

The Treasury

Reserve Bank of New Zealand Bill Information Release

November 2021

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Joint Report: Further advice on matters relating to the Reserve Bank of New Zealand Bill

Date:	10 May 2021	Report No:	T2021/1108
		File Number:	MC-1-7-3-1-3-3

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	<p>Agree to the recommendations in this report including your preferred option for the compensation of the Governor.</p> <p>Refer the report to Hon David Parker</p>	12 May 2021

Contact for telephone discussion (if required)

Name	Position		Telephone	1st Contact
Jack Starrett Wright	Analyst	[39]	N/A (mob)	✓
Tamiko Bayliss	Director, RBNZ Act Review		[35]	

Minister's Office actions (if required)

Return the signed report to Treasury.
Refer the report to the Associate Minister of Finance, Hon David Parker.

Enclosure: Yes – draft additional advice to Select Committee

Joint Report: Further advice on matters relating to the Reserve Bank of New Zealand Bill

Recommended Action

We recommend that you:

- a **note** that the Reserve Bank of New Zealand Bill is currently before the Finance and Expenditure Committee
- b **note** officials have been asked to provide further advice on a number of issues. A draft of this advice is annexed, and is subject to further decisions

A lower tier efficiency objective

- c **note** that the Finance and Expenditure Committee have asked for advice on creating a lower tier objective relating to efficiency
- d **note** the attached draft advice to the Committee reiterates that the current government position is that efficiency related concepts are best placed in the decision-making principles in the sectoral legislation

Parliamentary confirmation of new functions for the Bank

- e **note** that the Committee has asked for advice on the role of Parliament in confirming Ministerial directions for the Bank to exercise a new function
- f **agree** that the Bill should not be amended

agree/disagree

Compensation for the Governor for loss of office

- g **agree** to either

Option 1: Prohibit the Governor receiving any compensation for loss of office

agree/disagree

OR

Option 2: Do not prohibit the Governor receiving compensation for loss of office
(Treasury and Reserve Bank recommended option)

agree/disagree

OR

Option 3: Prohibit compensation for loss of office only in respect of a breach of a board duty

agree/disagree

h **refer** to Associate Minister of Finance, Hon David Parker

Refer/Not referred

Tamiko Bayliss
Director, RBNZ Act Review

Hon Grant Robertson
Minister of Finance

Joint Report: Further advice on matters relating to the Reserve Bank of New Zealand Bill

Purpose of Report

1. This report seeks decisions on matters that have arisen during the drafting and consideration of the RT version of the Reserve Bank of New Zealand Bill.

Background

2. The Reserve Bank of New Zealand Bill (the Bill) is currently before the Finance and Expenditure Committee (the Committee). On 5 May officials provided further advice to the Committee, and discussed the RT version of the Bill. The Committee has asked officials to report back on a number of issues:
 - a including efficiency (or a more concrete term, such as cost-effectiveness) as a secondary financial policy objective. This would sit underneath the new financial policy objective as introduced by the Bill.
 - b the relationship between principles, objectives, functions, and the Reserve Bank's remits.
 - c how there can be increased parliamentary scrutiny of a ministerial direction relating to additional Bank functions, which would still allow a direction to come into effect before Parliamentary scrutiny (to deal with an urgent matter), but have it lapse unless it was approved by the House of Representatives within a particular period.
 - d whether clauses 205A and 45 of the Bill currently capture the quantum of liabilities/risk that the Reserve Bank may expose itself to. Is the mechanism, including the term "capital", sufficient to prevent undue exposure to the Crown?
 - e whether or not there should be a prohibition on the Governor receiving compensation in relation to being removed from office.
 - f an explanation of the rationale for not including a general provision to the list in clause 70A(1).
 - g What differences, if any, there are in the processes for the removal of the Governor compared with the removal of a board member, as compared with the position under the current Act.
 - h an explanation of the difference between the current and proposed process surrounding MPC remits.
3. This report provides advice on issue a (including efficiency as a secondary objective) and seeks decisions on issue c (additional Parliamentary oversight when providing a new function).
4. Regarding issue e, Treasury provided some initial advice on prohibiting the Governor from receiving compensation related to loss of office on 28 April [T2021-1068 refers]. You have asked for further advice. In particular, you have requested advice on an option which ring-fences the Governor's role as a member of the board from their other duties as Governor.

5. The Bill is due to be reported back to the House on 8 June. There is little scope to substantively reconsider issues through the remaining Select Committee process. Extending the report back date would put pressure on the implementation process for the institutional reforms (for instance, the recruitment process for new board members has already started).

