

# The Treasury

## Reserve Bank Act Review Phase 2 Review Update Proactive Release

March 2020

This document has been proactively released by the Treasury on the Treasury website at

<https://treasury.govt.nz/publications/information-release/reserve-bank-act-review-phase-2-review-update-proactive-release>

### Information Withheld

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

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

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

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

- [26] 9(2)(ba)(i) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied
- [33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [39] appearing where information has been withheld in a release document refers to section 9(2)(k).

### Copyright and Licensing

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

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

### Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to [information@treasury.govt.nz](mailto:information@treasury.govt.nz).

## INDEPENDENT EXPERT ADVISORY PANEL MEETING SUMMARY

### RBNZ ACT REVIEW 4 - 5 August 2019

Sunday 4 August 4:30pm, Bolton Hotel

**Attendees:** Suzanne Snively (Chair), Barbara Chapman, Dr Malcolm Edey, Professor Girol Karacaoglu, Belinda Moffat, John Sproat, Nick Mulligan (minute-taker)

---

#### ***System stewardship and coordination***

- A member noted the importance of considering how the RBNZ fits into the wider financial ecosystem. A high-level preamble discussion could set the principles for the whole financial system and highlight the RBNZ's role and objectives (similar to APRA's Act). It should convey coherence in all areas (risk appetite, trans-Tasman arrangements, insurance, and climate change), and describe the broader story about financial stability and financial system efficiency. The Panel noted that consideration of the connectedness of the RBNZ within the broader domestic financial and regulatory system could be presented in the next consultation paper.
- The Panel agreed that the Council of Financial Regulators (COFR) should have some overarching role and responsibility for the financial ecosystem. The Review team refer to this concept as 'system stewardship'.
  - *What is the approach to coordination across the ecosystem?*
- The New Zealand COFR is informal – the Panel thinks it needs to be formalised (as discussed in Chapter 6 of the C2B paper). However, a panel member cautioned that a legislated COFR could constrain independent agencies. The Panel didn't see this as requiring another 'super-entity'.
- The Panel discussed ways to improve the functioning of COFR, including a role for the Minister(s) in setting expectations, having Cabinet clarify the role of COFR, or by providing directions to COFR agencies (whilst having regard to their independence, particularly ICEs). In effect, this would enable the government to 'nudge' the direction of COFR without interfering with independence.
- A member noted the importance of the ability to share information across agencies.
- A member noted that a collective view on policy can help make regulatory action more credible and less political, making any required legislative change more palatable.
- The Panel noted that policies and legislation should consider the broader costs and benefits, including the potential efficiency costs of under-resourcing the RBNZ and the Treasury. A member noted that COFR agencies need sufficient resourcing to be able to work effectively and efficiently.

#### ***Capital Review***

- A member expressed concerns that the RBNZ's Capital Review affects the frameworks that they are advising on for the Phase 2 Review, such as: bank resolution, depositor insurance, resourcing, and trans-Tasman relationships. Capital adequacy is a big lever in the context of financial stability.

- The Panel discussed the Minister’s in-principle decision to change the governance model of the Reserve Bank. This will have implications for the setting of the risk appetite. The Panel noted an expectation that decisions such as the capital adequacy settings would in future be taken by the Board. The Panel observed that major policy decisions were being made in parallel to the Review and discussed whether this would allow adequate scope for the various interdependencies to be taken into account. This issue was given more detailed consideration in later Panel sessions (see below).

### **Governance**

- A member questioned how the new governance Board may operate, including what level of delegation is likely to occur. How is business-as-usual decided?
- A member questioned who should determine the risk appetite for the overall financial stability of the system. *What is equivalent to an inflation target for financial stability?* The member noted that the RBNZ must be delegated independence, but the overall framework must have legitimacy from the government.
- The Panel discussed the appointment process for Board members and the Governor. A member noted that it is common for central bank governors to be appointed by the government. The Panel discussed the Crown entity model in which the Board appoint the CEO, but noted the MPC complicates the case for the RBNZ.
  - *Why does the Minister have the power to appoint the Governor/Board members and not the Governor-General on recommendation of the Minister? Do these appointments have to go through Cabinet?*
  - *What is the purpose of an independent nominations committee compared with the role that the Treasury could play in appointing Board members?*
  - *What is the Minister’s appetite to be involved in RBNZ decision-making? Is this limited to when public funds (or customer deposits) are at risk?*
  - *What mechanisms should the Minister have available to influence the strategic direction of the bank? What is the capacity for ministerial influence?*

### **Legislative design**

- The Panel discussed the proposal to split the RBNZ Act into an ‘Institutional Act’ and a ‘Deposit-taking Act’. The Panel supported the proposal to split the Act. One member noted that if the Act is split, there would need to be consideration given to what powers were kept in the ‘Institutional Act’. The Panel discussed the timeline for the legislation if the split was to occur.
- The Panel agreed that the Independent Crown Entity (ICE) model would be the best way to go. However, the requirements of the State Services Act around employing the CEO may be important to consider.
- A member questioned what elements may be required in legislation to motivate the most positive change in terms of how the Reserve Bank operates. There is an awareness of connectivity with the system, but what needs to be embedded in the ‘Institutional Act’? A member noted the new Board will set the culture through its interactions with the governor.

## ***Separation / Supervision and Enforcement / Crisis Management / Trans-Tasman***

- Given the decision not to separate prudential supervision from the Reserve Bank, the Panel discussed the subsequent follow-up issues they consider need to be addressed. Key issues noted included: sufficient resourcing of the function, increased capacity and capability, and the roles and responsibilities for crisis management.
  - *How do we get consistency and efficiency?*
- The Panel noted the trans-Tasman dimension to prudential regulation, supervision and crisis management. A member noted the desire to ensure that there is due recognition of the Australian regulatory bodies.
- The Panel discussed the historical relationship between APRA and the RBNZ. Two contentious barriers to closer coordination have been maintaining sovereignty and operational independence.
- A member referred to the session with Andrew Gracie on crisis management, the proposal for bail-in and NCWO, and the implication of these in the trans-Tasman context.
  - *The Panel are interested in views of whether there are incompatibilities between AU and NZ regimes, particularly with coordination/crisis management. Are there issues and how should these be addressed?*
- A member questioned how APRA monitors lenders that are not deposit takers. The Panel discussed the importance of information gathering powers, and a designation power/deeming in power to extend the regulatory perimeter.
- A member noted the Minister can act through the Public Finance Act in a crisis situation.

