

The Treasury

Reserve Bank of New Zealand Bill Information Release

November 2021

This document has been proactively released by **Minister of Finance (Hon Grant Robertson)** on the Treasury website at

<https://treasury.govt.nz/publications/information-release/reserve-bank-new-zealand-bill-information-release>

Cabinet Document Details

Title: **Cabinet Paper: DEV-21-SUB-0042: Reserve Bank of New Zealand Bill: Matters for Inclusion in the Departmental Report**

Date: **18 March 2021**

Creator: Office of the Minister of Finance

Information Withheld

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:

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

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [33] appearing where information has been withheld in a release document refers to section 9(2)(f)(iv).

Copyright and Licensing

Cabinet material and advice to Ministers from the Treasury and other public service departments are © **Crown copyright** but are licensed for re-use under **Creative Commons Attribution 4.0 International (CC BY 4.0)** [<https://creativecommons.org/licenses/by/4.0/>].

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

Office of the Minister of Finance

Cabinet Economic Development Committee

Reserve Bank of New Zealand Bill: Matters for Inclusion in the Departmental Report

Proposal

- 1 This paper seeks agreement to amendments to the Reserve Bank of New Zealand Bill (RBNZ Bill), primarily relating to Reserve Bank governance and financial risk management. These amendments will be recommended to the Finance and Expenditure Committee (FEC) as part of the Treasury's departmental report.

Relation to government priorities

- 2 The proposals in this paper are part of a broader review of the Reserve Bank of New Zealand Act, which was part of the coalition agreement between the Labour Party and the New Zealand First Party. Phase 1 of the Review, which was completed in 2018, amended the monetary policy framework for the Reserve Bank, creating the Monetary Policy Committee (MPC) and adding an objective to support maximum sustainable employment. Phase 2 of the Review is a wide-ranging review of the Reserve Bank's governance and financial policy framework, including the institutional reforms being progressed through the Reserve Bank of New Zealand Bill.

Executive Summary

- 3 The RBNZ Bill, which establishes a new governance framework for the Reserve Bank, is currently being considered by the Finance and Expenditure Committee (FEC). Key reforms include the establishment of a governance board for the Reserve Bank, changes to the Reserve Bank's financial policy decision making framework and strengthened accountability, transparency and coordination mechanisms.
- 4 I am proposing a number of amendments to the RBNZ Bill in response to further analysis, stakeholder engagement and submissions on the Bill:
 - 4.1 that the Governor be made a member of the Reserve Bank board. This would clarify the status of the Governor, and better ensure that the Governor can facilitate the coordination of monetary policy with both financial policy and balance sheet management;
 - 4.2 to provide that the board's obligation to implement monetary policy developed by the MPC is limited by its financial responsibility duties;
 - 4.3 to provide a duty on the board in relation to the management of the Reserve Bank's capital or equity, and to empower the Minister of Finance to specify elements of this duty from time to time following advice provided by the Reserve Bank;

- 4.4 to amend the process for replacing the MPC remit to empower the Minister of Finance to replace or amend monetary policy remits without an Order-in-Council, and to provide several provisions that should apply when the Minister amends or replaces a remit to ensure appropriate scrutiny and safeguards; and
 - 4.5 to make minor amendments to the currency offences in the Bill as necessary to ensure that they have an appropriate *mens rea* element and to update penalty levels to reflect the fact that they have not changed since 1989.
- 5 Together these amendments will further strengthen the Reserve Bank’s governance model, better allow for the management of fiscal risks and to align, update and clarify other elements of the RBNZ Bill.
 - 6 These amendments would be recommended to the Finance and Expenditure Committee in the Treasury’s departmental report.

