

# The Treasury

## Reserve Bank Act Review – Proposed Institutional Act Policy Decisions Information Release

**December 2019**

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Chair,

Cabinet Economic Development Committee

## **Reserve Bank Act Review - Proposed Institutional Act Policy Decisions**

### **Proposal**

1. This paper seeks agreement to the policy issues arising out of Phase 2 of the Reserve Bank Act Review (the Review) relating to the institutional form and governance of the Reserve Bank (the Bank). The decisions will be enacted in a new Institutional Act for the Bank. Decisions are sought now to allow for drafting instructions to be issued in late 2019.
2. One of the aims of the Review is to provide a robust and fit for purpose governance and accountability framework for the Bank, while maintaining the Bank's operational independence.

### **Executive Summary**

3. I am seeking Cabinet decisions on policy issues relating to the new Institutional Act for the Bank. Policy decisions relate to:
  - 3.1. the purpose statement for the Act, and the Bank's objectives, decision-making principles for financial policy, and specification of its functions
  - 3.2. a Financial Policy Remit
  - 3.3. governance arrangements
  - 3.4. accountability and transparency
  - 3.5. the process for setting the Bank's funding
  - 3.6. information gathering powers and other regulatory powers and duties
  - 3.7. coordination with other financial sector regulators, and
  - 3.8. other minor issues.

4. The Institutional Act will also include the Bank's functions, powers and duties relating to monetary policy, issuing currency, foreign exchange management, and acting as the lender of last resort (its central banking functions). No substantive policy changes are proposed to the provisions that were enacted in Phase 1 of the Review, which relate to monetary policy. However, there will be some amendments to the legislation to fit with the new legislative structure and consequential changes.

*Purpose statement, objectives and decision-making principles*

5. I am recommending that the purpose statement introduced to the Reserve Bank of New Zealand Act 1989 (the Reserve Bank Act) as part of Phase 1 of the Review is retained as the purpose of the new Institutional Act. This will provide that the purpose of the Institutional Act is to "promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy". The purpose statement recognises that monetary and financial policy are not ends in themselves, but are means to improve overall well-being.
6. I recommend that the Bank has an overarching financial stability objective along the lines of 'protecting and promoting the stability of New Zealand's financial system'. This recognises the role of the Bank in ensuring financial stability, including the Bank's role in mitigating risks to the financial system.
7. I recommend that the Bank be subject to decision-making principles that it must have regard to in exercising its financial regulatory powers. The intent is to ensure that financial stability is not pursued at all costs. The principles would, therefore, include efficiency related considerations, such as the need to consider net benefits in undertaking regulatory actions. The principles would also require that longer term risks are considered, for example, the risks associated with climate change.

*Financial Policy Remit*

8. I am recommending that the responsible Minister (the Minister) be required to issue a Financial Policy Remit (the Remit). The Remit would set out matters that the Board would be required to have regard to in the pursuit of the financial stability objective. This could include, for example, that the Board have regard to climate change risks when pursuing the financial stability objective. The empowering provisions for the Remit would be designed to provide a balance between protecting the Bank's operational independence, and providing an appropriate level of democratic influence over the very significant policy making functions that Parliament has delegated to the Bank in relation to financial stability.

## *Governance*

9. The Bank undertakes a range of complex functions including monetary policy, prudential regulation and supervision, and currency operations. It also undertakes commercial operations (such as operating settlement systems). Due to this complexity, the Bank's governance arrangements will necessarily be unique. It is proposed that many of the features of the Crown entity model be adopted. The Bank would not, however, be designated as a Crown entity due to several features that differ significantly from the Crown entity framework.
10. I recommend that a governance board (the Board) be established with statutory responsibility for all matters, except those reserved for the Monetary Policy Committee (MPC). I recommend that the Board have similar features to an independent Crown entity board, such as collective and individual duties, and accountability to the Minister. In addition, the Board would have a number of prescribed features:
  - 10.1. the Board would be non-executive and comprised of five to nine members
  - 10.2. the Board members would be able to serve a maximum of 10 years or three terms that total no more than 10 years
  - 10.3. the Board members must have proven skills and experience relevant to the position
  - 10.4. additional disqualification provisions to those in the Crown Entities Act 2004 (the Crown Entities Act) would apply to members of the Board: a person would be disqualified from being on the Board where the person is employed by, or is a director of, a regulated entity, or is a member of the MPC, and
  - 10.5. the process for appointment of Board members would include a nominations committee and consultation with other parties in Parliament.
11. I recommend that the Treasury be the Bank's monitoring agency similar to a Crown entity monitor. I have decided that the Treasury will administer the Institutional Act. The Treasury, as the Government's lead economic and financial advisor, is the most appropriate organisation to perform the monitoring role and administer the Institutional Act.

12. In relation to the Governor (the Chief Executive), I recommend that the current process whereby the Minister appoints the Governor on the recommendation of the Board be retained. Additionally, the Governor would only be able to be removed by the Governor-General on specified grounds following advice from the Minister, which may be following a recommendation of the Board. This reflects the significance of the Governor's role, and that it is a statutory position as a member and Chair of the MPC. The powers of the Board to manage delegations, establish decision-making committees and advise on appointment and removal would ensure that the Board is able to exercise sufficient oversight of the Governor. I also recommend that the statutory position of Deputy Governor and associated provisions are removed. This statutory position is unnecessary given the move away from the single decision-maker model.
13. Given the complex range of functions undertaken by the Bank, it will be important that the roles and responsibilities of the Board, the Governor and the MPC are clear. This will ensure the governance framework operates efficiently and effectively with robust accountability, while preserving the Bank's operational independence. These aspects will be prioritised by my officials in advice on any further detail necessary to operationalise the governance framework

#### *Accountability and transparency*

14. I am recommending changes that would enhance the accountability and transparency arrangements for the Bank. This includes legislative changes to end the current exemptions for the Bank from the Public Audit Act 2001 and the Ombudsmen Act 1975. I also recommend greater standardisation of the Bank's reporting requirements. In particular, changes are proposed that would require the Bank to publish an annual Statement of Performance Expectation and a triennial Statement of Intent.
15. Other measures to enhance transparency that I am recommending would require the Bank to publish a Statement of Approach for its regulatory functions and a framework for its balance sheet management.
16. I recommend that the requirements relating to the Bank's assessment of regulatory impacts are included in an amended form in the Institutional Act, updated to align the impact analysis requirements with current practice.

#### *Funding*

17. I recommend the retention of a funding agreement, with some modifications. I also recommend that the Bank be able to recover a portion of the cost of its regulatory functions via fees and levies.

### *Information gathering powers*

18. I am recommending that the Bank's current information-gathering power relating to its central banking functions be widened to enable the Bank to collect information from a broader set of individuals and entities. Currently the Bank can request information from 'financial institutions' for the purpose of enabling its central banking functions. This definition is too narrow as it is often necessary for the Bank to request information from a broader set of sources, such as securities registries. The proposed power would enable the Bank to collect information from a broader set of relevant persons (but not from individuals in their private capacities), where it considers it necessary or desirable for the purpose of exercising its functions, powers, or duties. The intention is to enable the Bank to collect information for a proper purpose from any financial service provider and other entities that support the financial sector.
19. The precise specification of this power will need to be considered by the Ministry of Justice to ensure compliance with the Bill of Rights Act 1990. Information collected under this power would be subject to statutory confidentiality provisions that protect raw survey data. Failure to respond to data requests made by the Bank would be an offence. Further advice will be provided on appropriate penalties, and a possible infringement fee regime.

### *Coordination*

20. I recommend that coordination by the Bank with other agencies is supported via a statutory function to cooperate with other public sector agencies. In addition, I recommend that the Council of Financial Regulators (CoFR) be established in legislation. The proposed changes recognise that multiple agencies have roles in the regulation of the financial sector, and that cooperation between these agencies delivers better outcomes.

### *Foreign exchange market intervention*

21. Many of the provisions in the Reserve Bank Act regarding foreign exchange management relate to the nature of the economy and the policy objectives and tools in place when the Reserve Bank Act was passed in 1989. I am recommending that sections that are no longer able to be practically used to meet their original policy objectives in modern financial markets are repealed.

### *Commencement*

22. It is anticipated that the provisions of the Institutional Act enabling the establishment of the Board, including the nominations committee, would commence on Royal Assent. Other parts of the Institutional Act would commence around twelve months after Royal Assent to allow time to appoint the Board. This would ensure that the Board is established and in a position to give effect to the functions, duties and powers conferred on it when it commences.

### *Minor issues*

23. Recommendations relating to minor issues include the application of Part 3 of the Crown Entities Act to the Bank, and the parts of the Crown Entities Act that would not apply.