## ***Depositor protection***

- A member discussed the importance to keep the deposit insurance levy separate to any other levy.
- A member noted the deposit insurance limit should be inflation adjusted or revisited on a frequent basis.
  - *Does Australia's deposit insurance apply to non-residents?*

## ***Funding***

- The Panel noted that the RBNZ is under-resourced, particularly for prudential regulation, supervision and financial stabilisation policy. However, they believe a more traditional Board/CEO relationship would help with the allocation of resources.
- The Panel questioned why the five-year funding agreements had been treated as fixed envelopes.
- The Panel noted the key issue regarding the RBNZ funding model was the degree of trust and independence granted to the RBNZ for spending decisions.
- The Panel broadly agree that the RBNZ should keep seigniorage funding for its costs and noted that levies are complex and less flexible.

### **Macprudential policy**

- The Panel discussed whether more investment in the development of macroprudential policy was required, including: what role COFR could play, the desire for cost-benefit analysis, and increased capability across the system (including in the Treasury to understand the broader implications of macroprudential policy for fiscal policy).
- A member noted the desire in Phase 1 to establish more formal coordination between macroeconomic policy and fiscal policy.
- The Panel agreed the role of the Treasury observer at MPC should be reconsidered given the changing nature of the Treasury's role overseeing the RBNZ. The Panel noted conflicts of interest arising from this role noted in the RBNZ's governance paper.

### **Climate change**

- The Panel noted that climate change should be part of the Board's risk matrix and would interrogate the Review Team about how management are addressing it.
- A member observed that climate change could be discussed at COFR.

### **A Panel Paper**

- The Panel discussed the potential to produce an independent paper canvassing what they were envisaging for the Act(s).
- The Panel expressed mixed views on the idea, particularly regarding the audience and timing of the paper.

Meeting concluded at 10:10pm

---

## **Questions for the meeting with the Minister:**

### **CONTEXTUAL QUESTIONS**

*What is the context for coordination across the full financial system to ensure efficiency and effectiveness? What's the vehicle to ensure that there is coordination, consistency and the capacity to ensure that the analysis can be done to produce the best outcomes for the financial system?*

*The Panel's second contextual question is - how does the Minister see the relationship between the capital adequacy requirements and the impacted topics that are part of the scope of the RBNZ Act Review?*

## **OTHER QUESTIONS**

### **RBNZ Governance**

*1. The Panel supports Section 6 in the consultation 2b document. How does the RBNZ fit into the financial system? Could there be a Preamble to the Act which includes a definition on the context of the RBNZ's activities within the wider financial system? How does the Trans-Tasman financial system fit into the picture?*

*2. The Panel agrees that the Independent Crown Entity model would be a good basis for defining the new governance model in the Act. How would the requirements of the State Services Act apply around employing the CEO?*

*3. Has consideration been given to providing more teeth for the Council of Financial Regulators (COFR) while maintaining the independence of the financial institutions who are members?*

*4. Splitting the Act - the Panel supports splitting the legislation. What thought has been given to the powers of institutions that need to be in the Institutional Act? Where will there be overlap and how will this be resolved so that the Institutional Act can be progressed in a timely fashion?*

*5. Separation: The Panel supports the decision to keep the prudential supervision role as part of the RBNZ. Have all the issues that flow on from this been fully canvassed, in particular within the financial sector including those being supervised? How is it proposed to address inconsistencies in supervision and crisis management across the Tasman? How can coordination with the Australian regulators be optimised? There are two aspects of the role of the RBNZ that the Panel sees as providing context - supervision and crisis management. In both cases, the Panel asks how the Act might further enable Trans-Tasman coordination to manage NZ's finite resources more efficiently and effectively?*

*6. Capability and Resourcing: What features of the new Governance structure and other independent crown entity activities (e.g. the Letter of Engagement) can be designed to ensure that the role of supervision and crisis management is resourced to succeed?*

*7. Where has consideration of levies gotten to? How does the levy fit into the picture when there is other RBNZ revenue including from coinage seigniorage and other income sitting there? Is there a case to find a more straightforward approach to renegotiating the 5-yearly RBNZ budget agreement than the provision in the current Act?*

*8. Does NZ trust the Board of the RBNZ to spend the RBNZ's revenue efficiently and effectively? If yes, then in what areas would the levy-based revenue still be appropriate? (The Panel notes that levy systems are disproportionately time consuming. Levy machinery can quickly get out of date.)*

*9. Deposit insurance: What consideration has been given to building in inflation adjustment - for example building in a formula that adjusts it every 5 years?*

*10. Enforcement and supervision: The Panel supports RBNZ legislation that includes powers to supervise insurers and NBDTs. A level playing field is in the best interest of customers. How can the RBNZ Act ensure that there is sufficient capability and capacity to support quality enforcement and supervision?*

*11. How can the RBNZ's structure/role be specified to insure sufficient consistency and coordination across the Tasman?*

*12. What is the Minister's appetite to be involved in decision-making by the Reserve Bank, given that the proposed new Board is accountable to the Minister? Where do you draw the line between political decision-making/ influence and necessary government interventions? To what extent do you make it possible for a government to change the strategic direction of the bank? Does the application of a risk management strategy provide sufficient context/ protection for retaining a viable long-term strategy that has coherence through time?*

*13. How involved does the Minister of Finance want to be in the application of macro-pru levers? What role is there for different agencies/COFR so that the depth of the analysis of their perspectives can go beyond that provided via the RBNZ on different topics? Given the critical point of independence - would strengthening the role of other regulators (including The Treasury) lead to a reconsideration of Treasury observing at the MPC, recognising that the MPC has the opportunity to invite anyone to its meetings as required?*

*14. Parameters of culture - what does a well-resourced Board of independent Directors look like that generates a culture of openness and accountability? What are the features of the independent crown entities act that can help shape this?*

*15. Climate change and the impact on insurers for example - does the risk management framework and regular discussion of risk appetite by the RBNZ Board provide a sufficient framework for climate change factors to be addressed? What is the thinking in regards to the provisions of the Act, the appointment of the Board and the resources required for research?*

## Monday 5 August 2019, The Treasury

**Panel members:** Suzanne Snively (Chair), Barbara Chapman, Dr Malcolm Edey, Professor Girol Karacaoglu, Belinda Moffat, John Sproat.