Background

- 7 The RBNZ Bill, one of two pieces of legislation resulting from Phase 2 of the Review of the Reserve Bank of New Zealand Act 1989, is currently being considered by the Finance and Expenditure Committee (FEC). The RBNZ Bill reforms the institutional arrangements of the Reserve Bank, including providing for:
 - 7.1 a governance board responsible for corporate matters and financial policy, and for implementing the monetary policy formulated by the MPC;
 - 7.2 alignment with the Crown entity governance model in many (but not all) respects;
 - 7.3 a new financial stability objective and financial policy remit for the Reserve Bank;
 - 7.4 strengthened accountability and reporting mechanisms; and
 - 7.5 measures to promote regulatory coordination, including a statutory mandate for the Council of Financial Regulators.
- 8 The governance model in the Bill centres on the introduction of a non-executive board, which will be responsible for all of the Reserve Bank’s functions, other than monetary policy decisions which will continue to be made by the Monetary Policy Committee (MPC). However, the board is responsible for ensuring the monetary policy is implemented. The Governor will be the chief executive of the Reserve Bank, subject to and under the direction of the board with the exception of their role on the MPC. The Governor will continue to be appointed by the Minister, reflecting their role as the chair of the MPC.

Potential governance model challenges

- 9 In the time since the introduction of the RBNZ Bill in July 2020, potential issues with the governance model in the Bill have been identified. These issues have been highlighted by the recent work on the financial consequences of alternative monetary

policy (AMP), alongside further consideration of the governance model in response to select committee submissions and broader stakeholder engagement.

Policy coordination

- 10 The current Bill does not provide for an explicit mechanism for the coordination of monetary and financial policy making, on the presumption that this coordination would occur at an executive level and be reflected in the advice being provided to the MPC and the board.
- 11 Recent stakeholder engagement, including with the International Monetary Fund (IMF), has highlighted concerns that this model may not be sufficiently robust. The IMF has noted that a fully non-executive board with policy making responsibilities is unusual from an international central banking perspective, with central bank boards typically having at least some executive membership. IMF staff have recommended reconsidering the current governance model to provide for “a robust substantive and procedural role for the Bank's executive management in public policy formulation”.

Monetary policy decision making and implementation

- 12 The current Bill presents a risk of conflict between the MPC and the board over the implementation of monetary policy decisions. In particular, the use of the Reserve Bank’s balance sheet for monetary policy purposes creates a tension between the MPC’s responsibility for formulating monetary policy and the board’s responsibilities to implement monetary policy, manage the Reserve Bank’s balance sheet, and its accountability for all the Reserve Bank’s other operational and financial policy responsibilities. Alternative monetary policy tools are a particular source of possible tension due to their significant financial impacts. For example, the large-scale asset purchases programme can expose the Bank to significant interest rate risk.
- 13 The fiscal risks of AMP are currently managed by the Reserve Bank requesting an indemnity from the Minister of Finance. Granting these requests under the new governance framework would remove the risk of conflict between the MPC and the board’s responsibilities. However, the risk would remain if a request was declined.
[33]

14 [33]

14.1 [33]

14.2 [33]

Status of the Governor

- 15 The RBNZ Bill provides that the Governor of the Reserve Bank will continue to be appointed by the Minister of Finance, on the advice of the board. This recognises the significant public role of the Governor and the Governor's significant statutory role as an *ex officio* member and chair of the MPC. However, the Governor will no longer have any independent authority or powers, other than as chair of the MPC.¹ In all other respects the Governor would act as the chief executive of the Reserve Bank, operating under the direction of the board, who decides the extent it wishes to delegate further powers to the Governor. The board is responsible for the performance of the Reserve Bank and while it is responsible for recommending the appointment and removal of the Governor, these decisions ultimately lie with the Minister (the Governor's remuneration is set by the Remuneration Authority).
- 16 This model creates risks in terms of blurred accountabilities for the Governor and the potential for tensions between the Governor and the board, and in particular the Chair. It is unclear whether the Chair or the Governor would be seen as the head of the Reserve Bank, responsible for communicating and 'fronting' the financial policy decisions of the board. In addition, the Governor and the board will not have employment duties to each other (such as good faith and trust and confidence) and nor does the Governor have any statutory duties (except as an MPC member).

Proposed governance amendments

- 17 While the above issues are important, I do not consider that they require fundamental changes to the Bill. There are, however, some targeted changes to the Bill that would mitigate these concerns and strengthen the overall governance model.

