The Treasury

Phase 1 RBNZ Act Review Information Release

December 2018

This document has been proactively released by the Treasury on the Treasury website at https://treasury.govt.nz/publications/information-release/phase-1-reviewing-reserve-bank-act.

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;
[2] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand;
[3] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials;
[4] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions;
[5] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice;
[6] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice;
[7] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.
[8] Not Relevant

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

Copyright and Licensing

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

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.
1 November 2017

Hon Grant Robertson
Minister of Finance

Modernising New Zealand’s Macroeconomic Framework:
Reserve Bank of New Zealand Act

New Zealand’s macroeconomic framework is built on three pillars: sustainable
government finances based on a responsible fiscal policy, stable prices
delivered by monetary policy and a stable financial system. These pillars
support long-term sustainability and also help the economy to recover from an
economic downturn and operate closer to full employment.

The three pillars are overseen by the Treasury, which advises on the overall
economic framework and on fiscal policy, based on rules and principles set out
in the Public Finance Act. The Reserve Bank of New Zealand is responsible for
delivering the Government’s monetary policy objectives and for the stability of
NZ’s financial system based largely on legislation set out in the RBNZ Act.

This legislative framework has been in place for nearly 30 years. It was
pioneering in its time and has enabled the relative price and financial stability
and sound fiscal position that the country is experiencing today. However, the
last thirty years have also seen significant change in the economy. And
following the global financial crisis, there has also been considerable debate
across the globe on some macroeconomic fundamentals, in particular the
regulation of the financial system, the effectiveness of monetary policy, the
appropriate role of fiscal policy, and the relationship between all three.
In light of this, the Treasury commissioned an external review of its fiscal policy advice in 2014, which concluded that it had been consistent with international principles and practices of responsible fiscal management. It also made a number of broadly technical recommendations aimed at keeping our approach at the leading-edge of best practice and to support the transparency that underpins NZ’s system of public finance.

Over the past 18 months we have also reviewed the monetary policy aspects of NZ’s macroeconomic framework and are reviewing the financial stability aspects in light of the IMF’s own assessment of NZ’s financial sector and other international initiatives led by the G20.

In the Treasury’s view it is time to step back and review the statutory framework under which the Reserve Bank operates. The attached paper sets out why we recommend a review of the RBNZ Act. Overall, we have concluded that NZ’s macroeconomic framework would be strengthened if some changes were made. We recommend three key areas of focus:

- first, the financial stability provisions in the Act, in particular the respective roles of Ministers and the Reserve Bank. Developments since the financial crisis (including the potential for significant fiscal costs, the evolution of global regulatory policy and the use of macro-prudential tools) mean that greater clarity is required to set out the responsibilities of Ministers and those of a regulator operating independently;

- second, the decision-making and accountability framework at the Reserve Bank. We believe this should be updated, moving away from a single decision-maker to a committee-based structure with appropriate accountability mechanisms to promote diversity of views. We also recommend reviewing the scope, role and function of the Board of the Reserve Bank;

- third, the monetary policy framework. We consider that monetary policy operated through flexible inflation targeting continues to provide significant economic benefits for New Zealand. However, we also believe that – in view of global monetary policy developments over the last 10 years – the statutory framework should be reviewed to ensure that it remains fit-for-purpose in the modern economy.

We also believe that the Reserve Bank’s unusual responsibility for both the policy/administration of the Acts it operates under and also for their operational delivery needs to change. The more conventional approach would be for the Treasury, as the Minister’s Department, to be responsible for the former.
In the Treasury’s view, a comprehensive review of the RBNZ Act provides an opportunity to strengthen a fundamental pillar of NZ’s macroeconomic framework, enhance and reinforce the Reserve Bank’s independence and build institutional resilience. It would put the Bank in a strong position to meet the challenges of tomorrow’s economy.

The attached paper sets out how a review could be managed. We look forward to discussing it with you.

I am copying this letter, and attachment, to the Prime Minister and to the Associate Minister of Finance (Hon David Parker).

Gabriel Makhlouf
Review of the Reserve Bank Act

1: Introduction

This paper proposes a comprehensive review of the Reserve Bank Act, including both the monetary policy and financial policy framework. The Treasury recommends that this review be undertaken in two phases, with phase one focused on changes to the monetary policy framework and progressed in 2018, and changes to the financial stability framework to follow.

Over the past 18 months the Treasury has undertaken a review of the monetary policy framework. This review involved commissioning expert reports on monetary policy, holding a monetary policy frameworks workshop, and reviewing the international debates on the role and effectiveness of inflation targeting as a monetary policy framework. Following this review the Treasury continues to consider that a flexible inflation-targeting regime, under which the central bank pursues medium-term price stability while having regard to economic conditions, provides a number of benefits to New Zealand. However, there are also some areas where the macroeconomic policy framework could be strengthened.

One of the most pressing challenges of today is ensuring that our macroeconomic policy framework as a whole will be adequate to manage a future large shock to economic growth. This includes ensuring that monetary policy plays its role in stabilising the economy, and reducing unemployment, in a downturn. The global financial crisis, however, highlighted that conventional monetary policy may be constrained in the face of a large negative shock due to the effective lower bound on interest rates. One priority is to ensure that should New Zealand suffer a large economic shock in the future, fiscal and monetary policy options would be available to stabilise the economy and support growth and employment.

Another priority in the Treasury’s view is to reform the monetary policy decision-making arrangements from the current single decision-maker model to a committee based decision-making approach. Given the degree of judgement required in monetary policy decision-making under a flexible inflation-targeting framework, and uncertainty as to how the economy works, we consider that the diversity inherent in committee-based decision-making better supports good decision-making than a single decision-maker model can. The Reserve Bank does in practice use a committee to make monetary policy decisions. However, the legislation constrains committee design, and the legitimacy of the Reserve Bank’s decision-making approach would be better supported if the committee decision-making approach were legislated.

Further, in our view governance reform should not be restricted to monetary policy decision-making. Over a number of years the Reserve Bank has taken on a range of new functions in respect of financial stability policy – including regulating insurers and the proposed regulation of financial market infrastructures – and its approach to regulation has become more interventionist in line with international standards. This has resulted in the Bank being a much more complex entity now than it was in 1989.
when the governance and decision-making framework was put in place. It is timely to review the overall governance and decision-making structure of the Reserve Bank, including the role of the Board and the potential use of committee decision-making for financial stability policy, in light of these new functions.

There are also a number of reasons for including the legislative framework for financial stability policy in this review of the Reserve Bank Act. The global financial crisis highlighted that financial crises can impose large and prolonged costs on economies. It is therefore important that the Government is confident that the approach taken to financial stability regulation is consistent with the Government’s objectives and desired level of risk mitigation.