---

**9:30 am** Panel Members meet at Reception in Parliament Buildings

**9:45 am – 10:30 am** Panel Members meet the Minister of Finance, Grant Robertson

---

### **10:35 am – 11:00am – Morning Tea, The Treasury**

---

#### **11:00am – 11:45am – Panel-only discussion**

The Panel discussed the meeting with the Minister.

The Panel noted the Minister's interest in questions concerning the overlap between Reserve Bank Capital Review and Phase 2 Review.

The Panel noted the Minister asked them to focus on the consequences of the sequencing. The Panel considered whether there is a case for one review to lead the other, and whether there are significant interdependencies between the two reviews that need to be considered.

#### ***Q. What if the new governance structure and set of tools and powers results in the capital decisions being subsequently reversed in the future?***

The Panel noted the scope of the Phase 2 Review is broad and could result in setting a prudential structure that is not complementary with the capital proposals.

The Panel noted the Phase 2 Review has a mandate to consider who sets risk appetite. The risk appetite will influence the capital calibration.

#### ***Q. Is the review compromised by the discussion of capital adequacy at the same time?***

Panel members considered that the Phase 2 and Capital Adequacy reviews could be carried out simultaneously but noted interdependencies between the two reviews. In-principle they could be independent, but it would be helpful for the Reserve Bank to show how they have considered implications of the Phase 2 Review. The reviews should be thought of in a complementary way. The Panel concluded that there is a risk of multiple layers of complexity if the two reviews are not aligned.

A member suggested inviting the Reserve Bank to consider the costs and benefits of this approach versus aligning the processes.

A Panel member raised a concern that the Capital Review could undermine the Phase 2 process because it creates uncertainty of the landscape.

Another member thought that the Capital Review could compromise the Phase 2 review due to the fact that the public are unclear about the relationship between the reviews, and the sequencing of decisions from the two reviews.

A member noted the capital decision is costly, which may provide reasoning for it to respond to the Phase 2 Review, rather than lead.

A member questioned whether capital would need to be as high as proposed if the supervisory approach arising from the Phase 2 Review was more intrusive.

A member thought the reviews could be done in parallel, but thought the capital calibration should have regard to the Phase 2 Review. This would enable tools or powers such as TLAC to be considered.

In light of these issues, the Panel had a preliminary discussion on the merits of recommending postponing completion of the Capital Review. These issues were further explored in the session with the RBNZ Governor before conclusions were drawn (see below).

Regarding question #12 posed to the Minister, the Panel discussed a need to manage the separation of policy and regulation.

### **Coordination and the Council of Financial Regulators**

The Panel noted the Minister was seeking suggestions on how coordination and the Council of Financial Regulators (COFR) could be improved. The Panel discussed the role of the COFR. The Panel considered how COFR be used to influence the Reserve Bank and whether this would create some conflicts. The Panel noted the key questions for coordination were:

- *What is the value of coordinating?*
- *Why would you coordinate?*
- *What is the functional gap?*
- *Where will efficiency break down?*

The Panel noted they would prepare some advice to the Minister on the two contextual questions raised.

---

### **11:45 am – 12:30 pm – Crisis Management**

Crisis management and suitable structures to enable appropriate transition from oversight and monitoring to intervention and response

- Tools and strategy for bank resolution
- Trans-Tasman dimension of resolution arrangements

*Attendees:*

*Review Team - Victor Kuipers, Bronwyn Kenna, David Hargreaves, Nick Mulligan*

*RBNZ - Geoff Bascand, Toby Fiennes, Ashley Dunstan, Walter Shea*

A Panel member noted the value of the call with Andrew Gracie.

A Panel member asked for clarification about how the Reserve Bank would manage the transition of a firm from BAU supervision to crisis management. The member noted the discussion of crisis management was being approached as being quite separate and distinct, rather than being at one end of a continuum. It was agreed that there is a spectrum of supervisory actions from BAU through to crisis management/resolution. Along that spectrum, interventions should escalate appropriately, until at some threshold, the resolution authority takes control. The Act needs to be permissive about the powers that the Reserve Bank have for intervention along the continuum.

There should be separation between the supervision and resolution authority within the institution (although decision makers can overlap). A Review team member noted that APRA are looking to separate the supervision and resolution committees, but with overlapping membership. APRA's resolution committee can see the risk ratings for the ADIs, leaving 'very little wriggle room' for the supervisors to hide issues.

It was noted that the new governance model would address the involvement of the Board in crisis situations. The Board oversee the crisis management processes and would get more involved as the supervisory actions became more serious. This may occur through a sub-committee. The Board would not be involved in day-to-day supervision.

***Q. Could you provide an update on the intersection of crisis management and the Capital Review and how the trans-Tasman dynamic has been considered?***

The Review Team and the Reserve Bank have been engaging with APRA and other Australian agencies (through the Trans-Tasman Banking Council) to improve understanding of the respective regulatory approaches. There is an improving engagement in terms of crisis management. In terms of resolution, there are lose agreements to work together (around preparedness) but it's hard to predict many issues that may arise in an actual crisis.

***Q. Is OBR part of the resolution process?***

The Reserve Bank believes that OBR is a viable resolution process and noted that some amendments to the legislation could support OBR. [26]

Both Australian and New Zealand authorities acknowledge the need to respect each other's sovereignty.

The Review Team noted that the Australian authorities were supportive of the consultation material published by the Review. [26]

The Review Team noted that OBR would be more credible if it was supported by a 'No Creditor Worse Off' policy.

