

The Treasury

Reserve Bank Act Review Phase 2 Review Update Proactive Release

March 2020

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Reserve Bank Act Review – Phase 2
Independent Expert Advisory Panel Meeting Minutes
Monday, 30 September
Treasury, Room 3.30

Session Objectives

- *Confirm timelines and deliverables for November and the new year*
- *Identify common ground and Panel's support for final and in-principle recommendations for November*
- *Where differences in view exist (RB–Treasury–Review Team–Panel) identify Panel views*
- *Put any other Panel issues on the table for conveyance to Minister*

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

Review Team: Bernard Hodgetts, Elizabeth Bolton, James Campbell, Enzo Cassino, Ashley Dunstan, David Hargreaves, Noemi Javier, Chris Hunt, Victor Kuipers, Nick Mulligan (minute-taker), Jack Starrett Wright

Reserve Bank: Geoff Bascand, Toby Fiennes

9:30 am – Timelines and Deliverables

The Review team provided an update on the Review's progress and an overview of the timeline. The Panel noted the election uncertainty in 2020 and recommended engaging with opposition parties to ensure multi-partisan support for the Review.

A Panel member asked if the Review has been bold enough. The Review team believe they have produced a coherent set of recommendations that present meaningful change to the way the Reserve Bank will operate (through the new Institutional Act). The Review team noted there is still more work to come on the Deposit-taking Act, in particular for the depositor protection scheme, executive accountability and the regulatory perimeter.

The Reserve Bank noted that accountability and legitimacy have been key areas of debate and focus of the Review to date. The shift from a single decision maker to a board is a solid construct, but the Reserve Bank are wary that the board's power is being diluted or constrained. The Reserve Bank are also concerned with the deviations from the Crown entity model with the remit and appointment of the Governor/CEO.

A Panel member noted that the majority of industry feedback has been supportive of prudential supervision remaining with the Reserve Bank. However, one Panel member noted some stakeholders did not support this decision.

A Panel member asked about intentions for future consultation. It was noted and agreed that there was no need for further consultation on the Institutional Act issues. However, there would need to be further consultation on the Deposit-taking Act.

A Panel member asked if recommendations had changed due to consultation feedback. The Review team noted that stakeholders had raised concerns around depositor preference and how the regulatory regime will treat small deposit takers. The Review will re-engage with industry to understand these concerns.

A Panel member asked how the Review had consulted Australian regulators. The Review team noted they had visited members of the Trans-Tasman Banking Council and discussed the direction of the Review and there is more engagement planned in the coming weeks.

Part 1 Institutional Act

9:45 am – Overview of Key Institutional Act Final Recommendations

The Review team highlighted the main recommendations and key developments since the last Panel meeting. A number of Panel members noted concerns that the board would not be responsible for appointing the Governor/CEO; the Minister would appoint on recommendation of the Board. It was noted that a Ministerial appointment is in line with international practice and the Governor is a statutory decision maker on the Monetary Policy Committee. The Reserve Bank noted they support the Governor being appointed by the board.

The Panel recommend the Institutional legislation be written in the context of being permissive and enabling as opposed to prescriptive. In line with this, the Panel noted the importance of strong governance, including clarity about the reasoning behind the Minister's role in appointing the Governor, and consideration of the relationship between an enabled board and its CEO.

A Panel member asked what protections would be in place to avoid unjustified dismissal of the Governor and board members. It was noted that there would be protections in the Act to ensure that there is due cause for dismissal.

The Panel discussed how board conflicts would be addressed through the size of the board and constraints regarding employment at regulated entities. A Panel member noted the rules for the board quorum should be clarified.

10:15 am – Financial Policy Remit

The Review team outlined the recommendation for a financial policy remit. The remit is designed to narrow the scope of Ministerial influence to the objectives (where the Reserve Bank should not have 'goal independence'), rather than a general and broad ability to issue a direction relating to any of the Reserve Bank's activities. The Reserve Bank noted concerns regarding the potential scope and form of the remit, the possibility that it is changed often, the inconsistency with the Crown entities framework (which the Reserve Bank prefer).