A review of the financial stability framework would also be timely as the Treasury and the Reserve Bank have been working on changes to the crisis management framework for a number of years in order to ensure authorities could manage a financial crisis. Furthermore, the IMF’s Financial Sector Assessment Programme (FSAP) report made a large number of recommendations for reform, including the need for clarification of the Bank’s objectives, a review of its approach to bank supervision to enhance the Bank’s ability to identify emerging financial risks, and clarification of roles and responsibilities in the financial stability framework. Lastly, there is a review of the macro-prudential policy framework scheduled to commence in 2018.

You have indicated that you have a number of priorities in respect of Reserve Bank reform, particularly:

- Broadening the objectives of monetary policy in the Reserve Bank Act to include the consideration that monetary policy should give to full employment;
- Amending the Act to change monetary policy decision-making to a committee based decision-making model;
- Reviewing the way inflation is measured and the adequacy and appropriateness of the Bank’s tools.

We recommend taking forward your priorities in a comprehensive review of the Reserve Bank Act, which includes consideration of both the monetary policy and financial stability policy framework as well as the governance model for the Reserve Bank. Section 2 of this paper discusses potential staging of a review to take these policy proposals forward. Section 3 discusses work we have undertaken on the PTA, which is an important part of the monetary policy framework. The annex to this paper discusses the detailed reasons for a review in respect of the three areas: governance of the Reserve Bank, monetary policy and financial stability policy. It also discusses the case for changing the administering agency for the legislation the Reserve Bank operates under to the Treasury.
2: Taking a review forward

There are a number of ways to conduct a review of the Reserve Bank Act. In terms of the speed and staging of the review, major considerations are: the breadth and complexity of the issues and the extent to which issues are inter-related. A reform programme could be considered in respect of the areas of: monetary policy, financial stability policy and governance/decision-making. We recommend that a review of the Reserve Bank Act be staged, with the first stage focused on monetary policy objectives and monetary policy governance and decision-making.

Monetary policy

We recommend a review of the monetary policy provisions in the Act focused on three key areas. The review would give consideration to:

- Changes to the Act to ensure that monetary policy decision-makers give due consideration to full employment along-side price stability in implementing monetary policy;
- Whether the tools used by the Bank for conducting monetary policy are adequate to manage a deep recession and whether the governance and accountability framework around these tools is sufficient;
- Whether changes to the Act are justified to enhance transparency and accountability more generally.

You have also indicated a desire to review the inflation measure. As the inflation measure is set in the PTA, we discuss this in section 3 on the PTA.

Governance and decision-making

There are three key areas of governance and decision-making that we recommend be covered in a review:

- Instituting a committee-based decision-making model for monetary policy;
- Instituting a committee-based decision-making model for financial stability policy;
- Consideration of the overall governance of the Reserve Bank, including the role of the Board.

The Treasury has undertaken a substantial amount of work looking at options for Reserve Bank governance and decision-making. While there is a large literature on monetary policy decision-making and a limited number of choices, committee design for financial policy committees is more of an evolving area and therefore would take more time to implement. There are a number of judgements that need to be made as to how different committee design features will achieve the objective of good decision-making. There is a lot of commonality between our thinking on a preferred model and
the model you have previously discussed, although there are some important differences. There are also some differences of view between the Bank and the Treasury, although both agencies agree committee-based decision-making has a number of benefits. We recommend that a review of Reserve Bank governance and decision-making consider different options for committee design and that public consultation on the proposed changes occur.

Financial stability policy
Key considerations for a review of financial stability policy would be:

- The adequacy of the statutory framework to identify and mitigate financial stability risks and manage financial crises;
- Whether Ministers have sufficient tools to ensure that financial stability policy is consistent with the Government’s economic policy objectives;
- Whether changes to the Reserve Bank Act are necessary in light of the recommendations from the IMF’s FSAP;
- Whether any changes to the Act are required to enable the macro-prudential framework.

There are a number of complex issues in the area of financial stability policy and a number of highly engaged stakeholders. Given this, we recommend aiming to review these issues over a longer time-period than for monetary policy. This would allow for a full public consultation process to be run, including an issues paper next year followed by a paper on options for reform.

Next steps for a review
We recommend a two-phase process for a review. Phase one would advance changes on monetary objectives and decision-making with an aim to introduce legislation in 2018. Phase two would consider broader Reserve Bank governance reform and the financial stability framework. Phase two would be advanced on a slower timetable.

The proposed review of the Act would consider a number of fundamental tenets of the Reserve Bank’s governance and decision-making framework. Our recommendation is that the review be led by the Treasury in consultation with the Reserve Bank. We also recommend the establishment of expert working groups to provide advice on the recommendations of the review.

3: Policy Targets Agreement (PTA)
The PTA is an important part of the monetary policy framework and provides an early opportunity for you to reconsider the objectives of monetary policy. You will be required to agree a new PTA with the next Governor of the Reserve Bank prior to 26
March next year. You are not required to sign a new PTA with Grant Spencer, although you may choose to do so.

The current PTA provides for a flexible inflation-targeting regime, requiring the Bank to take account of the state of the economy in pursuing its price stability objective. The Treasury and the Reserve Bank have had a number of productive discussions on the PTA. A number of potential changes to the PTA have been identified, including adding a requirement that the Bank should seek to avoid creating unnecessary instability in unemployment in monetary policy decision-making. Aside from this change, a number of “house-keeping” changes have been identified to improve the clarity of the PTA and reinforce transparency. The main changes we recommend are:

a. While we recommend retaining the current target range (1-3%) and mid-point (2%) for the inflation target, we recommend clarifying the wording of the inflation target in order to simplify the target (in particular removing the word average).

b. Extending the requirement that the Bank seek to avoid unnecessary instability in output in pursuing the price stability objective to apply to both output and employment as the level of unemployment should be a relevant consideration for monetary policy.

c. Rationalising the sections of the PTA that specify the matters to which the Reserve Bank must have regard in the conduct of monetary policy in order to simplify and clarify the PTA and to better communicate the flexible inflation-targeting regime.

d. Improving transparency by requiring the Bank to explain in the monetary policy statement the factors it has taken into account in the implementation of monetary policy and clarifying the reporting requirements in the PTA that apply when inflation falls outside the target range.

e. Removing from the PTA the requirement that the Bank monitor a range of price indices as it is unnecessary.

Section 6 of the annex to this paper provides a potential draft PTA with tracked changes, which we have consulted with the Bank on in developing. We will provide you a full advice paper on the PTA prior to when it needs to be signed.

The PTA also sets the inflation measure that the Bank must target. You have indicated that you intend to review the measure of inflation that the Bank must target. We recommend that this is completed prior to the resetting of the PTA due by 26 March 2018.
Annex: The rationale for a review of the Reserve Bank Act

This annex discusses the rationale for a review of the Reserve Bank Act and the rationale for changing responsibility for the policy/administration of the legislation the Reserve Bank operates under to the Treasury. It comprises the following sections:

- Section 1: Background to the Reserve Bank Act;
- Section 2: Governance and decision-making;
- Section 3: Monetary Policy framework;
- Section 4: Financial policy framework;
- Section 5: Administration of the Acts under which the Bank operates.