***Q. How does TLAC fit with OBR?***

The relationship between OBR, TLAC, and bail-in was discussed. It was noted there is some uncertainty regarding whether and how OBR can be used to assign losses. Bail-in powers would unambiguously provide legal authority for losses to be absorbed/assigned as well as provide an ability to internally recapitalise the bank.

There was a general consensus that the legislation should provide for explicit bail-in power.

Conceptually, TLAC prepositions liabilities to absorb losses/recapitalise the bank in resolution. Although a general bail-in power absent TLAC can achieve a similar outcome, it would be less transparent ex-ante and potentially face legal and operational impediments. APRA calibrate their TLAC requirements to advance their resolution objectives.

The group agreed that there is a need for a strong resolution regime with a range of options.

***Q. If going concern capital was set at 16 percent, why is TLAC required?***

The Reserve Bank noted a desire for strong going concern capital to prevent banks becoming stressed. The Reserve Bank consider TLAC a third tier of capital rather than a distinct resolution tool.

The Reserve Bank questioned the advantages of more gone concern capital in addition to high going concern capital levels. The Review Team noted that gone concern capital and TLAC relate to prepositioning where losses will be imposed. OBR assumes that all liabilities *pari pasu* will be haircut, including derivatives and operating liabilities. TLAC prepositions liabilities that are readily available, and can absorb losses or be converted to capital with speed and certainty.

The group acknowledged that given New Zealand operate a non-zero failure regime, there must be credible resolution options, even if capital requirements are high.

The Reserve Bank noted that if there is a desire for no government involvement to resolve a failed bank, this would likely require at least 6 percent TLAC in addition to 16 percent going concern capital.

***Q. What is the optimal number for loss absorbing capacity?***

The Reserve Bank noted they don't have an optimal number. OBR can be used to absorb the losses of the failed bank and return it to a state where assets = liabilities. OBR enables the bank to keep functioning in the short term, but assumes a government guarantee to maintain market confidence.

In a crisis scenario, the Reserve Bank noted they are comfortable for a bank to operate at zero capital under OBR.

In contrast, the Review Team believe there must be an ability to recapitalise the bank, so the bank can run without putting public funds at risk. They believe that a TLAC regime with bail-in allows the resolution authority to intervene before the bank has no capital remaining, and undertake the repair work required to restore capital.

The Reserve Bank noted it is not averse to TLAC but indicated it does not believe it would affect the proposed capital calibration. The RBNZ is keeping a watching brief and is not rushing into adopting TLAC given it is untested internationally. The Reserve Bank raised a concern that the discussion about TLAC could confuse the Capital Review decisions.

The group noted there was merit in looking at the legislation versus calibration. Providing the Reserve Bank with a range of appropriate tools and powers is different to how they may be calibrated – reflecting the Reserve Bank’s operational independence.

The Panel noted they may need further discussion on crisis management.

***Q. In terms of crisis resolution – did the Reserve Bank learn any lessons from the CBL Insurance case?***

The Reserve Bank noted that they had few resolution options available given that CBL was insolvent, making liquidation sensible.

The Trowbridge-Scholtens Review noted the Reserve Bank didn’t act as urgently or proactively as it could have. The Reserve Bank accepted that it should have done more when it noticed the ‘smoke’. The Trowbridge-Scholtens Review also noted the direction not to disclose was right, but should have been issued sooner.

It was also noted that CBL was a small entity, with a small number of policyholders. Therefore, even with more resourcing it is unlikely to have been a major priority, given there are approximately 90 insurers operating in New Zealand to supervise.

**The Panel-only session summary – the Panel noted:**

- there are clearly still issues to resolve on crisis management regimes and options, with a wide gap between the Review Team and the Reserve Bank in regards to different approaches to resolving a failed bank
- the Reserve Bank sees TLAC in addition to the proposed 16 percent capital level
- that provided the risk appetite of the new Board was clear, then the Board could review the settings. However, this emphasises the need for engaged and capable Board members
- No Creditor Worse Off (NCWO) is important for the relationship with Australian authorities
- The Panel would convey these views back to the Steering Committee

---

**12:30 pm – 1:30 pm – Macroprudential policy**

The development of macro-pru levers/ tools and governance of macro-pru/ cost benefit and economic impact considerations/ role of RBNZ and how it works with other agencies/what does the Act need to cover

*Attendees:*

*Review Team - David Hargreaves, Nick Mulligan*

*RBNZ - Geoff Bascand, Toby Fiennes, Ashley Dunstan*

***Q. The Panel asked about the role of the Reserve bank Board in macroprudential policy? Would the Board have any non-delegable policies?***

The Reserve Bank observed that there was a desire for the Board to be responsible for everything. However, it expects significant delegation to the Governor/management.

For macroprudential policy, the Reserve Bank view the Board as approving the frameworks and regime, while each calibration/setting of the policy would be done independently by the Governor.

The Governor would keep the Board informed of developments.

The Panel noted the Board would also be able to get independent advice on the policy, and set the over-arching risk appetite statement. To support independence, the Panel agreed that the legislation needs to be permissive and that it's important to set up a selection process to end up with quality (experienced and engaged) Board members.

***Q. How do we ensure that macroprudential is not looked at in a silo? What principles does the Act need to ensure additional considerations are taken into account?***

The quality of the Board and well specified primary and secondary objectives (efficiency and costs etc.) will be important to set a sound basis for the operation of macroprudential policy.

The Reserve Bank sees three types of prudential policy:

- 1) Resolution policies
- 2) Baseline prudential policies
- 3) Overlays/macroprudential policies

Macroprudential policy wouldn't be used all the time, rather only when risks are elevated.

***Q. How does macroprudential interface with other agencies, particularly for sectors where there are overlapping or conflicting objectives between agencies such as housing (MBIE/HUD) and agriculture (MPI/OIO)? Are the coordination bodies effective?***

The Reserve Bank noted that agencies are aware of what each are doing. However, it does become difficult when objectives conflict. Financial stability can be weakened by other decisions and policies. It is key though that for all of this, the focus on financial stability of the financial system is paramount.

