

Decision-making and Governance at the Reserve Bank of New Zealand

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Introduction

1. This report provides advice to the New Zealand Treasury on the appropriate governance and decision-making framework for the Reserve Bank of New Zealand (RBNZ). It is an input into advice that the Treasury will provide to the Minister of Finance in the government that will be formed after the General Election to be held on 23 September 2017. The Treasury is the principal economic and financial advisor to the New Zealand Government and, as such, has an important stewardship responsibility for ensuring that governments receive advice, from time to time, on the degree to which the designs of critical economic institutions, such as the central bank, are fit for purpose.
2. Apart from the impending General Election, several factors mean that it is prudent for the Treasury to build its capacity to deliver advice in this area at this time. The RBNZ Act, which is the legal framework that specifies the Bank's governance, decision-making and accountability framework, was passed into law in 1989, nearly 30 years ago. There have only been limited revisions to the governance and accountability framework since that time. For example, an amendment to the RBNZ Act in 2008 introduced a requirement for the RBNZ to publish a Financial Stability Report and to prepare regulatory impact statements, consistent with the expectations that apply to the New Zealand Public Service.
3. Significant time has also elapsed since the last public reassessments of the RBNZ's governance and decision-making framework and these reassessments did not examine the overall decision-making and governance framework for the RBNZ. Lars Svensson's report to the Minister of Finance, *Independent Review of the Operation of Monetary Policy in New Zealand*, was completed in February 2001. While Svensson's report looked in some detail at the optimal decision-making model for the RBNZ with respect to monetary policy, decision-making with respect to financial policy was not within the scope of his report.
4. The House of Representative's Finance and Expenditure Committee published its report, *Inquiry into the Future of Monetary Policy*, more recently, in September 2008. However, this report did not place a significant focus on decision-making and governance arrangements for monetary policy and decision making with respect to financial policy was also not within the scope of the Committee's report.

5. Much change of relevance to the governance and decision-making framework has occurred over the past three decades. This includes change in the role of the RBNZ, the evolution of decision-making in central banks internationally, progression in the frameworks around governance used in the New Zealand public sector and the RBNZ itself has evolved some of its arrangements in the light of experience and changed circumstances.
6. Since the RBNZ Act was passed in 1989, the scope and importance of the RBNZ's responsibilities with respect to financial regulation have expanded considerably. These include:
 - Responsibilities to oversee and designate payments and settlements systems between 2003 and 2008;
 - The regulation of non-bank deposit-takers (NBDTs) in 2008;
 - The supervision and enforcement of anti-money laundering and the countering of terrorist financing legislation for banks, NBDTs and life insurers in 2009;
 - The regulation and supervision of insurers in 2010.
7. Over the past thirty years, prudential supervision of the banking sector has also evolved considerably as the regulatory “pillar” of the prudential supervision framework has been progressively strengthened, particularly since the start of this century. Following the Global Financial Crisis (GFC), the RBNZ introduced a formal framework for the use of macro-prudential tools (vis-à-vis banks) in 2013.
8. The period since 1989 has seen the revision of central bank decision-making and governance frameworks in many other countries together with the development of some scholarly research and thinking about optimal decision-making structures, particularly regarding monetary policy decision-making. There has also been significant debate and discussion about governance and decision making around financial policy. These discussions include whether or not the relevant regulatory functions should be distributed across different agencies and how decision making should be organised within central banks if they perform significant financial regulation responsibilities.
9. The RBNZ sits in New Zealand's public sector but has a relatively unique organisational form. The principles behind the main public sector legislative frameworks, the Crown Entities Act and the State Sector Act, have not been comprehensively incorporated in the RBNZ's framework.
10. Finally, within current legislative constraints, the RBNZ has evolved aspects of its decision-making and governance. Most notably, the current Governor of the RBNZ introduced a Governing Committee to make significant monetary and financial policy decisions in 2013.

11. The reviewer has accepted this commission from the Treasury in the context of the stewardship perspective described above. For the avoidance of doubt, the review has not been commissioned on the basis of criticisms of the RBNZ's performance across its functions. Equally, this review has not been commissioned with a view that different decision-making and governance arrangements would necessarily have led to different outcomes with respect to monetary and/or financial policy.

Methodology

12. The Treasury has asked the reviewer to provide advice on the case for change to the RBNZ's existing decision-making and governance framework. This includes an assessment of the potential merits of committee decision-making for monetary and financial policy objectives and the major design features of any proposed committee system. The reviewer's remit also seeks advice about appropriate transparency and accountability arrangements for the RBNZ. Considering the advice on committee decision-making and accountability and transparency, advice is sought on the implications for the roles of the RBNZ Board. Advice is sought about potential pathways that could be taken towards reform of decision-making and governance.
13. The Treasury has commissioned this report to provide a general framework for the RBNZ's decision making and governance approach and is intended to set out the high level governance framework that would apply across all of the Bank's functions. It also provides some more detailed options for the design of a monetary policy committee. The Treasury will undertake further work on detailed design with respect to financial policy decision making.
14. The report takes the Reserve Bank's current responsibilities as a given. Internationally, there is some debate as to whether financial stability should be the responsibility of a separate authority leaving the central bank with a narrower mandate focussed around monetary policy. This report also takes the current delegation of powers to the RBNZ to make decisions as given.
15. The review has drawn on a range of materials in forming its recommendations. This includes the relevant governance and decision-making frameworks in the New Zealand state sector. The review also has drawn on a considerable body of work undertaken in the Treasury and the RBNZ in 2014 and 2015. This work, among other things, surveyed relevant academic literature relating to central bank decision-making and other relevant international central bank and New Zealand state sector practice. The reviewer has also drawn directly on some of the relevant academic literature on committee decision-making.
16. The RBNZ Governors and the RBNZ Board were interviewed for this review. In addition, several central banks – Reserve Bank of Australia, Bank of Canada, Bank of Israel and

Bank of England - were interviewed to gain further insight into their decision-making and governance frameworks. A discussion was held with the Bank of International Settlements (BIS) to understand current issues in central banking governance internationally.

17. Treasury and State Services Commission staff reviewed various drafts of this report. A draft was also peer reviewed by two international reviewers with strong central banking expertise, Charles Goodhart and Don Kohn. David Archer of the BIS also provided comments on a draft given his knowledge of central bank practice internationally as Head, Central Bank Studies at the BIS and his previous experience as a senior executive at the RBNZ. Feedback provided by all those who have reviewed drafts of the report has been very constructive and helpful. However, the views and recommendations expressed in this report are those of the reviewer. In particular, while the report has been commissioned by the Treasury, the report's recommendations cannot be attributed to the Treasury.

Structure of the Report

18. To set a context for the report, the first section of the report summarises the current governance and decision making system for the RBNZ. The report then analyses the current system from the perspectives of risk management, institutional resilience and political legitimacy. This analysis raises a series of potential problems with aspects of the current governance and decision making system. Recommendations to address these weaknesses are outlined.

Current Decision Making and Governance Approach in the RBNZ

19. The RBNZ Act 1989 sets out the key elements of its decision making and governance approach. This section also incorporates some of the relevant aspects of the RBNZ's practice towards decision making and governance that have evolved since the passage of the 1989 Act and are sufficiently material to include in the discussion.
20. The approach is summarised below by looking at the roles and responsibilities of the three major institutional actors – the Minister of Finance, the Governor and the RBNZ Board. This section also puts the RBNZ's current decision making and governance approaches into the context of the approaches currently used by other public sector organisations in New Zealand.

Minister of Finance

21. The Minister of Finance has political accountability for the RBNZ. Reflecting this responsibility, he or she answers questions relating to the RBNZ's performance in the Parliament and the Minister is responsible for the carriage through the Parliament of

any legislation that the RBNZ operates within. The Minister also agrees, with the Governor, subject to ratification by Parliament, the five-year funding agreement for the Reserve Bank.

22. The Act gives the Minister the authority to appoint and remove the other institutional actors who exercise significant influence within the RBNZ's decision making system. The Minister is responsible for appointing the Governor (on the recommendation of the Board) and the members of the RBNZ Board. Acting on the advice of the Minister, the Governor-General has the authority, within the grounds provided in the Act, to remove the Governor and members of the Board.
23. The Act requires that the Minister cannot act alone in exercising their right of appointment of the Governor. The Minister must make his or her decision on the recommendation of the Board. This is the so-called "double veto" arrangement where the Board holds the power of nominating the Governor and the Minister holds the power of appointment. This arrangement likely reflects an intention to limit the Minister's room for manoeuvre with respect to appointment of the Governor so that the Minister's ability to appoint the Governor cannot be used as leverage to influence tactical monetary policy decisions.
24. However, there is not symmetry between the appointment and removal of the Governor with respect to the role of the Board. Within the grounds provided in the Act for the Governor's removal, the Minister may recommend the Governor-General remove the Governor with or without advice from the Board.
25. With respect to monetary policy, the Act empowers the Minister to set the strategic policy framework. As with the appointment of the Governor, the Minister cannot act alone in exercising that power. The Minister agrees the Policy Targets Agreement (PTA) with the Governor (section 9 of the RBNZ Act).
26. In general, the Minister does not have a role in tactical monetary policy decisions except in circumstances that would be unusual where the Minister has powers of direction. For example, the Minister has the power to direct the RBNZ to deal in foreign exchange within guidelines (section 17) and can fix exchange rates for foreign exchange dealing by the RBNZ (section 18).
27. The role of the Minister in relation to the RBNZ with respect to financial regulation is more complex. In some respects, the Minister can provide strategic guidance to the RBNZ, as regulator, which has considerable discretion in making regulatory decisions. For example, the Minister may direct the RBNZ to have regard to a Government policy that relates to the RBNZ's functions under the Insurance (Prudential Supervision) Act (section 13), the NBDT Act (section 9) and the RBNZ Act as it relates to prudential supervision of banks (section 68B). As directions under these sections have not been given, it is hard to assess, in practice, the significance of this power.

28. Reflecting the reality that significant regulatory decisions may have broader economic impacts and implications for the Crown's financial position, the Minister is responsible for taking some significant decisions in the regulatory space, particularly in advising the Governor-General to place a failing bank into statutory management or to give directions to a registered bank.
29. Since 2013, as a matter of practice, the Minister has provided a letter of expectations to the Governor outlining his expectations for engagement with the RBNZ and to assist the development of the RBNZ's Statement of Intent. Also, in 2013, a Memorandum of Understanding was agreed between the Minister and the Governor that the development of further macro-prudential tools would be undertaken in consultation with the Treasury.