In addition, for your consideration a draft PTA is provided in Section 6.

Section 1: Background to the Reserve Bank Act

Reforms to the Reserve Bank Act in the 1980s created a new statutory framework for both monetary policy and banking regulation. Amendments to the Act in 1986 created a new “light-handed” approach to banking regulation and the 1989 Act brought in the new monetary policy framework. Thinking at the time saw the three pillars of macroeconomic policy as having largely separable objectives, with monetary policy aimed at price stability also, by “coincidence”, managing short run fluctuations in the business cycle, financial stability policy focused on banking sector resilience and fiscal policy focused on the long-term sustainability of government finances.

The main goal of the new monetary policy framework was to define clearly the roles of the Government of the day and the Reserve Bank in relation to monetary policy and to provide a framework that would achieve low inflation. The desire to create a low-inflation environment arose from widespread dissatisfaction with the performance of the economy over the decade to 1984. The inflation rate averaged over 10 per cent for more than a decade and New Zealand’s economic growth rate was the lowest in the OECD. Low and stable inflation was considered necessary to improve economic performance in New Zealand.¹

The focus on inflation control in the design of the Act drove the specification of the objectives of monetary policy and also the institutional design of the Reserve Bank and allocation of roles between the Bank and Minister of Finance. The Act provides that the primary objective of monetary policy is to achieve and maintain price stability,² the precise specification of which is defined in the Policy Targets Agreement (PTA). The Act then gives the Reserve Bank operational independence to, and makes them accountable for, achieving the price stability objective as defined in the PTA. These features of the regime provided a way for Parliament to commit successive Governments’ to achieving price stability over the long term thereby providing a credible commitment to achieving a low inflation environment.

¹ Hon David Cagill, Hansard, 1989.
² The Bank must also have regard to financial stability.
Changes to the Bank’s governance and decision-making structures were also a central feature of the 1989 Act. The powers that had previously been vested in the Board were vested fully in the Governor; the Bank’s Chief Executive. The Governor was also the Chair of the Reserve Bank Board, although the previous Labour Government changed this following the 2001 Svensson Review. This single decision maker model, combined with clear and specific goals, operational autonomy and the ability to remove the Governor from office for inadequate performance, provided a model in which there was a high degree of accountability for achieving the price stability goal. Accountability was further enhanced by giving the Reserve Bank Board a duty to keep the Governor’s performance under constant review, and the power to recommend the Governor’s removal if their performance was deemed inadequate. Given that the Board no longer had any formal governance powers, the primary role of the Board was performance monitoring, although some other key functions were retained. Most notably, the Board has the sole power to nominate candidates for Governor.

This legislative reform was successful in its goal of managing inflation with a significant reduction in inflation and inflation variability (Figure 1) as compared to prior periods and also some reduction in the variability of output (Figure 2).

Variability in CPI inflation (figure 1)  

Variability in output (figure 2)  

In terms of financial stability policy, the prudential provisions of the Act were enacted at a time of financial sector de-regulation focused on improving the efficiency of the

---

3 The box shows +/- 1 standard deviation from mean CPI inflation in the given period. The line shows +/- 2 standard deviations from mean CPI inflation.

4 The box shows +/- 1 standard deviation from mean GDP growth in the given period. The line shows +/- 2 standard deviations from mean GDP growth. Official GDP data is only available from 1987.
financial system. Quantity restrictions and interest rate controls were lifted and deposit guarantees on deposits at trustee banks and the government owned Post Office Savings Bank were repealed. The Act provided a framework for a light-handed prudential regime with a focus on the stability of the financial system, recognising the very large economic costs that can arise from financial crises. The Bank was, however, given power to impose requirements on registered banks by way of conditions of registration. The intention was to promote prudent behaviour by banks and to enable the Reserve Bank to set requirements that complied with developing international requirements for capital regulation. Thinking at the time on the need for minimum prudential standards was however nascent, and hence the Act was not designed to support a comprehensive regulatory regime.

The Act deliberately did not include a depositor protection mandate, due to concerns this would create moral hazard. Like professional investors, depositors were expected to monitor the riskiness of the bank in which they made deposits and could suffer losses if a bank failed. This was part of an approach that emphasised market discipline, which was further supported by disclosure and credit rating requirements. The Act also created an opt-in regulatory regime that applied only to entities registered as, and able to call themselves, a bank. Other deposit-taking entities were not subject to comprehensive prudential regulation until the late 2000s when the Non-Bank Deposit Takers Act was passed, following widespread failures in this sector.

The Act did not provide for financial stability policy to have the same sharp objective setting and accountability mechanisms that were created for monetary policy. There is no formalised mechanism to set objectives for financial stability policy, as there is for monetary policy, and while the Governor can be removed from office for failing to meet the Bank’s financial stability objectives, the Governor’s performance is not linked to meeting any specific, agreed outputs.

The following sections discuss the case for a review of the Reserve Bank Act in respect of the three areas of: Reserve Bank governance, monetary policy, and financial stability policy. Section 5 discusses the case to change the administering department for the Acts the Reserve Bank operates under to the Treasury.
Section 2: Governance and Decision-making

Key points
- We recommend legislating for a committee decision-making model at the Reserve Bank.
- All of the Reserve Bank’s policy functions will benefit from committee decision-making. We recommend introducing separate committees for monetary and financial policy.
- A shift to a committee decision-making model raises other issues about the Governance of the Reserve Bank, which should be also be addressed.
- To maximise the efficacy of a committee, members must be accountable and the committee dynamic needs to support robust debate. Achieving this will depend on good committee design.

Introduction
The Treasury recommends updating the governance and decision-making framework in the Reserve Bank Act to require committee-based decision-making at the Reserve Bank. This is consistent with your intention to introduce a committee for monetary policy decisions. Our recommendation is to legislate for a committee decision-making model for both monetary and financial policy (although we recommend implementing a committee for financial policy along with wider reform of the financial stability provisions of the Act). As noted above, we see changes to the Reserve Bank’s decision-making frameworks as one part of a more fundamental package of reforms. Accordingly, we also recommend reviewing the role of the Board to ensure it is clear, coherent and consistent with the decision-making model adopted.

The Case for Change

A committee decision-making model should result in better decisions
A growing body of literature has shown that committees make better decisions than individuals. This is because groups limit the risk of extreme preferences and allow for knowledge pooling and different information processing and decision-making processes.

These benefits have motivated changes to practices at the Reserve Bank and at other central banks around the world, such that New Zealand’s legislated model is now an outlier internationally.

Changes to the Reserve Bank’s practice and role since 1989 make the single decision-maker outdated
The overall effect of changes to the Reserve Bank’s practice and role since 1989 has been to increase the risk and reduce the validity of the assumption that a single person can be held accountable for the decisions of the Reserve Bank. This is because:
• The evolution to a flexible inflation-targeting regime gives the Bank significant discretion as to how to weight different factors and means that there is not a single metric by which to measure the quality of the Governor's decisions.