There was consultation with other agencies when LVRs were developed. This consultation led to the exemptions for new builds and Welcome Home Loans. The Reserve Bank are comfortable with broad consultation requirements for macroprudential policy, as long as decision making is not compromised.

The potential use of financial policy for industry policy objectives (i.e. the allocation of credit to sectors) was discussed. Consideration of objectives are important. For example, Minister's views can change over time between housing affordability and house prices.

The group noted that the COFR needs to grow and take collective ownership of the financial system and set its strategic direction. The COFR should discuss issues that are important and cut across agencies, socialise solutions, and seek input and views. However, the COFR doesn't have any legal authority. In Australia, APRA obtain support for their policies as the Council of Financial Regulators provide public endorsement.

***Q. Does the COFR need more status?***

The group stated that increased transparency and visibility would enhance the COFR's reputation and presence. This could be achieved by publishing meeting agendas and minutes. COFR could be given a 'comply or explain' power (which is common internationally).

The Crown Entities Act requires public sector agencies to collaborate. Ministerial directions or Letters of Expectation could be considered vehicles to encourage more transparent coordination through the COFR.

***Q. What lessons can be taken from the Conduct and Culture Reviews for how future reviews could work?***

The Reserve Bank noted the success of the Conduct and Culture Reviews of banks and life insurers was largely due to COFR working well. However, the membership may need to change over time to adapt to emerging issues. The Conduct and Culture Reviews were mainly undertaken by the Reserve bank and FMA.

The Reserve Bank believes the information sharing powers are adequate – It can share information if it is for a proper purpose.

The COFR's activities should be set at the strategic risk level. Interagency work may need to be supported through bilateral MOUs.

The COFR's vision is shifting to focus more toward shared ownership of the system rather than just information sharing. Resourcing should follow as agencies respond to signals they get from their Ministers or Boards.

The Reserve Bank noted they also share supervisory colleges with APRA and join APRA's New Zealand reviews.

The Treasury and MBIE are both members of the COFR, representing the government. There may be a case for rationalising the roles of the Treasury and MBIE into one agency. While this would be outside the Terms of Reference for the Phase 2 Review, the option could be noted. There has not been an obvious issue with this to date, apart from the perceived lack of coordination any low profile of the COFR.

***Q. Does the Reserve Bank need more resourcing for macroprudential policy?***

The Reserve Bank made a case for more resourcing, but not just for macroprudential policy. Additional resourcing would be used to keep marco-economic and financial system research up to date and to maintain coherence across prudential policy.

The Reserve Bank noted macroprudential policies are still under development worldwide, with a need to improve cost-benefit analysis and policy evaluation tools.

The group noted that while there is a need for technical capability and capacity at an operational level, there is also a need for more strategically focused policy experts that have an ability to consider the broader operating environment and interactions of policies.

## **Comparison with monetary policy**

Monetary policy looks simple in comparison to macroprudential policy. Monetary policy generally has one instrument and one target. Macroprudential policy has multiple instruments and multiple objectives.

## **Governance of macroprudential policy**

As with all policy functions, robust governance and decision making processes are required. The Reserve Bank is wary of macroprudential policy being subject to different governance arrangements than for other prudential policy and noted the Board should hold management accountable for decisions. It was agreed that Board members with the skillsets required to operate macroprudential policy are required, but could be hard to find.

The Panel noted the Board should have the ability to commission external independent reviews of macroprudential policy. While the Board would have a mandate to do so, this would be in addition to, not instead of, the capabilities of Board directors. The capability of the Board must be established and protected.

## **Macroprudential tools and powers**

The Review Team noted it was exploring the option of setting macroprudential policy through standards and how tools could be added to the macroprudential toolkit under such a framework. Under such a framework, the Board would publicly consult on adding new tools to the toolkit, balancing independence with transparency and accountability.

APRA uses the legal basis for Pillar 2 capital surcharges to implement macroprudential policy if institutions are taking greater risk. Such arrangements provide a simple solution without a complicated framework, but introduce a significant lack of transparency.

## **Macroprudential resourcing and capability**

Dis-investment in the Reserve Bank's financial stabilisation and prudential supervision occurred 30 years ago with the passing of the 1989 Act. The Panel discussed the risk of this happening again – *what does the legislation need to say to prevent this in the future?*

It was agreed that if the Reserve Bank is classified as an Independent Crown Entity, the Board of independent-minded directors would be responsible for ensuring that macroprudential policy capability is considered when setting risk appetite. The Reserve Bank's objectives are also a key to guide directors. Regarding resourcing, the Board will be required to publish financial reports that include details of its spending on different activities.

---

**1:30 pm – 2:00 pm – Lunch**

---

## **2:00 pm – 3:00 pm – RBNZ Governor, Adrian Orr**

Thoughts on RBNZ Governance

*Attendees:*

*Review Team - James Haughton, Nick Mulligan*

*RBNZ - Geoff Bascand, Toby Fiennes*

The Reserve Bank Governor had been initially invited to discuss his perspective on how the new governance Board would be most effective. Since then, the Panel had prioritised the topic of the relationship between the Reserve Bank's Capital Review and the Phase 2 Review.

### **The Reserve Bank's Capital Review and the Phase 2 Review**

The Governor noted that the Reserve Bank cannot afford to pause its Capital Review to wait for final decisions from Phase 2.

The Reserve Bank has a full work agenda that needs to be progressed. The Capital Review is coming to the end of a three-year work programme. Final decisions will be made by the end of November 2019. The Reserve Bank has been keeping APRA informed of developments and the Capital Review was discussed at TTBC.

The Governor noted the Reserve Bank has employed external reviewers to assess the Capital Review. These reports will be released when appropriate. Preliminary findings are highly supportive of the process. The Governor noted the consultation process was presented as a net benefit analysis, noting the external reviewers thought the research was world-class and that it was good for these conversations to be in the public domain.

The Governor described capital as being a fence at the top of a cliff, whereas he viewed TLAC as potentially playing a role at the bottom of the cliff. Deposit protection is also described as being at the bottom of the cliff – a higher deposit insurance limit results in a shallower fall for depositors. OBR was another instrument to be used at the bottom of the cliff.