A Panel member noted concerns around how the Council of Financial Regulators (COFR) may be directed through the remit. The Review team clarified the recommendation relates only to the Reserve Bank's participation and collaboration with other regulators, not the COFR.

10.30 am – Morning Tea

10.45 am – Coordination and role of COFR

- including any reflections on Australian approach from Dr Malcolm Edey

The Review team provided an overview of the coordination recommendations and the role of COFR. Dr Edey outlined the structure and operational processes for the Australian Council of Financial Regulators (CFR).

A Panel member asked how the Australian CFR is funded. It was noted the CFR doesn't receive any direct funding. Agencies contribute resources and the RBA uses its extensive budgetary independence if necessary.

Part 2 Deposit Taking Act and Depositor Protection

11.15 am – Overview of In-principle recommendations and Work Programme

The Review team provided a broad overview of the in-principle recommendations and timeline.

A Panel member asked how the efficiency and distributional influences of macroprudential policy will be considered. A Panel member noted they viewed macroprudential policy as time-varying prudential policy, and therefore, the powers to undertake such policy should be covered under the power to set prudential regulations/standards.

The Panel did not think the prudential powers should be prescribed or constrained in legislation. Rather, the Panel supported a general power to set prudential regulations or standards (without specifying categories for which standards could be set), in accordance with the objectives and functions of the Act. This would provide for significant flexibility. In doing so, the Panel consciously support macroprudential tools, such as loan-to-value ratio restrictions or more general restrictions on lending, being able to be applied to all forms of lending (not just residential mortgages). It was noted that Australian authorities have very broad powers to set prudential regulations.

The Reserve Bank support legislatively empowering the macroprudential tools by prescribing broad areas for which standards can be set (such as capital, liquidity, lending standards etc.), given the specification is sufficiently broad.

The Review team noted that the ability for the Reserve Bank to set standards autonomously already provides for significant independence. Specifying categories for which the Reserve Bank can set standards is consistent with the current Act and broader practice regarding delegated instruments. In the macroprudential context, this would mean explicitly empowering the Reserve Bank to be able to set standards on 'lending standards' or specify tools such as loan-to-value ratios or debt-to-income ratios.

12.00 pm The Perimeter – Feedback from submissions and key issues

The Review team provided an overview of the key issues relating to the regulatory perimeter.

A Panel member recommended consulting officials that worked on the FMA/FMC transition. A Panel member encouraged the Review team to take a consumer-centric approach to the perimeter in order to consider how consumers may respond to different perimeters and incentives.

The Panel noted that finance companies have a large impact on confidence and must be regulated. The Panel questioned whether finance companies should be excluded from deposit insurance, given the experience prior to the Global Financial Crisis of many unsophisticated members of the public investing in high risk finance companies.

12.30 pm – Lunch

1.15 pm – Capital Review (Update from Reserve Bank)

The Reserve Bank noted that final decisions from the Capital Review will to be announced in the first week of December 2019. The Reserve Bank view capital as providing a ‘fence at the top of a cliff’, while deposit insurance is an ‘ambulance at the bottom’. On this basis, the Reserve Bank do not believe that the existence of deposit insurance (DI) requires reconsideration of the level of capital.

A Panel member asked whether DI is necessary if capital is sufficiently high. It was noted that while higher capital would reduce the expected cost of operating a DI scheme, it would not remove the need for a scheme, given New Zealand operates under the principle of a non-zero failure regime – i.e. the ambulance is still required.

The Panel asked how capital interacts with the wider financial safety net. The Reserve Bank noted the paper was written within the narrow scope from the Minister around the Capital Review and its intersection with a depositor protection scheme. It was not intended to address the interaction between capital and the broader safety net.

1.50 pm – Depositor protection

The Review team provided an overview of the depositor protection work stream.