Governor

30. A major change in the 1989 Act from the previous, 1964, Act was that the Bank's authorities which previously resided with the RBNZ Board were, in large measure, given to the Governor personally and the Governor was to be accountable to the Minister of Finance for the use of those authorities (the so-called single decision maker model). This sat alongside the considerable expansion in the operational autonomy of the RBNZ that was a central feature of the 1989 Act. The Act also designated the Governor as Chief Executive of the RBNZ with the full authority to manage the organisation.
31. The single decision making model has not precluded successive Governors in seeking advice prior to making the decisions for which they are statutorily responsible. In the monetary policy domain, this has included extensive information, analysis and advice provided by RBNZ staff and, more recently, advice from external advisors. In the area of financial policy, the RBNZ also uses internal committees to provide a range of analysis and technical advice to the decision maker. In this respect, it is more accurate to describe the model followed since 1989 as a "Single Decision Maker with Expert Advice".
32. In the context of the New Zealand public sector, it is not unusual for a single individual to be accountable to a Minister for the performance of an agency's statutory authorities (e.g. statutory requirements for officials to act independently in some matters) together with the chief executive organisational responsibilities. However, this model is more typical of agencies that are closer to Ministers by virtue of other functions (e.g. departments with a policy advice function or where service delivery activities are sufficiently complex that it is difficult to fully contract for their provision by a Crown entity). While the Chief Executive of a department will frequently exercise statutory functions independent from the Minister, the governance arrangements are centred on a direct Minister-chief executive relationship.

33. There are a range of accountability mechanisms provided in the Act for the Governor to account for the performance of the RBNZ with respect to their monetary policy, financial regulation and organisational responsibilities. Section 15 requires the publication of two Monetary Policy Statements annually (practice has been to publish four statements) that have both a forward-looking component (i.e. how the Governor proposes to implement monetary policy to achieve the PTA) and an assessment of the implementation of monetary policy since the last Monetary Policy Statement. Section 165A of the Act, added in 2008, requires the six-monthly publication of a Financial Stability Report on the soundness and efficiency of the financial system and information that will allow an assessment of the Reserve Bank's responsibilities in this area. With respect to the RBNZ as an organisation, section 162A requires the annual publication of a Statement of Intent that provides forward-looking information on the organisation's performance while section 163 requires the publication of an Annual Report reviewing the performance of the RBNZ over the previous year. The consideration of these reports by the relevant parliamentary select committee requires the Governor and RBNZ staff to appear regularly before them.
34. With respect to financial policy, formal accountability includes the requirement for a regulatory impact analysis (section 162AB). Finally, of particular importance to regulatory functions, decisions on matters of law are reviewable by the courts.
35. Accountability also has a more informal aspect as the RBNZ engages with a broad range of its stakeholders to explain the decisions that it is making. This includes regular meetings with Ministers, media conferences, led by the Governor, on the release of the Monetary Policy Statement and Financial Stability Report and presentations from senior RBNZ staff to business and community groups.
36. Accountability also has an evaluative dimension where the effectiveness of aspects of the central bank's performance is assessed. In the case of the RBNZ, an annual assessment of the RBNZ's performance, prepared by the RBNZ Board, is published in the RBNZ's Annual Report.
37. Section 167 of the RBNZ Act also allows the Minister to commission an assessment of the performance of the RBNZ or particular functions of the RBNZ. With respect to internally commissioned reviews, McDermott (2016) notes a 2016 study by the BIS that the RBNZ has self-commissioned more reviews than any other central bank.
38. Finally, accountability has a substantive dimension. This is where the determination of performance leads to performance rewards and sanctions for individuals. For example, the accountability framework set out in the RBNZ Act has the potential for the RBNZ Governor to be removed from office if performance, including performance against the PTA and performance of the RBNZ's regulatory functions, is deemed to be sufficiently

poor. Assessment of the Governor's performance is also likely to be a factor in determining whether the RBNZ Board recommends the Governor's reappointment to the Minister of Finance in the situation where reappointment is sought.

39. In 2013, the current Governor established the *Governing Committee*. While remaining solely responsible in a statutory sense, in effect, the Governor has delegated a significant degree of his policy responsibilities for monetary policy and financial regulation to a committee of RBNZ senior staff of which he is the Chair. Two public speeches, one made by the Governor (2013) and one made by the Assistant Governor (2016), outline the key features of the Governing Committee.
40. The Committee comprises the Governor (Chair), the two Deputy Governors and the Assistant Governor. It discusses major monetary and financial policy decisions. Monetary policy decision making operates on a collegial basis where consensus is sought as the standard operating approach. However, majority decisions are accepted by the whole Committee if consensus cannot be reached. The Governor retains the right of veto and has a casting vote in cases where the Committee does not have a majority. This framework is very similar to the decision making framework for monetary policy decisions used by the Bank of Canada.

The RBNZ Board

41. The RBNZ Board's current role, as a Board, is unusual in the New Zealand public sector context. It is not a typical governance board as the RBNZ's functions and accountabilities largely sit with the Governor. In organisations whose activities, like the RBNZ's, are characterised by a significant degree of operational independence from Ministers (i.e. Crown entities), the board itself normally holds responsibility for the organisation's functions and accountabilities and the board makes decisions around the delegations provided to the Chief Executive and staff of the entity to undertake the organisation's responsibilities. Typically, board members are not executive members of the organisation to maintain a distinction between the governance and management of the organisation. However, the Governor, *ex officio*, is a member of the RBNZ Board.
42. The Board's current role with respect to the appointment of the Governor is not common practice among boards within the New Zealand public sector. Crown entity boards, as the employer of the agency's Chief Executive, are responsible for the appointment and removal of the Chief Executive. In respect of Chief Executive appointments that are made by a Minister (and are not Public Service positions), appointment support and, in a number of cases, performance assessments of the Chief Executive are made by the State Services Commissioner and reported to the relevant Minister. This includes important public sector roles including the Commissioner of Police, the Chief of the New Zealand Defence Force and the Solicitor-General.

43. As noted above, the responsibility to appoint and remove the Governor sits with the Minister on the Board's recommendation, rather than the Board itself. The Board manages the recruitment process for the position of Governor and also appoints the Deputy Governors (on the recommendation of the Governor). The responsibility to recommend that the Governor-General removes the Governor sits with the Minister and that decision may or may not be based on advice from the Board.
44. The Board's role as a check and balance on the Minister's decision making with respect to the Governor's appointment can be seen as a mechanism to minimise the likelihood that an appointment that could be motivated by political opportunism. In that sense, part of the Board's role is to act as a buffer between the political system and the leadership of the RBNZ. The ability of the Board to appoint its own Chair and Deputy Chair, rather than the Minister as generally occurs with other public sector entities, can also be seen as consistent with this perspective.
45. The Board has an advisory role to both the Governor and the Minister of Finance. One of the Board's duties set out in the Act (Section 53) is to offer advice to the Governor on any aspect of the Bank's performance. This can be seen as a further way in which one of the Board's roles is to support the leadership of the RBNZ.
46. At the same time, the Board's also provides support and advice to the Minister of Finance for him or her to carry out their political accountability with respect to the RBNZ in addition to the advice that is provided with respect to the appointment and removal of the Governor. This includes keeping the performance of the Governor for their policy, regulatory and corporate responsibilities under review. As noted above, the Board is required to publish an annual assessment of the Bank's performance which is presented in the RBNZ's annual report.
47. It should be noted that the Treasury, as well as the RBNZ Board, supports the Minister of Finance by assessing the performance of the RBNZ on an ongoing basis. This is consistent with Treasury's general economic and financial advice mandate.

Analysing the Current Governance and Decision Making System of the RBNZ.

48. There are a range of perspectives that can be taken to evaluate the governance and decision making system of a public entity. This review has focussed on risk management, institutional resilience and political legitimacy as distinct, but interrelated, perspectives to assess the current decision making system of the RBNZ and options to reform that system.
49. The starting point is that the RBNZ is required to make a number of its monetary and regulatory policy decisions in the face of considerable uncertainty. For example, monetary policy decisions need to handle very considerable uncertainties about the

evolution of the economy into the future and the unknowable nature of shocks that could hit the economy. Macro-prudential decisions also need to handle very considerable uncertainties about the course of the credit cycle and the nature of systemic issues that may arise over the cycle.

50. There can be considerable costs arising from significant monetary and financial regulatory decision errors. For example, monetary policy errors can lead to higher and more volatile inflation rates. In turn, this can lead to greater volatility in output and employment rates which reduces community wellbeing. Similarly, some financial crises can give rise to large negative shocks to real per capita GDP from which recovery can take several years.
51. A risk management perspective seeks to minimise the likelihood of policy errors by ensuring that the best quality decision making system is in place. In a dynamic sense, effective risk management also leads to ongoing assessment of the governance and decision making system and the processes that support it so that experience and improvements in knowledge contribute to timely system improvements.
52. Institutional resilience relates to the capacity of the organisation to learn from its mistakes and successes. The capability of an organisation to sustain the appropriate level of technical and decision making expertise through time as people move in and out of the organisation and as the needs of the organisation evolve is also an important element. This is especially important for the RBNZ as a relatively small organisation, by public sector standards, that has a broad range of functions that it exercises. An organisational culture that encourages open and purposeful deliberation and an ongoing improvement in performance is a characteristic of resilient institutions. In relation to the decision making and governance system, this perspective seeks to question the system settings that encourage and require ongoing performance improvement and to assess the incentives on the key institutional actors to prioritise active stewardship of the organisation.
53. The perspective of political legitimacy reflects that the functions undertaken by the RBNZ have a significant impact on community wellbeing. The RBNZ is a public sector institution undertaking functions assigned to it by parliament and using public resources in the process. The RBNZ will make decisions that are contentious publicly from time to time and, as noted already, there is an inherent risk of policy error at some point that has a negative impact on community wellbeing. Whatever the set of decision rights assigned to the RBNZ through the political process, it is important that the decision making and governance system maintains a high level of support across the political spectrum so that there is an expectation that the RBNZ can act consistently and predictably act over time to maintain low inflation and support a sound financial system. From this perspective, we are interested in how the RBNZ's decision making and governance system compares to other public entities in terms of the norms around

the respective roles of elected officials and unelected officials, in this instance, RBNZ management. The nature of transparency around the organisation's decisions and the ways in which the organisation is held to account for its performance is also relevant in forming a judgement around the likely political legitimacy of the governance and decision making system.

