workshops with exercises for key players to think through how such a plan would work in practice. Given the discretion that OBR allows and the questions about the Minister's role during statutory management, the Panel wonders whether Ministers might want to attend a workshop as an opportunity to test New Zealand's crisis management readiness. This would lead to useful insights for the legislation about the role of the Minister including about when the Minister is receiving information only and when the receipt of information leads to decision-making.

(7) No creditor worse off

As noted above, the Panel considers the no creditor worse off provision to be very important in the context of trans-Tasman crisis management. The Panel commends the Cabinet's in principle decision that an after-the-event compensation mechanism be established to compensate creditors if a resolution left some creditors worse off than they would have been in an ordinary liquidation (the 'no creditor worse off' principle).

A particular concern of the trans-Tasman banking groups has been whether, under existing legislation, OBR would allow discretion for the resolution authority to allocate losses disproportionately to intra-group claims. This has been seen as a source of uncertainty which adds to business costs. Based on our recent discussions, it appears that the no-creditor worse off provision would remove this concern. It is good to have some further clarification of this point.

(8) Macro-Pru, macro-economic analytical capacity and the broader role of CoFR

One of the areas of focus in Phase I of the RBNZ Act Review was the interface between macro-prudential policy and financial system stability. In this context, the Panel had expressed concern about the availability, as well as the effective and efficient use, of sufficient resources to properly model, analyse, and then provide advice on addressing, some of the systemic economic and financial system challenges presented by the interface between macro-prudential policy and financial system stability.

During Phase One of the RBNZ Act Review, as part of its advice about an effective and sustainable financial system, the Panel emphasised the multi-faceted dimensions of ensuring financial stability. An important contributor to this is cross-Agency collaboration on the design and implementation of macro-prudential policy, including strong macroeconomic analysis, that integrates with monetary policy to achieve financial stability.

The Panel supports the decision to resource CoFR to be able to consider systemic interactions. The Panel considers that CoFR is a body with some of the key attributes that would enable it to look at systemic issues impacting on the financial system, and especially those that may fall through the cracks because no one Agency has full responsibility for them.

Recent events (specifically, the sustained strong rise in house prices which is seen by some as significantly underpinned by RBNZ's recent monetary policy moves aimed at offsetting some of the impact of Covid-19 on the economy) have highlighted the systemic (financial-system stability) risks arising from silo-based (single-bullet) approaches to what are systemic issues. There are further risks too as in the absence of specific, systemic analysis, New Zealand's macro-economic capacity has declined.

The Panel also pointed this out at one of the first meetings of the Review Team and the Panel for Phase 2.

- By way of a specific/practical example, the development and operation of a fit-for-purpose macro-prudential model, that takes into account all sources and impacts of such systemic problems, properly resourced.

- This could be a first-of-its-kind multi-agency effort, owned (in the sense of governance) by (say) CoFR. It is consistent too with the Public Service Act's provision for cross-agency collaboration.

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