### **Background**

24. I recommend that the Reserve Bank of New Zealand Act 1989 (the Reserve Bank Act) be replaced by two pieces of legislation. The first piece of legislation will provide for the institutional form and governance of the Bank (the Institutional Act). The second piece of legislation will set out the Bank's prudential functions and powers in relation to deposit taking institutions (the Deposit Takers Act).
25. This paper relates to the Institutional Act. It sets out recommendations regarding the purpose statement of the Act, the Bank's objectives and decision-making principles, a Financial Policy Remit (the Remit), governance, accountability and transparency arrangements, funding, information gathering and coordination. The Institutional Act will also include the Bank's central banking functions, including its monetary policy functions.
26. This report proceeds on the basis that the Bank will retain its monetary policy and other central banking functions, and prudential regulatory functions, as previously agreed by Cabinet [CAB-19-MIN-0303].
27. The intention is to develop a bill so that it can be introduced into the House prior to the election. The Treasury will instruct the Parliamentary Counsel Office (PCO) on the Institutional Act. The Treasury intends to provide instructions to the PCO in December of this year in order to meet the proposed introduction timeline.
28. A joint review team comprising members of both the Treasury and the Bank is carrying out Phase 2 of the Review.
29. An Independent Expert Advisory Panel (the Panel) has supported and advised the officials undertaking the Review. The Panel also provides advice directly to me, as appropriate. The Panel consists of Suzanne Snively (Chair), Malcolm Edey, Girol Karacaoglu, Barbara Chapman, Belinda Moffat, and John Sproat.

## Analysis

### ***Purpose, objectives, decision-making principles and functions***

30. Legislative purposes and objectives help to communicate the policy intent of the legislation. They provide statutory criteria on which to base the exercise of discretion and act as a guide to interpretation. Objectives also provide a basis against which to assess the performance of an entity and hold it to account. Objectives and purposes need to be drafted in such a way as to be enduring over time. They should provide a guide for the regulator's actions and not be too specific.
31. The Reserve Bank Act was amended in Phase 1 to provide that the purpose of the Act is to: "promote the prosperity and well-being of New Zealanders, and contribute to a sustainable and productive economy". It is proposed that this continue to be the purpose of the Institutional Act in providing for the continuation of the Bank and its governance structure. This recognises that monetary and financial policy are not ends in themselves, but are means to improve well-being overall.
32. It is common for legislation to set out the objectives that the entity seeks to achieve. Consistent with the Crown entity framework, the Board would be required to ensure the Bank acts in accordance with its objectives. I recommend that the Bank has two main objectives, which recognise its roles in monetary policy and financial regulation:
  - 32.1. the economic objectives (unchanged from Phase 1):
    - I. achieving and maintaining stability in the general level of prices over the medium term, and
    - II. supporting maximum sustainable employment.
  - 32.2. a financial stability objective, directed at: protecting and promoting the stability of New Zealand's financial system.
33. Introducing a single over-arching financial stability objective is consistent with Cabinet's previous in-principle decision [CAB-19-MIN-0303]. It recognises the Bank's role in mitigating risks to the financial system and provides direction for sector specific regulation. It also recognises the role of certain central banking functions, such as the lender of last resort function, in stabilising the financial system during times of stress.
34. The Bank also has some functions that are not solely directed at the financial stability and economic objectives. The Institutional Act will need to enable the Bank to act consistently with any objectives and purposes it may have in relation to its other functions.

- 35.** It is intended that the purpose statements in the sectoral Acts<sup>1</sup> would specify in more detail how the general objective of financial stability is implemented in those Acts. However, amendments to the purpose statements in these Acts will take place following the enactment of the Institutional Act. Officials will consult on the purpose statement for the Deposit Takers Act next year.
- 36.** Stakeholders were generally supportive of the proposal for a financial stability objective. However, several stakeholders raised concerns that there would no longer be a reference to 'efficiency', as there is in the purpose statements that the Bank currently operates under. In order to address this concern, it is recommended that a number of decision-making principles are included in the Institutional Act. These principles would provide matters that the Bank must have regard to in exercising its financial regulatory powers. The proposed principle relating to long term risks would include consideration of long term risks associated with climate change.
- 37.** It is recommended that the principles that the Bank is required to have regard to when exercising its financial regulatory powers are along the following lines:
- 37.1. the desirability of minimising unnecessary costs from regulatory actions, taking into account the value of outcomes to be delivered
  - 37.2. the desirability of taking a proportionate approach to regulation and supervision, and ensuring consistency of treatment of similar institutions
  - 37.3. the desirability that sectors regulated by the Bank are competitive, taking account of the size of the market
  - 37.4. the value of transparency and public understanding of the Bank's objectives and how the Bank's functions are exercised
  - 37.5. practice by relevant international counterparts carrying out similar functions, as well as guidance and standards from international bodies, and
  - 37.6. the desirability of taking into account long term risks to financial stability.
- 38.** It is intended that the principles would apply across all of the sectoral Acts. I recommend that the principles be applied to each of those Acts at the same time as new purpose statements are enacted in those Acts. This will ensure that the purpose statements and the principles work coherently together. The principles would apply to the Deposit Takers Act (banks and non-bank deposit takers) from the point that Act is enacted. The principles (and an amended purpose statement) would apply to the Financial Markets Infrastructure (FMI) Act after the Institutional Act passes, by way of report backs agreed as part of the FMI Bill process.

<sup>1</sup> The Deposit Takers Act, the Insurance (Prudential Supervision) Act and the Financial Markets Infrastructure Act (currently under development).

## ***Financial Policy Remit***

- 39.** Financial stability is a broad concept. Listing the matters that the Bank should have regard to when pursuing the financial stability objective in primary legislation would be inflexible over time. The broad scope of the objective, combined with the Bank's policy making powers, means that the Bank would be making important policy decisions when pursuing this objective.
- 40.** I recommend that the responsible Minister be required to issue a Remit that provides matters the Board must have regard to when pursuing the financial stability objective. The Remit would only relate to the exercise of the Bank's financial regulatory powers in the sectoral Acts. It would specify matters to consider in the exercise of these powers to support the achievement of the financial stability objective. The Remit would be issued five yearly. Although the Remit is similar to a Letter of Expectations, it would have legislative backing and would be directly and exclusively linked to the financial stability objective.
- 41.** Matters that may be addressed in the Remit could include:
- 41.1. expectations as to risk tolerance, for example, the Remit could provide an expectation that the prudential framework is broadly aligned with international standards
  - 41.2. expectations as to how the Bank identifies and manages long term risks
  - 41.3. that the Bank have regard to any relevant guidance issued under the Climate Change Response (Zero Carbon) Amendment Act 2019, and
  - 41.4. information in relation to emerging risks to the financial sector that may be relevant to the Bank's financial stability monitoring.
- 42.** I recommend that the Minister's current powers to direct the Bank to have regard to Government policy are repealed.<sup>2</sup> A direction has never been issued under these provisions. The Remit would focus on the policy relating to the financial stability objective, rather than the Bank's operations. It would set out matters that the Board should have regard to. For these reasons, the Remit would continue to appropriately preserve the Bank's operational independence.
- 43.** A similar approach to the Remit is provided for in the Bank of England Act. This Act provides that HM Treasury<sup>3</sup> may at any time make recommendations to the Financial Policy Committee (FPC) on matters including the following:
- 43.1. matters that the FPC should regard as relevant to the FPC's understanding of the Bank's Financial Stability Objective, and
  - 43.2. matters relating to the responsibility of the FPC in regards to achievement of that objective.

<sup>2</sup> Section 68B of the Reserve Bank Act, Section 13 of the Insurance (Prudential Supervision) Act 2010 and section 9 of the Non-Bank Deposit Takers Act 2013.

<sup>3</sup> In practice the Chancellor.

44. In terms of the process for setting the Remit, it is recommended that, consistent with sections 114-115A (and 141) of the Crown Entities Act, the following apply:
- 44.1. the Minister be required to consult with the Bank before issuing the Remit
  - 44.2. the Remit be published in the *Gazette* and tabled in the House
  - 44.3. the Remit be reviewed at least every five years, with amendments allowed prior to this
  - 44.4. the Bank be required to have regard to the Remit, and
  - 44.5. the Bank be required to report back in its Statement of Intent on how it has taken the Remit into account.
45. I also recommend that, consistent with section 113 of the Crown Entities Act, the Remit would not be able to require the performance or non-performance of a particular act in respect of a person. This would ensure that the Remit does not impinge on the Bank's operational independence in regards to supervisory and enforcement activities. This is similar to the restriction that applies to policy directions under the current Reserve Bank Act.
46. The Review's terms of reference provides that the operational independence of the Bank remains paramount. It is important that the Bank's operational independence is preserved with the introduction of the Remit. The Remit provides a balance between protecting the Bank's operational independence, and providing an appropriate level of democratic influence over the very significant policy making functions that Parliament has delegated to the Bank in relation to financial stability. The Legislative Design Advisory Committee (LDAC) has reviewed this proposal and considers that instruments of this kind can be legitimate tools for the Government to make policy objectives clear. Transparency would be provided through the publication of the Remit. The Bank has more significant policy making powers than many other regulators, such as the Financial Markets Authority (FMA), making the Remit more necessary for the Bank.