• The 1989 reforms were based on a much more limited prudential regulatory regime than is now the case. Further, since financial imbalances can take years to build up and are not always easy to recognise, it is difficult to hold a Governor accountable for prudential policy decisions and the management of systemic financial risks in the short term.

• The increased focus on prudential regulation demands a much wider skill set for a Governor, which greatly exacerbates the key person risk of the single decision-maker.

Accountability is also weaker than originally envisaged. This is because reviewing the quality of monetary policy decisions ex-post is difficult given lags, the variety of factors that influence inflation outcomes and the challenge of separating good management from luck.

Given that the single decision-maker model was chosen for the strong accountability it offered, the difference between the theory and the reality strengthens the case for change.

**Change will build public and political support for the Reserve Bank**

The divergence of the Reserve Bank’s *de jure* and *de facto* decision-making models is undesirable as it creates uncertainty about the Reserve Bank’s decision-making processes. More significantly, the Reserve Bank’s current Governing Committee has evolved within the constraints of the existing legislation, which means the present arrangements have been constrained in their ability to evolve and in our view are not optimal. For example, the Governor appoints all members of the Governing Committee, which creates a hierarchy within the committee.

A strong mandate and a high degree of political legitimacy is critical for the Reserve Bank, as it ensures that it can act consistently and predictably. It follows that the choice of the Reserve Bank’s decision-making model should be a decision for Parliament and set in legislation. We expect that doing so would strengthen public and political support for the Reserve Bank.

**Reform gives an opportunity to clarify the role of the Reserve Bank Board**

Given that a key principle of institutional design is role clarity, the Board’s role and functions should be clear and complementary. The evolution of the Reserve Bank’s role has made it less clear in practice about what the Board’s role is in some areas. In recent years, the Minister of Finance has sent a letter of expectations to the Board, to clarify his expectations. The Board’s role should be specified clearly in legislation.

The Board’s role is unusual as the majority of the Reserve Bank’s powers are vested in the Governor, including powers that would more typically sit with a board. The Board is
therefore better thought of as a combination of a monitoring agent for the Minister (it reports on performance and plays a significant role in appointments and dismissal) and as an advisory Board (it has the power to advise the Governor on any matter relating to the performance of the Reserve Bank). While not a legislative function, the Board also performs the risk and audit function, and oversees large projects such as the introduction of new bank notes and coins.

The specificity of the Board’s monitoring role varies across the Reserve Bank’s functions. The Act gives the Board very specific monitoring duties with respect to monetary policy, but does not clearly define its monitoring duties for financial stability policy. Consequently, the Board’s role on financial stability policy is less clear. We recommend reviewing the role of the Board given the implications that arise from a shift to a committee decision-making model, and from an increased focus on prudential policy since 1989.

**Design Choices**

A number of issues need to be considered when legislating for a committee decision-making model at the Reserve Bank.

First, it is necessary to determine what decisions become the responsibility of a committee and which the Governor retains responsibility for, as well as the nature of the relationship between the Governor and the committee(s). As discussed above, it is also necessary to determine the Board’s role and responsibilities. Decisions about the overall structure of the Reserve Bank also need to reference to other issues covered in this document, including the boundaries of the Reserve Bank’s powers, and crisis governance arrangements.

Beyond these structural issues, implementing a committee decision-making model requires good design to minimise agency problems such as “group think” (where committee members unduly prioritise consensus in decision-making) and “social-loafing” (where a committee member exerts less effort than they would if they were solely responsible for a decision). A good design will see decision-makers held accountable for their choices, and will lead to a non-hierarchical committee dynamic that supports robust debate and genuine deliberation. We therefore do not recommend a continuation of the current model where the Governor has a role in appointing other committee members, as this risks creating a hierarchy within the committee and could stifle debate.

Given the overlaps across the Reserve Bank’s different objectives and tools, the design should also support policy coordination across its various functions, and be practical and suited to the roles the Reserve Bank performs and the tools that it uses. These overarching goals are not always consistent and there are trade-offs between design choices. For example, a model with multiple committees allows for clearer objectives and therefore stronger accountability, while also allowing more expert participants in the decision-making process. For this reason we support having two or more committees, one for monetary policy decisions and others for financial policy. However, separating responsibilities across multiple committees may bring
coordination challenges. Similarly, choices about whether or not to include external committee members and the appropriate transparency settings can minimise the risk of group think and social-loafing, while bringing more diverse perspectives to the decision-making process. However, the clarity of the Reserve Bank’s communications could be reduced if committee members are presenting divergent views in public, which could in turn reduce the efficacy of the Reserve Bank’s forward guidance on monetary policy.

Finally, given the Reserve Bank’s importance as an economic institution, any reform needs to be well managed to minimise transition risks. Specifically, open consultation and thorough signalling to the markets will be important to ensure as smooth a transition as possible.

While the design issues highlighted above are important, it should be recognised that there is no single “right” system for decision-making and governance. This is shown by the diversity of arrangements worldwide, and the fact that the Treasury and the Reserve Bank have different perspectives on some of the finer details of a reform package. Accordingly, the most important factor is introducing a system that is coherent as a whole and tailored to New Zealand’s circumstances.

Overall, the Treasury sees clear benefits in reforming the Reserve Bank’s governance and decision-making arrangements in order to strengthen public and political support for the Reserve Bank and make it a more resilient institution. In our view the risks and trade-offs inherent in progressing reform can be managed through careful design following a review process that includes working with the Reserve Bank and open public consultation, to the extent your desire for rapid change permits.
Section 3: Monetary Policy Framework

Key points

- Monetary policy aims at achieving low and stable inflation, and plays a role in stabilising output in the economy, particularly in a downturn.
- New Zealand’s monetary policy framework, based on a flexible inflation-targeting regime and a floating exchange rate, has assisted New Zealand in achieving both of the above outcomes.
- While the output-stabilisation role of monetary policy is recognised in the PTA to some extent, recognising it in the Act would make this consideration durable and may provide increased transparency and accountability as to the consideration of output-stabilisation in monetary policy decision-making.
- Amending the Act to broaden the objectives of monetary policy provides an opportunity to undertake a more comprehensive review of the monetary policy statutory framework in order to enhance transparency and accountability and consider the adequacy of the governance framework around managing deep recessions.

Introduction

The monetary policy framework, as set out in the Act and implemented through the PTA and other supporting instruments, has provided a regime that has resulted in a long period of low inflation and relatively stable macroeconomic conditions in New Zealand. Such macroeconomic stability improves wellbeing through several channels including reducing the impact of inflation on our most vulnerable citizens, reducing the extent and length of periods of above average unemployment and providing clear price signals to support economic development. The regime has also been flexible enough to allow for evolution in the approach to monetary policy over time.