The group noted the interdependencies between the Capital Review and the Phase 2 Review. In particular, does the existence of deposit insurance mean that less capital is required at the top of the cliff? The Governor was not convinced that deposit insurance influenced the probability of a bank failure like capital does. However, it was acknowledged that deposit insurance reduces the loss given default. It makes explicit what people assume is implicit – therefore, has it truly added anything or not? The bottom of the cliff is important as New Zealand operates a non-zero failure regime.

The Governor described that while the Reserve Bank has set its risk appetite at 1/200 year risk of failure, it was acknowledged this should be set by society. In future, the risk appetite would be set between the Minister and the RBNZ Board.

The Governor reported that consultation submissions from the major banks were broadly supportive of the level of capital. The submissions were more focused on the quality of the capital, with a preference for more AT1 and Tier 2 capital, rather than common equity. Messages regarding the transition timing were more mixed.

The submissions also lacked quantitative details.

The Governor stressed the Reserve Bank is open-minded about the level of capital, the type of capital instruments, and the transition timing to the new requirements.

***Q. The quality of capital comes back to TLAC. Do you see a role for TLAC?***

The Reserve Bank attendees said they are thinking hard about the role of different tiers of capital. They were uncertain, though, regarding the consideration of TLAC or convertible debt as an instrument for the top of the cliff or the bottom of the cliff.

Regarding the international standard of 8 percent capital, there is an emerging desire to increase capital levels globally.

Many stakeholders have questioned why the Reserve Bank's proposals rely on CET1 capital and exclude hybrid capital. The Reserve Bank noted that CET1 capital is simple and effective capital.

The Governor questioned, from a customer perspective, the likelihood that banks will stop lending. The Governor noted that the SME and rural sectors are more risky than others. In particular, the banks have become overexposed in dairy lending in recent years and may be using the Capital Review to justify reduced risk appetite for these sectors.

***Q. Do you believe that the major banks won't invest in New Zealand?***

The Governor agreed this outcome might occur if the banks have to maintain their current ROE. However, they don't. The banks will allocate capital to business units that provide the best return. The New Zealand subsidiaries are the most profitable part of the Australian banking groups. The increased capital requirements in New Zealand should equalise the ROE with the Australian parent banks. The Governor reported that while the banks referred to their shareholders, their shareholders were largely silent. There wasn't the same level of concern expressed by investors themselves and a reason for this is that investors prefer that the banks are safer.

***Q. If you weren't raising capital requirements, would you be using other prudential instruments such as high-LVR restrictions on dairy?***

The Reserve Bank noted that recently 70 percent of dairy loans were interest-only, with a further 25 percent on revolving credit.

***The Trans-Tasman relationship***

The Reserve Bank described how it is operating under a no surprises basis with APRA. The Reserve Bank also reminded the group that the IMF FSAP characterised the Reserve Bank's relationship with APRA as 'gold-plated'.

The Governor described the complexity of the big-four Australian-owned banks given their separate legal regimes, tax regimes, depositor preference regimes, probability of default given different operating environments, legislative systems, and reputational arrangements.

The big-four banks are listed in Australia and not in New Zealand. However, both countries have failure regimes, clear lines of communication and different capital requirements to address these differences.

### **The new RBNZ governance Board and the role of the Minister**

The Governor spelled out how the Minister sets the goals through things like a risk appetite statement (RAS) and legislative objectives such as monetary and financial stability. Some of these are precisely specified, such as the inflation target, while others are broader. The Reserve Bank then has operational independence to pursue these objectives subject to a risk appetite.

The Board would design the RAS, using the expertise of the institution to assist on the calibration. For example, if 1/200 was thought to be too high, society would raise this with the Minister, who would discuss it with the Board. If the Minister is unhappy with the Board's calibration, the Minister can sack the Board. The RAS could form part of a financial policy remit.

The Board could also use external experts to inform the RAS and the capability and expertise of staff. The Board would have the legal responsibility for the Reserve Bank's budget and finances.

The Auditor-General would have oversight of the Reserve Bank's financial decisions and the institutions efficiency and effectiveness.

The risk of the Board model is whether that management overrun the Board, or that the Board overruns management. There must be balance.

### ***Q. What is the role of the Minister in appointments? Is there a role for the Governor-General?***

The Reserve Bank's preference is that the Board would recommend a candidate for Governor to the Minister who would appoint. The Minister would dismiss the Governor on the recommendation of the Board. The Board could also nominate internal MPC members.

The Reserve Bank recommends an independent nomination committee (INC) to ensure politically neutral appointments. An INC would nominate Board candidates and external MPC members to the Minister for appointment. The INC would only be able to nominate candidates that meet predetermined criteria.

It was felt that the Treasury is too close to the Minister to consider it independent. The Treasury would nominate the INC. The State Services Commission would not have a role in the appointment processes. The MPC complicates the appointment process as compared to the Crown Entities process.

The Reserve Bank see the optimal Board size as seven non-executive/ external members. The Board would set the vision, strategy, and standards for management to enact.

The Reserve Bank do not believe that Board members need to be financial or economic sector experts. There is a risk that those members with financial expertise feel obliged to channel board discussion around that expertise. The Reserve Bank

stated a preference for Board members to be long-term thinkers, have some industrial experience, an ability allocate resources, and make tough decisions.

***Q. Why not wait for the new Board to be appointed to finalise the Capital Review? Are you prepared for the new Board to re-litigate the capital review?***

The Capital Review is an existing multi-year work stream. The existing Board have been treated like a governance Board and had oversight of the Capital Review. It was noted that the CEOs job is to manage the Board. The Governor expressed an openness to challenge the future Board. It was also noted that while the current Board are not responsible, they are challenging the Governor and management.

In addition, there would be transparency throughout the new model, from strategy through to performance measures.

***Q. How do you see the 5-year funding plan – does it support this structure?***

The Governor noted the five-year funding agreement has ruled out investment. Governors' have been blamed for lack of supervisory intensity, but been expected to operate within a budget constraint.

