

Review of the Reserve Bank Act 1989 Phase 2 – Terms of Reference

Aim of the Review

In November 2017, the Government announced it would undertake a Review of the Reserve Bank of New Zealand Act 1989 (the 'Act').

The goal of the Review is to modernise New Zealand's monetary and financial stability policy frameworks and the Reserve Bank of New Zealand's ('Reserve Bank') governance and accountability settings. This will ensure that the Act and the Reserve Bank's approach support good economic management and reflect the changing environment in which New Zealanders live and work, which will support the development of a New Zealand economy that is productive, sustainable, and inclusive. The operational independence of the Reserve Bank remains paramount and will be protected.

The Review has been split into two phases, with phase 1 focusing on high-priority improvements to the monetary policy framework. Policy decisions for phase 1 have been taken, and later this year legislation will introduce an employment objective for monetary policy alongside price stability and provide for a Monetary Policy Committee as decision maker.

Phase 2 will primarily focus on a comprehensive review of the financial policy provisions of the Act that provide the legislative basis for prudential regulation and supervision. Phase 1 raised some questions about the governance structure of the Reserve Bank but stopped short of a full review, recognising that there would be implications for phase 2. As a result, phase 2 will also consider the broader governance arrangements for the Reserve Bank, including the respective roles of the Board and Governor.

A successful regulatory regime is one that has the following characteristics¹:

- The Act's purpose and the Reserve Bank's objectives are clear
- The roles and responsibilities of key participants, including the Minister, the Board, and the Governor, are defined in statute and are clear and coherent
- The regime engenders trust and confidence in New Zealand financial markets
- The regime is enduring
- The regime provides sufficient flexibility to adapt and evolve in response to market developments

¹ These characteristics draw on the *Government Expectations for Good Regulatory Practice*, <http://www.treasury.govt.nz/regulation/informationreleases/pdfs/good-reg-practice.pdf>

- The regime engenders trust and confidence in decision-making processes
- Powers available to the Reserve Bank are sufficient to achieve its objectives
- There is clarity as to how the regime interacts with other regulatory regimes and government policy as whole
- The regime is clear about the role of government and the scope of the Reserve Bank's operational independence.

Context

The Act has been in place for nearly 30 years. In that time there have been many changes to the economy and the financial sector. The volume of transactions has increased, and financial institutions have grown both in terms of their size and the range of financial services that they offer. As a result, the global financial system is both larger and more interconnected than it was in 1989.

Financial regulation has responded to these changes on an international scale. The pace of change has increased over the last ten years as most advanced countries undertook significant reforms following the global financial crisis. At the same time, international standards have been developed that increase the attention given to consistency and comparability across jurisdictions. The role and mandate of prudential regulators have increased both in New Zealand and abroad.

The role of the Reserve Bank expanded over the late 2000s to include oversight over insurance companies and non-bank deposit takers. The scope, focus, and intensity of regulation and supervision have also evolved over the last 30 years, enabled by the flexibility provided by the current statutory framework. Change to the statutory framework has occurred through a series of separate, targeted amendments rather than through a comprehensive review.

It is nearly ten years since the last substantive review of the Reserve Bank's empowering legislation and accountability arrangements. The governance of some other regulators under the Crown Entities Act 2004 has since been reviewed. Similarly, the more recent Non-Bank Deposit Takers Act 2013 and Insurance (Prudential Supervision) Act 2010 have either been reviewed or are in the process of being reviewed.

Expert and sector perspectives

As well as responding to changes in context, the phase 2 Terms of Reference has been guided by a range of expert and sector perspectives.

The Productivity Commission's 2014 report on *Regulatory Institutions and Practices* provides a comparison of regulatory regimes and notes that regulatory institutions need to be designed to provide clarity of role, an appropriate institutional form and degree of

independence to enable them to function as intended, good governance and decision-making arrangements, adequate funding where the funding mechanism does not create perverse incentives for either the regulator or regulated parties, and strong monitoring and oversight.

The International Monetary Fund's (IMF) Financial Sector Assessment Programme (FSAP) provides a starting point for aspects of the Review. The IMF highlighted that a significant amount of progress had been made since the last FSAP in 2004. Notwithstanding this, the IMF recommended an increase in the Reserve Bank's resources for supervision and regulation, steps to strengthen cooperation with Australian authorities, and clarifications of responsibilities to reinforce the role and autonomy of the Reserve Bank as prudential regulator and supervisor. The IMF also made sector-specific recommendations to strengthen arrangements for macro-prudential policy and to revise the Act to provide greater clarity and certainty in resolution.

A stakeholder consultation and feedback process in February and March 2018 also revealed wide-ranging support to review the Act.

Given this, it is timely to stand back and comprehensively review the framework set out in the Act to ensure it remains fit for purpose.