Given this, we consider that there continue to be clear benefits to New Zealand from flexible inflation targeting with a medium-term price stability anchor. However, both the economy and practice of monetary policy have evolved over the 30 years since the Act was developed. Specifically, central banks have built up credibility as to their ability to maintain low inflation, and following the GFC there is a renewed awareness of the long-term costs of prolonged deep recessions and unemployment. Inflation-targeting regimes today generally recognise the role of monetary policy in stabilising the economy as well as maintaining low and stable inflation. Over recent years, there has also been evolution in the (potential) set of tools of monetary policy and greater awareness of the limits of conventional monetary policy to manage downturns.

Accordingly, we consider that there is the potential for some beneficial evolution of the legislative framework for monetary policy to update it to better align with current practice and the challenges of the future. We discuss potential areas of change here.
The Case for Change

The role of monetary policy in stabilising the economy could be recognised in the Act

As discussed, given New Zealand’s high rate of inflation when the Act was passed, the Act provided a sole focus on price stability as the objective of monetary policy. In practice however, inflation-targeting central banks today not only aim at stabilising inflation around the inflation target but also put some weight on stabilising real economy measures such as output and employment. Monetary policy can play this stabilisation role in most circumstances as in the short run it impacts on the level of output and employment; however in the long run prices and wages adjust to monetary policy settings and therefore monetary policy cannot be used to permanently increase output and employment above their sustainable levels. This stabilisation role of monetary policy has been important both globally and in New Zealand following the GFC. The significant monetary accommodation provided by central banks assisted the world economy to recover from this large negative shock and likely prevented further falls in unemployment.

These considerations mean that today inflation targeting is practised globally through flexible inflation targeting. This is also the case in New Zealand. Our inflation targeting approach has evolved, through the PTA, from the relatively strict approach of the 1990s to a flexible inflation-targeting regime that recognises the output-stabilisation role of monetary policy. For example, the 1999 PTA added the requirement that the Bank seek to avoid unnecessary instability in output, interest rates and exchange rates in monetary policy implementation and the 2002 PTA formulated the inflation target as a future target. Both these requirements are still in the PTA today and underpin the flexible nature of the regime. The labour market is also a consideration in monetary policy decision-making, although it is not currently included in the PTA.

While the PTA has provided an effective mechanism to allow for the evolution of monetary policy over time, including the consideration monetary policy decision-makers should give to the real economy in the Act would have the advantage of making this consideration durable. It would also make it a more prominent consideration in monetary policy decision-making. There are a number of options as to how the monetary policy objective could be specified. A key consideration is whether the price stability and full employment objectives should be equally weighted or hierarchical in the Act. Further, the objectives do not need to be specified identically in the Act and the PTA. In particular, the Act could take a broader approach than the PTA, providing greater flexibility to adjust to changing circumstances over time. These considerations would be considered in a review of the Act.

A review would consider the adequacy of our stabilisation framework

The GFC highlighted that monetary policy may be limited in its ability to stabilise the economy in a downturn in two main cases. These are when monetary policy interest

---

5 For example, see Wadsworth, An international comparison of inflation targeting frameworks, Reserve Bank Bulletin 2017.
rates reach their effective lower bound (ELB) and can no longer be lowered or where the financial sector is impaired to the extent that the transmission of monetary policy is affected. This set of circumstances occurred in some other countries following the GFC; several countries cut policy interest rates to zero (or below) resulting in conventional monetary policy reaching its limit in these countries. In some countries the central bank undertook new approaches to monetary policy through large scale asset purchases, called quantitative easing. Although New Zealand has not reached the ELB, a large shock to the economy could result in this occurring in the future.

A review of the Act would provide an opportunity to consider the adequacy of the current tools and governance framework to stabilise the economy in a deep downturn. In particular, a deep downturn may give rise to a need to undertake fiscal stimulus or unconventional monetary policy. One issue to consider is appropriate co-ordination between monetary and fiscal policy. This could be achieved through informal measures and without the need for a legislative change. However, this may come with costs in terms of speed of decision, clarity of communication, democratic legitimacy, or distorted policy choices. Another issue to consider is that unconventional monetary policy measures have fiscal implications, and the decision-making framework needs to be robust to take this into account. A review of the Act would allow a full set of options to be considered in respect of the adequacy of the stabilisation policy framework in the event of extreme events.

**A review would consider accountability and transparency**

In considering accountability and transparency settings for monetary policy operations, it would be possible to review both the exchange rate management provisions of the Reserve Bank Act, as well as more general transparency requirements.

**Improvements to accountability and transparency for exchange rate management**

A country with open capital flows, such as New Zealand, has a choice to control domestic monetary conditions, and therefore inflation, or to fix the exchange rate. A floating exchange rate therefore is an important element of maintaining a low inflation environment. A floating exchange rate also benefits New Zealand by helping the economy to absorb shocks to income. For example, exchange rate depreciation during the GFC helped to support exporters and maintain incomes and jobs in New Zealand.

However, within this floating rate regime, the Reserve Bank does have responsibility to combat both exchange rate market dysfunction and manage unjustified cyclical fluctuations. The Bank is subject to a direction from the Minister of Finance, issued in 2004, allowing it to intervene in the foreign exchange market for the purpose of stabilising the market in a period of market dysfunction. Additionally, the Bank has developed a strategy for foreign exchange intervention aimed at foreign exchange rate market disorder. The Bank has capacity to intervene in the foreign exchange market in order to influence the level of the exchange rate when the exchange rate is exceptionally and unjustifiably high or low. In practice, the Bank rarely intervenes.

---

The Bank’s intervention strategy and associated reporting, risk management and accountability requirements are set out in a 2004 letter from the Governor to the Minister of Finance and the general provisions of the Act.

While there is no presenting problem in respect of exchange rate management, we consider that there is an opportunity to improve the transparency of objectives and accountability for exchange rate management to ensure objectives remain relevant. The Minister currently has a different role in the setting of intervention objectives aimed at market dysfunction versus disorder. Further, there is currently no formal mechanism to review intervention objectives, and informal instruments are less directly linked to the accountability mechanisms in the Act than a formal instrument would be. A review of the Act would provide an opportunity to consider the desirability of putting in place more transparent mechanisms to set the objectives of exchange rate management and provide more formalised accountability and review procedures.

**Other transparency requirements**

The Act currently provides for transparency and review processes for monetary policy through the requirements for a monetary policy statement and the re-setting of the PTA every five years. While these processes have been effective in providing transparency and allowing evolution in the regime, we consider that there are some areas in which transparency and review processes could be strengthened. Moving to a committee decision-making model provides an opportunity to improve transparency. However, other areas of transparency and review could be strengthened, such as providing stronger mechanisms to ensure adequate review of the framework is undertaken regularly over longer-term horizons than is currently required by the Act.