Making the Governor a board member

- 18 Appointing the Governor to the board would mitigate the concerns raised about the governance model in the Bill. It would allow the Governor to act as the conduit between the board and the MPC on the coordination of monetary policy with both financial policy and balance sheet management. While it would not eliminate the risk of a disagreement between the Governor and the rest of the board, it would mean that the Governor is explicitly involved in board decision-making and is better placed to act as the spokesperson for the Reserve Bank on both financial and monetary policy matters. It would also clarify the Governor's accountabilities, giving them substantially the same duties and obligations as board members. Having the Governor as a member of the board would also be more internationally conventional.
- 19 To some extent this change would reflect the role that I would expect the Governor to play in practice under the current Bill – being involved in board discussions as the chief executive of the organisation. Appointing the Governor (who would continue to be the chief executive) to the board would embed this expectation and give the

¹ As chair of the MPC, the Governor has one of seven votes, the casting vote when votes are tied, and certain functions under the MPC's Charter.

Governor a ‘voice’ at the table, ensuring that the Governor plays a leading role in policy formulation. The Governor would not be involved in the board’s role of monitoring the performance of the MPC (given their role as chair of that committee).

- 20 I am comfortable that the benefits of this change, in terms of facilitating coordination and promoting role clarity, outweigh any costs. This change would resolve the Governor’s status, both in terms of employment law and in terms of the visible role that central bank governors are expected to have in formulating and communicating policy. Having a CEO on the board of a Crown entity would ordinarily create potential conflicts between their duties to the Minister and their duties to the board. However, these conflicts already exist under the current Bill, given that the Minister already appoints the Governor. Overall, this approach would better serve the board’s responsibility in terms of balancing both oversight and decision making.
- 21 A range of consequential amendments to the Bill will need to be considered to give effect to this change (such as the application of board duties to the Governor and potential changes to the appointment process for the Governor) reflecting the Governor’s special status as chair of the MPC, chief executive and (now) board member. Given the need to finalise policy decisions ahead of the Treasury providing its departmental report to the FEC, I am seeking delegated authority to make decisions on these matters, consistent with the overall approach agreed by Cabinet.

Clarifying the board’s obligation to implement monetary policy

- 22 I consider that the best response to the risk of conflict between the MPC and the board would be to make it clear that the board will determine how much exposure it is prepared to take onto its balance sheet to support monetary policy. This change is likely to involve providing that the board’s obligation to implement monetary policy is subordinate to its financial responsibility duties.
- 23 In practice, I expect that this would mean that the board would provide guidance to the MPC on how much balance sheet exposure it is prepared to take on in implementing monetary policy. If the MPC decides that a larger intervention is needed than what can be accommodated on the Reserve Bank’s balance sheet, then the board would be required to seek either an indemnity or a capital injection from the Crown rather than implement the MPC’s decision. The Governor’s role as both chair of the MPC and a board member would support coordination of this process.

Other amendments to the Bill

- 24 I am also seeking approval of a number of other changes to the Bill, in response to ongoing work on the financial implications of AMP and issues raised during the select committee process for the RBNZ Bill.

Strengthening the board’s financial responsibilities

- 25 The board’s financial responsibility duty in the RBNZ Bill is broad and unspecific. The board’s duty reflects an initial policy decision to incorporate limited elements of the Crown Entities Act 2004 framework, although since that decision was taken the introduction of AMP tools has increased the importance of the board’s risk management duties.

- 26 The lack of specificity in this duty could create problems for the Minister and the board. The breadth of the duty could limit the Minister’s ability to manage fiscal risk, because the lack of specification means that a wide range of actions could reasonably be considered to meet the Bill’s current requirements for any given level of capital or indemnification. As a result of this, the Minister may have difficulty holding the board to account for its financial management. The breadth of this duty could also create a problem for the board, because there may not be consensus on what constitutes operating in a “financially responsible manner”.
- 27 To address this concern, I propose to amend the Bill to provide that:
- 27.1 as part of, or in addition to, its general financial responsibility duty, the board has a specific duty in relation to the management of the Reserve Bank’s capital or equity.
- 27.2 the Minister is empowered to specify elements of this duty from time to time.
- 27.3 the Reserve Bank would provide advice to the Minister prior to the Minister changing the specification of this duty.
- 28 These amendments would provide clearer decision rights and greater overall practicality to respond in a crisis. The changes will provide the Minister the ability to set the high-level parameters for the Reserve Bank’s financial management and legal recourse if the Reserve Bank acts outside of these parameters, but will also provide the MPC, board and the Reserve Bank operational independence to formulate and implement policy within these parameters.
- 29 Officials are undertaking further work on the detail of the board’s amended financial responsibility duty. I am seeking delegated authority to finalise the detail of this proposal, consistent with the approach outlined above.