54. When assessed through these perspectives, while there are a number of robust elements to the current system of decision making and governance within the RBNZ, it is not best practice overall in terms of international central banking, New Zealand public sector practice or our current intellectual understanding about what makes a high quality decision making system. This review has identified four principal opportunities to move the RBNZ system towards best practice. Given the significance of the responsibilities that the RBNZ exercises and the potential cost of significant policy errors, there is a strong case to take these improvement opportunities as a matter of some urgency. The four principal areas for reform (discussed, in turn, in more detail below) are:

- There is a strong case to move from the single decision maker model to committee-based decision making for both monetary policy and financial regulation. While the formation of the Governing Committee in 2013 represented a step in this direction, an optimal committee system should include external expertise and, with respect to monetary policy decision making, there should be a high level of transparency with respect to the nature of the committee's policy deliberations. This would reduce the level of key person risk inherent in the current system, would support a more resilient institution and support the political legitimacy of the decision making system.
- Relative to the end of the 1980s, the Reserve Bank's role with respect to financial regulation has expanded very considerably and, in the context of the RBNZ's functions, is arguably now as important as monetary policy. The governance and decision making system should much more explicitly acknowledge this shift and address the management of the risks associated with financial regulation. This includes an increased focus on and specialisation of decision making on regulatory matters, the inclusion of external expertise as part of the decision making process and ensuring that the RBNZ Board is well supported to provide transparent assurance on the quality of the RBNZ's regulatory performance.
- The RBNZ Board currently has a broad range of roles to perform with limited support given the importance of its function. There are also potential tensions between some of the roles that the Board undertakes. Currently, the Board is asked to assess the performance of the Governor but also give him or her advice on the Bank's performance. Similarly, the Board advises the Minister of Finance to support the Minister's political accountability and carries out roles where it effectively acts as a buffer between Minister and the RBNZ. This report argues that the Board's focus should be narrowed to provide independent assurance of the Bank's performance

in undertaking its functions and the overall stewardship of the RBNZ as an organisation. The Board should also receive increased, appropriate and independent resourcing to undertake this role.

- The *de jure* and *de facto* decision making models have diverged since the advent of the Governing Committee in 2013. This is undesirable in terms of creating uncertainty about both how the RBNZ will make decisions in the future and causes uncertainty over the current nature of the decision making framework used by the RBNZ. The RBNZ's decision making model should be a decision for Parliament and that decision should be codified in legislation. There would be benefits in respect to the democratic legitimacy of the RBNZ's decision making framework in ensuring that the decision making approach aligns both in practice and in legislation.

The Case for Committee-based Decisions

55. The first reason to move away from the single decision maker model towards committee-based decision making is a considerable body of academic work over the past two decades with respect to monetary policy decision making. This literature argues persuasively that group-based decision making reduces exposure to the preferences, decision-making processes and qualities of an individual. As a consequence, committee-based decisions are better, on average, and, as a consequence, there are likely to be more stable policy outcomes, reducing volatility and enhancing welfare. These theoretical frameworks have generally been supported in experimental policy settings.
56. Theoretical research has focussed on monetary policy decision making. However, it is very likely that the strong support for committee-based decision making in respect of monetary policy decision making is also applicable with respect to financial regulation decisions.
57. There are strong reasons for collective-based decision making in complex and uncertain situations that typify many regulatory decisions. Decision makers are able to pool information, experience and expertise. Collective-based decision making structures therefore open the possibility of deliberation where information can be shared and analysis and perspectives interrogated and debated contributing to the creation of a more robust basis for a decision.
58. Over many decades, social psychology has developed a compelling set of insights that human decision makers experience multiple and systematic biases in the decisions that they make. These findings have been shown to be robust regardless of the intelligence, professional competence and skill of the decision maker in question. Collective-based decision making structures, by introducing different decision heuristics held by different individuals, have been shown, on average, to generate better quality decisions than can be made by individual decision makers.

59. Committee-based decision making comes with its own unique cognitive biases, such as “group think” and their own agency costs, such as social loafing. These potential problems highlight the importance of good design to maximise the potential for the group to out-perform an individual’s decision making and to mitigate the risks of committee-based decision making. These mitigations centre on the design of quality decision making processes with strong incentives for committee members to exercise care and diligence and to contribute actively and with candour. In addition, there are also grounds for a diversity of backgrounds and perspective among committee members.
60. The second reason to move away from the single decision maker model is that practice among central banks internationally strongly aligns with theoretical and research findings. More than 80 central banks take monetary policy decisions in a committee and no country has ever replaced a monetary committee by a single decision maker (Mahadeva and Sterne, (2000)).
61. As in the case of monetary policy, practice also supports the case for committee-based decision making in financial policy decision making. Central banks that exercise financial regulatory functions and separate regulatory organisations that carry out financial regulation both use committee-based approaches. For example, the Bank of England uses the Financial Policy Committee and Prudential Regulation Committee to make decisions in the financial policy domain while, in Australia, the Australian Prudential Regulation Authority (APRA) also makes regulatory decisions in a committee.
62. Good practice in public administration and some evidence in the decision making approaches taken within the New Zealand public sector also argues in favour of a committee-based approach towards regulatory decision making. In its 2014 report, *Regulatory Institutions and Practices*, the New Zealand Productivity Commission (NZPC) looked at the circumstances that may favour single decision making and those where committee-based decision making may be more appropriate in the context of regulatory decision making. Adapting a model from the Victorian State Services Authority, the NZPC argued that a single decision maker is likely to be more appropriate where the particular risks of the regulated activities are relatively low, the area of regulation is well defined and the subject matter is not particularly complex.
63. On the other hand, the NZPC took the view that committee-based decision making is more appropriate where there are considerations such as the power of the regulator to make administrative decisions that have significant commercial consequences and the regulator has a large industry and functional scope. In addition, where the regulations being implemented are complex and principle-based, requiring a greater degree of judgement and where regulatory consistency over time is very important, a committee-based decision making approach provides more corporate memory. When

assessed against these considerations, a committee-based approach in the RBNZ to financial regulation is highly likely to be more appropriate than the single decision maker model.

64. While there is diversity in the decision making approach used by regulatory agencies within the New Zealand public sector, there are a number of agencies that make significant regulatory decisions using a committee-based approach. The Commerce Commission, which makes decisions on a wide range of regulatory and competition issues, makes decisions as a relatively small group of mainly full-time commissioners. The Financial Markets Authority (FMA), which regulates securities and financial advisers and enforces company, securities and reporting law as it applies to financial services and securities markets, makes regulatory decisions through a board of between five and nine members, all of whom are non-executives.

65. The Governing Committee has introduced a committee-based approach to decision making but literature and practice would suggest that it is not optimal and therefore should not be codified. While committees are likely to out-perform individual decision makers, this is most likely to occur when committee members face strong incentives to contribute in a free and frank manner, the committee operates in a non-hierarchical manner and where committee members understand that they will be accountable for the views that they express in the committee. These attributes are likely to reduce the likelihood that “group think” will dominate the committee’s deliberations from time to time. The current Governing Committee is an internal committee. The Governor is responsible for recommending the appointment of the Deputy Governors to the Board and appointing the Assistant Governor. He or she assesses the performance of the Deputy and Assistant Governors. There is an inescapable hierarchy to the relationships within the committee which is not best practice. This is not a commentary on the current members on the Committee or the interaction between them. It is an assessment of the incentives created by the particular design of the Committee. Similarly, the lack of transparency concerning the policy views expressed by individual committee members in the Governing Committee weakens the incentives on individual committee members to exercise care and to foster a deliberative environment that harnesses a diverse range of perspectives.

The Increasing Importance of Financial Regulation to the RBNZ’s Business

66. The business of the RBNZ has evolved significantly, particularly during this century. Incrementally, the RBNZ has steadily developed the strength of the regulatory pillar with respect to its core banking prudential supervision activities. In the early years of this century, the RBNZ assumed responsibilities for supervision of a broader group of financial institutions (eg insurers, NBDTs). While the addition of functions has tended to occur in an incremental manner, the accumulation of regulatory functions is

significant and, arguably, the performance of the RBNZ's financial regulatory functions is now of similar importance to its monetary policy responsibilities.

67. The assessment of performance with respect to financial regulation is more complex. For example, in the case of macro-prudential policy, the objectives are less clear than in the case of monetary policy. Similarly, the success of policy actions may be hard to assess fully except over a very long period of time. As a consequence, assessing the overall performance of the Governor has become more complex as financial regulation has increasingly become a very important part of the RBNZ's business.
68. Regulation oversight demands a skill set that many practitioners of monetary policy with experience in macroeconomics and monetary economics may not possess. Skills in microeconomics, regulatory policy and implementation together with an understanding of markets regulated by the RBNZ are also relevant. It is unlikely that RBNZ Governors over time will systematically have skill sets that comprehensively span all relevant domains. In this context, the key person risk inherent in the single decision maker model with respect to monetary policy is exacerbated by the critical importance of the RBNZ's financial regulation responsibilities. This further supports the argument towards more committee-based decision making together with a shift towards stronger collective leadership that develops a depth of decision making skills across the RBNZ and therefore enhances the resilience of the institution.
69. A strength of the monetary policy framework established in the 1989 Act was the clarity with which the objectives and considerations for the implementation of monetary policy were set out in the PTA. There is no similar clear statement as to what the Governor should take account of in the financial policy space. Equally, it means that it is hard to establish effective accountability mechanisms for the RBNZ in the financial regulation space.
70. In recent legislation that outlines the Reserve Bank's functions with aspects of financial regulation, the Insurance (Prudential Supervision) Act 2010 and the Non-bank Deposit Takers Act 2013, the principles that underpin the Reserve Bank's functions are laid out (in Sections 4 and 8 respectively). However, there are many principles in each (10 for Insurance and 7 for NBDTs) with no guidance in statute as to how to weight or trade off individual principles. There is also provision in each Act (in sections 9 and 13 respectively) for the government to issue a policy statement to which the RBNZ shall have regard in its decision making (although these provisions have not been used).
71. In contrast, there is much less clarity provided in the RBNZ Act 1989 with respect to the powers used in the registration and prudential supervision of banks and the more recent use of macro-prudential tools. Whereas the RBNZ's more recent financial regulation legislation outlines a number of principles for the RBNZ to consider, section 68 of the Act offers limited statutory guidance to the Minister and the RBNZ when they exercise their powers under the Act. Section 68 specifies that the registration and

supervision of banking, “shall be exercised for the purposes of promoting the maintenance of a sound and efficient financial system or avoiding significant damage to the financial system that could result from the failure of a registered bank.” Section 68B also allows the Minister to direct the Bank to have regard to a government policy that relates to the Bank’s banking prudential functions (although this provision has also not been used).