A Panel member raised concerns regarding how the deposit insurer’s objective would relate to the high-level objectives of the Reserve Bank’s Institutional Act. It was noted that the deposit insurance would be its own function with unique objectives. However, the entity may end up being part of the Reserve Bank or the Treasury.

A Panel member noted the difficulty that some banks may have in upgrading systems to provide a single customer view.

The Reserve Bank noted they support a \$50,000 DI limit, but see merits in a lower limit.

A Panel member did not support depositor preference and viewed deposits in line with other unsecured creditors. Another Panel member noted that deposits aren’t just a liability, they need to act as a safe asset, and that a preference for depositors gives the public additional confidence to trust deposits like money/cash.

A Panel member noted the public interest in communications around DI and capital.

2.30 pm Crisis Management – Submissions feedback and Issues (Victor Kuipers)

The Review team provided an update on the crisis management work stream.

A Panel member asked whether the framework precludes a public bail-out. It was noted it does not, but more work on the interaction with the Public Finance Act is required.

A Panel member asked if the No-Creditor-Worse-Off safeguard (NCWO) could lead to inaction at the point of resolution. It was noted that NCWO relates to the liquidation counterfactual.

A Panel member asked if the liability and equity structure would encourage use of Total-Loss-Absorbing-Capacity (TLAC). It was noted this is likely to be the case and this is in line with what other jurisdictions are doing. The use of TLAC ensures the resolution authority abides by NCWO as much as possible.

A Panel member encouraged the crisis management work stream to consider the impacts on broader capital market development. The Reserve Bank noted they are open to looking at the additional capital instruments when considering the broader crisis management framework.

The key in-principle recommendations that were discussed included:

1. Designating the Reserve Bank the resolution authority
 - this was supported by the Panel and the Reserve Bank
2. The specification of the resolution functions and objectives
 - views were mixed, positions to be clarified
3. Vesting resolution powers with the Reserve Bank, rather than the statutory manager
 - views were mixed, positions to be clarified
4. Providing statutory bail-in powers.
 - Panel view to be clarified. The Reserve Bank noted significant concerns.
5. Introducing creditor safeguards (NCWO).
 - views were mixed, positions to be clarified.

There was a discussion regarding whether recommendations 3-5 should be presented as in-principle decisions and the merits of delaying seeking these decisions.

The Panel requested an ability to provide a view in the final paper.

Action point: the Review team will circulate the updated papers going to the Minister to the Panel for their comment and views to be incorporated.

3.25 pm – Follow-up issues

The Panel asked for a discussion about the Reserve Bank's funding model. The Reserve Bank outlined their preference for an autonomous model where the board approves budgets. The Reserve Bank noted they think the board should be empowered to do its job effectively, and this requires funding to be managed by the board. The Review team noted the preference for an agreement-based model.

Some Panel members noted concerns that a budgetary constraint may disempower the board. One Panel member noted the desirability for Ministerial oversight of the spending of public funds by a public institution. Given the Panel recommend the Institutional legislation be written in the context of being permissive and enabling and include clarity about the reasoning behind Minister's role and the relationship between an enabled Board and its CEO, the Panel support a funding framework that enables the Reserve Bank to be strategic and responsive to future conditions.

A Panel member asked how are monetary policy decisions would be split between the board and the MPC. It was noted that the MPC would formulate monetary policy and the board would be responsible for implementing the policy. There may need to be some further

clarification of the governance and reporting requirements for unconventional policy measures. The Review team is undertaking more work in this area.

3.50 pm – Panel-only Discussion

The Panel re-iterated three key points from their discussions:

1. The institutional legislation should be written in the context of being permissive and enabling as opposed to prescriptive.
 2. In line with this, the Panel noted the importance of strong governance including clarity about the reasoning behind Minister's role in appointing the Governor and due consideration of the relationship between an enabled Board and its CEO.
 3. Consistent with the above, a funding framework that enables the Reserve Bank to be strategic and responsive to future conditions.
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4.00 pm – Session finish