**Reserve Bank Exchange rate intervention (figure 3)**

![Graph showing Reserve Bank Exchange rate intervention](image)
Section 4: Financial Stability Policy Framework

Key points

- New Zealand’s financial stability policies are an international outlier in that we have a light-handed supervisory regime. The IMF judged the Reserve Bank of New Zealand’s supervisory approach as materially non-compliant with nearly half the relevant international standards.
- Failure of a large New Zealand bank has the potential to impose large costs on the New Zealand economy, suggesting large New Zealand banks are increasingly "too big to close/fail".
- New Zealand’s Open Bank Resolution tool continues to rely on government guarantees. While the Minister of Finance is politically accountable for the regulatory regime, and has statutory obligations to ensure that fiscal risks in the financial system are prudently managed, the decision-making process in a crisis and the exercise of resolution powers are not clear. The Minister has no powers to manage risks and the regulator is not mandated to act on the government’s behalf.[2]
- The Act does not currently give the Minister effective and appropriate levers to determine or influence the degree of risk in the financial system that the government is willing to accept.
- The Minister also requires tools to encourage consistency with other Government objectives relating to financial market efficiency, innovation, or competition.
- The Act requires changes to ensure the resulting economic and fiscal risk is adequately managed. A review of the financial stability policies in the Act could address Ministerial and Parliamentary oversight, transparency and certainty, and clarify the Reserve Bank’s role, responsibilities, and operational objectives without jeopardising its operational independence as a regulator.

Changes since 1989

Financial stability policy (prudential policy) in New Zealand has developed over the last 30 years from a light-handed regulatory approach with a strong emphasis on disclosure requirements to a regulatory approach that is broader in scope and more prescriptive.

This growth in the scope and intensity of regulation was necessary given the concentration, complexity and interconnectedness of the sector, changes in international standards, and increased international understanding of the risks that financial contagion presented through the global financial crisis. However, in our view the Act is not designed to support such a prescriptive regulatory regime and there are a number of ways in which the approach to decision-making and accountability could be improved.

While regulation has increased, the level of supervision of individual entities remains very light by international standards. The recent IMF assessment of New Zealand’s financial system recommended a number of changes to New Zealand’s prudential
regime, emphasising particularly the need to undertake more intensive supervision to ensure New Zealand authorities adequately monitor and can respond to emerging financial risks. A review of the Act would be an opportunity to consider whether the current supervisory approach adequately monitors and mitigates risks within the financial system.

**The Act should specify clear objectives for the Bank**

Operational independence should come with clearly defined responsibilities and accountabilities. Financial stability and the Bank’s targets relating to market efficiency remain undefined. Clarification of objectives could guide the exercise of the Bank’s powers, and increase innovation, competition and regulatory certainty. A clear statutory objective should communicate the role that Parliament has delegated to the Bank to provide guidance, increase transparency, and make it accountable for its performance.

A review could consider the role objectives play, in particular:

- The IMF said in its FSAP report that the Bank’s “broadly defined” objectives had allowed it to independently develop a light-handed approach to bank supervision that departs from conventional practice. The IMF judged the Bank’s supervisory regime to be materially non-compliant with nearly half the relevant international standards.7

- New Zealand’s Open Bank Resolution (OBR) tool is relatively unique in that it relies on Crown guarantees in place of other internationally-accepted solutions to restore a failed bank. While the Crown is exposed to significant fiscal risk, and the Minister is politically accountable for any cost that may arise, the Minister has no powers and the Act does not give any party a clear objective to manage the resulting risk on his or her behalf.

- Steps to promote a sound and efficient financial system may have implications for consumers and depositors. While the 1989 Act did not include formal depositor protection, New Zealand is now the only OECD country that does not provide formal deposit insurance. The evidence to support the belief that exposing depositors to loss will encourage individuals to proactively monitor risk (i.e. would reduce moral hazard) is limited and was questioned by the IMF during its recent review. Both the Reserve Bank and the Treasury have recommended steps to provide a basic safety net. The Reserve Bank prefers an “enhanced de minimis” under OBR, which acts as an exemption from haircuts. The Treasury recommends that depositor protection be introduced to reduce the risk of a bank run and better manage the risk to the Crown.

- Macroprudential policy is relatively new and different jurisdictions define policy objectives differently. [2]

A review scheduled for 2018 will look at the appropriateness of the current macro-

---

7 The IMF’s FSAP report assessed the Bank to be materially non-compliant on 13 out of 29 Basel Core Principles for Effective Banking Supervision, including supervisory approach, risk management process and operational risk.
prudential framework and its role in mitigating the risk of financial and economic crises. Incorporating the review into the broader review of the statutory framework for financial stability policy allows for a holistic approach to be taken.

The Minister has a legitimate role in influencing the bank’s objectives and risk appetite

Government and/or Parliament should have the key role in setting the Reserve Bank’s objectives as they influence key strategic judgements affecting the wellbeing and long-term health of the New Zealand economy and of individual New Zealanders.

The Minister has a legitimate role in influencing the bank’s objectives and risk appetite

The Minister has a legitimate role in influencing the bank’s objectives and risk appetite

The Minister has a legitimate role in influencing the bank’s objectives and risk appetite

The Act currently allows for Ministerial input through the issuance of a direction to the Bank to consider government policy. This power has never been used to date and officials have been unable to agree how the power could or should be used in practice. The Bank must also take account of the Minister’s comments on its operational objectives within the Statement of Intent (SOI). A number of extra-statutory instruments have also been created to allow Ministers input into objective setting, such as the memorandum of understanding (MOU) on macroprudential policy and letters of expectations to the Reserve Bank Governor and the Reserve Bank’s Board. These instruments have had limited impact in practice as the Act provides insufficient guidance as to their purpose and appropriate use – and there is no legal obligation on the Bank to follow them.

There is an opportunity to provide clearer mechanisms for Government to input into the strategic direction of the Bank. This could be done in a range of ways – from changes to the Act, through to provisions for the issuance of statements of government policy that guide the Bank’s policy.

The role of the Minister and his/her relationship to the Bank should be clarified

The role of the Minister and his/her relationship to the Bank should be clarified

The role of the Minister and his/her relationship to the Bank should be clarified

The role of the Minister and his/her relationship to the Bank should be clarified

The role of the Minister and his/her relationship to the Bank should be clarified

The role of the Minister and his/her relationship to the Bank should be clarified

The role of the Minister and his/her relationship to the Bank should be clarified

The role of the Minister and his/her relationship to the Bank should be clarified

The role of the Minister and his/her relationship to the Bank should be clarified

The role of the Minister and his/her relationship to the Bank should be clarified

There are a number of areas of Reserve Bank operation where roles and responsibilities are unclear, for example:

- Bank resolution – OBR requires Crown guarantees and the Minister is politically accountable and has statutory obligations to ensure that the resulting fiscal risks are prudently managed. The IMF noted ambiguity around the RBNZ’s role and the RBNZ Act does not specify who is responsible for managing the provision of public support to a bank in OBR, or how the Minister would specify a tolerance for risk.