MPC remit process

- 30 The MPC remit provides the MPC with its operational objectives to achieve and maintain price stability over the medium term and support maximum sustainable employment. Currently, the MPC remit is issued by the Minister every five years following remit advice (including public consultation) from the Reserve Bank. The process for changing the remit before the term of that remit has expired involves the Governor-General replacing the remit by Order-in-Council (OIC), on the Minister’s recommendation. This process was introduced as a safeguard to ensure replacement remits were not issued too frequently or as a means of postponing the wider remit advice process required every five years after the ‘natural’ expiry of a remit.
- 31 I recently invoked the process for replacing the remit for the first time so that the MPC remit incorporated Government housing policy objectives. This highlighted problems with the current requirements. The remit has a different legal form and process depending on whether it is issued before or after the term of the previous remit expired. In addition, making out-of-cycle replacement remits by OIC is incommensurate with the remit’s purpose of providing direction to the MPC (rather than rules for or restrictions on the public). Finally, the OIC process does not in

practice achieve the objective of providing a higher hurdle to remit changes, because it is unlikely to discourage a government from replacing the remit.

32 I propose to amend the remit provisions in the Bill to provide that:

32.1 the Minister of Finance is empowered to amend or replace MPC remits without an OIC;

32.2 MPC remits (including a replacement or amended remit) should not be secondary legislation for the purposes of the Legislation Act 2019; and

32.3 there should be appropriate procedural safeguards for replacing or amending the remit, including that the Reserve Bank is required to provide remit advice at five-year intervals.

33 These changes would ensure that remits have consistent legislative form regardless of when they were issued, while better achieving the original policy goal of ensuring that the remit advice process may not be circumvented. They are in line with the Legislation Design and Advisory Committee's guidance on the appropriate allocation of power to make secondary legislation.

Currency offences

34 The Finance and Expenditure Committee has queried whether some of the currency offences in the Bill should be amended to require *mens rea* (i.e. a mental element such as intent). The currency offences relate to:

34.1 defacing bank notes;

34.2 making or issuing other bank notes or coins; and

34.3 reproduction or imitation currency.

35 The Bill currently carries over these offences unchanged from the current Act, as they were not within the scope of the Reserve Bank Act Review process. While I do not recommend substantively revisiting these offences at this stage in the process, I propose to make any minor amendments that are necessary to ensure that they have an appropriate *mens rea* element and to update the penalty levels (which have not been updated since 1989). I am seeking delegated authority to finalise the detail of this proposal, consistent with this approach, in consultation with the Ministry of Justice to ensure that amendments and penalties are proportionate and appropriate

Minor or technical changes

36 I am also seeking Cabinet authorisation to further develop the detail of the proposals outlined in this paper and to approve other more minor or technical amendments to the RBNZ Bill, consistent with the overall framework agreed to by Cabinet. This would include less significant changes to the Bill needed to address issues identified in FEC's scrutiny of the Bill.

Financial Implications

- 37 The proposals in this paper have no direct financial implications.
- 38 Changes to the financial responsibility duties of the Reserve Bank board should better allow the Minister of Finance to manage fiscal risks associated with the Reserve Bank's use of its balance sheet for monetary policy and other purposes.

Legislative Implications

- 39 The proposals in this paper will be recommended to the FEC by the Treasury in its departmental report on the RBNZ Bill.