## **Governance**

### *Institutional arrangements*

47. The Bank sits within its own category in the state sector and its governance structure is unique. Prior to the implementation of Phase 1 of the Review, the governance framework for the Bank placed all the powers of a board and chief executive in the Governor, who acted at arm's length from Ministers. This design was seen as instrumental in reducing New Zealand's high inflation rate as it ensured operational independence for monetary policy. At the time this governance structure was put in place, however, the Bank had limited prudential regulatory functions.

- 48.** Phase 1 of the Review updated the Bank’s governance of monetary policy by creating the MPC. This framework will be included in the Institutional Act substantively unchanged. The Bank’s prudential regulatory functions and powers have grown considerably over the years, and the Bank now plays a more active role in prudential regulation than was previously the case. As a result, the governance structure for prudential regulation is out of date. In particular: the Bank’s institutional framework does not align with the wider state sector; and standards otherwise applicable across the public sector do not apply to the Bank.
- 49.** The Review considered designating the Bank as a Crown entity in order to ensure uniformity with other independent institutions, and the consistent application of standards that apply to independent entities. An alternative option is to retain the unique status of the Bank in the public sector, and deliver the outcomes sought by adopting many of the governance and accountability provisions in the Institutional Act that would otherwise apply to independent Crown entities.
- 50.** There are three significant challenges associated with designating the Bank as a Crown entity. First, the independence of the Bank may be compromised, as a result of proposed changes to the State Sector Act 1988 which could enable the State Services Commissioner to set standards on a range of matters applicable to Crown entities, including independent Crown entities. Second, a critical element of the Bank’s institutional design, the appointment and removal of the Governor by the Minister (see below), is incompatible with the Crown entity model. Third, the creation of the MPC makes the Crown entity framework less appropriate because the MPC is a statutory decision maker, and this does not fit neatly with the Crown entity framework. Under the Crown entity framework, a board has responsibility for the performance of the entity’s functions and authority for all decisions relating to the operation of the entity.
- 51.** The State Services Commission has advised, that if the current appointment process for the Governor is retained, then the Reserve Bank should not be designated as a Crown entity. Rather, alignment with the Crown entity framework should be achieved by importing the relevant provisions of the Crown Entities Act into the Institutional Act, where appropriate.
- 52.** For these reasons, it is not recommended that the Bank be designated as a Crown entity. Instead, it is recommended that the Institutional Act incorporate many of the features of an independent Crown entity, as well as other bespoke arrangements, such as the Remit and the MPC. In particular, the provisions in Part 2 of the Crown Entities Act (establishment and governance of Crown entities) would generally apply, with amendments to reflect the policy decisions below.

## *The Board*

- 53.** Consistent with Cabinet’s previous in-principle decision [CAB-19-MIN-0303], it is proposed that a governance board (the Board) is established with responsibility for all matters, except those reserved for the MPC. The Board would be modelled on the Crown entities framework, and would be accountable to a responsible Minister. It would also have the collective and individual duties set out in Part 2 of the Crown Entities Act, except where amendments are necessary to support the policy decisions discussed here. Introducing the Board would support decision-making based on diverse perspectives and experiences. It would also protect against individual biases and preferences.
- 54.** As the new Board would be significantly different from the current Board, I recommend that the current Board be disestablished the day before the new Board commences.
- 55.** I recommend that the Board be fully non-executive. This would reinforce the Board’s governance role and ensure its separation from management. It would also be consistent with the structure that applies to the majority of Crown entities.
- 56.** I recommend that Board members be appointed by the Governor-General on the advice of the Minister, consistent with the process for independent Crown entities. The administrative procedures for appointments, validity of appointments and the cessation of a member’s term would be substantially the same as in the Crown Entities Act.
- 57.** In addition, I recommend the establishment of a nominating committee appointed by the Minister to nominate Board members. This is the process used for the Guardians of New Zealand Superannuation. The nominating committee would be appointed by the Minister and comprise not less than four members. Members would need to have proven skills or relevant work experience that would enable them to identify candidates. The nominating committee would undertake the search for and nominate Board candidates to the Minister. The Minister would consult with other political parties in Parliament before making a recommendation for an appointment to the Governor-General. The nominating committee would be legislatively required to consult with the Minister on nominations.
- 58.** It will be important that Board members have proven skills and experience relevant to the position and that collectively the Board has the range of skills and experience necessary to effectively fulfil its functions. I recommend that the nominating committee be required to identify candidates with appropriate skills and experience. This includes skills and experience in banking, insurance, finance, prudential policy, prudential regulation and supervision, or governance. The nominating committee would need to have regard to the overall composition of the Board when making nominations. In addition, the provisions of the Crown Entities Act would apply that require the Minister to only recommend for appointment to a board persons with the appropriate knowledge, skills and experience.

- 59.** A nominating committee is recommended as it protects the operational independence of the Bank by: providing cross-party consultation on appointments; and ensuring that appointments are focussed on the specific skills and experience required by the Board.
- 60.** I recommend that Board members be subject to removal by the Governor-General. Removal would be for 'just cause' on the advice of the Minister and following consultation with the Attorney-General. This aligns with the process for the removal of members of independent Crown entity boards in the Crown Entities Act. 'Just cause' is defined in that Act to include "misconduct, inability to perform the functions of office, neglect of duty, and breach of any of the collective duties of the board or the individual duties of members".
- 61.** It is recommended that the Board be comprised of a minimum of five and a maximum of nine members. The size of the Board would ensure a range of expertise. It would also provide sufficient flexibility to deal with conflicts of interest and variations in the availability of suitable candidates. This is the same size as the FMA board. It is expected that the Board will operate at the upper end of the size range.
- 62.** It is recommended that Board member terms are for a period of up to five years. Five year terms would limit political influence over the Board, as longer terms would necessarily reduce the number of appointments an individual Minister will make. This would support the independent status of the Board. It is also consistent with board terms for independent Crown entities. Shorter terms would remain an option and are likely to be utilised for the initial Board to ensure a staggered appointment process going forward.
- 63.** Board members would be able to serve a maximum of 10 years, or three terms that total no more than 10 years. This is not a standard feature of the Crown Entities Act, but is considered necessary to ensure that new perspectives and different types of experience are introduced with relative regularity.
- 64.** I recommend that persons currently sitting on the boards of or employed by entities registered or licensed by the Bank not be eligible for appointment to the Board. This would assist with the management of actual or perceived conflicts of interest associated with the Bank's significant level of oversight of regulated entities. I am also recommending that members of the MPC be disqualified from Board membership. This recognises the statutorily independent decision-making role of the MPC, and the Board's role in monitoring the performance of the MPC. These disqualification criteria would apply in addition to the disqualification criteria in the Crown Entities Act which relate to matters such as bankruptcy and criminal offences.
- 65.** I recommend that the remuneration of Board members is set by the Remuneration Authority. This is consistent with the process for remunerating the members of independent Crown entities.

66. I recommend that the provisions of Schedule 5 of the Crown Entities Act relating to the appointment of board chairpersons and board procedures apply to the Board. Schedule 5 provides a comprehensive and standardised procedural framework for Crown entity boards.
67. Consistent with Cabinet's previous in-principle decision [CAB-19-MIN-0303], I recommend that the Treasury is the Bank's monitor. The Treasury's role would be the same as the role of a monitor in section 27A of the Crown Entities Act. Consistent with this decision, I have made the decision that the Treasury will administer the Institutional Act. The Treasury, as the Government's lead economic and financial advisor, is the most appropriate organisation to perform the monitoring role and administer the Institutional Act.
68. I recommend that a legislative requirement be introduced for the responsible Minister to issue a Letter of Expectations to the monitor. This would clarify the role of the monitor and the Minister's expectations.

*Provisions relating to the Governor*

69. The Governor is currently appointed by the Minister on the recommendation of the Board. Options for appointment of the Governor considered as part of the Review include retaining the status quo, or enabling a Board appointment.
70. I recommend that the current ministerial appointment process remain, given the significance of the role of Governor. A ministerial appointment also recognises that the Governor has a statutory role as an *ex officio* member and Chair of the MPC. Other members of the MPC are appointed to the MPC by the Minister on the advice of the Board, and can only be removed from the MPC by the Governor-General on the advice of the Minister.
71. The proposal for ministerial appointment of the Governor will result in unique institutional and governance arrangements. The Board's inability to independently hire or dismiss the Governor means that the Board's authority could be diminished. The Board would, however, be empowered to make decisions regarding delegations. This would enable the Board to control which responsibilities are delegated to the Governor. The Board would also be able to establish decision-making committees. Both mechanisms would mean that the Board has sufficient scope to meet its responsibility to ensure that the entity acts in a manner consistent with its objectives and functions.
72. Appointment of the Governor would be on the recommendation of the Board. This would give the Board the opportunity to select the candidate, effectively creating a 'double veto'. The Board would be required to ensure it nominates candidates with the requisite skills and expertise.

- 73.** I recommend that the Governor only be able to be removed from office by the Governor-General on the advice of the Minister for the reasons specified in the legislation. These reasons would align with the concept of 'just cause' in section 40 of the Crown Entities Act. The Board would continue to have a duty to advise the Minister if the Governor meets the grounds for removal.
- 74.** The Governor would be the Chief Executive of the Bank. The Governor's duties, would be delegated to the Governor by the Board. This is in addition to the Governor's duties as a member and chairperson of the MPC. The Reserve Bank Act provides for an 'acting' Governor to perform the duties of the Governor if the Governor is temporarily absent or incapacitated. This provision will no longer be necessary, as temporary absences of the Chief Executive can be dealt with through the Board's delegation framework. Further, the Institutional Act will continue to specify the person who acts as alternate Chair of the MPC if the Governor is absent, given that this is a statutory role (see paragraph 78).
- 75.** The Institutional Act would, however, continue to contain provisions that allow for a ministerial appointment of an interim Governor when the office of Governor is vacant. For example, an interim Governor could be appointed where a Governor has ceased to hold office before the end of a term and a permanent appointment has not yet been made. An interim appointment may be for up to six months. I recommend that this provision would no longer allow a director of the Bank to act as interim Governor, given that the Board is intended to be non-executive.

#### *Provisions relating to the Deputy Governor*

- 76.** The position of Deputy Governor was created in legislation to address risks associated with a single decision-maker structure. This 'key person' risk does not exist in the proposed group decision-making structure, except in relation to the Governor's statutory role as Chair of the MPC. The establishment of a new Board with full decision-making powers means that the legislative requirement for a Deputy Governor can be removed. As a consequence, the Deputy Governor would no longer be an *ex officio* member of the MPC. The position would continue to be reserved for an internal member of the Bank to retain the current balance of internal and external members.
- 77.** Removal of this position has minor implications for other parts of the Institutional Act. In particular, if the office of Governor is vacant, the Deputy Governor currently acts as Governor pending the formal appointment of an interim Governor by the Minister. I recommend that if the position of Governor is vacant, and the Minister has not made an interim appointment, then the Board would nominate an employee of the Bank to act as Governor pending a ministerial appointment. The appointment would last for a period of up to 28 days, but may be renewed if a ministerial appointment has not been made.

78. The Deputy Governor also acts as the alternate Chair of the MPC if the Governor is absent. I recommend that the Board be required to nominate an alternative Chair of the MPC to act as the Chair if the Governor is absent. This person would need to be an internal member of the MPC. A quorum for the MPC currently requires that the Governor or the Deputy Governor be present (as well as the minimum number of internal and external members). I propose that a quorum for a meeting of the MPC include the Governor, or the alternate Chair of the MPC in the Governor's absence.
79. Currently staff members can serve on the MPC for two terms in one capacity, and another two terms if that person is later appointed as Governor or Deputy Governor. The removal of the Deputy Governor position effectively removes this possibility for a future Deputy Governor. I recommend that the number of terms an internal member can serve on the MPC be increased to a maximum of 15 years or a maximum of three terms (of cumulatively not more than 15 years). This would ensure that there is a sufficient number of internal candidates with the requisite experience available for the MPC.

#### *Monetary Policy Committee*

80. No change is proposed to the appointment and removal processes for the MPC except as provided above. The Minister will continue to appoint MPC members based on the recommendation of the Board. MPC members may be removed from the MPC by the Governor-General on the advice of the Minister if statutory grounds are met.
81. I also recommend that the new Board assumes the role of monitoring the MPC. The current Board has a number of duties with regard to monitoring the MPC. This includes advising the Minister if the MPC or members of the MPC have breached a statutory duty. The monitoring duties are necessary as the removal process requires the Minister to recommend to the Governor-General the removal of MPC members. As part of its monitoring duties, the Board would continue to be required to provide information on the performance of the MPC and its members in the Annual Report.

#### ***Accountability and transparency***

##### *Application of the Public Audit Act 2001*

82. I recommend that the Auditor-General be legislatively enabled to conduct performance audits and inquiries into the Bank's activities. The Bank is explicitly excluded from sections 16(1)(a) and 18(2) of the Public Audit Act 2001. Section 16(1)(a) provides that the Auditor-General may examine the extent to which a public entity is carrying out its activities effectively and efficiently. Section 18(2) allows the Auditor-General to inquire into any matter concerning a public entity's use of its resources. The Auditor-General is supportive of the Bank being brought within the Auditor-General's oversight. There was general support for this change among stakeholders.

- 83.** The Minister would also have the power to review the operations and performance of the Bank as per section 132 of the Crown Entities Act. This is in addition to associated powers to require information be provided on the entity's operation and performance, and offences for failure to provide information. As a consequence, section 167 of the Reserve Bank Act is no longer required. Section 167 enables the Minister to initiate a performance audit.

#### *Application of the Ombudsmen Act 1975*

- 84.** I recommend that the Bank be subject to the Ombudsmen Act 1975 (the Ombudsmen Act). The Bank is one of the few agencies not currently subject to the Ombudsmen Act. This provides the Office of the Ombudsman (an office of Parliament) with the ability to investigate administrative conduct by government agencies that affect a person or group of persons 'in their personal capacity' (this includes non-natural persons). An investigation can be the result of a complaint, or on the initiative of the Ombudsman. The Ombudsman may make recommendations to an agency, but cannot compel an agency to accept a recommendation.
- 85.** The Ombudsman cannot investigate conduct which is legislative, judicial, or ministerial in nature. In addition, the Ombudsman does not have the authority, barring special circumstances, to investigate a matter where there is a statutory right of appeal or review on the merits to a court or tribunal.
- 86.** The Ombudsman also has a statutory discretion not to investigate complaints in certain cases. This includes if the complainant does not have a sufficient personal interest in the subject matter of the complaint. It cannot be determined in advance how the Ombudsman would exercise this discretion in a particular case. The Office of the Ombudsman has advised that it typically declines to investigate complaints where the complainant has no greater personal interest in the subject-matter than an average New Zealander. For example, the Ombudsman would be able to exercise this statutory discretion in relation to a complaint regarding a decision that does not obviously affect a person in their 'personal capacity', such as a monetary policy decision.
- 87.** LDAC guidelines state that all public bodies should be subject to the Ombudsmen Act unless there is a compelling reason otherwise. This is because the Ombudsmen Act is an important way to hold public bodies to account. There is not a clear rationale for excluding the Bank from the scope of the legislation. Some of the Ombudsman's wider administrative investigations would also be relevant to the Bank, such as the recent review of Official Information Act 1982 practices across government.

### *The Statement of Intent*

- 88.** The Statement of Intent (SOI) is the primary *ex ante* accountability document. I recommend that the Bank's SOI process be aligned with the Crown Entities Act, except as provided in paragraph 89. The SOI outlines the entity's medium-term intentions and allows the Crown to participate in the setting of these intentions. The SOI also specifies measures which can be used to assess the entity's performance. The Bank is already required to issue an SOI. The main change is that the SOI would be required triennially. SOIs are currently an annual requirement for the Bank. Annual reporting would instead be via the Statement of Performance Expectations (SoPE).
- 89.** A difference between the SOI provisions in the Crown Entities Act and the Reserve Bank Act is that under the Reserve Bank Act, the Minister cannot require amendments to an SOI (but can make comments). However, under the Crown Entities Act, a Minister may direct amendments to an SOI in relation to defined matters. This includes an entity's strategic intentions, the scope of its functions, and how it intends to manage its functions. Amendments cannot be applied to statutorily independent functions. I recommend that the Minister's involvement in the SOI (and SoPE) process remain restricted to commenting on the SOI, and not be extended to amendment. This will protect the operational independence of the Bank.

### *The Annual Report*

- 90.** The Annual Report is the primary *ex post* reporting document. The purpose of the Annual Report is to report on the activities of an entity over the previous year, and assess these activities against the intentions set out in the SOI. The Annual Report also includes financial reporting. It is recommended that the requirements for Annual Reports (and the keeping of accounting records) in the Crown Entities Act apply to the Bank as appropriate. This would replace the current bespoke requirements for an Annual Report in the Reserve Bank Act. Changes relate to: the process for providing the Annual Report to the Minister; matters that must be reported on; publication of the Annual Report; and presentation to the House of Representatives.
- 91.** The Institutional Act would include some additional reporting requirements for the Annual Report, relating to the Governor and the MPC. For example, the Governor's remuneration and the remuneration of external members of the MPC would need to be disclosed in the Annual Report. I also recommend that the Board continues to be required to include a statement in the Annual Report regarding the performance of the MPC. This would include whether:
- 91.1. the MPC and members of the MPC, have adequately discharged their respective responsibilities
  - 91.2. how the Board assessed the MPC's performance of its responsibilities, and
  - 91.3. whether the MPC has formulated monetary policy consistent with its operational objectives set out in the Remit for the MPC.

### *The Statement of Performance Expectations*

- 92.** I recommend that the Bank be required to publish an annual SoPE consistent with the requirements of the Crown Entities Act. The purpose of the SoPE is to: enable the responsible Minister to participate in the process of setting annual performance expectations; enable the House of Representatives to be informed of those expectations; and provide a basis for assessing performance. The SoPE bridges the gap between triennial SOIs by providing updated forecasts of financial statements and performance measures on an annual basis. The Bank's activities would be defined as 'reportable classes of output' (and the Minister would be able to exempt certain classes of output) to ensure alignment with the Crown entity framework.

### *Statements of Approach*

- 93.** I recommend that the Bank be required to publish Statements of Approach (SoAs) outlining the approach to fulfilling its regulatory functions. While the Bank currently produces high level SoAs, making this a legislative requirement would enhance the status of these documents. The SoAs would be 'living' documents and would be updated by the Bank as necessary. They would provide guidance and certainty to stakeholders. They would also provide clarity with regard to the Bank's approach to the performance of its regulatory obligations. The Prudential Regulation Authority (UK) is statutorily required to provide statements of policy and procedure. In New Zealand, both WorkSafe and the FMA have general legislative functions to provide information regarding their regulatory approach.

### *Regulatory impact assessments*

- 94.** Assessing the regulatory impacts of policy proposals is standard practice for policy and legislative development in New Zealand. Section 162AB of the Reserve Bank Act requires the Bank to undertake regulatory impact assessments. This is required as many of the Bank's statutory instruments are not subject to the Cabinet requirements for regulatory impact assessments. I recommend that a regulatory impact analysis requirement is included in the Institutional Act. I also recommend that this requirement be updated by requiring the Bank in undertaking the assessment to: outline the policy problem; set out the objectives of the proposal; evaluate the costs and benefits of the proposal and the alternative means of achieving the objectives; and demonstrate that it has considered stakeholder views. An exception for minor and technical matters will continue to apply.

### *Financial Stability Report*

- 95.** I recommend that the Financial Stability Report requirements be included in the Institutional Act. I also recommend that they be updated to reflect the change in the wording of the financial objectives, but otherwise remain the same.

### *Balance sheet management*

96. The exercise of many of the Bank's powers requires it to undertake financial market transactions. For this reason the Bank's activities give rise to financial risks. There should, therefore, be a level of oversight and transparency as to how the Bank is managing its balance sheet, and the benefits that are being obtained from financial risks that are taken.
97. For this reason, I recommend that the Bank be required to publish its framework for balance sheet management. This would provide greater transparency as to the Bank's approach to the management of balance sheet risks, and assist the Treasury in its role as monitor. The framework would include the Bank's management of financial risks arising from: foreign reserves; lender of last resort activities; and unconventional monetary policy tools if they are used by the Bank in the future. The framework document would be a living document that the Bank would update at appropriate intervals.

### **Funding**

#### *Funding agreement*

98. The Bank's funding has a direct bearing on its ability to achieve its statutory objectives. The Bank receives its funding from a combination of self-generated revenue and fees for providing certain services. The vast majority of the Bank's funding comes from revenue generated via its balance sheet and currency operations. The amount of this income that the Bank can use to cover operating expenditure is currently set out in a five-year agreement between the Minister and the Governor. This agreement can be amended at any time, upon agreement between the Minister and the Governor. The funding agreement, and any amendment, must be ratified by Parliament. The agreement aims to achieve a balance between budgetary independence and value for money.
99. I am recommending that the Bank and the Minister agree on a five-year funding agreement that would *prima facie* cover all expenditure. This will ensure a good balance between operational independence and accountability. The intention is to provide:
- 99.1. funding certainty through the five years covered by the agreement
  - 99.2. significant operational independence over how the funding is allocated across the five years
  - 99.3. democratic legitimacy and oversight of the Bank's spending
  - 99.4. accountability and assurance of value for money
  - 99.5. improved transparency of the agreement process and realised spending, and
  - 99.6. a flexible process.

- 100.** Under this model:
- 100.1. the funding agreement would *prima facie* cover all expenditure (operating and capital) regardless of the funding source
  - 100.2. existing legislative exclusions would be included,<sup>4</sup> and officials will consider whether other legislative exclusions are justified
  - 100.3. the Minister and the Bank would be able to agree to exclude particular items/activities from the funding agreement (as is the case at present), and could agree on certain expenditure extending over a timeframe that exceeds the term of the agreement
  - 100.4. the Minister and the Bank could also agree the sources of funding for particular functions, including the extent of any cost recovery via new fees or levies
  - 100.5. the funding agreement would outline dividend principles, from which the annual dividend is calculated (these are currently set in the SOI)
  - 100.6. the funding agreement period would cover anticipated expenditure for a five year period (or longer if agreed for particular items)
  - 100.7. the funding agreement could be amended or renegotiated at any time
  - 100.8. the funding agreement would be based on a budget proposed by the Bank, and
  - 100.9. publication requirements would be applied to proposed and final versions of the documents.
- 101.** The Parliamentary ratification of the funding agreement is considered unnecessary. Rather it is proposed that the funding agreement is tabled in Parliament. Tabled the funding agreement in Parliament will ensure that Parliament will continue to have oversight of the Bank's expenditure. Parliament also has a number of other channels to oversee the Bank's operations and expenditure, including through the presentation of the SOI and Annual Report to the House. Parliamentary ratification has potentially led to the funding agreement process being less flexible than intended.
- 102.** To date, the Bank has generated revenue in excess of its expenses. A portion of this surplus income is paid to the Crown through an annual dividend, with the remainder retained as capital. The Minister determines the annual dividend, following a recommendation from the Bank. The Bank formulates its recommendation according to 'dividend principles'. I recommend this process remain broadly the same, subject to paragraph 100.5.
- 103.** The Reserve Bank's view is that including capital expenditure in the funding agreement is problematic for a number of reasons and will need to be worked through. The Treasury considers that the funding agreement should be used flexibly, and items to be excluded agreed on a case-by-case basis.

<sup>4</sup> As set out in the definition of operating expenses.

## *Levies*

- 104.** I recommend that some of the costs of undertaking the Bank's financial regulatory functions be able to be recovered through levies. Internationally and domestically, it is common for independent regulators to be funded, at least in part, by industry levies. Only Parliament can approve the levying of money by the Crown or an agency of the Crown. Therefore, to allow cost recovery (via levies or fees), empowering provisions must be added to the Bank's primary legislation. The levies would be set by regulations, issued by the Governor-General on the advice of the Minister, following consultation with the Bank and industry. The Institutional Act would prescribe the procedural requirements that must be followed in determining a levy. Dividends paid by the Bank to the Crown would be higher to the extent levies are imposed.
- 105.** It is worth noting that even if cost recovery powers were broadened in the Institutional Act, it may be a number of years before they are fully operationalised.

## *Fees*

- 106.** I also recommend that fees for prescribed services would be able to be set by regulation. There are currently a number of fee provisions relating to specific functions in legislation under which the Bank acts. These would be replaced with a general regulation making power for fees. The fees and levies will be paid direct to the Bank (rather than the Crown with a subsequent appropriation).

## ***Coordination***

- 107.** Regulatory coordination in the financial sector is critical. Multiple agencies have roles in the system. The roles frequently interact and overlap. Coordination helps to deliver better policy outcomes by providing a forum for agencies to: identify synergies; consider policy trade-offs; and manage regulatory gaps and overlaps.
- 108.** I recommend that the Bank have a function to cooperate with other relevant public sector regulatory agencies (including overseas regulators). This has a number of benefits:
- 108.1. it is consistent with the Bank's membership on the Council of Financial Regulators (CoFR)
  - 108.2. it will enable the Bank to assist other agencies in performing their functions, particularly in relation to information sharing
  - 108.3. the proposed function would also align with the FMA's cooperation function, clearly signalling that it is a reciprocal relationship
  - 108.4. introducing a cooperation function would reinforce the desirability of a culture of coordination, and
  - 108.5. it would encourage consideration of whether this function is appropriately resourced.

- 109.** I also recommend that the Institutional Act establish a mandate for the Council of Financial Regulators (the CoFR) in legislation. The CoFR currently meets quarterly to discuss financial market regulatory issues, risks, and priorities. The CoFR ensures system wide monitoring and operational coordination, particularly in regards to regulatory actions. Providing it with a mandate in legislation will ensure that it continues to be adequately resourced and prioritised.
- 110.** The legislative mandate for the CoFR will need to be flexible and enabling. A prescriptive approach could create additional complexity in decision-making and limit the ability of the CoFR to evolve in response to changing circumstances. The mandate will focus on the CoFR's purpose and role, rather than detailed functions.

### ***Information gathering powers***

- 111.** The Bank can currently require financial institutions to provide information for the purposes of enabling it to carry out its central banking functions. It uses this power to conduct a range of surveys which are critical to the formulation and implementation of monetary policy. The power is also used to collect information required to monitor the financial system and undertake other central banking functions.
- 112.** While the Bank's current information gathering power is fit for purpose in most cases, its restriction to information held by "financial institutions" has been problematic. The legal meaning of financial institutions is relatively narrow and limited to persons carrying on the business of borrowing and lending or providing financial services. This means that it cannot be used by the Bank to collect some information that is important to central banking functions. For example, it cannot collect information about securities holdings from securities registries.
- 113.** I recommend that this information collection power be replaced by a power that will enable the Bank to collect information from a broader set of persons where it considers it necessary or desirable for the purpose of performing or exercising its functions, powers, or duties under the Institutional Act. The Bank would not be empowered to collect information from individuals in their private capacities. The intent is to enable the Bank to collect information from any financial service provider, as well as other entities that support the financial sector. The current ability of the Bank to require information provided to be audited would be retained. This requirement would also be clarified and made more flexible.

- 114.** The precise specification of this power will need to be assessed against the provisions of the Bill of Rights Act 1990 (the Bill of Rights Act) and be vetted by the Ministry of Justice. In particular, consideration will need to be given to the right to be secure against unreasonable search or seizure. I will report back to Cabinet on the details of the power, including penalties and offences, following further advice from officials.
- 115.** Information gathering powers relating to the Bank's regulatory functions will be considered separately as part of the development of the Deposit Takers Act.

### ***Foreign exchange***

- 116.** The Reserve Bank Act provides a number of provisions with regard to the management of foreign exchange. Many of these provisions related to the nature of the economy and tools of economic management in place when the Reserve Bank Act was passed in 1989. In particular, New Zealand had recently moved from a fixed exchange rate regime, to a floating exchange rate regime with the central bank focussed on price stability.
- 117.** I recommend that several sections of the current legislation related to foreign exchange market intervention are repealed, as they are no longer able to be used to meet the original policy objective. These are:
- 117.1. Section 18 – provides a power for the Minister to direct the Bank (under the authority of an Order in Council) to deal in foreign exchange at rates of exchange determined by the Minister. We consider this power is unnecessary and undesirable as:
- i. A fixed exchange rate regime is not consistent with independent monetary policy.
  - ii. The Governor-General can on the advice of the Minister change the objective of monetary policy to be something other than achieving price stability and supporting maximum sustainable employment (the economic objectives), including moving to a currency objective.
  - iii. The Minister can also direct the Bank to deal in foreign exchange within guidelines for the purpose of influencing the exchange rate through section 17. A direction under this section is currently in place giving the Bank authority to act at its own initiative in the event of disorder in the foreign exchange market where urgent action is required.

- 117.2. Section 22 – provides the Governor the power to direct all registered banks to stop dealing in the foreign exchange market. Most foreign exchange market trading of New Zealand dollars now takes place overseas by financial institutions that are not New Zealand-registered banks, meaning this provision could not be practically implemented to meet the policy objective. Furthermore, stopping New Zealand banks from participating in the foreign exchange market would likely cause significant economic disruption.
- 117.3. Section 23 – provides that the Bank will advise the Minister on foreign exchange matters. This section is redundant, as under Section 33, the Bank may provide advice to the Minister on any matter connected to its functions.

### ***Commencement and transitional arrangements***

- 118.** The following sections address transitional matters in regards to the enactment of the new Institutional Act.
- 119.** It is anticipated that the Institutional Act will commence prior to the Deposit Takers Act. During the intervening period, it will be necessary for Parts 4 and 5 of the current Reserve Bank Act (use of the word ‘bank’ and derivatives thereof, and prudential regulation of banks) to remain in force, pending the enactment of the Deposit Takers Act. This includes the supporting interpretation provisions and certain miscellaneous provisions not being transferred to the Institutional Act.
- 120.** The purpose statements in the sectoral Acts will not change during the transition period between enactment of the Institutional Act and the Deposit Takers Act. This will avoid the need for transitional purpose statements. Rather, a new purpose statement would be enacted in the Deposit Takers Act, and when other sectoral Acts are reviewed.
- 121.** Currently the Reserve Bank Act provides certain requirements that commercial banks must meet in relation to the retention of documents (such as retention of cheques). It is recommended that these requirements be moved to the Bills of Exchange Act 1908 as they are more relevant to that Act.
- 122.** Transitional arrangements will be needed to enable the appointment of the Board. This is so that it can be established and undertake its duties under the new Act from the time that it comes into effect. To enable this, I am recommending that the legislative provisions providing for the establishment of the Board commence approximately twelve months prior to the rest of the Institutional Act. This will include enactment of the provisions relating to the nominating committee, who will nominate Board members, as well as provisions that set out the features of the Board (such as the size of the Board).

- 123.** Consideration has been given to the establishment of an interim Board prior to the enactment of the legislation via administrative means. The legislation will, however, require that Board members are nominated to the Minister by the nominating committee. The process will also require consultation with other parties in Parliament. Members will then be appointed by the Governor-General on the advice of the Minister. Even if Board members were to be appointed prior to the enactment of the legislation, the procedural requirements would still need to be followed. As a result, establishing an interim Board via administrative means would result in an inefficient process.
- 124.** Candidates for the nominating committee could, however, be identified prior to the legislation receiving Royal Assent to enable the nominating committee to commence as soon as the Institutional Act passes.
- 125.** Initial Board terms will be staggered, that is some will be less than five years, to allow for succession planning.

### ***Minor issues***

- 126.** Part 3 of the Crown Entities Act will apply, except as provided in paragraph 127. Provisions in Part 3 that will apply include the following:
  - 126.1. the issuance of whole of government directions (the current whole of government directions relate to procurement, ICT and property)
  - 126.2. processes for issuing ministerial directions
  - 126.3. the ability of the Minister to add functions to the Bank
  - 126.4. requirements to be a good employer and other aspects related to personnel (these will replace sections 168 and 169 of the Reserve Bank Act which provide good employer and social responsibility requirements<sup>5</sup>)
  - 126.5. provisions relating to the application of certain provisions of the Crimes Act 1961 (for example, provisions relating to bribery), the appointment of attorneys, and other legal process matters, and
  - 126.6. the ability of the responsible Minister to review the operations and performance of the entity, and to request information relating to the operations and performance of the entity.
- 127.** There are a number of provisions of the Crown Entities Act that would not be applicable to the Bank, or may require amendment. This is because of the Bank's role as a central bank and the specific requirements it will remain subject to in relation to funding and other policy decisions in this paper. This includes the following:

<sup>5</sup> The Crown Entities Act provisions requiring the Bank to act in a manner consistent with the spirit of service to the public will also apply.

- 127.1. Provisions that relate to:
  - i. restrictions regarding banking and financial market activities, such as restrictions on borrowing and limitations on the use of bank accounts
  - ii. financial viability, financial management and reporting, including the potential application of formal liquidation procedures, payment of surplus income, capital charges and forecasts of the balance sheet
  - iii. certain matters relating to subsidiaries, and
  - iv. the terms of appointment of the chief executive.
- 127.2. Provisions in Part 5 of the Crown Entities Act that relate to legislation that does not apply to the Reserve Bank.
- 127.3. Provisions that do not need to be applied as the Bank will not be designated as a Crown entity.
- 127.4. Part 3 provisions relating to collective employment agreements (a limited number of the Bank's employees are covered by collective agreements), and the liability of judges appointed as a member of the Board (as the Board is not an adjudication Board).
- 127.5. Minor amendments that may be needed to provisions in the Crown Entities Act due to specific requirements that apply to the Bank in the Reserve Bank Act, and requirements that are not applicable to the Bank.

### **Next steps**

- 128.** Following Cabinet decisions on the recommendations in this paper, the Treasury will prepare drafting instructions for the PCO. This will enable drafting of a bill in the first half of next year.
- 129.** There are a number of other policy matters which will require Cabinet decisions early next year. This includes potential changes to the Bank's duties in respect of the management of bank notes and coins, matters related to penalties and offences, and other minor matters.

### **Consultation**

- 130.** The following agencies were consulted on the contents of this Cabinet paper: the Ministry of Business, Innovation and Employment; the FMA; the Commerce Commission; the State Services Commission; the Office of the Auditor-General; the Office of the Ombudsman; PCO; the Department of Prime Minister and Cabinet; and the Ministry of Justice.
- 131.** Two rounds of public consultation have taken place as part of Phase 2 of the Review. The first round closed on 25 January 2019 and received 67 submissions. The second round of public consultation closed on 16 August 2019 and received 45 submissions. A third round of public consultation is planned for next year but will only relate to matters relevant to the Deposit Takers Act.