- Ambiguity of overall roles – Modern Acts such as the Crown Entities Act 2004 clearly specify the roles of all relevant parties. The Reserve Bank Act does not set out the roles and responsibilities (i.e. functions) of the Bank, the Minister, and the Treasury, which has created debate as to the purpose for which the Minister should exercise his/her powers.
Ministerial and Parliamentary oversight of the Bank’s regulatory functions should be strengthened

There is currently limited Ministerial and Parliamentary oversight over significant areas of prudential policy. A review of the Reserve Bank’s regulatory functions could consider the level of scrutiny in the following areas:

- Conditions of registration are currently treated as a form of administrative instrument rather than as regulations, and so are not subject to Parliamentary disallowance or oversight by the Regulation Review Committee.

- The scrutiny of the Bank’s Regulatory Impact Statements also differs from those in other areas of policy.

- The Bank has broadly defined powers, so it can create new approaches to regulation without oversight. For example, broad authorising provisions allowing the bank to regulate “risk management” have been interpreted as authorising the use of new tools including loan to value restrictions.

Statutory powers should be defined to provide transparency and certainty

Regulatory best practice encourages the transparent application of rules in a way that is proportionate, fair, and equitable. However, there is a trade-off between regulatory flexibility and certainty.

- Regulated entities have, over recent years, raised a number of issues relating to procedural fairness, transparency and certainty. These issues have become more pressing as the Bank’s regulatory approach has become more intensive and greater use has been made of administrative decision-making. A review would provide an opportunity to hear and consider these views to ensure that the Act supports sufficient procedural fairness in light of the scope of the Bank’s powers.

- Australian regulators have indicated concern about the level of regulatory “discretion” the RBNZ has as to how losses should be allocated without internationally recognised safeguards. The Australian Council of Financial Regulators wrote to the New Zealand Treasury in 2014 questioning the uncertainty about the legal position in New Zealand on property protection before limiting lending to the New Zealand subsidiary banks. These restrictions may limit access of New Zealand subsidiaries to funding in a liquidity crisis.

There are also a number of areas where the Act could provide more transparency, certainty and procedural fairness:

- There is presently no central registry of conditions which are currently used to impose prudential requirements. This makes it difficult to determine how rules are applied across the banking sector. A review would consider options to improve the transparency of regulatory requirements.

- The Reserve Bank makes decisions that are legally defined as “administrative”, but have grown to be increasingly regulatory in nature (i.e. the setting of capital...
standards or governance requirements). There are opportunities to improve procedural transparency around these decisions. Approaches may include consideration of legislating decision-making processes (such as appeal rights) and publishing decisions.\(^8\)

**Institutional Form & Other Issues**

The Bank needs to be independent from government in respect to its monetary policy implementation decisions, and in terms of prudential decisions relating to individual institutions.

In contrast the Bank could be more akin to a department in respect to financial policy decisions (if these remained within the Bank). The Bank could also participate in all-of-government processes for things like procurement. At the moment, their institutional form makes them independent on a wide range of matters.

---

\(^8\) Every-Palmer Report, p. 12.
Section 5: Administration of the Acts under which the Bank operates

Key points
- It is highly unusual for any organisation other than a department to be responsible for the policy and administration of legislation.
- A regulatory agency that has the lead policy role on its own objectives, powers, and governance and accountability framework gives rise to a conflict of interest.
- The more conventional approach would be for the Minister’s policy department to be responsible for the policy and administration of legislation.
- Industry stakeholders would likely support the Treasury administering the legislation and it would create a mutual inter-dependence with the Reserve Bank that would be beneficial to overall policy advice.
- Administration of the Reserve Bank’s legislation by the Treasury would not interfere with the Bank’s continued operational independence.

Introduction
The Reserve Bank is currently responsible for the policy and administration of the Acts under which it operates. It is highly unusual for any organisation other than a department to be responsible for the policy and administration of legislation. A regulatory agency that has the lead policy role on its own objectives, powers, and governance and accountability framework gives rise to a conflict of interest. The more conventional approach would be for the Minister’s policy department to be responsible for the policy and administration of legislation. Industry stakeholders would likely support the Treasury administering the legislation and it would create a mutual inter-dependence with the Reserve Bank that would be beneficial to overall policy advice. Administration of the Reserve Bank’s legislation by the Treasury would not interfere with the Bank’s continued operational independence.

What Acts is the Reserve Bank responsible for?
The Reserve Bank currently operates under – and has been designated the responsible entity for three Acts: The Reserve Bank of New Zealand Act 1989, the Insurance (Prudential Supervision) Act 2010 (IPSA), and the Non-Bank Deposit Takers Act 2013. The Bank administers two further pieces of legislation which do not confer regulatory powers. The Reserve Bank is also leading the development of a fourth Act (which would establish a new regulatory regime over financial market infrastructures) and is currently undertaking a review of IPSA.

---

9 Within New Zealand, no Crown entity administers its own enabling legislation; all have a monitoring department (apart from Tertiary Education Institutions which are monitored by the Tertiary Education Commission) whose responsibilities include administering the legislation. The Reserve Bank having responsibility for its own legislation perhaps reflects practices of a different era; there have previously been other examples of legislation being administered by an entity other than a department, but responsibility in all these cases has since been transferred to departments.

10 These are the Decimal Currency Act 1964 (which establishes New Zealand’s currency) and Part 2 of the Finance Act 1988 (which is now inoperative, having been superseded by subsequent bank acquisitions and mergers).
What does responsibility for administering an Act mean?

The State Sector Act 1988 defines the responsibilities of a department’s or departmental agency’s Chief Executive as including “stewardship of … the legislation administered by the department or departmental agency.”11 “Stewardship” is defined as “active planning and management of medium- and long-term interests, along with associated advice.”12

In practice, this would generally include that the entity that administers an Act:

- is the policy lead on review and changes to the legislation

- is responsible (on behalf of the Minister) for proposed changes to legislation, including managing stakeholder and industry engagement, instructing the Parliamentary Counsel Office (PCO), finalising the draft legislation, and supporting the Minister in taking the legislation through the House, and

- commonly provides advice on the policy intention of the legislation.

Principle issues for consideration

1. Separation of policy functions from regulator functions

The legislation under which the Reserve Bank operates sets out the functions, objectives, and powers of the Reserve Bank. The Reserve Bank Act 1989 also sets out the governance and accountability framework to which the Bank is subject.

The Treasury is not aware of any other jurisdiction where a central bank or non-departmental prudential regulator has responsibility for the legislation establishing the regulatory frameworks under which it operates. The New Zealand Productivity Commission has also noted that the Reserve Bank’s responsibility for being the principal adviser to the Minister of Finance in respect of its own legislation is very unusual in any OECD country.13 We consider the case in other jurisdictions reflects fundamental principles of good governance where an agency that wields independent regulatory powers should not also be the lead policy reviewer and advisor to the government on those powers and the governance and accountability framework to which the regulator is subject.

The conflict of interest presented in co-locating these roles risks sub-optimal policy processes and legislative outcomes. It can undermine stakeholder confidence in the policy process and, consequentially, the regulatory framework itself. It can result in insufficient attention being given to matters such as accountability or procedural fairness in legislative design. In contrast, it is common in both New Zealand and other jurisdictions for core government departments to have both policy and regulatory roles. Core government departments

---

11 Section 32(1)(d)(ii).
12 Section 2.
departments in New Zealand, however, do not also have policy responsibility for their governance and accountability arrangements and are subject to extensive powers of direction by their Minister (provided that such directions are consistent with the law).