Policy issues raised by the Finance and Expenditure Committee

Including a lower tier efficiency objective

6. The Committee has requested a drafting slip showing how 'efficiency' (or a related concept) could be included as a secondary objective to financial stability. Cabinet has decided that the Reserve Bank should have financial stability as an objective, and efficiency would not be included in the Bill as a secondary objective [DEV-19-SUB-0345]. PCO will provide the Select Committee with drafting showing efficiency as a secondary objective.
7. The Committee has also requested advice from officials on such a change to the Bill. In our Departmental Report to the Committee we have already recommended no changes to the financial policy objective in the Bill and have outlined the Government's policy position. In particular, we have explained that efficiency related concepts are captured by the decision making principles in the sectoral legislation.
8. While there will be drafting presented to the Committee in response to their request, we intend to reiterate the policy position above to the Committee and will recommend rejecting such a change to the Bill. In terms of process, a change in policy would require new Cabinet decisions which would affect the timeline for both the Reserve Bank of New Zealand Bill and the Deposit Takers Bill (as this Bill will include decision-making principles).

Parliamentary agreement to new functions for the Bank

9. Within the Crown Entity framework functions serve as a boundary to the scope of the entity's activities. The Bank may only act for the purpose of performing one of its functions and any function must be performed consistently with its objectives. Clause 11 of the Bill provides that the Reserve Bank may request an additional function from the Minister. Following such a request the Minister may direct the Reserve Bank to perform such a function.
10. The policy intent is to provide some flexibility to respond to unforeseen events which fall outside the scope of the Reserve Bank's current functions, and which may need an expeditious response. Requiring the Reserve Bank to request such a function first is intended to protect the independence of the Reserve Bank. The direction power is an existing mechanism in the Crown Entity framework and is used elsewhere in the Bill.¹ It provides for a process which includes gazetting and presentation to Parliament, and cannot be used to direct the Reserve Bank to undertake a particular action.
11. The Select Committee had concerns that this power provides undue ability for the Minister to expand the functions Parliament has provided to the Reserve Bank, without appropriate Parliamentary oversight. Recognising that swift action may be necessary, members of the committee expressed the view that such a direction could be subject to scrutiny and approval from Parliament within a given time period. The Committee requested drafting reflecting such a change.

¹ A similar mechanism can be used to add functions to Maritime New Zealand and New Zealand Trade and Enterprise.

12. Treasury and the Reserve Bank do not support this proposed change and as such will recommend rejecting such a change to the Bill. Such a change would create additional process and complexity at what might be a time of crisis, and would be inconsistent with the approach for other directions. We expect new functions to be added rarely, and any new function must be consistent with the Reserve Bank's objectives.

Further advice on prohibition of compensation for Governor's loss of office

Context

13. Since the Bill was introduced, Cabinet has agreed that the Governor should be a member of the new Reserve Bank board [DEV-21-MIN-0042 and CAB-21-MIN-0084 refers]. During drafting of the RT version of the Bill a consequential policy question arose. In making the Governor a member of the board there is a question as to whether the prohibition on compensation for loss of office which applies to other board members should also apply to the Governor.
14. The RT version of the Bill was provided to the Committee on 30 April. This version of the Bill specified the Governor was not prohibited from receiving compensation for loss of office. Officials have conveyed to the Committee that this matter is still under consideration, and that government policy may change. Changes to this approach could be either done through the Select Committee stage, or later through a supplementary order paper (SOP).
15. The Crown Entities Act 2004 bars board members from receiving any compensation relating to loss of office for any reason. The Bill follows the Crown Entity Act approach for board members, and has a similar provision for members of the Monetary Policy Committee. One rationale for this prohibition is to prevent members from seeking compensation based on a claimed expectation of reappointment if the Minister decides not to reappoint them at the end of their term. However, the clause is drafted widely to prohibit any payment, benefit or compensation for loss of office for any reason.
16. There is no similar prohibition applying to the loss of office of a Crown entity chief executive (although it should be noted that employment law applies to the relationship between the chief executive and the board). While the Governor is not an employee,² they will be engaged by the board under terms and conditions of appointment that will adopt many features of a typical chief executive employment agreement.
17. The current Act does not prohibit the Governor from receiving compensation or any other payment or benefit on loss of office.
18. Under the Bill the Governor will have three substantive roles: on the board as a member; as chair of the MPC; and as chief executive of the Reserve Bank. It will be impossible for the Governor to cease to hold office in one role without also ceasing to hold office in the other.

Options

19. There are two scenarios where the Governor might cease to hold office:
 - a They meet the statutory criteria for removal of a board member. This includes breach of members' duties as well as broad criteria such as misconduct.