Scope of the Review

To ensure the Act continues to support the operation of the Reserve Bank, the Review will consider the following:

- The institutional arrangements for prudential regulation and supervision
- Objectives, objective setting processes, and alignment with government policy and risk appetite
- Statutory functions and powers
- Role clarity for the Minister of Finance, the Board, and the Governor, including the allocation and coordination of powers, functions and tools
- Accountabilities
- The strengths of current legislation, including its flexibility
- The balance between primary, secondary, and tertiary legislation, including in respect of setting policy
- Coordination across government, including pre-existing forums such as the Council of Financial Regulators
- Alignment with the domestic regulatory management system
- Procedural approaches, fairness, and safeguards
- International experience and best practice.

The Review will be organised around the following key topics.

1. Overarching objectives and the scope, coverage, and coherence of the legislation

The Review will consider whether the Act provides a coherent framework for the Reserve Bank's roles and responsibilities, whether the Act's purpose and Reserve Bank's objectives are clear, whether they remain appropriate, and the process by which they are set. Stakeholders raised the balance between stability and efficiency, the links between a systemic mandate and institutional soundness, and the weight placed on depositor protection.

2. Institutional governance, and decision-making

The Review will consider the Reserve Bank's accountability to the Board, the Minister of Finance, and Parliament. This will include consideration of best practice. The current role of the Board and the Minister, how these roles should evolve, and committee decision making for prudential decisions will be considered.

3. Trans-Tasman co-ordination

The Review will consider options to work more closely with Australian regulatory agencies to explore, and perhaps improve, the coordination of policy.

4. Prudential regulation

The Review will consider financial stability objectives, tolerance for risk, and how both of these are set. It should also consider the regulatory instrument (e.g. conditions of registration), safeguards, due process, accountability, and transparency. It is not the government's intention to separate out the prudential regulation functions from the Reserve Bank. However, given the level of interest from stakeholders in this topic and the importance of it, the Review will consider submissions on the rationale for retaining prudential supervision in the Reserve Bank as part of the first round of public consultation on phase 2 of the Review.

5. Supervision and enforcement

The Review will consider the IMF's FSAP recommendations with respect to the supervisory model. The Review will consider the flexibility under the current Act, supervisory objectives, and the compliance and enforcement regime.

The Review will also include consideration of monitoring and managing the risk that climate change poses to New Zealand's financial stability, in light of the recommendations of the Task Force on Climate-related Financial Disclosures.

6. Resolution and crisis management

The resolution and crisis management framework will be reviewed to ensure the framework can respond to serious institution-specific or system-wide stress. The Review will consider the IMF's FSAP recommendations, whether resolution objectives are appropriate, clarification of the roles and responsibilities of the Minister, the Treasury, the statutory manager, and the Reserve Bank. Resolution powers, procedures and reporting, and depositor protection will also be considered. The crisis management framework will also need to consider limitations of the Public Finance Act 1989 with regard to the authority to use public funds in a timely manner in a financial crisis.

7. Macro-prudential policy

The scope and objectives for macro-prudential policy will be reviewed to define the policy, its use, and its relationship to prudential and/or monetary policy. The Review will also consider decision making, the macro-prudential toolkit, and processes to provide transparency, accountability, and review.

8. Resourcing and funding

The Review will consider the funding model for the Reserve Bank, including whether some activities should be funded through industry levies, while ensuring an appropriate balance between transparency, accountability and independence.

The Review may also have implications for the level of funding the Reserve Bank receives. This may be dealt with in parallel to the Review.

9. Miscellaneous issues

Obsolete or unclear sections of the Act that should be clarified or repealed will be considered within the Review.

Matters out of scope of the Review

The following matters are out of scope of the Review:

- Fundamental change to the New Zealand-Australian home-host relationship, whereby the Australian Prudential Regulation Authority becomes the sole regulator and supervisor of Australian banks operating in New Zealand
- The Insurance (Prudential Supervision) Act 2010, the Non-Bank Deposit Takers Act 2013, and the proposed Financial Markets Infrastructures Bill, except where consequential changes are necessary or could encourage alignment
- Covered bonds or netting, except to the extent that any issues requiring change are identified during the review process (for example, if work on crisis management or

depositor protection created the need to also look at how encumbrance limits are set)

- Clearing, payment, and settlement systems, and the regulation of Financial Market Infrastructures
- AML/CFT functions – statutory review of operation of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 will commence following referral by the Minister of Justice no later than 1 July 2021 (AML/CFT Act s. 156A). New Zealand’s AML/CFT regime is scheduled to be assessed for compliance by the Financial Action Task Force in 2020
- Other financial system functions within the Reserve Bank such as market operations, other than those that are relevant to the areas for phase 2.

Process and public consultation

A significant review of this nature will attract public interest and will impact a range of stakeholders. The Review will be run in an open and transparent manner with public consultation on policy and an exposure draft prior to the introduction of legislation.

As its first task, the Review team will develop a work programme for phase 2 of the Review and identify key deliverables. This will include advice on the prioritisation and sequencing of workstreams and timelines for the development and introduction of legislation. It is envisaged that most of the major legislative amendments could be advanced within the current Parliamentary term.