Impact Analysis

- 40 Cabinet's impact analysis requirements apply to the proposals in this paper. A Regulatory Impact Statement (RIS) on the proposed amendments to the Reserve Bank's governance arrangements, has been prepared and is attached to this paper.
- 41 A quality assurance panel with representatives from the Regulatory Impact Analysis Team at the Treasury and the Ministry of Business, Innovation and Employment has reviewed the RIS "Further Changes to the Institutional Framework for the Reserve Bank" produced by the Treasury. The panel considers that it **meets** the Quality Assurance criteria.
- 42 The higher criteria weighting placed on effective governance, effective policy coordination and in particular the ability to practicably deliver on the changes within the current legislative process (and therefore less weighting on clarity and other criteria) explain the preference for the Governor as a board member option relative to the statutory Financial Policy Committee option.
- 43 There is some uncertainty in how the proposed arrangements would work in practice. There is also flexibility afforded to the board in delegating financial policy decisions to sub-committees (while remaining accountable). This emphasises the importance of monitoring the proposed arrangements to ensure that risks and unexpected issues are identified and addressed.
- 44 The Regulatory Impact Analysis team at the Treasury has determined that two additional proposals for 'Further Changes to the Institutional Framework for the Reserve Bank' (relating to the internal administration of the Reserve Bank and aligning the process for amending a MPC remit with the process for setting the original MPC remit) are exempt from the requirement to provide a Regulatory Impact Statement on the basis that they have no or only minor impacts on businesses, individuals, and not-for-profit entities.
- 45 The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

- 46 The proposals in this paper are not likely to have significant impacts on any particular population groups as they relate primarily to institutional arrangements for the Reserve Bank.

Human Rights

- 47 None of the proposals in this paper are in any way inconsistent with the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Consultation

- 48 The proposals in this paper have been jointly developed by the Treasury and the Reserve Bank as part of the Reserve Bank Act Review process.
- 49 The Public Service Commission, the Ministry of Justice, the Ministry of Business, Innovation and Employment and the Financial Markets Authority have been consulted on this paper. The Department of Prime Minister and Cabinet has been informed.
- 50 The FEC has sought public submissions as part of its scrutiny of the RBNZ Bill. Twenty one submissions (and three supplementary submissions) were received and were considered as part of formulating this advice.

Communications

- 51 I expect that the Finance and Expenditure Committee will adopt these changes as part of their report back to Parliament. The Treasury will subsequently update the Reserve Bank Act Review section of its website to reflect these changes. I am not proposing to release any further communications material to support these changes.

Proactive Release

- 52 I am proposing to delay the release of this paper until the FEC reports back to the House, beyond the usual 30 business days after the paper has been approved by Cabinet.

Recommendations

The Minister of Finance recommends that the Committee:

- 1 note that in December 2019, Cabinet agreed to a new institutional framework for the Reserve Bank, including a fully non-executive board [DEV-19-MIN-0345];
- 2 note that the RBNZ Bill, which implements the institutional reforms to the Reserve Bank, is currently being considered by the Finance and Expenditure Committee;
- 3 note that further analysis and engagement, along with issues raised during the select committee process, have highlighted the need for amendments to elements of the RBNZ Bill;

- 4 agree to amend the RBNZ Bill to provide that the Governor will be a member of the Reserve Bank board;
- 5 agree to make further amendments to the Bill as appropriate given the Governor's special status as chair of the MPC, chief executive and (now) board member;
- 6 agree to provide that the board's obligation to implement monetary policy developed by the MPC is limited by its financial responsibility duties;
- 7 agree to provide a duty on the board in relation to the management of the Reserve Bank's capital or equity, and to empower the Minister of Finance to specify elements of this duty from time to time following consultation with the Reserve Bank;
- 8 agree to amend the remit provisions in the Bill to provide that the Minister of Finance is empowered to replace or amend monetary policy remits without an Order-in-Council, and that remits (including a replacement or amended remit) should not be secondary legislation for the purposes of the Legislation Act 2019;
- 9 agree to amend the remit provisions in the Bill to provide that there should be appropriate procedural safeguards for replacing or amending the remit, including that the Reserve Bank is required to provide remit advice at five-year intervals;
- 10 agree to amend the currency offences in the RBNZ Bill as necessary to ensure that they have an appropriate *mens rea* element and to update the penalty levels;
- 11 agree that the Minister of Finance is authorised to further clarify and develop policy matters relating to the proposals in this Cabinet paper in a manner not inconsistent with the policy recommendations contained in the paper and to approve other more minor or technical amendments to the RBNZ Bill;
- 12 note that the proposals in this paper will be recommended to the Finance and Expenditure Committee in the Treasury's departmental report.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance