

The Treasury

Reserve Bank Act Review Phase 2 Review Update Proactive Release

March 2020

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Report: Phase 2 of the Reserve Bank Act Review – plan for legislative reform

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|--------------|--------------|---------------------|---------------|
| Date: | 24 July 2019 | Report No: | T2019/2242 |
| | | File Number: | MC-1-7-3-1-13 |

Action sought

| | Action sought | Deadline |
|--|---|---------------|
| Minister of Finance (Hon Grant Robertson) | Consider and agree to the recommendations in the report Agree to meet the Review team, the Treasury, and the Reserve Bank to discuss the report | 2 August 2019 |

Contact for telephone discussion (if required)

| Name | Position | Telephone | | 1st Contact |
|------------------|---|--------------|---------------|-------------|
| James Haughton | Acting Manager, Reserve Bank Act Review Phase 2 | [39] (wk) | [39] (mob) | |
| Bernard Hodgetts | Director, Reserve Bank Act Review Phase 2 | [39] (wk) | n/a (mob) | ✓ |

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Report: Phase 2 of the Reserve Bank Act Review – plan for legislative reform

Executive Summary

Decisions from the Phase 2 Review will result in changes to the Reserve Bank Act and related legislation. The Review's terms of reference, and announcements from the Prime Minister and you in late June about changes arising from the Review, both anticipate substantial progress towards legislation by early 2020. The Review team is considering how the legislation should be structured and progressed given these expectations.

The current Act is large and relatively complex, covering the Reserve Bank's institutional arrangements, monetary policy related functions, and the prudential regulatory regime for registered banks. While maintaining a single piece of legislation remains an option, an amended single Act would likely remain large and relatively difficult to navigate.

The Review team recommends splitting the Act into two separate pieces of legislation as follows:

- An 'Institutional Act' covering the Reserve Bank's objectives, functions, governance and accountability arrangements, and funding. The Institutional Act would also include provisions relating to the Reserve Bank's non-regulatory responsibilities including monetary policy, currency and foreign exchange.
- A 'Deposit Takers Act' covering the prudential regulation and supervision of banks and non-bank deposit takers (NBDTs) as well as matters concerning crisis management and enforcement. The Deposit Takers Act would implement Cabinet's in-principle decision to capture banks and NBDTs under a single regulatory regime (DEV-19-MIN-161). Work on the depositor protection regime would be progressed in parallel with the Deposit Takers Act.

Splitting the Act, and regulating banks and NBDTs under one regulatory regime, would result in a more coherent and consistent legislative framework that is more accessible to regulated industry.

Splitting the Act would have the additional benefit of creating optionality around the timing for introducing legislation to Parliament. Due to the range of changes being proposed, and the more advanced progress on institutional aspects, it is unlikely that all legislative aspects of the Review could be progressed within the current Parliamentary term. Splitting the Act would allow work on the Institutional Act to be prioritised, with the aim of introducing an Institutional Bill by July 2020.

The Review team recommends that the Deposit Takers Act, and the depositor protection regime, be progressed on a longer timeframe, and in parallel reflecting the inherent link between accepting, and protecting, deposits. De-linking these work-streams carries significant risk. A longer timeframe appears necessary to allow for industry and public engagement.

Recommended options for progressing reform are:

- Institutional Act – targeting July 2020 for the introduction of legislation to the House.
- Deposit Takers Act and depositor protection – targeting November this year and April/May 2020 for Government announcements of final policy decisions relating to the Deposit Takers Act and depositor protection, and the second half of 2021 for the introduction of legislation to the House.

Meeting this timeframe will be challenging, and there are risks to delivery. Cabinet will need to make decisions on topics relating to the Institutional Act this November. A key decision in this package is whether the Reserve Bank should be classified as a Crown entity as this will affect timing and the final shape of the legislation. The Review team is also currently short-staffed reflecting resourcing pressures being experienced by both the Reserve Bank and the Treasury.

Recommended Action

We recommend that you:

- a **agree** that the Reserve Bank Act be split into an Institutional Act and a Deposit Takers Act to provide for a clearer legislative framework, and help address consistency and complexity issues with the existing legislation.

Agree/disagree

- b **note** that splitting the Act would have the additional benefit of increasing optionality around timing and allow work on an Institutional Act to be prioritised.

- c **agree** that the Review team prioritise the Institutional Act with the aim of introducing a Bill by July 2020.

Agree/disagree

- d **note** that advancing legislative reform for the Institutional Act by July 2020 will be challenging, and Cabinet decisions will be required on most components of the Institutional Act in November.

- e **agree** that legislative reform for a Deposit Takers Act and the depositor protection regime be progressed together, and on a longer timeframe to the Institutional Act, to enable appropriate industry engagement and suitable transition periods to the new regime.

Agree/disagree

- f **note** that the Review team is conducting further analysis on an Institutional Act, and the decisions required to progress legislative reform, with a view to providing you with advice in September after the second round of stakeholder consultation closes.

g **agree** in principle that the Treasury lead on providing drafting instructions to PCO for an Institutional Act in consultation with the Reserve Bank in a manner consistent with Phase 1 of the Reserve Bank Act review.

Agree/disagree

h **agree** to meet with the Review team, the Treasury, and the Reserve Bank to discuss this report.

Agree/disagree

Bernard Hodgetts
Review Director, Reserve Bank Act Review Phase 2

Hon Grant Robertson
Minister of Finance

Report: Phase 2 of the Reserve Bank Act Review – plan for legislative reform

Purpose of Report

1. The Review team is considering how to progress legislative reform following decisions on Phase 2 of the Reserve Bank Act review (the Review). The Review team recommends progressing institutional aspects of the Reserve Bank (such as objectives, governance and functions) ahead of the more detailed aspects of the prudential regulation and depositor protection regimes. This approach would involve a split of the Reserve Bank Act (the Act) into an ‘Institutional Act’ and a ‘Deposit Takers Act’.
2. The purpose of this report is to provide further analysis on the merits of this approach and the timeframes associated with it. The report seeks agreement to structuring a work program around this approach.

Background

3. The current Reserve Bank Act is large and relatively complex, covering the institutional arrangements for the Reserve Bank, special arrangements for monetary policy, and the Reserve Bank’s role in regulating and supervising banks. The broad range of areas covered by the Act reflects its piecemeal evolution over time as the Reserve Bank has taken on responsibility for regulating more types of financial firms and sectors. The Review presents a good opportunity to restructure the Act to reduce complexity and increase its accessibility.
4. Maintaining a single piece of legislation is not recommended because an amended single Act would remain large and relatively difficult for users to navigate. The Act is already complex and would increase in complexity over time as further Review decisions are enacted.
5. The remaining sections of this paper consider how all legislative aspects of the Review could be progressed and how the Act could be structured in light of Review decisions. The sections are divided as follows:
 - Legislative design of the Reserve Bank Act – describes the current legislative framework, and how splitting the legislation into an Institutional Act and a Deposit Takers Act could help improve the current framework and provide optionality around timeframes.
 - Progressing an Institutional Act – describes the key components of an Institutional Act and the Cabinet decisions that would be required in November to progress legislative drafting.
 - Progressing a Deposit Takers Act - describes how a Deposit Takers Act could be progressed, and notes implications for other legislative reform.

- Progressing depositor protection – describes how work on the depositor protection regime could be progressed in parallel with the Deposit Takers Act.
- Timeframe and process for legislative reform – summarises the timeframe and process for legislative reform based on the desire to introduce a Bill by July 2020.

Legislative design of the Reserve Bank Act

The current legislative framework

6. The Reserve Bank Act has two primary components:
 - The first component sets out the governance arrangements for the Reserve Bank, including the Reserve Bank’s legal form, decision-making structure, objectives, functions, powers and funding. This component covers both monetary policy and financial stability policy.
 - The second component sets out the framework for the prudential regulation and supervision of banks.
7. The legislation governing the prudential regulation of the financial sector is currently structured around three (soon to be four) Acts:

Current legislative structure

| Reserve Bank of New Zealand Act 1989 | Non-bank Deposit Takers Act 2013 | Insurance (Prudential Supervision) Act 2010 | FMI Act (TBC)* |
|---|---|--|--|
| <ul style="list-style-type: none"> ▪ Objectives, functions ▪ Institutional governance. ▪ Non-regulatory responsibilities (e.g. monetary policy, currency) ▪ Bank regulation, supervision, and crisis management | <ul style="list-style-type: none"> ▪ NBDT regulation and crisis management | <ul style="list-style-type: none"> ▪ Insurer regulation, supervision, and crisis management | <ul style="list-style-type: none"> ▪ FMI regulation, supervision, and crisis management |

* Part 5 of the Reserve Bank Act also covers the oversight of payment systems and includes various powers and frameworks that relate to settlement systems. It is currently intended that this content will be shifted into a new Act currently under development for ‘financial markets infrastructures’.

8. When the 1989 Act was passed, its design largely reflected the Reserve Bank’s then primary function of monetary policy, alongside a relatively narrow prudential role focused on registered banks. Since then, the Reserve Bank’s role in the financial system has expanded substantially, and the financial system itself has evolved.
9. The Reserve Bank’s prudential responsibilities have expanded to include insurers and NBDT’s, and it now has oversight responsibilities in respect of Financial Market Infrastructures (FMIs). Internationally, financial policy has also expanded and the Reserve Bank’s regulatory approach has evolved to reflect these developments. For example, capital and disclosure requirements have been refined, and new policies on corporate governance, liquidity, Open Bank Resolution and outsourcing have been added. The Reserve Bank now is at least as much of a financial regulatory and supervisory agency as it is a monetary policy one. A large share of the staff, the budget, and management oversight, is now devoted to these functions.

Potential Issues with the current legislative framework

10. The current legislative structure has evolved in a piecemeal fashion over time as the Reserve Bank has been given new responsibilities for regulating more types of financial firms and sectors. While some of these sectors are different and require a different regulatory approach, arguably the existing legislative structure has led to unnecessary inconsistencies and complexity. Examples include:
 - Governing legislation – the framework for prudential regulation and supervision of banks is contained in the Act, together with its monetary policy responsibilities, institutional components (such as governance arrangements) and other non-regulatory functions (such as currency). In contrast, all other entities regulated by the Reserve Bank have sector specific legislation setting out the framework for prudential regulation and supervision. Insurers are regulated under the Insurance (Prudential Supervision) Act 2010 (IPSA) and NBDTs are regulated under the Non-bank Deposit Takers Act 2013 (NBDT Act).
 - Objectives and powers – the Act has less guidance on its objectives and powers in respect of banks than the more modern NBDT Act and IPSA (which contain detailed regulatory principles that apply when regulating the NBDT and insurance sectors).
 - Prudential requirements – in general, prudential rules for banks are made by the Reserve Bank through an administrative instrument, and for insurers and NBDTs through delegated legislation. Disclosure rules for banks are also made through delegated legislation. This has led to inconsistent and potentially inefficient processes, safeguards, and accountability mechanisms for prudential requirements across the regulated sector.
 - Liability frameworks – the liability that flows from breaches of rules are different across all three regulatory regimes, including meaningful differences in liability for individuals. Different frameworks apply across regulated sectors in areas like fit-and-proper criteria or information sharing.

Improving the current legislative framework

11. To help improve the current legislative framework, and address unnecessary inconsistencies between sectors, the Review team recommends that the Act be split into two pieces of legislation as follows:
 - An 'Institutional Act' covering the Reserve Bank's objectives, functions, governance and accountability arrangements, and funding. The Institutional Act would also include provisions relating to the Reserve Bank's non-regulatory responsibilities including monetary policy, currency and foreign exchange.
 - A 'Deposit Takers Act' covering the prudential regulation and supervision of banks as well as matters concerning crisis management and enforcement. The Deposit Takers Act would implement Cabinet's in-principle decision to capture banks and NBDTs under a single regulatory regime and would also pick up on

any changes to supervision and enforcement, macro-prudential policy and the crisis management regime.

Proposed legislative structure

| | | | |
|--|--|--|--|
| <p style="text-align: center;">Institutional Act - Reserve Bank of New Zealand Act (TBC)</p> <ul style="list-style-type: none"> ▪ Objectives, functions ▪ Institutional governance. ▪ Non-regulatory responsibilities (e.g. monetary policy, currency) | <p style="text-align: center;">Deposit Takers Act (TBC)</p> <ul style="list-style-type: none"> ▪ Deposit taker regulation, supervision and crisis management | <p style="text-align: center;">Insurance (Prudential Supervision) Act 2010</p> <ul style="list-style-type: none"> ▪ Insurer regulation, supervision, and crisis management | <p style="text-align: center;">FMI Act (TBC)</p> <ul style="list-style-type: none"> ▪ FMI regulation, supervision, and crisis management |
|--|--|--|--|

12. An Institutional Act and Deposit Takers Act represents a more simple and accessible legislative framework for regulated industry. Splitting the Act, and regulating banks and NBDTs under one regulatory regime, would result in a more consistent and accessible framework. From an administrative and usability perspective, it is desirable to distinguish between institutional matters and regulatory matters.
13. The legislative framework governing financial market conduct regulation is structured in a similar manner to that recommended for the Act. Financial markets conduct legislation is split between institutional legislation (the Financial Markets Authority Act 2011) and sectorial legislation (the Financial Markets Conduct Act 2013). The institutional legislation establishes the Financial Markets Authority (FMA) and provides for its objectives, governance and functions. The sectorial legislation covers conduct regulation of financial sector participants. A similar approach could be taken to the Reserve Bank legislation.
14. The table below summarises where the main elements of key Review topics would fit under a split legislative structure:

| Topic | Institutional Act | Deposit Takers Act |
|---|-------------------|--------------------|
| Primary and secondary financial policy objectives | ✓ | |
| Governance and monitoring | ✓ | |
| Balance sheet and non-regulatory functions | ✓ | |
| Funding and resourcing | ✓ | |
| Co-ordination | ✓ | |
| Regulatory perimeter | | ✓ |
| Regulatory tools and powers | | ✓ |
| Supervision and enforcement | | ✓ |
| Crisis management | | ✓ |
| Depositor Protection | | ✓* |

* The form of legislation depends on how the depositor protection work is taken forward. Depositor protection could require separate legislation or be part of the Deposit Takers Act.

15. The Legislation Design and Advisory Committee (LDAC) advises that if existing legislation is to be heavily amended (or it is already old or heavily amended), consideration should be given to replacing it instead. If multiple amendments will cause the resulting law to be so complex it becomes difficult to understand, replacing the legislation is preferred. LDAC advises that a key factor to consider is accessibility and who the users of legislation will be. Deposit takers (banks and NBDTs) are primarily interested in the prudential regulatory requirements applying to their industry, and how they will be supervised and monitored against these requirements. These aspects would be included in the Deposit Takers Act. In contrast, the focus of an Institutional Act is on the Reserve Bank's organisational form, governance, and accountability to Parliament.
16. Unnecessary inconsistency and complexity across different legislative regimes will not be fully addressed by the creation of an Institutional Act. The provisions of the Institutional Act and the Deposit Takers Act should reflect best practice within the regulatory sector. The Review team anticipates that minor amendments will be required over time to address inconsistencies in other financial sector legislative regimes and to better align, where appropriate, regulatory powers and processes across the Reserve Bank and the FMA. Splitting the Act could also simplify this process by enabling adjustments to be made to legislation governing the relevant sector, with minimal (if any) amendment to the Institutional Act. Progressive stewardship of financial sector legislation is desirable over time, using existing or planned legislative processes where possible.

Implications for the timing of legislative reform

17. Splitting the Act would have the additional benefit of increasing optionality around the timing for introducing legislation to Parliament. The Review's terms of reference, and announcements from the Prime Minister and you in late June about changes arising from the Review, both anticipate substantial progress towards legislation by early 2020. As indicated in our report of July 2018 (T2018/1888), the range of changes being proposed means that it is unlikely that all legislative aspects of the Review could be progressed within the current Parliamentary term to the point of being able to introduce a full package of legislation. Splitting the legislation would allow work on an Institutional Act to be prioritised, with the aim to introducing a Bill by July 2020. The Deposit Takers Act would be progressed on a longer timeframe as decisions on the prudential framework and depositor protection are taken.
18. The Institutional Act could be progressed on a faster timeframe than a Deposit Takers Act and the depositor protection regime for the following reasons:
 - An Institutional Act on its own will have less drafting complexity than a Deposit Takers Act, particularly if the Reserve Bank is classified as a Crown entity as reliance will be placed on the provisions of the Crown Entities Act (see paragraph 24 below). Many of the core components of an Institutional Act have already been consulted on. The Review team expects that Cabinet decisions for most elements of an Institutional Act could be taken in November. This timeframe, while challenging, should be sufficient for the Parliamentary Counsel Office (PCO) to draft a Bill for an Institutional Act for introduction in July 2020.

- In contrast to an Institutional Act, a Deposit Takers Act, and depositor protection regime, will have more technical components and significant implications for banks and other financial institutions. A Deposit Takers Act, and depositor protection regime, would be progressed on a longer timeframe to allow sufficient consultation with stakeholders, and consideration of all technical and transitional aspects. Further detail on how a Deposits Takers Act and depositor protection could be progressed is included at paragraphs 32 - 54 below.

Progressing an Institutional Act

Components of an Institutional Act

19. An Institutional Act would cover the following areas:

- Preliminary - matters such as purpose, interpretation
- Objectives and functions – legal status, description of the Reserve Bank’s main objectives and functions including monetary, prudential and resolution functions
- Non-regulatory responsibilities – provisions relating to the Reserve Bank’s non-regulatory responsibilities including monetary policy, foreign exchange, and currency
- Governance – provisions relating to the new board, monetary policy committee and monitor
- Funding and reporting
- General information gathering powers and confidentiality provisions
- Miscellaneous – standard legislative provisions

Cabinet decisions needed to progress an Institutional Act

20. In order to progress an Institutional Act within the current Parliamentary term, final Cabinet decisions will be required on a number of the Review topics in November. Some of the key decisions required are summarised below:

- Institutional form – whether the Reserve Bank will be a Crown entity operating under the Crown Entities Act 2004
- Objectives - the high level financial policy objective of the Reserve Bank, secondary objectives and guidance on the Reserve Bank’s financial policy functions (including provision for a financial policy remit)
- Resolution - establishing the Reserve Bank as the resolution authority and resolution functions
- Governance - establishing the new board, composition, appointments and removals, procedure for appointing the Governor, monitoring arrangements
- Funding – funding arrangements and provision for charging industry levies

21. Many of these topics (such as the high level objectives, governance arrangements and functions) have already been advanced in the consultation process and in-principle decisions have been taken. More detailed aspects of these arrangements are being progressed in the second round of consultation, which opened on 24 June. Other topics (such as resolution functions and funding) are also included in the current consultation. At this stage, the Review team expects to provide recommendations on these topics for Cabinet decisions in November without seeking further public feedback.
22. Some of the decisions required will have implications for monetary policy and the monetary policy committee (MPC). For example, there will no longer be a monitoring board that monitors the performance of the Governor and the MPC. Monitoring of the new board, and the MPC, will be conducted by the Treasury in a manner similar to a monitor of a Crown entity. The Review team also expects that it will be possible to simplify some of the arrangements relating to the MPC in the Institutional Act (for example, removing provisions for agreeing the first monetary policy remit and charter for the MPC). Legislative provisions will also be updated to reflect more modern legislative provisions.
23. Ideally, all Cabinet decisions needed for an Institutional Act would be taken in November to allow sufficient time for PCO to draft the Bill for introduction to the House in July 2020. While it is preferable to advance most elements of the package of legislative reform in November, it should still be possible to instruct PCO on some residual issues for inclusion in the Bill after Cabinet makes decisions on any remaining substantive matters in April/May 2020. The Review team will aim to provide advice on the package of decisions needed for an Institutional Act in September after the second round of consultation closes.

The Crown Entities Act and reporting on Crown debt

24. The decision on whether the Reserve Bank will be a Crown entity (likely an independent Crown entity) operating under the Crown Entities Act (CEA) framework is important from a policy and timing perspective. The decision may also have implications for the reporting of Crown debt.

Policy and timing considerations

25. The purpose of the CEA is to provide a consistent framework for the establishment, governance, and operation of Crown entities. The framework helps clarify accountability relationships between Crown entities, board members, Ministers, and the House of Representatives. Using a Crown entity model could provide greater clarity on the Reserve Bank's independence and make its institutional components consistent across the state sector for operationally independent entities. With a new board and monitor, the legislative architecture that sits around the Reserve Bank is very similar to a Crown entity.

26. The decision on the Crown entity model is also important from a timing perspective. Based on discussions with PCO, it will be more challenging for legislative reform to be progressed by July 2020 if the Reserve Bank is not classified as a Crown entity. This is because a Crown entity model would simplify legislative drafting and the structure of the Bill for the Institutional Act. Substantial reliance would be placed on the existing provisions in the CEA as opposed to drafting bespoke legislative provisions.
27. While there are good reasons to consider changing the Reserve Bank to a Crown entity, it is important that the Reserve Bank has all of the qualities it needs to operate effectively and fulfil its functions. The Reserve Bank has a number of distinct functions that are not mirrored elsewhere in the State sector (for example, monetary policy and the issue of currency). Any shift to a Crown entity model would have to accommodate these distinctive features. The CEA provides for a flexible framework, and any provisions of the CEA could be supplemented, modified or negated by the Institutional Act. However, if the features of the Reserve Bank extensively depart from the standard features of a Crown entity, it may call into question the benefits of moving to the framework in the first place.
28. The Review team is prioritising analysis on the merits of the Reserve Bank as a Crown entity given the potential impact on timeframes.

Reporting of Crown debt

29. The classification of the Reserve Bank as a Crown entity may have implications for the reporting of Crown debt. At present, the Reserve Bank's assets and liabilities are included as part of the core Crown, and are therefore included as part of the Government's chosen debt anchor, currently defined as net core Crown debt (excluding New Zealand Super Fund (NZSF)). Classifying the Reserve Bank as a Crown entity would require the same accounting treatment as other Crown entities, which are currently excluded from net core Crown debt. Without changing the definition of the debt anchor, classifying the Reserve Bank as a Crown entity would have a substantial impact on net core Crown debt, under the current definition.
30. However, as the Government has discretion over the fiscal indicator it uses to specify the debt anchor, it can therefore define the debt anchor to include or exclude the Reserve Bank. There are options to change the definition of the debt anchor that retain consistency with the Budget Responsibility Rules. A change to the definition of the debt anchor would, however, need to be carefully communicated.
31. If you decide on a Crown entity framework for the Reserve Bank, the impact on net core Crown debt would not occur until the commencement of legislation resulting from Phase 2 of the Review. If you pursue this framework, the Treasury will provide further advice on reconciling this increase with your current debt target as part of the fiscal strategy advice prior to Budget 2020.

A Deposit Takers Act would be progressed over a longer timeframe

32. The timeframe necessary for progressing legislative reform for a Deposit Takers Act will be longer than for the Institutional Act, partly because the regulatory decisions are less advanced, but also due to (1) the complexity associated with implementing the decisions, and (2) the need for increased engagement with industry on options for reform and the legislative process:
- Complexity - the integrated regulatory regime envisaged under a Deposit Takers Act will not be introduced immediately due to the complexity associated with some elements of the legislation. There is a need to settle the outlines of any regime, such as the definition of a deposit taker, and the nature and scope of the powers the Reserve Bank has to regulate deposit taking entities. As new legislation is finalised, the Reserve Bank will also need to make consequential changes to transpose the existing regulatory regimes into the instruments empowered under the new law. This will harmonise the rules applying to large and small institutions to some degree. However, while all deposit takers will need to meet minimum standards, NBDTs transitioning into the regime will not necessarily be subject to the same rules as the larger banks. The development of a comprehensive failure resolution regime will also take some time, including the resolution tools that are available, and the circumstances in which tools may be deployed by the resolution authority.
 - Industry engagement - a Deposit Takers Act will have important implications for deposit takers and how they are regulated. The design and operation of transitional arrangements will be important given the impact the legislation will have on regulated industry and on those trustees that are the current front-line supervisors of NBDTs. In these circumstances, it may be appropriate to consult with stakeholders on an exposure draft of a Bill for the Deposit Takers Act as part of the legislative development process.
33. Progressing an Institutional Act first will also enable new Reserve Bank governance structures to be established. The new board will then be able to oversee the transition to the new approach to regulating deposit takers, enabling the Reserve Bank to gradually build up its supervisory resources, and develop the greater supervisory intensity that is likely to be needed under a revised regulatory approach.
34. Additionally, the introduction of a depositor protection scheme (discussed below) will require regulated industry to invest in updated information and technology system to ensure the scheme operates as intended. Industry will need sufficient time to transition to the new regulatory framework.
35. For these reasons, even if the Deposit Takers Act was prioritised over the Institutional Act, it is unlikely that the Deposit Takers Act could realistically be introduced before late 2021. Once the Deposit Takers Act is passed, there will need to be a transitional period before it is fully in force (to ensure all secondary legislation and rules are in place and institutions are authorised to operate under the new regime). Doing the Institutional Act first allows for quicker progress, and the residual policy work on the Deposit Takers Act discussed above can happen in parallel.

Timetable and announcement of key policy decisions

36. While the Deposit Takers Act would be progressed on a longer timeframe, we expect the work programme should enable the Government to announce key policy decisions relating to the Deposit Takers Act in November this year and in April/May 2020 which may include:
- Definition of the regulatory perimeter (who is covered by prudential regulation) and whether the Reserve Bank can extend the perimeter to respond to new risks
 - The Reserve Bank's supervisory and enforcement approach
 - The Reserve Bank's balance sheet functions including lender of last resort and foreign exchange intervention powers
 - The crisis management regime including roles, responsibilities and powers.
 - Macro-prudential policy including the use of tools that regulate lending standards
 - Regulatory instruments and powers including executive accountability
37. Once these key policy decisions have been taken, a working group would develop more detailed design features in consultation with industry before instructing PCO on the drafting of a Bill for the Deposit Takers Act for introduction in late 2021 and enactment in 2022. Preparation of secondary legislation, rules and supporting documents (such as policy guidance) would be progressed alongside the Bill process.

Implications for other legislation and reform

38. The Phase 2 Terms of Reference state that the Insurance (Prudential Supervision) Act 2010 (IPSA), the NBDT Act, and the proposed Financial Markets Infrastructures (FMI) Bill are out of scope of the Review except where consequential changes are necessary or could encourage alignment. However, the decision to create a common deposit takers regime will necessarily lead to the eventual repeal of most or all of the NBDT Act.
39. Recommendations on crisis management (which we expect to make later this year) could result in substantial amendments to the legislation noted above (and related legislation) if it is considered appropriate that the crisis management framework should be consistent across the financial institutions the Reserve Bank regulates. There are also implications for the proposed FMI Bill, which will be reviewed and may need to be updated in light of those Review decisions and once the deposit takers legislation is in place.
40. The Reserve Bank is planning to provide advice in December 2019 on the future role of cash in New Zealand, and what intervention (if any) is needed to sustain that role. The advice may include recommendations for some expansion of the Reserve Bank's mandate, in support of it playing a greater management role in the cash system as a whole. Some of these recommendations, if accepted, may require legislative amendment. The Reserve Bank suggests that these changes are included in the drafting of the first Bill for an Institutional Act, along with the existing currency

provisions in the current Act. The practicality of this timetable will, however, depend on what changes (if any) are proposed in December.

Progressing depositor protection

Progressing the depositor protection regime alongside the Deposit Takers Act is recommended

41. The Review team recommends that the depositor protection regime be progressed in parallel with the Deposit Takers Act.
42. The Deposit Takers Act will establish a regime that covers all institutions authorised to accept customer deposits in New Zealand; and all customer deposits in institutions authorised under the deposit takers regime will be eligible for depositor protection. This reflects the inherent link between accepting, and protecting, deposits. Being a member of the protection regime could be made a core requirement of being authorised under the deposit takers regime. Institutions outside of the protection regime would also sit outside of the deposit takers regime, and would not be permitted to accept retail customer deposits.
43. This approach has the benefit of leveraging off the close overlap between the regulatory/supervisory perimeter – which will be a core part of the Deposit Takers regime - and the depositor protection perimeter. New Zealand’s deposit guarantee scheme in the GFC showed the negative consequences of extending the protection perimeter beyond the regulatory perimeter: allowing un-regulated finance companies to join the scheme encouraged protected deposits to flow into these companies where risky lending activities were funded. This was ‘moral hazard’ at work.
44. To minimise moral hazard under the new protection regime, the protection and regulatory/supervisory perimeters should align (i.e. any deposit-taker who is a member of the protection regime must be subject to proper regulation and supervision).
45. The implications for legislation will depend to a large extent on decisions regarding who is responsible for meeting the objectives of the deposit protection scheme, the legal entity in which it resides and a range of other design details. Until these aspects are progressed, the implications for legislation are unclear. Depositor protection could require separate legislation or be part of the Deposit Takers Act.

Progressing the legislative framework for depositor protection separately is not recommended

46. To accelerate the development of the legislative basis for depositor protection, consideration could be given to a separate depositor protection Act, establishing the governance arrangements of the regime, assigning the regime’s objectives, functions and powers, and possibly giving depositors a legal preference.
47. The Review team does not recommend this approach because it could give rise to unintended consequences for industry. It will be important that the Deposit Takers Act supports the deposit protection regime by ensuring that deposit takers do not engage in risk-taking behaviour of a nature that could pose undue risk for the deposit protection

scheme. Accordingly it is important that the depositor protection scheme and the Deposit Takers Act are developed in unison.

48. In addition, even with the legislative architecture in place, the deposit protection scheme is unlikely to be operational for at least two years due to the information technology upgrades required to be made by industry as described further below.

Effective depositor protection will require upgrades to IT systems

49. The legislative framework for depositor protection needs to be considered alongside the IT systems that will be required to operationalise a depositor protection scheme. Upgrades to deposit takers' IT systems and debt registers will likely be required to operationalise the scheme and achieve a rapid pay-out of depositors in a failure event. Deposit takers with outdated legacy systems will need to upgrade these before the protection scheme can operate effectively.
50. New Zealand's experience with the deposit guarantee scheme during the GFC is illustrative. Tellingly, while the deposit guarantee scheme was implemented overnight, the first pay-outs took more than 8 months to complete due to the poor quality of the member institutions' systems as well as a lack of robust pay-out protocols. Even after pay-out processing rules were devised, it still took 2-3 months post-failure to verify debt registers before pay-outs could commence.
51. Required system upgrades may be time consuming and will involve costs for some member institutions. This means that, irrespective of how rapidly the legislation and rules empowering the scheme are progressed, the depositor protection regime is unlikely to be fully operational until at least 2022.