Clarifying the Role of the RBNZ Board

72. A key principle of institutional design is role clarity. Where bodies have multiple roles, care should be taken to ensure that the roles are complementary rather than potentially competing. The current role of the RBNZ Board does not meet this test. As discussed above, the bundle of functions assigned to the Board is highly unusual in the New Zealand public sector context and there are potential conflicts between the Board’s functions. The Board provides several roles in support of whoever is the Governor. The Board nominates the Governor and one of its duties is to advise the Governor. *Ex officio*, the Governor is also a member of the RBNZ Board. At the same time, the Board is asked to keep the performance of the RBNZ and Governor under constant review and publish an annual assessment of the Bank’s performance and assesses each MPS. There is a tension between the Board’s advice role and its assessment of the RBNZ’s performance (which presumably reflects, to some extent, the advice that it has previously provided to the Governor).
73. There are similar potential tensions in the roles that the Board is asked to undertake with respect to the Minister of Finance. The Board provides advice to the Minister on the Bank’s and Governor’s performance to support the Minister discharge their political accountability, including providing advice on the Governor’s removal if required. There are aspects of the Board’s role that puts it at arm’s length from the Minister. This includes the Board’s own ability to determine its Chair and Deputy Chair and the role that the Board plays in the appointment of the Governor.
74. The Board is a part-time body, has many functions to undertake and it does not have independent resourcing available to it to undertake its performance assurance role. Transparent and systematic performance assurance can make an important contribution towards the management of risk in the RBNZ, enabling a resilient institution and supporting a high degree of political legitimacy for the RBNZ. There is a significant opportunity to enhance the governance system by creating a more focussed and better resourced performance assurance function.

The Significant Variance between de jure and de facto models

75. There are several problems with the current situation of a significant variance between the *de jure* and *de facto* models of decision making with respect to the RBNZ. First,

given that the RBNZ is given significant powers under statute to exercise, it is legitimate that the “constitution” of the RBNZ (including how decisions are made and the accountability arrangements for those decisions) is set by the Parliament and to expect that the RBNZ’s practice is consistent with Parliament’s resolution.

76. It may be argued that the extent of the difference between the *de jure* and *de facto* models may not be great and therefore there is no strong argument for aligning statute and practice. In terms of the Governing Committee, the Governor retains statutory accountability, consistent with the Act. In addition, the Governor retains a veto over decisions in the Committee. It can be argued that holding such a veto ensures that the Governor can still make the decision if he or she judges that the committee’s decision would otherwise be inconsistent with the objectives he is seeking to achieve and the personal accountability that the Governor holds for making those decisions.
77. However, the creation of the Governing Committee was motivated by a legitimate desire to improve the decision making system by moving to committee-based decision making. Therefore, in practical terms, the Governor has made a significant delegation of his policy responsibilities to the committee of which he is just one member. Given the intent of the change and the fact that there are very good grounds to move to committee-based decision making, the agreement of Parliament should be sought to confirm that change and to make appropriate changes in the nature of the RBNZ’s accountability arrangements, particularly with respect to how the PTA is set. This would maintain a high level of democratic legitimacy for the RBNZ’s approach to decision making.
78. Secondly, the move to committee-based decision making is not reflected in the RBNZ’s legislation and therefore could be changed by a future Governor. It is undesirable that the RBNZ’s decision making approach should be person-dependent. The current governance committee lacks the appropriate legitimacy as to the substance of the approach as it is merely the preference of the Governor of the time. Decision making determined at management level rather than at the statutory level means that the committee-based approach to decision making could be reversed or suspended at a management level as well.
79. Finally, lack of codification with respect to committee-based decision making introduces some uncertainty about how the RBNZ actually makes decisions today, how it will make decisions in the future and what this may mean for monetary and financial policy outcomes. Recently, Stanley Fischer (2017), Vice-Chair of the Federal Reserve Board of Governors, noted New Zealand as an example of a country that has moved to committee-based decision making. Also recently, Grant Robertson (2017), Labour Party Finance Spokesperson noted that the Governor was the sole arbiter of the Official Cash Rate in the Labour Party’s release on its approach to monetary policy. Each commentator has grounds to support the view that they have about the RBNZ’s

decision making approach. The current lack of clarity about the decision making approach is at odds with the objectives of many of the transparency and accountability frameworks of the RBNZ.

Potential Reform Options for the RBNZ's Decision-Making and Governance System

80. The proposed reform package outlined here seeks to focus on those elements that are most pertinent to the improvement of the RBNZ's decision making system. To be successful, reform should be clear in its objectives and relatively simple to communicate and implement. The day-to-day work of the RBNZ is important and institutional reform needs to be managed in a way that enhances the RBNZ's effectiveness and does not confuse or distract.
81. In a practical sense, the reform package outlined here therefore does not detail all the changes that could be desirably made. With respect to the parts of the RBNZ Act that deal with governance and accountability frameworks, they are now dated in a number of respects. For example, some of its provisions archaic (e.g. age limit of 70 for an individual to hold the position of Governor) and are unclear. In addition, there is scope to import elements of other, more recent, public sector management and governance legislation into the RBNZ Act, such as the Crown Entities Act and State Sector Act that would helpfully modernise the governance and accountability sections of the RBNZ Act and integrate the RBNZ within the state sector where this does not compromise the statutory independence of the RBNZ (e.g. elaboration of the roles and responsibilities of Board members and the Chief Executive, permit the application of appropriate whole-of-government directives to the RBNZ without legislation, place explicit organisational stewardship responsibilities on the Governor similar to those on Public Service Chief Executives and the inclusion of the RBNZ in the state sector's talent management system).
82. The Treasury should consider further the merit of including proposals that would improve the day-to-day administration of the Act and appropriately integrate the RBNZ into the state sector. However, in doing so, priority and focus should remain on those aspects of change that are most likely to support better performance of the RBNZ as an institution over time.
83. A principle behind the reform package is to provide a clear framework for change that could be codified in legislation with respect to objectives, roles and responsibilities and accountability. However, within this framework, consideration has been given for the legislation to be appropriately permissive and resilient to permit future policy makers the opportunity to evolve and innovate in light of experience and in the face of circumstances that it may not be possible to anticipate fully from this distance. This is an important consideration given that the governance and accountability provisions of the RBNZ Act are unlikely to be revisited frequently.

84. Even if there is an openness to revisit the RBNZ Act as a matter of priority within the new administration's programme after the General Election, the practical reality is that it would be likely to be two to three years from now before passage of amending legislation was completed. In part, this reflects the time required for detailed policy analysis and recommendations to Cabinet, legislative drafting, legislative consideration at select committee and passage through the House. In addition, it is recommended that there is a public consultation on proposed changes prior to legislation is introduced. This is to ensure that there is an opportunity to build a broad constituency of support for any changes. In addition, at the level of detailed design, there is scope for reasonable debate about what is the best option. A transparent consideration of these issues is desirable given the important role that the RBNZ plays within the economy.
85. Within the package outlined here, with the agreement of the Minister of Finance, the Governor and the RBNZ Board, there is considerable scope for change to occur ahead of legislative codification. This is desirable for a few reasons. On the assumption that the proposals will support better performance over time, there is merit in adopting change sooner rather than later. The appointment of a new Governor in 2018 is a potential moment to make change. Finally, testing some of these proposals prior to legislation may mean that legislation will be able to be prepared in light of some experience and will therefore be better as a result.

Proposal 1. Codify a committee-based approach to monetary and financial policy decision making with consequential changes to the accountability frameworks for monetary policy and financial policy.

86. The most important proposal of this report is to codify a committee-based approach to monetary and financial policy decision making with consequential changes to the accountability frameworks for monetary policy and financial policy. This would address the undue degree of key person risk inherent in the current institutional design and support the development of a more resilient institution.
87. What does a well-designed committee look like?, While committee-based decision making is likely to be superior to individual decision making over time, potential problems with committee-based decision making need to be addressed in the design of a committee.
88. Maier (2010) summarises the criteria of a "good" committee in the context of monetary policy decision making although these criteria are also useful at a general level in terms of financial policy decision making. These include the committee having an overarching framework, that is, a clearly defined target and freedom to adjust its instruments in order to achieve that goal. The body taking monetary decisions should be small enough

to allow for an exchange of views (i.e. not much larger than 5 members, rotation leading to better information and limiting the group size). Encouraging group members to act and think independently is crucial to avoid polarization and “group think” (i.e. possibility to identify and evaluate individual contributions). Having group members with diverse personal backgrounds (e.g. different nationalities, professions, mix of internal and external members) may help in this regard. Finally, Maier’s assessment is that the literature offers no clear preference for voting or consensus. Both can work well, provided that arrangements exist to identify and evaluate individual contributions to avoid shirking.

89. Blinder (2008) summarises his understanding of what “best practice” looks like with respect to monetary policy decision making. There is weight of theory, evidence and international practice that points strongly in the direction of a committee rather than a single policymaker. The optimal size of committee is less clear. While 7-9 members appears popular internationally, the upper end of this range may be challenging for a small country and one that is managing turnover rapidly. In terms of committee type, Blinder argues for seeking to strike a balance between the values of diversity that are the hallmark of an individualistic committee (e.g. Bank of England) and the clarity of communication of a genuinely-collegial committee (e.g. European Central Bank). The need for diversity suggest that not all members of a monetary policy committee need be specialists in monetary economics. All committee members should be appointed by the government according to the particular country’s governance norms. To manage conflicts of interest, Blinder argues that every monetary policy member should be a full-time employee of the central bank and drawn from a pool that includes career central bankers and externals who would include a blend of monetary policy specialists and a few others.
90. Maier’s and Blinder’s summaries provide a useful reminder that while there are strongly convergent threads of thinking about committee design with respect to monetary policy decision making, there are also elements that remain less settled. In addition, the institutional settings cannot guarantee consistently good decisions on their own. The quality and motivations of individuals and the relationships between individuals will always matter.
91. The recommendations for the key design elements for a committee-based approach to monetary and financial policy decision making in the New Zealand are made as follows:
 - *Clarity as to the operative policy framework for the committee system should continue to be provided through a PTA with respect to monetary policy and a policy statement with respect to financial sector regulation should be developed ;*
 - *Establish through legislation three committees (one each for monetary, macro-prudential and micro-prudential policy) with the charters for these committees to be agreed by the Minister of Finance and the relevant committees every five years and published;*

- *The Minister of Finance should appoint members of the policy making committees, whether they are internal or external members;*
- *The Minister of Finance should receive advice on the appointment of the Governor and Deputy Governors from a panel convened by the State Services Commissioner and on the external members of the policy making committees from a suitably qualified nominating committee;*
- *Each committee would comprise between five and seven members and each committee should have a broadly equal number of internal and external members with at least two external members and the Governor and two Deputy Governors, ex officio, as individual members ;*
- *Steady turnover of committee members should be managed through staggered appointments with fixed terms of committee membership;*
- *With respect to macro-prudential and micro-prudential policy, the committees would act in a way that was collegial in public and individualistic in private and with respect to monetary policy, the committee would act in an individualistic manner and there would be appropriate scope for monetary policy committee members to articulate differing analysis and policy judgement in public;*
- *The record of discussion of all committee meetings would be made available to the RBNZ Board and the record of discussion of macro-prudential and monetary policy committee meetings would be released publicly after the monetary policy decision with a short lag; and*
- *Move the PTA from a person-dependent to a time dependent agreement.*

Recommendation 1

Clarity as to the operative policy framework for the committee system should continue to be provided through the PTA with respect to monetary policy and a policy statement with respect to financial sector regulation should be developed.