² The exceptions are the chief executives of the Law Commission and the Electoral Commission, who are both also board members. This prohibition also applies to the Retirement Commissioner and the Privacy Commissioner.

- b They meet the statutory criteria for removal of the Governor. This includes specific grounds relating to the role of Governor, such as failure to adequately perform the duties delegated by the board.
20. The Governor could also resign, they could be incapacitated or be otherwise ineligible, or their term could expire and not be renewed.
21. It is common, and often practical, for an organisation to arrange an exit for a chief executive with some appropriate compensation. This can avoid the parties being forced to resort to a contested legal process to execute, or resist, a removal. Compensation may also be appropriate if the board fails to meet legal duties, such as that of natural justice when dealing with the potential removal of its chief executive. This may be particularly important where there is a breakdown in trust and confidence between the Governor and the Board which falls short of the provable statutory standards for removal.

Option 1: Prohibit the Governor receiving any compensation for loss of office

22. This approach would prohibit the Governor receiving any payment relating to the cessation of their office as a member of the board, which as noted will also mean they no longer hold office as Governor. Treasury previously recommended this approach to provide consistency with other Board members, as well as with the few Crown Entity chief executives who are also board members. You did not agree to this approach.
23. The disadvantage of this approach is that it does not account for the chief executive role of the Governor, and the centrality of their role to the performance of the Bank. In addition, unlike other members, the Governor will be operating under negotiated terms and conditions of appointment likely similar to those of a typical public sector chief executive. This will create uncertainty, and additional complexity in applying the no-compensation rule.
24. This approach might also 'cut across' existing arrangements, but this could be dealt with via a transitional provision which protects the current Governor but has an outright prohibition for future Governors.

Option 2: Do not prohibit the Governor receiving compensation for loss of office

25. This option would require no changes to the current RT version of the Bill and would allow for the flexibility around exit that is described above.
26. The disadvantages are a perception around permitting 'golden handshakes', and inconsistency with other board members. However, we note the board is under a financial responsibility duty and we would expect it to take into account public sector guidance, such as those issued by the Office of the Auditor General.

Option 3: Prohibit compensation for loss of office only in respect of a breach of a board duty

27. You have asked us for further advice on 'ring-fencing' the Governor's role as board member from their role as Chief Executive. Option 3 would be to prohibit the Governor receiving compensation for loss of office if removal related solely to the Governor's breaching a member duty. In this respect, the Governor would be in an equivalent position to other members (although board members cannot receive compensation for loss of office for other reasons than removal).
28. A 'ring fencing' approach would be novel and more complex compared to other provisions of this nature in the statute book. In practice there will likely be considerable overlap between breach of member duty by the Governor and breach of other removal criteria. The ring-fencing therefore seems difficult to apply in practice and could create unnecessary legal complexity in trying to deal with the overlap.

Process

29. Options 1 and 2 would be straightforward to adopt for the drafting of the Bill and would likely be able to be done through the Select Committee process. Option 3 would be more complex to draft, and it is possible that it could raise other issues due to interactions with other parts of the Bill. It is likely that this would require a SOP.

Recommendation

30. Treasury and the Reserve Bank recommend Option 2. This is because Option 2 gives the flexibility to the board to make decisions about when compensation is appropriate; in practice, Option 3 would achieve the same or a similar result but in a more ambiguous manner.

Timing and process for the RBNZ Bill

31. Treasury will provide the Committee with the attached further advice on 17 May. This will reflect your decisions on whether the direction to add functions should be agreed to by Parliament and the approach to the Governor's compensation for cessation of office. The RT version of the Bill, currently before Select Committee, reflects Treasury and the Reserve Bank's preferred positions on these issues.
32. In order to finalise these issues during the Select Committee process we will need your decisions by 12 May. If further consideration or advice is required then it may not be possible to make any necessary changes during the Select Committee process and further changes may need to be made through a Supplementary Order Paper instead.
33. If the Committee wishes to ask for further advice, or to consider any of these matters further, it will need to secure an extension of the report back date. This would not be desirable because of the pressure it puts on the implementation process, and because the major issues (such as the objectives of the Bank) are settled Government policy.

28 July 2020	Introduction
8 December 2020	First reading, and referred to Select Committee
15 February 2021	Initial briefing to Select Committee
7 April 2021	Departmental report presentation
5 May 2021	Supplementary departmental report in response to FEC information requests
19 May 2021	Presentation of commentary Additional advice in response to FEC information requests
8 June 2021	FEC report back to the House