### *Views of the Independent Expert Panel (the Panel)*

132. The Panel is supportive of the majority of the Institutional Act recommendations. The Panel recommends that the Institutional Act be written in a way that is permissive and enabling, as opposed to being prescriptive. The Panel members see dependencies in regards to the decisions on the appointment of the Governor, the Remit, and the funding model that will impact on the final legislation.
133. The Panel notes that the Ministerial appointment of the Governor is international practice as is the role of the Governor as a statutory decision-maker and Chair of the Monetary Policy Committee. The Panel notes that modern governance experience demonstrates the role of Board accountability when it has the mandate to appoint and remove the Governor, in line with the Crown Entities Act.
134. On balance, the Panel is supportive of the Remit while noting that the Minister's preferences could also be covered by a Letter of Expectations. A key consideration is to ensure that the Remit enables responsive decision making in key areas where the Board is accountable.
135. The Panel supports a funding framework that enables the Bank to be strategic and responsive to future conditions. Panel members noted that an effective agreement model is one that provides democratic oversight of spending and is flexible enough to enable appropriate budgetary independence across different functions.

### **Financial Implications**

136. Additional costs are anticipated in relation to the establishment and ongoing resourcing for the Board to ensure that it has the capacity to be effective. The nominating committee will be funded within the funding agreement. These costs will need to be considered as part of the Bank's funding agreement.
137. Additional costs are associated with the transition to the new Institutional Act. It is expected that these costs can be managed within current funding.

### **Legislative Implications**

138. The policy issues outlined above will be included in a new Institutional Act for the Reserve Bank. There will also be consequential amendments to other legislation.
139. The proposed Bill has not yet been given a slot on the Legislative Programme. The Treasury has submitted a legislative bid.
140. The Institutional Act will bind the Crown. This is consistent with section 4 of the current Reserve Bank Act.
141. The Bank would continue to be a 'public authority' for the purpose of the Income Tax Act 2007 (see section CW38(6)). This would mean that the Bank will continue to be included in sections CW38(1) and (2) which exempt public authorities from paying tax on: income derived from sinking funds relating to the debt of a public authority; and any other amount of income derived by a public authority.

## **Impact Analysis**

- 142.** A Quality Assurance Panel with representatives from the Ministry of Business, Innovation and Employment and the Treasury has reviewed the attached 'A New Institutional Framework for the Reserve Bank' Regulatory Impact Assessment (RIA) produced by the Treasury and dated November 2019.
- 143.** The Quality Assurance Panel considers that the RIA **meets** the Quality Assurance criteria.
- 144.** The RIA is generally clear and concise. The analysis has been well-consulted, and the trade-offs between, and rationales for, options are complete and convincing within the confidence limits of some of the evidence. The level of uncertainty in some evidence means that the monitoring and review arrangements signalled in the RIA will be important for ensuring that the Government's objectives are achieved.

## **Human Rights**

- 145.** My officials will be working with the Ministry of Justice to ensure that any concerns relating to the Bill of Rights Act are addressed.
- 146.** The Bill will be assessed against the Bill of Rights Act before introduction into the House.

## **Gender Implications**

- 147.** I have recommended that equivalent provisions to that in section 118 of the Crown Entities Act apply to the Bank. This would require the Bank to be a 'good employer' as provided for in the Crown Entities Act. This includes: operating an equal employment opportunities programme; operating personnel policies containing requirements for the impartial selection of persons for appointment; and operating personnel policies that recognise the employment requirements of women.

## **Disability Perspective**

- 148.** Section 118 of the Crown Entities Act also requires the entity to operate a personnel policy containing provisions that recognise the employment requirements of persons with disabilities.

## **Publicity**

- 149.** I recommend that Cabinet's decisions, this paper and related material will be publically released in conjunction with the attached Review Update shortly after decisions are made.

## **Proactive Release**

- 150.** I also recommend to proactively release supporting material and advice (such as policy advice reports, Panel papers and presentations) relating to these recommendations.

## Recommendations

151. The Minister for Finance recommends that the Committee:

### General matters

- 1 note the previous in-principle decisions by Cabinet [CAB-19-MIN-0303] to:
  - 1.1 retain the prudential regulation and supervision functions within the Reserve Bank (the Bank)
  - 1.2 replace the Bank's existing 'soundness' and 'efficiency' financial policy objectives with a single overarching 'financial stability' objective
  - 1.3 establish a new governance board, with statutory authority over all Reserve Bank decisions (except those reserved for the Monetary Policy Committee (MPC)), including prudential policy decisions
  - 1.4 (in light of the above) not establish a new Financial Policy Committee, and
  - 1.5 appoint the Treasury as the external monitor of the Reserve Bank
- 2 agree that the Reserve Bank of New Zealand Act 1989 (the Reserve Bank Act) be replaced by two new pieces of legislation: a new Reserve Bank Institutional Act and a Deposit Takers Act
- 3 confirm the previous in-principle decision that the Bank retain its prudential regulation and supervision functions
- 4 agree that the Institutional Act include policy decisions relating to the Bank's objectives, governance, accountability and transparency, funding, information gathering powers, other generic regulatory powers, and coordination
- 5 agree that the Institutional Act also include provisions relating to the Bank's central banking functions, amended to reflect the decisions in this paper
- 6 note that officials are aiming for introduction of a Bill for the Institutional Act around July 2020
- 7 note that the Bank's monetary policy functions, including provisions relating to the MPC, will be enacted in the Institutional Act substantially unchanged, except to the extent necessary or desirable to fit into the new legislative scheme and subject to recommendation 31
- 8 note that duties performed by the current Board, in respect of the Bank's monetary policy functions, will be performed by the new Board (including approval of the MPC's Code of Conduct, and recommending members of the MPC)
- 9 note that the Bank is currently reviewing the policy relating to the provision and management of bank notes and coins, and that advice resulting from this review may be provided at a later stage

## **Purpose, objectives, decision-making principles and functions of the Bank**

- 10 agree that the purpose of the Institutional Act, in providing for the continuation of the Reserve Bank, remains: “to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy”
- 11 agree to the Bank’s economic and financial stability objectives being included in the Institutional Act
- 12 agree to a new financial stability objective along the following lines: protecting and promoting the stability of New Zealand’s financial system
- 13 note that the Bank has other objectives and purposes in legislation that the Bank will need to be able to act in accordance with when fulfilling its functions
- 14 agree that the Institutional Act contain decision-making principles that the Bank must have regard to in exercising its regulatory powers under the sectoral Acts, and that the principles will apply to those Acts from the point those Acts are updated to align with the new financial stability objective in the Institutional Act
- 15 note that the Bank’s decision-making principles will require the Bank to consider longer term risks such as those associated with climate change
- 16 agree that the functions of the Bank be listed in the Institutional Act (refer to Appendix I for the preliminary list of functions)
- 17 agree that the Minister may direct the Bank to perform additional functions consistent with the Bank’s objectives, as provided for in section 112 of the Crown Entities Act

## **Financial Policy Remit**

- 18 agree that the responsible Minister be required to issue a Remit which sets out matters the Board should have regard to when pursuing the financial stability objective
- 19 agree that the current powers of the responsible Minister to direct the Bank to have regard to Government policy in the Reserve Bank Act, Insurance (Prudential Supervision) Act 2010 and the Non-Bank Deposit Takers Act 2013 be repealed
- 20 agree that the following requirements apply to the Remit:
  - 20.1 the responsible Minister be required to consult with the Bank before issuing the Remit
  - 20.2 the Remit be published in the Gazette and tabled in the House
  - 20.3 the Remit be reviewed at least every 5 years, with amendments allowed prior to this
  - 20.4 the Bank be required to have regard to the Remit, and
  - 20.5 the Bank be required to report back in its Statement of Intent on how it has taken the Remit into account

## Governance

- 21 agree that the Bank will not be designated a Crown entity, but that Part 2 and Schedule 5 of the Crown Entities Act will be used as the basis for the institutional design of the Bank and the Board's responsibilities and procedures, adapted to reflect the policy decisions in this paper and as otherwise appropriate
- 22 agree that there be a responsible Minister for the Bank with the duties of a responsible Minister as provided in the Crown Entities Act
- 23 confirm Cabinet's previous in-principle decision [CAB-19-MIN-0303] to establish a Board with statutory responsibility for all Bank decisions, except those reserved for the MPC
- 24 agree that the Board will have the following features:
  - 24.1 the Board will be fully non-executive
  - 24.2 it will be comprised of between five and nine members
  - 24.3 Board members can be appointed for a term of up to five years, but will be limited to serving for no more than 10 years or three terms in total
  - 24.4 individuals will be disqualified from serving on the Board if they are employed by, or are a director of, a regulated entity
  - 24.5 individuals will be disqualified from serving on the Board if they are a member of the MPC, and
  - 24.6 the disqualification provisions for Board members in the Crown Entities Act will also apply
- 25 agree that the current Board will be disestablished at the close of the day before the new Board takes office