92. Consistent with Maier’s (2010) criteria for a “good” committee, a committee requires a clear understanding about the goal or goals that it is seeking to achieve. It also needs a clear and efficient set of instructions about how it should go about its work, for instance:
- clarity as to the objectives and what other government objectives should be taken into account,
 - guidance on trade-offs on competing policy objectives, and
 - direction on the approach to handle particular types of shocks.
- This framework will also enable a committee to account for its performance and to be held to account for performance.
93. In the New Zealand context, it is recommended that the PTA should continue to be the vehicle to provide the monetary policy framework to the relevant committee. However, the move to committee-based decision making desirably requires some

changes in how the PTA is developed and agreed. This recommendation is discussed in more detail below.

94. Currently, in the area of financial sector regulation, there is no analogous statement to the PTA to provide goal clarity to the RBNZ and to enable an appropriate accounting for performance. This is a gap in the RBNZ's decision making system whether or not a decision is made to move away from a single decision maker model. There are undoubted challenges in developing a statement. For example, there is no obvious metric available for the purposes of monitoring and accountability that is analogous to monitoring inflation outcomes relative to a target of monetary policy. Primary legislation would continue to set broad objectives for regulation while the proposed statement would lay out some medium term objectives to this end and address possible secondary objectives and trade-offs. There would be merit in the statement spanning all the RBNZ's regulatory functions. This would place accountability for the RBNZ's systemic risk monitoring function in an appropriately broad context and not solely limited to specific entities and it would therefore encourage consistency in the approach taken across the various regulatory functions.

Recommendation 2.

Establish through legislation three committees (one each for monetary, macro-prudential and micro-prudential policy) with the charters for these committees to be agreed by the Minister of Finance and the relevant committees every five years and published.

95. There is a strong argument that there should be separate committees. While an argument exists to integrate decision making across monetary and financial regulation as the objectives of monetary and financial stability overlap and the instruments used in each area impact on both objectives, the lack of practical and rigorous frameworks to assess the potential competing trade-offs between monetary policy and financial regulation highlights the risks of fully integrating decision making. Furthermore, the different skill sets that need to be brought to bear to assess monetary policy and financial regulation decisions support those decisions being taken in separate committees.
96. With respect to financial regulation, there is scope to debate whether the breadth of decision making is most efficiently carried out within one committee or across two committees. This review recommends the establishment of two financial regulation committees – one for macro-prudential policy (focussed on systemic financial stability purposes) and one for micro-prudential policy (focussed on institutional regulation and supervision). In part, this reflects that the skillsets and tools used to analyse macro-prudential and micro-prudential policy are different in some respects. More substantively, maintaining a distinction between the two elements of prudential policy

recognises the differences that can arise between policy focussed at the financial system and regulation focussed on an individual financial institution or sector. As the Global Financial Crisis demonstrated, individual institutions may be sound in most circumstances but not when strong, negative system-wide externalities are at play. Equally, the financial sector and its customers should be clear whether regulatory changes are being implemented because of the characteristics of an individual financial institution or because of system-wide considerations.

97. The Bank of England, which has a broad regulatory mandate like the RBNZ, also separates these decisions between the Financial Policy Committee (dealing with systemic issues) and the Prudential Regulation Committee (handling institutional regulation and supervision). However, the two committees cooperate on issues which are of genuine interest to both committees (e.g. bank stress testing).
98. The challenge of dividing financial regulation into the business of two committees and separating monetary policy decision making from financial regulation is to ensure that there are appropriate arrangements to share information between the committees and to ensure that there are ways in which decisions that need to integrate across monetary and regulatory domains can be taken in a timely and well-considered manner if significant tensions arise. Overlapping membership of the Governor and Deputy Governors is one mechanism to achieve this goal. However, should this proposal proceed, further detailed consideration should be undertaken as to whether there needs to be overlapping membership of external members and what formal arrangements should be put in place to share information between the committees and for the RBNZ to take timely financial regulation decisions in the event of differing macro-prudential and micro-prudential stances.
99. As a matter of good practice, legislation should stipulate that each committee should have a charter for its operation. Legislation would specify the areas to be covered in a charter. However, flexibility should be given to the particular expression of those elements, recognising that they may need to change over time in the light of experience and to anticipate changes in the RBNZ's environment. The matters that would be covered by charters would include setting out the nature of decisions that the committee would make, the number and composition (i.e. number of internal and external members) of members subject to any legislative constraints, setting out the requirements with respect to transparency of operation of the committee (both to the RBNZ Board and externally) and any other specified operational matters.
100. Balancing the flexibility to adapt the way in which committees operate without change in primary legislation, legislation should constrain the frequency of changes in the charters to a review every five years unless the Minister of Finance and the relevant committee both agree to review the charter before the five-yearly review is scheduled. The reason to impose a discipline on the frequency of reviews is to reduce the likelihood

that changing some of the elements of the charter (e.g number of committee members) could be used as an instrument to change policy decisions. Legislation should require that charters agreed between the Minister and the Governor are published in the interests of transparency.

101. Each of the policy making committees would be supported by internal committees that would provide advice to the policy making committees. There would also be decisions that would need to be delegated to RBNZ staff in respect of both monetary policy (e.g. decisions on financial market activities to implement monetary policy) and in the financial regulation area, there will be decisions that will continue to be appropriately delegated to RBNZ staff. As a matter of good practice, the charters of internal committees and the nature of decision making delegations should be regularly reviewed by the management of the RBNZ and subsequently endorsed by the RBNZ Board.

Recommendation 3.

The Minister of Finance should appoint the members of the policy making committees whether they are internal or external members.

102. Committee members are exercising significant powers delegated by the Parliament that have a significant bearing on community wellbeing. There is a strong logic that there should be a democratic legitimacy provided to those that are appointed. As with other public bodies in New Zealand, the way in which this legitimacy is typically conferred is that committee members are appointed by the relevant Minister of the government of the day. In contrast, the current Governing Committee is appointed by three different parties – the Minister of Finance on the recommendation of the Board (in the case of the Governor), the RBNZ Board on the recommendation of the Governor (in the case of the Deputy Governors) and the Governor (in the case of the Assistant Governor).
103. It is proposed that the Minister would appoint both the Governor and Deputy Governors (who would also be *ex officio* members of the policy making committees) and external members.
104. There may also be a case that staff below the level of Deputy Governor, who would be appointed to their job within the RBNZ by the Governor, should also be members of a policy committee. In the Bank of England, this occurs in respect of the Monetary Policy Committee and Financial Policy Committee. Provision could be made for the placement on the committee of such staff to be agreed between the Minister and Governor in the relevant committee charter.

105. A further consideration is whether the Minister should consult other parliamentary parties (either the Leader of the Opposition or political parties more generally) before making their decision on the appointment of the Governor and Deputy Governors and the external members of the policy committees. There are arguments for and against such a requirement. The RBNZ is an important institution and the impact of its monetary policy decisions and, increasingly, its decisions in respect of financial regulation have a pervasive impact through the economy. A high degree of political legitimacy is important for the RBNZ to continue to exercise the powers that it is been delegated by Parliament. Since the passage of the RBNZ Act in 1989 there has been an ongoing but generally low-level political debate about the RBNZ's objectives, powers and accountability, indicating that these issues are not considered settled across the political spectrum. Providing an opportunity for parliamentary parties to have a voice on these appointments provides the Minister with some indication about the extent of support that these appointees will bring to their positions. The requirement for the Minister to consult political parties could also reduce the likelihood that a Minister could seek to use the appointment lever to get tactical leverage over particular monetary or regulatory decisions.
106. In the past, with respect to appointments more generally, some Ministers have chosen to test some potential ministerial appointees with parliamentary colleagues from different parties (even when not required) as well, of course, consulting within their own Cabinet, caucus and, potentially, parliamentarians from parties that support the Government. While the vast majority of ministerial appointments do not require consultation with non-government parties, there are some instances where legislation requires such consultation. For example, the New Zealand Superannuation and Retirement Income Act 2001 requires (section 56) the Minister of Finance to consult with other parliamentary parties in respect to appointments to the Guardians of the New Zealand Superannuation Fund.
107. The 1989 RBNZ Act also sought to balance the Minister's ability to appoint the Governor while constraining their ability to use the appointment instrument opportunistically. In the Act, the RBNZ Board essentially acts as a buffer against the appointment instrument being used in that manner through the "double veto". In that sense, it can be argued that the requirement for the Minister to consult with political parties on the appointment of the RBNZ's policymakers and the RBNZ's "double veto" role in the appointment of the Governor are alternative solutions to the same potential problem.
108. On the other side of the argument, as the Minister has clear political accountability for making the decision on appointments and therefore must be prepared to defend those appointments in the House or in public, he or she currently has strong incentives to consider the likelihood that particular appointments may draw criticism and to assess what that might mean for their decision. Unlike other jurisdictions where the parliament has an input into key appointments, general New Zealand practice over

successive governments is that it is the prerogative of the government of the day to make appointments and relatively few appointments draw significant amounts of political criticism. The move to committee-based decision making reduces the extent of the policy authority of the Governor. Indeed, the argument for consultation with other parliamentary parties may indeed be stronger in the current single decision maker model given the extent of the powers vested in the Governor. In addition, as discussed below, it is recommended that the terms of appointment of the Governors and external members are staggered. Therefore, it is conceivable that any particular group of decision makers may have been appointed by different governments, reducing the influence that any particular government can have on Reserve Bank decision making.

109. Both views have merit and both approaches operate in the New Zealand context. On balance, it is recommended that the Minister of Finance is required by legislation, in a similar fashion to the consultation requirements for the Guardians of the New Zealand Superannuation Fund, to consult other political parties on the appointment of the Governor, Deputy Governors and external members of the policy committees. This recommendation puts heavy weight on the argument that given the particular responsibilities that the RBNZ exercises, a high degree of political legitimacy is necessary for the central bank to be able to exercise those authorities, particularly in times of crisis. Broad political backing for the appointment of the RBNZ's policy decision makers is one way to bolster that legitimacy.

Recommendation 4.

The Minister of Finance should receive advice on the appointment of the Governor and Deputy Governors from a panel convened by the State Services Commissioner and on the external members of the policy making committees from a suitably qualified nomination committee.

110. The Minister should receive advice on proposed candidates, to fill *ex officio* roles as well as external members. As the Minister is responsible for the appointment decision, he or she should be assured that the candidates have the appropriate skills and experiences to be competent members. Equally, the public should have the assurance that there is a transparent appointment process to ensure that a diverse pool of appropriately qualified people have been considered for these roles. The Minister also requires assurance that all conflicts of interest have been declared, and if these exist, that they can be managed in such a way that the committee member can undertake their role effectively and that any perceptions of conflict can be managed successfully in the public environment.
111. Currently, the RBNZ Board manages the recruitment process for the RBNZ Governor and makes a recommendation to the Minister that he can either accept or reject

(“double veto”). The Treasury manages the appointment process with respect to RBNZ Board members and provides advice to the Minister of Finance. The Minister of Finance does not currently have a role in the appointment of Deputy Governors.

