

REVIEW OF FINANCIAL INTERMEDIARIES, PRODUCTS AND PROVIDERS: BACKGROUND INFORMATION AND QUESTIONS AND ANSWERS

INSTITUTIONAL ARRANGEMENTS FOR PRUDENTIAL REGULATION

19 June 2007

Background

In December 2005, Cabinet agreed that prudential supervision for the financial sector be consolidated into a single regulator. Cabinet also agreed in principle that this regulator should be the Reserve Bank, subject to officials reporting back on detailed institutional arrangements for the prudential regulator. Cabinet took decisions in principle to allow time to assess in more detail what additional arrangements would be suitable for the Reserve Bank, given its expanded prudential role, and whether the risk of undermining the independence of its monetary policy activities was sufficiently manageable through governance and accountability arrangements. The Reserve Bank is to be the prudential regulator for non-bank deposit takers and insurers.

The changes will preserve the independence of the Reserve Bank's monetary policy functions and support the extension of the Reserve Bank's prudential regulation functions. The changes include modifications to:

- governance and accountability arrangements associated with the Reserve Bank's financial sector regulation functions;
- policy responsibilities for prudential regulation;
- funding arrangements for prudential regulation functions;
- legislative arrangements for prudential regulation.

Policy responsibilities: the Reserve Bank will be responsible for the provision of policy advice on prudential regulation to the Minister of Finance. MED and Treasury will continue to provide advice to their respective Ministers on the implications of prudential regulation in their areas of responsibility. They will also provide second opinion advice in relation to the Reserve Bank's policy role.

Funding arrangements: the costs to the Reserve Bank of regulating NBDTs and insurance companies are to be publicly funded. The Reserve Bank will receive additional funding for these functions through a renegotiation of its Funding Agreement with the Minister of Finance.

Legislation amendments: A Reserve Bank of New Zealand Amendment Bill is to be introduced to give effect to the governance and accountability arrangements outlined above. Changes to legislative will also be required to house the Reserve Bank's new regulatory purposes and functions. Assessment is underway on which existing Acts should be amended and whether new Acts are required.

Who will be responsible for prudential regulation of the financial sector?

The Reserve Bank is to be the prudential regulator for the financial sector.

Who will be regulated by the Reserve Bank?

The Reserve Bank will regulate banks, non-bank deposit takers (such as finance companies, building societies and credit unions) and insurance companies.

Will the prudential regulation of non-bank financial institutions and insurance companies affect the Reserve Bank's monetary policy responsibilities?

No, the Reserve Bank's additional prudential regulation functions will not affect its monetary policy responsibilities. There will be a clear legislative separation of the Bank's monetary policy and its new financial sector functions.

What changes are proposed to the Reserve Bank's functions in light of the extension of prudential regulation responsibilities?

A number of changes are proposed to ensure the Reserve Bank is well placed to be the prudential regulator for the financial sector. These include:

- changes to some of its governance and accountability arrangements to enhance its transparency and responsiveness to Government while maintaining its regulatory independence;
- responsibility for providing lead policy advice to government on prudential regulation; and
- additional funding to carry out its new functions.

What changes are proposed to the Reserve Bank's governance and accountability arrangements?

Changes include:

- A Ministerial authority to comment on the Reserve Bank's draft Statement of Intent and require it to demonstrate how it has taken these comments into account in the formulation of its objectives for the financial sector;
- A Ministerial authority to direct the Reserve Bank to have regard to a statement of Government policy objectives for the financial sector;
- An amendment to the Reserve Bank Act to reflect the increase in focus on prudential regulation, while recognising that monetary policy remains the Reserve Bank's primary function;
- The Reserve Bank's Statement of Intent (SOI) is to provide more ex ante information about the Bank's intended actions and measures for judging performance;
- The Reserve Bank's Annual Report to contain reporting against the enhanced SOI.
- The Reserve Bank's Financial Stability Report is to provide information on performance of prudential regulation regime and its implications for the financial sector and is to be provided to Parliament;
- The Reserve Bank is to increase transparency around its policy process by publishing assessment of net benefits of its policies; and
- The Reserve Bank Board and Treasury are to increase their monitoring of financial sector regulation.

What changes are proposed to policy responsibilities for prudential regulation?

The Reserve Bank is to become responsible for providing lead policy advice on prudential regulation to the Minister of Finance. While the Ministry of Economic Development will no longer provide lead prudential policy advice on NBDTs and insurance companies, the Treasury and the Ministry of Economic Development will continue to provide advice to their respective Ministers on the implications of prudential regulation for their areas of responsibility.

How are the Reserve Bank's new regulatory functions going to be funded?

Regulation of non-bank deposit takers and insurance companies is to be funded through a renegotiation of the Reserve Bank's Funding Agreement with the Minister of Finance.

What legislative changes are required to give effect to the changes to the Reserve Bank's prudential regulation responsibilities?

Changes to governance and accountability arrangements are to be given effect to through a Reserve Bank of New Zealand Amendment Bill. Decisions will be taken later in the year on which Acts will be amended and whether new Acts are needed to house the Reserve Bank's new purposes and functions related to the regulation of non-bank deposit-takers, insurance companies and banks.