- 26 agree to the establishment of an independent nominating committee to nominate Board candidates to the Minister for appointment by the Governor-General, and that the nominating committee would:
- 26.1 be appointed by the Minister
  - 26.2 comprise not less than four members
  - 26.3 have proven skills or relevant work experience that will enable them to identify candidates
  - 26.4 be required to identify and nominate Board candidates to the Minister
  - 26.5 be required to consult with the Minister in relation to nominations, and
  - 26.6 be required to nominate persons with appropriate skills and experience (such as in banking, insurance, finance, prudential policy, prudential regulation and supervision, or governance) and have regard to the overall composition of the Board
- 27 agree that the Minister will be required to consult with other political parties in Parliament prior to recommending the appointment of a Board member
- 28 agree that Board members will only be able to be removed by the Governor-General for 'just cause' on the advice of the Minister, following consultation with the Attorney-General
- 29 note that 'just cause' has the same meaning as section 40 of the Crown Entities Act, and includes misconduct, inability to perform the functions of office, neglect of duty, and breach of duty
- 30 agree that the remuneration of the members of the Board be at a rate and of a kind determined by the Remuneration Authority
- 31 agree to retain the current process for appointing and removing MPC members, but the number of terms that internal members can serve will be increased to three terms (from a previous limit of two terms), of up to five years per term
- 32 note that I have decided that the Treasury will administer the Institutional Act
- 33 confirm Cabinet's previous in-principle decision that the Treasury will be the Bank's monitoring agency
- 34 agree to introduce a legislative requirement for the Minister to issue a Letter of Expectations to the monitoring agency setting out the role of the monitor and the Minister's expectations
- 35 agree that the appointment of the Governor continue to be a ministerial appointment on the recommendation of the Board
- 36 agree that the Board be required to nominate persons who in its opinion have the appropriate knowledge, skills and experience

- 37 agree that the Governor's current term length of five years be retained, with a maximum of two terms
- 38 agree that the Governor can be removed from office by the Governor-General on the advice of the Minister on specified grounds
- 39 agree that the provisions of the Reserve Bank Act providing for a person to act as Governor if the Governor is temporarily absent be repealed
- 40 agree to remove the legislative requirement for a Deputy Governor, and that:
- 40.1 if the office of Governor is vacant, and the Minister has not appointed an interim Governor, then the Board must nominate an employee of the Bank to act as Governor for a period of up to 28 days
  - 40.2 the Board must nominate an internal member of the MPC to be the alternate Chair of the MPC where the Governor is temporarily absent, and that person must be present for a quorum if the Governor is not present
  - 40.3 the *ex officio* Deputy Governor position on the MPC be replaced with an internal position, to ensure the same number of internal MPC members
- 41 agree that a director of the Bank will not be able to be appointed to act as an interim Governor in order to maintain the status of the Board as non-executive
- 42 agree that the Board has the duty to monitor the MPC, members of the MPC, and the Governor. This includes advising the Minister if the Board considers an individual member or the Governor meets any grounds for removal and reporting on the performance of the MPC and individual members in the Annual Report

### **Accountability and transparency**

- 43 agree to amendments to the Public Audit Act 2001 to enable the Auditor-General to conduct performance audits of, and inquiries into, the Bank
- 44 agree that the current power of the Minister to initiate an audit be replaced with a section equivalent to section 132 of the Crown Entities Act (and associated powers to request information) which enables the Minister to review the operations and performance of an entity
- 45 agree to add the Reserve Bank to the list of organisations in Schedule 1 of the Ombudsmen Act 1975
- 46 agree that the Bank be subject to requirements equivalent to Part 4 of the Crown Entities Act, including the requirements that relate to Statements of Intent, Annual Reports (supplemented with the information in paragraph 91), Statements of Performance Expectations and accounting records, except as provided in the next recommendation and recommendation 62
- 47 agree that the Minister not be able to direct the Bank to make amendments to the Statement of Intent or Statement of Performance Expectations

- 48 agree that the Bank be required to publish and keep up to date Statements of Approach that set out its approach to its regulatory functions
- 49 agree that the requirements relating to the Financial Stability Report be included in the Institutional Act and updated to reflect consequential amendments
- 50 agree that the requirement for the Bank to undertake regulatory impact assessments in implementing financial policy be included in the Institutional Act, and be updated to align with state sector practice
- 51 agree that the Bank be required to publish and keep up to date its framework for balance sheet management

### **Foreign exchange**

- 52 agree to repeal the following sections of the Reserve Bank Act on foreign exchange market intervention that could no longer be practically used to meet the original policy intent or are redundant:
  - 52.1 **Section 18** – that the Minister can direct that all foreign exchange dealings by the Bank shall be at fixed rates of exchange
  - 52.2 **Section 22** – that the Governor can direct New Zealand-registered banks to stop dealing in the foreign exchange market
  - 52.3 **Section 23** – that the Bank advises the Minister on foreign exchange matters

### **Funding**

- 53 agree that the Bank's expenditure be subject to a funding agreement with the features broadly set out in paragraph 100
- 54 agree that the funding agreement be tabled in Parliament, but no longer ratified by Parliament
- 55 agree that some of the costs of undertaking the Bank's financial regulatory functions be able to be recovered through levies set by regulation
- 56 agree to a general fee-setting regulation power, to replace the current fee making provision

### **Regulatory powers and duties**

- 57 agree that the Institutional Act broaden the Bank's existing information gathering powers in Part 2, subject to Bill of Rights Act vetting
- 58 agree that the Institutional Act may consolidate, modernise and make consistent the Bank's standard regulatory powers and duties

### **Coordination**

- 59 agree to establish a legislative mandate for the Council of Financial Regulators (CoFR) that enhances coordination while retaining flexibility and regulators' statutory independence

### **Minor issues**

- 60 agree to move requirements relating to commercial banks' retention of documents to the Bills of Exchange Act 1908
- 61 agree that the Bank will be subject to the provisions of the Crown Entities Act, Part 3, except as provided in recommendation 62
- 62 agree that the provisions in the Crown Entities Act discussed in paragraph 127 not apply to the Bank
- 63 agree to repeal sections 168 and 169 of the Reserve Bank Act (good employer and social responsibility) as these will be replaced by broadly equivalent provisions from the Crown Entities Act

### **Commencement**

- 64 agree that the legislative provisions enabling the establishment of the Board, including the nominations committee, commence on Royal Assent
- 65 agree that the other parts of the Institutional Act commence around twelve months following Royal Assent
- 66 agree that the initial terms of Board members will be staggered to allow for succession planning

### **Legislative implications**

- 67 agree that the Institutional Act should include a provision stating that the Act will bind the Crown

### **Publicity**

- 68 agree that Cabinet's decisions and this paper be publically released
- 69 agree to the proactive public release of material (such as policy advice reports, Panel papers and presentations) relating to these decisions
- 70 agree to the public release of the Review Update attached to this paper at the same time that this paper is released, subject to minor amendments

## **Legislative drafting**

- 71 invite the Minister of Finance to issue drafting instructions to PCO to give effect to the proposals in this paper via a new Reserve Bank Institutional Act
- 72 agree that the Minister of Finance be authorised to further clarify and develop policy matters relating to the proposals in this Cabinet paper in a manner not inconsistent with the policy recommendations contained in the paper.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance

Date

## Appendix I: Recommended Functions

Recommended functions are:

- a. To act as the central bank of New Zealand including by:
  - I. issuing bank notes and coins to meet the needs of the public
  - II. providing settlement accounts for qualifying entities
  - III. managing foreign reserves
  - IV. providing liquidity to the financial system
  - V. acting as lender of last resort
  - VI. carrying out any other central banking activities consistent with the objectives and purposes of this Act
  - VII. liaising and cooperating with other central banks and related international institutions
  - VIII. conduct market transactions in support of its economic and financial stability objectives, and
  - IX. formulating and implementing monetary policy directed to the economic objectives, while recognising the Crown's right to determine economic policy
- b. To monitor financial sector developments, including the collection and analysis of information and the publication of statistics relevant to the main objectives
- c. To act as prudential regulator and resolution authority by performing and exercising the functions, powers, and duties conferred or imposed on it under prudential legislation
- d. To act as prudential supervisor, including by monitoring compliance with and investigating conduct that constitutes or may constitute a contravention of, and enforce, any requirements imposed on entities under or pursuant to prudential legislation
- e. To keep under review laws, policies and practices relevant to the performance of prudential regulation and supervision (similar to the function provided for in section 9(1)(e) of the Financial Markets Authority Act 2010)
- f. To cooperate with:
  - i. other relevant public sector agencies including in relation to its role as a member of CoFR, and
  - ii. relevant overseas regulators
- g. To provide information about its functions, powers, and duties under this Act and other enactments

- h. To provide, or facilitate the provision of, public information relevant to its objectives in order to enhance public understanding, and
- i. To carry out other functions, and exercise powers, specified in this Act or any other Act.