112. Going forward, the source of support for the Minister of Finance for the appointment of the Governor, Deputy Governors and external policymakers depends to a considerable extent on the continuation of the “double veto” mechanism. If the “double veto” for the Governor appointment continues, it would also seem logical for the “double veto” to apply to the other decision making roles. It would also be logical for the RBNZ Board to manage the appointment process for all of the decision making roles. As the Board would be dealing with a greater frequency of appointments than was currently the case, it should receive resourcing to manage the ongoing appointment workload together with support to manage the succession of internal and, especially, external members.
113. However, if the “double veto” mechanism is replaced, a broader set of options exist to support the Minister of Finance in respect of appointment mechanisms.
114. The State Services Commission undertakes recruitment of Public Service Chief Executives and other state sector chief executives which are appointed by Ministers (e.g. Commissioner of Police, Chief of New Zealand Defence Force (NZDF)). It also manages the recruitment of senior state sector executives appointed by Ministers below Chief Executive level (e.g. Deputy Police Commissioners, Service Chiefs in the NZDF, Vice Chief of Defence Force). In recent years, the Commission has developed rich insight in the talent pool for these and other senior public sector roles. The number of senior level executive appointment processes that it manages annually means that it has developed a depth of capability to manage senior executive recruitment processes well. There is therefore a good case for the State Services Commission to manage the senior executive positions (i.e. Governor and Deputy Governors) on behalf of the Minister of Finance and is the proposal recommended by this review. If accepted this responsibility should be codified in legislation. Legislation should also require that the Chair of the Reserve Bank Board and the Secretary of the Treasury should participate in the recruitment process along with the State Services Commissioner.
115. In respect of the external members of the RBNZ’s policy committees, the State Services Commission could also manage the appointment of these members. However, this is not the favoured option. The Commission has deep expertise in the appointment of senior executives. While some external members may well have senior executive experience, they should have a broad range of economic and/or regulatory perspectives and decision making skills that mean they would be able to make good quality monetary policy or regulatory policy decisions.

116. It is proposed to establish a nominating committee appointed by the Minister of Finance of not less than 4 persons with proven skills or relevant work experience. The committee would call for expressions of interest in these positions and consult widely for potential applicants who are suitably qualified. The nominating committee would submit nominations of suitable candidates from which the Minister could make appointments after consultation with other political parties. This model is used for appointments to the Guardians of the New Zealand Superannuation Fund. It is legislated in the New Zealand Superannuation and Retirement Income Act 2001. The case of the Guardians is analogous in that high quality governance skills are sought with particular backgrounds or skill sets. In addition, it is proposed that the Chair of the RBNZ Board would be consulted if existing committee members were seeking renewal. This would mean that the nominating committee would be able to draw on the assessments of performance of current members as appropriate.
117. As the Minister would be responsible for appointing internal and external members to the policy committees, it would be appropriate for the Minister to remove members in cases of unacceptable personal behaviour or failing to undertake their professional duties in an appropriate manner. The Minister should be able to seek advice from the RBNZ Board in coming to his or her decision on removal.

Recommendation 5.

Legislation should permit the policy committees to have a membership of between five and seven members and each committee should have a broadly equal number of internal and external members with at least two external members and the Governor and 2 Deputy Governors, ex officio, as internal members.

118. As discussed above, there is no “right” size for a committee. This research has focused on monetary policy committees but, with some qualifications, a number of the arguments are also likely to apply to financial policy committees. There is a strong argument for a relatively small committee so that there is the best opportunity for a genuine deliberative conversation between all committee members and for all perspectives to be understood, explored and challenged. As the committee is required to make decisions, a committee with a smaller size may be better able to move to a decision without undue delay following deliberation than a larger committee. However, there are overseas central banks such as the US Federal Reserve and the ECB that are able to make clear, timely monetary policy decisions with much larger committees than proposed here. An argument against small committees is that the size of the committee is an important tool to introduce additional information to the Committee’s deliberations, to bring different decision heuristics to the committee’s decisions and to introduce greater diversity of skills and experiences into the committees.

119. Given that the RBNZ's governance legislation is unlikely to be reviewed frequently, there is merit in having some flexibility in the size of committee membership to reflect changes in the scope and size of the RBNZ's responsibilities and the capacity to include varying numbers of members who do not hold executive or staff roles within the RBNZ. Some legislation that creates other regulatory bodies in New Zealand also gives scope for some variation in members who comprise the decision making body. For example, the legislation that establishes the FMA provides for between five and nine members to comprise the Authority.
120. There are arguments that financial regulation committees may need to be larger than monetary policy committees. These arguments point to the broader sets of skills that are required to make good financial policy decisions than is the case for monetary policy. These skills include microeconomics, accounting, actuarial skill sets and specialists in financial markets and regulatory policy. While the diversity of skills is reflected in the technical advice that is provided to the decision makers, it can be argued that the skill sets of the decision makers should be similarly diverse.
121. Experience in other central banks varies on this point. In the case of the Bank of England, financial regulation committees do have more members than for monetary policy. The Monetary Policy Committee has nine members, the Financial Policy Committee has thirteen members and the Prudential Regulation Committee has twelve members. On the other hand, in Australia, the Reserve Bank Board which makes monetary policy decisions has nine members while the Australian Prudential Regulation Authority (APRA) has between three and five, full-time, members.
122. Maintaining committee numbers between five and seven reflects the strength of argument in favour of bringing more diversity into the RBNZ's decision making while recognising the arguments for maintaining committee sizes at a level that facilitates effective deliberation. At the same time, the proposed maximum number of seven members recognises New Zealand's small size and hence availability of appropriate talent, even if overseas talent is engaged, at any one time.
123. An important design question is to what extent decision makers are *ex officio* and hold executive roles within the RBNZ and to what extent additional decision makers are engaged beyond the RBNZ on either a part-time or full-time basis.
124. There is a strong argument in favour of a committee having a balance between senior central bank staff and external membership. Legislation should specify a minimum number of *ex officio* and external members on each committee with capacity for the number of members to be increased above the statutory minimum in the relevant committee charter. The balance between internal and external members varies in practice in overseas central banks and the balance between internal and external members with respect to monetary policy decision making is debated between

practitioners and academics. The point of external members is to bring more diverse perspectives to the table and to reduce the risks of “group think”. In particular, the hierarchical relationship between the Governor and his or her executives means there is an intrinsic risk that the Governor’s analysis and policy judgement has a disproportionate weight in the committee’s judgements. Therefore, the number of external members must constitute a critical mass to contest this tendency. There are differing views about what numbers of external members are required to form such a critical mass. These range from requiring several individuals through to views that external members should form the majority of the policy making committee.

125. On balance, it is recommended that the principle reflected in legislation is that there should be broad equality between the number of internal and external members on each committee with a minimum of two external members on each committee and the Governor and 2 Deputy Governors, *ex officio*, as internal members (consistent with five being the minimum size of committee). The exact number of members would be agreed as part of the charter process. In effect, this would permit situations where some committees had a majority of internal members and other circumstances where external members comprised the majority of a committee.
126. There are other recommended steps that can support internal committee members to mitigate the risks of hierarchy. Performance on the committee of internal members should be assessed independently by the RBNZ Board (in the context of an overall performance review undertaken by the Governor). In addition, in the case of the Deputy Governors, it is proposed that they are appointed by the Minister and can only be removed from their roles by a decision of the Minister.
127. Successfully managing the introduction of external members will be a significant undertaking. The arguments against external members are not insuperable but require careful consideration and management. Identifying and managing conflicts of interest for external members would require care. In a small country like New Zealand, the management of conflicts of interest for internal members also requires care given the greater likelihood, than in a larger country, that close family or personal relationships may give rise to a real conflict or a perception of conflict. With respect to decision making for monetary or financial policy, the principal set of conflicts that require avoidance or management relate to personal financial or professional interests of the proposed member. A key task for the proposed nominating committee discussed above would be to undertake due diligence with respect to conflicts of interest prior to recommendation to the Minister of Finance. This assessment would be periodically reviewed with the committee member during their term in case any conflicts have subsequently arisen.

128. It is recommended that external members who live outside New Zealand should be considered for appointment. Apart from broadening the available talent pool, it may reduce the degree of risk around some conflicts of interest.
129. A further argument against part-time external candidates is that the in depth, technical nature of both monetary and financial policy decisions mean that it is difficult to undertake these roles on a part-time basis, even if the external member is talented and has significant amounts of relevant experience. The question of time commitment required from external members will need to be determined as part of an implementation process. However, given that a number of central banks and financial regulators appear to use external members on a part-time basis, these considerations would not, in themselves, appear to preclude the use of external members.
130. While members may have strong, relevant technical backgrounds (e.g.: expertise in monetary and financial policy), candidates should also be sought with a diverse range of economic, regulatory and other professional backgrounds who can effectively process and debate analytical and technical arguments and also make sound decisions in the context of considerable uncertainty. The most likely benefits to the quality of decision making from diverse membership are likely to come from the addition of different decision heuristics to the committee as well as adding additional technical skillsets and more diverse information sources.

Recommendation 6.

Steady turnover of committee members should be managed through staggered appointments with fixed terms of committee membership.

131. While committee size, the use of external members and the breadth of professional backgrounds are tools to facilitate diversity at any point of time, the rules around how committee membership changes is an important tool to influence an ongoing change of perspectives on the committee and to mitigate some of the risks of “group think” associated with teams that have spent considerable periods of time together. Managing turnover well is also important in ensuring that the committee is able to preserve a corporate memory which is especially important in maintaining consistency in the approach taken to regulatory decisions over time.
132. At the same time, the advantages of turnover need to be balanced against the need for members to learn and develop in their role. Professionally, these committee roles are likely to be an attractive option for those within the RBNZ and outside. As such the design of the roles should consider the incentives provided to invest in professional development or work assignments that will be good positioning for committee member roles in the future. In addition, providing some security of tenure in role mitigates the

risk that members are incentivised to seek reappointment by making policy or regulatory decisions that are politically expedient.