Timetable and announcement of key policy decisions

52. A summary indicative timetable for legislative reform for the deposit takers regime is included as Annex 1 which anticipates introduction of legislation to the House in late 2021.
53. The Government will be able to announce key policy decisions needed to progress legislative reform for depositor protection either later this year or in April/May 2020. These decisions may include:
- The objectives of the scheme
 - Coverage limit
 - The governance arrangements for the scheme
 - Mandate (protection approach, fund management approach)
 - Powers (e.g. the ability to levy members, ability to set rules in regulations)
 - Depositor preference
 - Size of targeted fund
 - Access to public funding backstop

54. Once these key policy decisions are taken, a working group would develop more detailed design features in consultation with industry before instructing PCO on the drafting of a Bill for legislation. Some of these detailed design features of the depositor protection scheme will be included in regulations and rules empowered by the primary legislation. These features include accounts protected, pay-out protocols, and funding mechanisms. Decisions on these features, and the drafting process, would be progressed alongside the primary legislative process. Close engagement with industry will be required to ensure the implications for industry are well understood.

Timeframe and process for legislative reform

55. As noted above, the Review team recommends prioritising the Institutional Act and targeting July 2020 for introduction of legislation to the House (option 1 below). Other options have also been considered and are included in the table below.

| | Introduced 2020 | Introduced 2021 | Introduced 2021/22 |
|-------------------------------|--|--|--|
| Option 1 (recommended) | Institutional Bill | Deposit Takers Bill Deposit Protection Bill | |
| Option 1a | | Institutional Bill | Deposit Takers Bill Deposit Protection Bill |
| Option 2 | Institutional Bill Deposit Takers Bill Deposit Protection Bill | | |
| Option 3 | Institutional Bill Deposit Protection Bill | Deposit Takers Bill | |

56. Option 1 (recommended) would prioritise the introduction of an Institutional Bill by July 2020. Option 1 would maximise the prospect of being able to introduce legislation to the House by July 2020 in line with the goal set out in the Review’s Terms of Reference.¹ However, Option 1 is not without risk. It would require final Cabinet decisions on all matters relating to the Institutional Bill by the end of 2019. It is also based on the premise that legislative drafting can be progressed quickly over the first half of next year (PCO advise that this may hinge partly on whether a decision is made to categorise the Bank as a Crown Entity). If not, potentially a slower path of legislative development may be required implying later introduction (option 1a).

¹ Under Option 1, the drafting and introduction of a Deposit-takers Bill would follow drafting of the Institutional Bill, but preparatory work on the policy content of this bill would continue in parallel with the work on the Institutional Bill.

57. Option 1 (or 1a) would see the Deposit Takers Bill and potentially a Deposit Protection Bill come later. Whether a separate Deposit Protection Bill is required will depend largely on decisions regarding who is responsible for meeting the objectives of the deposit insurance scheme, the legal entity in which it resides and a range of other design details. Until these aspects are progressed, the implications for legislation are unclear. It may be that a separate piece of legislation will be required to establish the depositor protection scheme and its institutional arrangements.
58. Option 2 would attempt to progress the introduction of the complete package of legislative changes by July 2020 including both the Institutional and Deposit Takers Bills. However, the option is not considered realistic, particularly given the volume of final decisions required by the end of 2019, the need for close engagement with Industry, current Review resource levels, and the extent of the legislative drafting task.
59. Option 3 would attempt to progress the introduction of a separate Depositor Protection Bill along with the Institutional Bill. As noted above, while this is potentially achievable, it remains undesirable for two primary reasons. First, it would de-link the work on Depositor Protection from work on the regulatory perimeter, which carries significant risks. Second, fast-tracking legislation on the scheme would be unlikely to speed-up the implementation of depositor protection (for example, required upgrades to deposit-takers' IT systems are likely to be more of a constraint). Simply passing legislation would not equate to the scheme being up and running.
60. A fourth potential option not shown would be to progress the Deposit-takers Bill before the Institutional Bill. This appears to make little sense, particularly given the desirability of confirming changes in the Reserve Bank's institutional structure to enable these to be bedded in. Moreover, for the reasons discussed it appears unlikely that a complete Deposit-takers Bill could be introduced by July 2020.
61. Overall, therefore, Option 1 (or 1a if necessary) is recommended. A proposed indicative timeline for progressing legislative reform on the basis of Option 1 is included in Annex 1. The timeline contemplates three sets of Cabinet policy decisions:
- November 2019 - final decisions on topics relating to the Institutional Act and any decisions that can be taken on the Deposit Takers Act and depositor protection
 - April/May 2020 - any residual decisions relating to the Institutional Act, key policy decisions relating to the Deposit Takers Act and depositor protection
 - April 2021 – final decisions, including design and technical details, relating to the Deposit Takers Act and depositor protection
62. The timeline is contingent on substantial progress being made by November 2019. The Review team is currently short staffed reflecting resourcing pressures being experienced by both the Reserve Bank and the Treasury. We are actively attempting to address these shortages but the labour market across the state sector remains tight.