The Reserve Bank noted a preference for no funding agreement. Instead, the Reserve Bank would spend what is needed and pay any remainder to the government through a dividend. The Board will see the business cases showing the net benefits of the spending. Transparency is required and auditors will be able to review any spending. This would be similar to the RBA's funding model, and would empower the Board.

The Reserve Bank noted that a five-year agreement would be superior to a shorter agreement. However, a longer agreement reduces flexibility. [34]

[34]

Having a role for government in the funding process leaves the risk that a government may force the Reserve Bank to fund its fiscal priorities.

The Panel observed that the structure of funding has some merit given that the Reserve Bank self-generates income.

***Q. What stops a new government from sacking the Board and putting in new people?***

Transparency. Also, the ICE model provides for certainty of mandate so that Board members could challenge unjust dismissal.

---

### **3:00 pm – 4:00 pm – Role of Act in setting parameters for culture**

Including independence of the RBNZ and relationship with Minister and Treasury as monitor in the refreshed structure/ attributes of permissive legislation that support responsiveness.

*Attendees:*

*Review Team - Bernard Hodgetts James Haughton, Nick Mulligan, James Campbell, Elizabeth Bolton*

*RBNZ - Adrian Orr, Geoff Bascand, Toby Fiennes, Ashley Tomlinson,*

The Governor outlined the Reserve Bank's vision statement and the Statement of Intent.

The Reserve Bank acknowledged that independence is not granted through legislation, it is earned every day. Tane Mahuta communicates how the Reserve Bank fits together and conveys its roles in the financial system.

The Reserve Bank's internal culture of policy creation is good. However, the Reserve Bank is also an enforcement agency and this role requires healthy skepticism and a willingness to act. The Reserve Bank has communicated that it needs more tools to ensure that financial institutions show they are complying with requirements.

The Reserve Bank is a caretaker of the financial system. This comes down to:

- building and maintaining stakeholder relationships
- attracting the people who share the values
- communicating more widely.

#### ***Q. How can we be confident the change in the COFR's activities is permanent?***

The COFR has agreed to new longer-term vision. This will be supported through Minister's comments on SOIs and LOEs, transparency, and commitment.

#### **Fostering capability**

The group discussed how the financial system can build and maintain capability. The challenge is designing long-term careers in central banking and financial regulation.

Organisations need to establish an ability to self-sustain over time. In New Zealand, the lack of focus on financial stability policy as a career may have hindered past development and will reduce the speed of future development.

In addition, organisation health starts with the leadership and tone at the top. Robust governance structures should help, but need to be supported through codes of conduct, charters of behaviors, and maintenance of key relationships.

---

### **3:40 pm – 4:00 pm – Afternoon Tea**

#### **4:00 pm – 4:30 pm – Legislative framework**

Legislative framework for optimum management of risk and resilience.

*Attendees:*

*Review Team - Bernard Hodgetts, Nick Mulligan, James Campbell, Elizabeth Bolton*

*RBNZ - Geoff Bascand, Ashley Tomlinson*

#### **Splitting the legislation – an ‘Institutional Act’ and a ‘Deposit-takers Act’**

The group discussed the proposal to split the Reserve Bank Act into an ‘Institutional Act’ (IA) and a ‘Deposit-takers Act’ (DTA). The Review Team noted the motivation of the split was to provide legislation that is user-friendly.

The Minister initially expressed some concerns that split legislation would be perceived as making it easier to separate prudential regulation from the Reserve Bank in the future. However, the Minister has since seen advice from the Legislative Design Advisory Committee (LDAC) and Parliamentary Counsel Office (PCO). Both agencies while not strongly supportive of the split, could see the benefits (as being a similar design to the FMA legislation). Subsequently, the Minister has agreed to proceed with the split legislation. Most lawyers engaged by the Review Team were in favour of the split.

The Review Team plan to seek major policy decisions from the Minister in late-2019. Drafting instructions for the IA will be provided to PCO so that drafting can begin with the aim to introduce the bill prior to the election. The DTA will take longer due to the increased complexity of crisis management and the regulatory perimeter. This work will likely last through 2020, with a bill to be introduced into the House in 2021.

#### ***Q. How would powers be split between the IA and the DTA?***

Generic powers, such as information and data gathering powers, would be in the IA. Monetary policy will be in the IA. Supervisory, enforcement, perimeter, and some crisis management powers would be in the DTA. The NBDT Act will be combined into the DTA. However, some finance companies may not be explicitly included in the perimeter of the DTA. The key feature is that the DTA is an activities-based regime rather than a name-based regime.

Some powers may need to be duplicated across the two Acts. The FMA Act and FMC Act are good examples of how a split could work.

The group noted that ‘Deposit-takers’ may not be the best name for the Act if it includes flexible perimeter powers to enable regulation and supervision of non-deposit takers.

Having an IA supplemented with sectoral Acts makes it easier to make amendments in the future. In addition, deposit insurance could either be in the DTA or have its own Act.

The Review Team noted that insurance would continue to be covered by IPSA.

#### ***Q. What is the consultation process from here?***

The Review Team is currently planning the third stage of consultation. The Review has consulted on the in-principle decision to establish a regime. Other topics, such as crisis management are at earlier stages. The Review will look to form recommendations following public feedback.

Due to the split legislation and different timelines between the IA and the DTA, there will need to be a transition period from the 1989 Act to the new IA and DTA. There is also a risk of a change in government mid-process.

It is unlikely that either act will be passed by the 2020 election, as bills take around six months to progress through the House.

***Q. Have you been actively discussing the Review with the Opposition?***

The Review Team has not engaged with the Opposition parties. However, the Reserve Bank has regular meetings with different parties in Parliament which provide an opportunity for them to raise concerns.

**Interactions between the new Board and the MPC**

The group discussed how the MPC fits with the new Board structure. The Panel noted some features of the MPC may be worth revisiting. This issue has not been raised with the Minister. The IA could repeal or amend parts of Phase 1 sections on the MPC.

**The Crown Entities framework**

There are two options regarding the Crown Entities framework. The first option includes beginning by drafting a bespoke IA for the Reserve Bank, drawing on sections of the Crown Entities Act where appropriate. Alternatively, the Reserve Bank could be classified as a Crown Entity and the IA would only include sections to supplement the basic Crown Entities framework where required (such as for the MPC).