133. In terms of designing the RBNZ's committee model, appointments to the committee should be staggered so that there is a planned, predictable way to turn over positions (while accepting that unplanned turnover will also occur as committee members' professional and personal circumstances dictate). A fixed term of up to five years for both the *ex officio* and external members would be consistent with practice elsewhere in the New Zealand public sector. This formulation would permit shorter appointments if preferred, say, by some external members who may not wish to fill a full, five-year term. The RBNZ Governor and Deputy Governors are currently appointed for five year terms with the potential for reappointment. Public Service Chief Executives are appointed for up to five years with reappointments also of up to five years. Members of Independent Crown Entities are also appointed for terms of up to five years.
134. The difference proposed here is that there would explicitly be only consideration for one renewal of up to five years (theoretically the RBNZ Act and the State Sector Act currently permit further extensions) in an external member role or in a particular *ex officio* position (e.g Deputy Governor). This would mean that a Deputy Governor who had served several years and then became Governor would be able to be considered for two terms in the Governor role.
135. The provision to limit the term occupied in any one role is to reduce the risk that the RBNZ does not become captured by the thinking and perspectives of one or more members on what will be a relatively small committee. In practice, this is unlikely to be a large change with respect to *ex officio* members. Using the example of the Governor, since the RBNZ was established in 1934, only two of the 11 Governors have served significantly more than 10 consecutive years (1948-1962 and 1988-2002).

Recommendation 7.

With respect to macro-prudential and micro-prudential policy, the committees would act in a way that was collegial in public and individualistic in private and, with respect to monetary policy, the committee would act in an individualistic manner and there would be appropriate scope for monetary policy committee members to articulate differing analysis and policy judgements in public.

136. The current governing committee follows a collegial approach in public. That is to say, the monetary policy decision reached by the Governing Committee, whether that is reached by consensus, majority or the Governor exercising a casting vote or veto, is supported by all members of the Committee in public. One benefit of this approach is that there is clarity and consistency of communication of the RBNZ's view which is also reflected in the forecast track released in the MPS.

137. There is considerable debate among central bankers with respect to monetary policy decision making whether a committee should use voting or operate consensus-based decision making. As Maier notes, there is no reason to believe that either of the two options always delivers better results. Voting has the advantage that every group member has to reveal his or her preference. Voting can act as a device to reduce free-riding, in particular if individual voting patterns are published. A similar arrangement can, however, be implemented in a consensus-oriented approach when the contribution of individual committee members is identifiable.
138. There are also potential disadvantages of publishing votes and attributing them to individual members. Group members who are seeking to preserve their reputation for competence may be less willing to advocate a position that may not align with a public consensus or received wisdom Lerner and Tetlock (1999) who survey the social psychology literature with respect to the impact of various accountability mechanisms on human decision making report some studies that support this view.
139. On balance, this review favours aligning the expression and attribution of views in private with respect to monetary policy decisions with the identification of those views in public. In practice, this would mean that the Monetary Policy Statement would record the votes cast for different positions and attribute those views to individuals. The performance of committee members is likely to be enhanced and accountability for performance is certainly easier to assess when there is congruence of private and public views.
140. Monetary policy decisions are often finely balanced. Competent individual decision makers can reasonably come to different policy judgements. This review puts weight on the value to the public of understanding the range of views that have been drawn on to come to a monetary policy decision and the importance of highlighting the inherent high levels of uncertainty around the trajectory of the economy beyond the very short term.
141. To mitigate the risks of undue communication confusion arising from disagreements among the monetary policy decision makers, the charter for the monetary policy committee should articulate agreed protocols for communication. Drawing on other central bank experience, these could include confirmation that only the Governor speaks for the whole committee and agreement on “blackout” periods, prior to and following monetary policy decisions. The nature of the inflation forecasts contained within the MPS would need to be reassessed in the context of the proposed decision making and transparency approach.
142. The literature on the merits of voting versus a consensus-based approach is based on monetary policy decision making. To date, there appears to have been little work

undertaken on the merits of alternative approaches with respect to financial policy. This review has not found evidence of financial policy committees that release votes in the published minutes of discussions and decisions. Micro-prudential regulators are required to provide clear guidance or direction to protect their soundness. This argues in favour of a collegial public stance. With respect to macro-prudential decisions, most decisions on policy settings will be in place for some time and it is important that financial institutions have an appropriate degree of certainty about those settings that can be factored into its business planning so the committee should also act collegially in public.

Recommendation 8.

The minutes of the committee meetings would be made available to the RBNZ Board and with respect to monetary policy and macro-prudential decisions published with a short lag.

143. While the addition of decision makers can, on average, improve the quality of decision making relative to a single decision maker model, individuals have been shown to behave in group situations in ways that can reduce the advantage of the group approach if not managed carefully. Some of the issues that may reduce the independence of members, such as the presence of an implicit or explicit hierarchy in the group have been discussed above. The group setting can provide incentives for the committee member to free-ride on the contributions of other members. There is a strong argument that the position of individual members and the nature of the policy discussions and debates is recorded. Through making their contribution transparent, the way in which the committee is operating is likely to improve the incentives for individual members to take care in terms of their role and exercise diligence.

144. There is an option to identify the contribution of individual members in a record of discussion for the purpose of assessing the performance of committee members but not publish the record of discussions. As recommended below, the RBNZ Board would be responsible for assessing the performance of all committee members. It would therefore be appropriate for the Board to be provided with the minutes of committee discussions which identify the contributions of individual members. This approach would be relatively close to how the RBNZ Board currently assesses the performance of the Governor. This option could be favoured if significant weight was placed on the argument that public disclosure of individual contributions could have a chilling effect on the diversity of views expressed if committee members, for reputational reasons, were wary about expressing views that may be contrary to the received wisdom of the time. This option would also acknowledge that a degree of transparency around the views of individual committee members was important to make an informed judgement of the committee's performance.

145. There is also a persuasive argument that publicly releasing the minutes of committee meetings would be in the public interest. There is debate around what form of minutes can maintain a free flow of analysis and policy judgement internally while communicating the diversity of opinions and maintaining a high level of transparency and accountability externally. Those who are concerned about the chilling effect of publication on genuine deliberation and debate tend to favour minutes that have less individual attribution of particular views and/or favour publication of minutes a considerable period of time after the monetary policy decision is taken.
146. Those who emphasise the value of transparency in terms of the performance and accountability of committee members favour minutes that attribute contributions to individuals in a full and accurate manner and are released as soon as practicable after the monetary policy decision is taken.
147. The form of minutes issued and their timing would be matters to be agreed in respect of each of the committee charters. Given the institution-specific nature of micro-prudential decisions, it is unlikely that it would be appropriate to publish a record of discussion for the micro-prudential committee. It would be feasible to consider publication of macro-prudential minutes, bearing in mind the preference to express consensus-based decisions as discussed above.
148. With respect to monetary policy, this review leans towards a timely publication of the record of discussion with respect to monetary policy. One option that could provide clarity about the reasoning and range of views expressed without detailed individual attribution would be to take the approach used in the appellate courts where either a single opinion is released (in the event of unanimity) or one or more dissenting opinions are also published in the event of a disagreement with transparent association of individual members to the opinions published.
149. The judgement in favour of more open disclosure is also shaped by the RBNZ's obligations, as a public institution, to support the spirit of the Official Information Act. The Official Information Act 1982 has been a significant and overwhelmingly positive influence in shaping what is a highly transparent state sector in international terms. The presumption in the Act in favour of public disclosure of official information, with some caveats, should be an important influence in setting the context for decisions around the degree and timing of disclosure around committee decisions.

Recommendation 9.

Moving the PTA from a person-dependent to time-dependent document.

150. Legislating for a committee-based approach to decision making would require the Act's policy objectives and purposes to be expressed as being the objectives and purposes of

the Committee responsible for making monetary policy decisions. The PTA would be reframed as an agreement between the Minister of Finance and the committee and it should be signed by all the members of the committee serving at the time that the PTA is negotiated. This would underscore to committee members the importance of the framework assessment function of committee members and also reinforce the collective responsibility of all committee members.

151. Currently, the Governor is accountable for the monetary policy and financial regulatory performance of the RBNZ. The Governor is also accountable for the performance of the RBNZ as an organisation as its Chief Executive. The Governor would remain accountable for the performance of the RBNZ as an organisation. The Governor's policy accountabilities would reflect their responsibilities as chair of the policy committees, the important role in the public communication of monetary policy decisions and the associated responsibility to ensure that the committees operated effectively together with their contribution as an individual committee member.
152. This change would also bring about improvements in the way in which the PTA is agreed. Currently, the PTA must be renegotiated whenever there is a new Governor. The difficulty with this practice is that a new Governor must agree to a PTA before they have commenced their role and therefore are without the maximum benefit of advice from the RBNZ, Treasury or external sources. In contrast, the Bank of Canada reviews its Inflation Control Target every five years. This permits a much more open and transparent discussion of potential changes to occur prior to the scheduled review.
153. In the New Zealand context, it is recommended that the PTA and the policy statement for financial policy would be reviewed every six years (although not necessarily in the same year) unless the Minister of Finance and Governor agreed to undertake a revision between scheduled reviews. The proposed time frame of six years between reviews would allow sufficient time to elapse to come to considered judgements about the operation of the current PTA or statement on financial policy. Provided that the first review was not undertaken in an election year, a six-year review cycle would mean that the subsequent reviews would most likely not occur in an election year.
154. Providing the RBNZ, as an institution, with a clearer role in setting the PTA than is presently the case may assist it to enhance its social licence by providing an opportunity to harness its research capability and expertise to inform political agreement on the operative policy framework for monetary policy decisions.
155. As the PTA is agreed between the Minister and monetary policy committee, it would be appropriate for the review process to be the joint responsibility of the Treasury (as the advisor to the Minister) and the RBNZ.

Proposal 2. Focus the role of the RBNZ Board on providing an independent performance assurance function to the Minister of Finance and provide the Board with appropriate support to undertake this function.

156. An objective for this review is to ensure that there is clarity and coherence to the role of the RBNZ Board. An earlier section of this report noted that the current role of the Board is unusual in the New Zealand public sector. It is also argued that the Board should be better resourced in order to carry out its current responsibilities to the best of its ability. The move to committee-based decision making also has important consequential implications for the RBNZ Board.
157. There is an argument that there is no need for the RBNZ Board going forward. The section on supporting the Minister of Finance with respect to appointments argues the importance of using focussed, ongoing capabilities around talent identification and recruitment to support the recruitment of the Governors and external committee members. It is proposed that the State Services Commission and proposed nominating committee for the external members undertake this function. The inclusion of external policy makers into the RBNZ's monetary policy and financial regulation decision making weakens the argument for an external board that assesses the policy performance of the RBNZ. The Treasury's economic and state sector performance roles mean that the Minister of Finance is able to seek advice from the Treasury on both the policy and corporate performance of the RBNZ. The current RBNZ Act also permits the Minister to commission external reviews of aspects of the RBNZ's performance. There is ongoing public debate by economists, media and other commentators on the RBNZ's policy performance, particularly with respect to monetary policy.
158. Equally, an option is for the role of the RBNZ Board to move closer to a more orthodox Crown entity board by assigning the Board an explicit governance role with respect to all the RBNZ's functions with the exception of monetary policy and financial regulation decisions where those decisions would be taken by the relevant policy committees. The Board would then make the usual delegations to the Governor and other RBNZ staff to manage the organisation. The Board, on behalf of the RBNZ, would be responsible for the preparation of the Statement of Intent and the Annual Report.
159. It is not proposed that the RBNZ Board is discontinued or that the RBNZ assumes a governance role for the RBNZ as an organisation. There is a persuasive argument that an internal performance assurance board is warranted to enhance performance monitoring of the policy decision makers and the overall organisation. Publicly available information is one source of such performance information. However, while public information may allow considered judgements to be formed with respect to monetary policy, this is likely to be much less true with respect to regulatory decisions, particularly those that impact on individual institutions. Furthermore, a mechanism is required to assess the performance of individual policy makers, including the

Governors, and, when required, advise the Minister if dismissal is warranted if consistently poor performance is observed. An internal board, with access to a rich set of observations and information, is likely to be better placed than an external agency, for example, the Treasury, with more limited observations and information, to undertake this assessment.