63. Work on the drafting instructions for the Bill will need to start well in advance of the November Cabinet decisions to ensure the responsible agency can provide prompt instructions to PCO once policy decisions are finalised by Cabinet. The agency responsible for administration of the relevant legislation would normally provide drafting instructions to PCO. Decisions on administration of the Act, and the related sectorial legislation have not been taken, and the Treasury and the Reserve Bank expect to provide further advice on administration of the legislation later this year. In the interim, the Review team recommends that Treasury issue drafting instructions to PCO for the Institutional Act in consultation with the Reserve Bank. This proposal is consistent with the arrangements in place for phase 1 of the Review.

Next steps

64. The Review team will conduct further analysis of the components of an Institutional Act, and the decisions required to progress legislative reform, informed by stakeholder engagement and responses to the second round of consultation. The Review team expects to provide advice in September on how to progress legislative reform for an Institutional Act and the likely timetable.

Annex 1 – Summary timetable for legislative reform

Indicative pathways to legislation

KEY

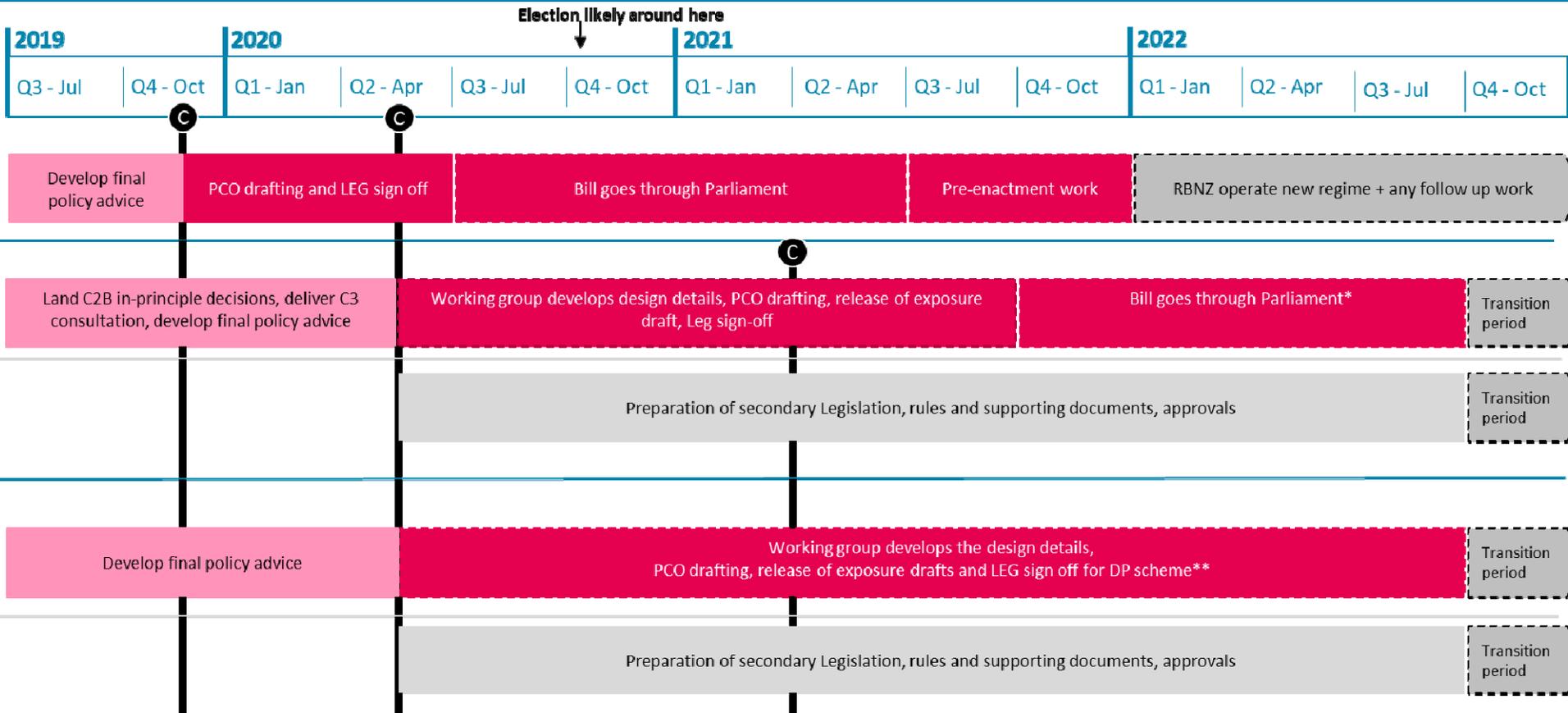
Colour denotes type of work

Light pink = Policy development work

Dark pink = Legislative stage

Circle with C = Cabinet policy decisions

Led by Review team



* Timeframe indicative

** Legislation depends on how DP work is taken forward. DP could require separate legislation or be part of the Deposit Takers Act.