The Review Team is working through the case for classifying the Reserve Bank and Independent Crown Entity (ICE), with a prima facie view that there is a good case for this classification. Classifying the Reserve Bank as an ICE would speed up the drafting process.

The key issues for the IA are the governance arrangements and the objectives. In particular, the role of the Minister needs to be explored more. There is a subtle difference between formal roles for the Minister and acknowledging softer means through which influence can be exerted. There needs to be some transparent mechanisms for ministerial influence.

While there are provisions for ministerial directions in the Crown Entities Act, these do not apply if the Reserve Bank is an ICE.

The group discussed the various means through which the Minister could convey their views and preferences. These included a possible 'Financial Policy Remit' which could include a risk appetite statement.

In addition, the Minister could issue a 'Letter of Expectation' (non-legislative) or a 'Government Policy Statement' (GPS) for which the Reserve Bank would be required to have regard to.

A Statement of Performance Expectations (SPE) could also be required, as with other Crown Entities. This would require 'reportable outputs' relating to funding. An SPE would enable the Minister to have a role in setting performance measures and reporting.

The Reserve Bank's funding arrangements would primarily be specified in the IA. However, provisions for charging levies could also be in the DTA to provide clarity that these measures could be used to fund that function.

The levy mechanics would not be specified in the Act, rather through regulations.

### **Feedback for moving forward**

The Review Team asked the Panel for feedback on any particular messaging that the Review should include in the next consultation. The group noted that setting up the institution and its objectives are important and there is merit in getting the narrative right. Signalling that we are prioritising the IA shows that significant changes have been made already.

A Panel member suggested the messaging start with explaining what we want from the financial system, rather than just focusing on the Reserve Bank. This should highlight that efficiency is being in the system. With this discussion, it is possible to explain the role of the Reserve Bank within the context of the financial system.

---

### **4:40 pm – 5:30 pm – Recap Key Conclusions/ Actions**

*(Review Team/Steering Committee welcome)*

*Attendees*

*Review Team: Nick Mulligan*

The Panel discussed the Minister's request for a paper from the Panel addressing the two contextual questions posed in their meeting.

### **The Reserve Bank Capital Review and Phase 2**

The Panel noted the key question they need to answer is: *does the timing of the Capital Review compromise or undermine the Phase 2 Review?*

The Panel agreed there are interdependencies between the Capital Review and the Phase 2 Review. The main interdependencies are between the level and quality of capital with the crisis management toolbox (TLAC and bail-in) and the deposit insurance fund and levy calibration. The Panel posed the question, *what does world class resolution look like in the case of higher capital?* The Panel considered if having Capital Review decisions announced before the Phase 2 decisions could be considered the 'tail wagging the dog'.

The Panel observed that there are both costs and benefits of the Capital Review proposals. A Panel member noted some of the social benefits claimed by the Reserve Bank have been questioned by external stakeholders. Other commentators have noted the Capital Review is about broader systemic instability which is currently not internalised by the banks. Therefore, raising the cost of capital has benefits.

The Panel referenced comments made by the Governor in the earlier session. The Panel was encouraged by the Governor's openness about the "new Board" reconsidering the level of capital, quality of capital, and implementation timing.

The Panel was also pleased to hear that the current Reserve Bank Board has had oversight of the Capital process. However, it was noted that this is outside the current formal Board mandate as is the primary monitor of the Reserve Bank in the interim.

Some Panel members raised concerns regarding the speed at which the Capital Review will announce decisions relative to the Phase 2 decisions.

The Panel also acknowledged the Capital Review implementation timeframe was around five years, by which time a new Board would be in place. The Panel took comfort that the new governance Board will be able to revisit capital calibrations, but acknowledged this may be costly.

The Panel considered whether in light of all these issues, there was a case for recommending that the Capital Review process be slowed to take account of relevant Phase 2 decisions. On balance, the Panel did not see a sufficiently clear case to make such a recommendation.

The Panel believes that more detail on the interdependencies between the reviews needs to be communicated to the public. It was noted that many of the interdependencies relate to the calibration of the tools, rather than the tools themselves. The Phase 2 Review has been operating with a principle of producing enabling legislation that is fit for purpose and the future, independent of the calibration of any regulatory tools or current use of powers (including capital).

The Panel also stated that it is important that the new Board members need to be competent and willing to be engaged and focused. The Panel observed that the directors/members selection could be made using a capability matrix. Members would be expected to have some expertise and association with the financial sector. A Panel member noted the distinction between personal attributes of members that enabled them to reflect courage and constructive, solution-based decisions versus expertise.

A Panel member was not convinced about an independent nominations committee. The member suggested follow up with the NZ Superfund to see how it has worked in practice.

### **Coordination of financial system regulators**

The Panel concluded that they do not support a statutory Council of Financial Regulators (COFR). The Panel supported the Council's recent direction of travel, which includes a refreshed vision statement and Regulatory Charter.

The Panel believes the Council remains the appropriate vehicle for coordination across the financial system.

The non-statutory basis of the Council provides flexibility for it to adapt over time. However, the Panel believes the Council's status could be further elevated and endorsed through 'Letters of Expectations' to the Chairs and/or Chief Executives of the participating entities from government.

It was agreed that the preamble for the Act should position the Reserve Bank in the financial ecosystem. This would involve strengthening the purpose statement in the Act (section 1A).

Action: The Panel asked the Review Team to draft a letter setting out the Panel's response to the contextual questions and seek approval from Panel members via email.

### **General comments**

The Panel discussed the process for the Phase 2 Review for the next few months.

The next Panel meeting is likely to be in September.

The Panel agreed that based on the outcomes of their discussion over their two days of deliberation, that a separate paper for the Minister was not required. It was important to answer the two contextual questions as requested by the Minister of Finance. The other questions raised provide a record of what the Panel have discussed, and the Panel would wait to for the Minister of Finance to reply before deciding to do anything.

Notes of the Panel meeting would be collated and circulated to Panel members for comment and approval.

**Meeting concluded 5:30pm.**