160. In clarifying the Board's role, the grounds on which the Governor could be removed should also be reassessed. It is proposed that the current grounds around the Bank's inadequate performance (including resource mismanagement), the Governor's inadequate discharge of his or her responsibilities and various elements of personal misconduct (e.g conflicts of interest, neglect of duty) are maintained. It is suggested that the specific references to inadequate performance against the PTA and consistency of the MPS with legislation are dropped. In part, these references are redundant given the grounds of inadequate discharge of the Governor's responsibilities. In part, given the increased importance of financial regulation, it does also not seem logical to have specific reference to particular monetary policy issues and not regulatory issues.
161. This report argues against the Board having governance responsibilities for the RBNZ. Given the importance of the RBNZ as an institution in the public sector, the Minister should receive independent assurance from the Board that the RBNZ, as an organisation, is well stewarded. The ability for the board to provide this assurance is undermined if it holds executive responsibilities.
162. It is proposed that legislation provide much more clarity than is currently the case as to the skill sets that should be held by Board members. Board members should have skills and experiences that, in combination, can come to high quality judgements on the quality of the RBNZ's regulatory performance, monetary policy decision making and implementation and the quality of the organisational stewardship provided by the Governor and management of the RBNZ.
163. Bringing a clear focus to the Board as a performance assurance board that advises the Minister of Finance has implications for elements of the constitution of the Board. As the purpose of the Board is to provide advice to the Minister of Finance, it would be appropriate for the Minister to appoint the Chair and Deputy Chair. This would also align with the rights of Ministers to appoint these positions with respect to other boards in the state sector. The Svensson review in 2001 recommended that the RBNZ Board should be comprised of non-executive directors only. However, the Governor has continued to be a member of the RBNZ Board. Given the focus of the Board proposed here, it would not be appropriate for the Governor to be a member of the Board and legislation should clarify that the Board should be comprised of directors who are not RBNZ executives or external members of the policy committees. Similarly, given the

performance assurance focus of the Board, it would be logical to drop the current duty of the Board to offer advice to the Governor.

164. While the proposed Board skill sets will assist the Board to undertake its performance assurance function, the Board itself will be appropriately part-time in terms of time commitment. As part of its assurance function, the RBNZ Board should have available resource to commission external reviews of aspects of either the Bank's regulatory, monetary policy or corporate performance. In addition, the Minister should have the power to request the Board to commission reviews on aspects of the RBNZ's performance.
165. Consideration should be given to some of the Board's other current roles. For example, the Board currently reviews, through an Audit Committee, the RBNZ's financial statements. Given the systemic performance assurance function for the Minister described here, it is not clear that the Board should continue to perform this role. Properly, the preparation of the RBNZ's financial statements is the responsibility of the Governor. In the Public Service, many Chief Executives who have the same responsibility for preparing their department's financial statements have advisory Audit committees. If the Governor wished to have a similar assurance role, it may be more appropriate for him or her to establish such a committee.
166. There are some overseas models that provide examples of review approaches that could have merit. For example, the committee of the Swedish Parliament that oversees the Riksbank's performance commissions an independent review of the Riksbank's monetary policy implementation over the preceding five years. The most recent review, published in 2016, was co-authored by Mervyn King and Marvin Goodfriend and provides a constructively challenging assessment of the Riksbank's monetary policy performance over that period.
167. A characteristic of the Swedish review approach described above is that it is focussing on monetary policy performance over a period of some years. This medium term focus would be valuable in the context of reflecting on the RBNZ's performance in a range of circumstance and drawing out observations that could support the organisation to perform more effectively over time. A current role of the Board is determine whether each MPS is consistent with the RBNZ's primary function and the PTA. There may be merit in allowing the Board to assess the RBNZ's monetary policy in a less prescriptive manner. The inclusion of external members into monetary policy decision making reduces the importance of a real time external review of the RBNZ's short term monetary policy decision making. A more permissive approach would allow the Board to under reviews of monetary policy performance over different time periods and also to seek assurance around some of the inputs that are important to making monetary policy decisions (e.g inflation forecasting).

168. The Board should also be able to be supported by RBNZ staff who are working to the Board independently to undertake or assist the commissioning externally of the Board's performance assurance programme. The Bank of England has established an Independent Evaluation Office that works at arm's length from the Bank's other business units and reports to the Bank's Court of Directors to undertake the Bank of England's assurance programme. This model is worth studying closely in establishing a similar function within the RBNZ. Transparent funding separate from the five-year funding agreements and appropriated by Parliament through Vote Finance is one mechanism that could empower the Board to undertake its more active review and evaluation function through the use of internal and external resources.

Proposal 3. To support the proposed changes to the RBNZ's decision making and governance model, clarify the roles of The Treasury in respect of developing the PTA and financial regulation policy statements and make explicit the expectation of Treasury stewardship of aspects of the RBNZ Act.

169. The changes to the Reserve Bank's decision making and governance structure described have several implications for the role of the Treasury.

170. Some of these implications have already been noted above. The proposed public, periodic review of the PTA is proposed to be jointly led by the Treasury and the RBNZ. This will require the Treasury to maintain an ongoing capability to contribute to the analytical and research work that should be undertaken to assess what is the best form and expression of the PTA. This role is consistent with Treasury's existing role to provide macroeconomic policy advice to the Minister of Finance.

171. This review proposes that the Treasury would take responsibility for leading, in consultation with the RBNZ, the proposed policy statement on financial regulation. The statement would need to balance a system focus, looking across the span of the RBNZ's regulatory functions, together with providing sufficient policy clarity and guidance on matters that the RBNZ should have regard to with respect to the specific Acts for which it has responsibility.

172. The Treasury has commissioned this review into the RBNZ's decision making and governance approach. The RBNZ is the administering "department" for the RBNZ Act, including its governance and management provisions. However, there are strong arguments to suggest that it is difficult for an agency to be dispassionate about periodically and transparently reassessing the way in which it is governed and makes decisions. That is one reason why the administering department for legislation that establishes an entity is generally the monitoring department for that entity rather than the entity itself. This model has much to commend itself.

173. Going forward, it is proposed that the Treasury is the administering department for the RBNZ Act with the exception of Parts 4 and 5 (which relate to banking supervision,

oversight of payments systems and regulation of settlements systems). These would continue to be administered by the RBNZ. Given the argument made above, there is an argument that the Treasury should be the administering department for the whole RBNZ Act. However, arguing against that view is the highly technical nature of those parts of the RBNZ Act. It is unlikely to make sense for the Treasury to develop sufficient technical capability on an ongoing basis to steward those parts of the RBNZ Act.

Conclusion

174. Since the passage of the RBNZ Act in 1989, the RBNZ has built considerable credibility in sustaining low rates of inflation over an extended period of time. This is a significant achievement. It means that care needs to be taken in considering changes to aspects of the RBNZ's decision making and governance approach to avoid the risk that poorly conceived changes erode that hard-earned credibility.
175. However, much of the careful design of the RBNZ's decision making and governance approach in the late 1980s was made in the context that the RBNZ's primary function was the formulation and implementation of monetary policy. Today, monetary policy continues to be a very important function for the RBNZ. However, the RBNZ now also carries out a wide range of financial stability and financial regulation functions and, arguably, the successful overall management of these responsibilities is as significant as the successful management of monetary policy.
176. In addition, our collective understanding of the processes through which monetary policy decisions are made has advanced significantly since the late 1980s. There are strong grounds to believe that well-designed committees will tend to make better decisions over time than any one individual. It is also likely that a well-designed committee system will support the objective of a broad political and public legitimacy for the RBNZ's decision making roles.
177. Together, the expansion of the RBNZ's regulatory responsibilities and the improved understanding of the optimal processes by which monetary policy decisions argue in a similar direction in terms of the desired nature of change for the RBNZ's decision making and governance approach. Bringing a wider group of decision makers to the table and harnessing a broader range of technical and decision making skills would be a prudent approach to strengthen the quality of the RBNZ's decision making. Expanding the range of evaluations of the RBNZ's performance, particularly in the area of financial regulation would also support the ongoing development of the RBNZ as a learning organisation. These would be important gains in permitting the RBNZ to manage the risks of undertaking its current, broad set of functions more effectively and it would also support a resilient institution.

178. A strength of the 1989 reforms was the way in which government was required to be transparent as to the monetary policy objectives that the RBNZ was expected to achieve within the Act's framework. It provided transparency to the public about the government's intentions, it provided clarity to the RBNZ as to the objective it was seeking to achieve and any considerations to which it should have regard in implementing monetary policy. The accountability of the RBNZ was also facilitated by the clarity and transparency of policy objectives. While financial regulation is aimed at several policy objectives and the articulation of what successful performance looks like will be described in a different manner from monetary policy, there is a strong argument to create an analogous statement given the importance of financial stability and financial regulation to the RBNZ's current mission.
179. The proposed accountability provisions for the operation of the committees and the proposed new statement for the RBNZ's financial regulatory decisions will enhance accountability, particularly with respect to financial regulation policy. Finally, the refocussing of the RBNZ Board to include a stronger focus on providing independent assurance on the RBNZ's activities will both support effective accountability and assurance with respect to the stewardship of the RBNZ.
180. Overall, these proposals seek to evolve the RBNZ's legislative framework in a way that is both consistent with practice seen elsewhere in the New Zealand public sector and in central banks internationally that have similar spans of business to that of the RBNZ. Successful institutions seek to adapt in a timely fashion to changes in their environment and to developments in our knowledge about governance and decision making rather than have change forced on them in the aftermath of a significant performance failure. As steward of the central bank's decision making and governance framework, the Treasury has an important responsibility to ensure that the framework within which one of our most important institutions operates is fit for purpose for the future.

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