Representations against the current arrangement have been made from expert consultants, the insurance industry (formally to the previous Minister of Finance), and the banking industry (informally to the Treasury), including concerns that the current IPSA review is being undertaken by the Reserve Bank.14

The Reserve Bank has indicated to us that the current arrangements have led to successful outcomes. The Bank has indicated that they argue against a change. The Bank is also concerned that the Treasury doesn't currently have the experience, expertise, or resources to do this work. Our approach would be to work closely with the Bank to leverage their expertise as noted below.

2. *Relationship with the responsible Minister*

Departments operate under a close, hierarchical relationship with the Minister. A department's primary duty is to serve the Minister's aims and objectives. The Reserve Bank, on the other hand, is a more independent entity with its functions set out in its enabling legislation.

The Reserve Bank's arm's length operation from the Minister of Finance is appropriate for carrying out the Bank's monetary policy and prudential regulatory functions, for which it is independent. That independence is less suitable for administering government legislation. The policy advisory role on government legislation usually resides with the responsible Minister's policy department rather than an independent regulator. In this case, the role would be more appropriately located with the Treasury, the Minister of Finance’s policy department.

3. *Expertise of the regulator*

Irrespective of who administers the Bank’s legislation, the Bank’s expertise and experience plays an important role in ensuring that primary legislation is fit for purpose and workable as a regulatory framework. Administration of legislation, however, does not need to reside with the regulator in order to make use of the regulator’s expertise.

We have consulted a number of other government departments on the processes followed in administering legislation where technical expertise is held by regulatory agencies. Specifically, we have consulted with the Ministry of Business, Innovation & Employment in New Zealand, the Australian Treasury (in relation to the Reserve Bank of Australia and the Australian Prudential Regulation

---

14 If the Treasury assumes responsibility for the Reserve Bank’s legislation, consideration should be given to whether it would also be appropriate for current legislative work and reviews to transfer to the Treasury at some stage.

15 Departments also have wider stewardship obligations under the State Services Act and some departments have specific statutory functions.
Authority), and the UK Treasury (in relation to the Bank of England). In all cases, the administering department has collaborative arrangements with the respective regulators involving regular engagement and involvement of regulator staff where their expertise is required. These collaborative arrangements are seen as critical to the departments’ ability to administer the legislation and become a central feature in their relationship with the regulator.

We have also discussed the issue with the State Services Commission who share our view that the current arrangements should change.

**Existing core Reserve Bank functions would not change**

Assigning responsibility for administration of the Reserve Bank’s legislation to the Treasury would not change the Bank’s core functions. Not administering the legislation would have no impact on the ability of the Bank to perform its monetary policy function or its prudential regulatory functions. Nor would a change have any impact on the degree of independence with which it can perform those functions.

**Process for effecting a change**

Because the Minister of Finance is currently the responsible Minister for the legislation, the Minister is able to make a decision on re-assigning responsibility for these Acts without recourse to anyone else, including the Prime Minister. The Minister merely needs to direct the Treasury and the Reserve Bank as to what the position is to be. Once the Minister has made a decision to re-assign responsibility for the legislation, we would advise the Cabinet Office so that it can update its records, as well as PCO so it can update the legislation website. The Minister may nonetheless still wish to first consult the Prime Minister on reassigning responsibility of administration of the Act given that the current arrangements have been long-standing.

**Conclusion**

While there would be some transitioning to work through, on balance we see responsibility for the Reserve Bank’s legislation better sitting with the Treasury. Apart from better aligning the policy and administration function with the Minister’s responsibility for the legislation, moving responsibility for the legislation to the Treasury would create a mutual inter-dependence between the Treasury and the Reserve Bank that does not currently exist. Such inter-dependence would encourage, if not require, a more collaborative relationship between the two organisations. It would also require, in line with established best practice, the regulator to more thoroughly make the case for additional or different powers that it seeks, rather than rely on the Treasury to challenge new proposals.

We would also expect outcomes to be improved to the extent that stakeholders and the public in general may have greater confidence in regulatory frameworks where the lead policy advice role on those frameworks is separated from the regulator that implements them.
Section 6: Draft Amended PTA

The following text is a draft PTA, showing tracked changes from the current PTA. This proposed draft has been discussed with the Reserve Bank.

This agreement between the Minister of Finance and the Governor of the Reserve Bank of New Zealand (the Bank) is made under section 9 of the Reserve Bank of New Zealand Act 1989 (the Act). The Minister and the Governor agree as follows:

1. Price stability

   a) Under Section 8 of the Act the Reserve Bank is required to conduct monetary policy with the goal of maintaining a stable general level of prices:

   b) The Government's economic objective is to promote a growing economy that ensures all New Zealanders share in economic prosperity. Monetary policy directed at maintaining medium-term price stability plays an important part in supporting this objective.

   Emphasise medium term nature of price stability objective to underscore the need to weight other factors, such as the state of the economy

   The Government policy statement is typically changed with a new Government

2. Policy target

   a) The price stability target will be defined in terms of the All Groups Consumers Price Index (CPI), as published by Statistics New Zealand:

   b) For the purpose of this agreement, the policy target shall be to keep future annual CPI inflation between 1 and 3 percent in the medium term, while focusing on the 2 percent mid-point.

   Clarify wording but keep numerical target the same

   Context that the regime is a flexible inflation-targeting regime. Gather up other considerations decision-makers must take account of

   Unnecessary wording

   c) In pursuing its medium-term price stability objective, the Bank will implement a flexible inflation-targeting regime that takes account of the impact of monetary policy on the level of economic activity and employment in the short run and on financial stability. In particular the Bank shall:

   i. have regard to the efficiency and soundness of the financial system

   ii. seek to avoid unnecessary instability in output and employment and in interest rates and the exchange rate; and

   iii. respond to events whose impact on inflation is expected to be temporary in a manner consistent with meeting the medium-term target.
3. Transparency and accountability

a) The Bank shall implement monetary policy in a transparent manner.

b) The Bank shall explain in its Policy Statements made under section 15 of the Act what factors it has taken into account in its implementation of monetary policy, including the factors it has considered in determining the time horizon over which it forecasts inflation to return to target.

![require transparency as to the factors taken into account in the implementation of monetary policy.]

![clarify application to inflation outcomes to provide consistency with the future inflation target and flexible inflation-targeting regime]

c) For a variety of reasons annual inflation outcomes may fall outside the future target range. On such occasions, the Bank shall explain in Policy Statements made under section 15 of the Act why such outcomes have occurred, and how long inflation is expected to stay outside the future target range, and what measures it has taken, or proposes to take, to ensure that inflation will return to the future target range.

iv. The Bank shall be fully accountable for its judgements and actions in implementing monetary policy.