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Reserve Bank of New Zealand Bill (2020)

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The Reserve Bank of New Zealand Bill strengthens the institutional arrangements of the Reserve Bank. It creates a new and empowered governing board for the Reserve Bank, while adding an overarching financial stability objective and providing a transparent avenue for the Government to influence its approach to financial stability while maintaining its independence. The Bill also modernises and strengthens the Reserve Bank's accountability and reporting frameworks, including bringing it within the scope of the Office of the Auditor General, and the Ombudsman.

The Bill also:

- carries over recent changes to the monetary policy framework,
- increases cooperation and coordination across the financial regulatory system,
- increases the accountability and transparency in the Reserve Bank's financial risk management and use of foreign reserves, and
- enables the Reserve Bank to regulate to ensure public confidence in the cash system.

Background

The role of the Reserve Bank

The Reserve Bank has an important role in New Zealand's economy through its monetary policy decision making and in maintaining the stability of New Zealand's financial system. The Reserve Bank's monetary policies are aimed at managing inflation and keeping as many people employed as possible, while its financial stability functions include the regulation and supervision of our banks and insurers to keep them running prudently, and a stable financial system.

An effective central bank is essential for New Zealand's long-term well-being, and it needs to operate with efficacy and legitimacy, and be independent of undue influence. Establishing an independent central bank was a significant step in 1986, which was further embedded by the current Reserve Bank Act in 1989. The Act was revolutionary at the time – it established a central bank able to pursue its objectives, and it tackled the brave new world of regulating commercial banks. Since then New Zealanders have benefitted from confidence that inflation could be controlled, and that banks are subject to at least a minimal level of supervision.

Since 1989 the Reserve Bank's functions have expanded – as well as being our monetary policy maker, its role as a prudential regulator has become increasingly important, particularly after the GFC. The Reserve Bank regulates banks, as well as insurance companies, credit unions, other non-bank deposit takers.

The 1989 Act was written when the Crown Entities Act was drafted, and before the New Zealand Bill of Rights Act came into force. The governance and operational framework of the Reserve Bank, as well as its suite of regulatory tools, is looking increasingly obsolete. It was built for a different time, and now needs to be updated.

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The Bill follows changes made to the monetary policy arrangements in 2018

In November 2017 the Government initiated a review of the Reserve Bank Act. The purpose of the review is to create a modern monetary and financial policy framework, whilst maintaining the operational independence of the Reserve Bank.

This Bill follows the changes made in 2018 after the first phase of the Review of the Reserve Bank Act. Phase 1 focused on modernising New Zealand's monetary policy framework, by

- amending the objectives of monetary policy to require consideration of maximum sustainable employment alongside price stability in monetary policy decision-making; and
- instituting a monetary policy committee (MPC) to take decisions on monetary policy.

These changes were made by the Labour-led Government in 2018. The Government wanted monetary policy to contribute to the shared prosperity of all New Zealanders, and put the well-being of New Zealanders' at the heart of this reform. The 2018 amendment created a new purpose: "to promote the prosperity and well-being of New Zealanders, and contribute to a sustainable and productive economy".

The Bill incorporates these 2018 amendments. These changes represented a significant step in the evolution of our monetary policy framework. They retained the operational independence of the Reserve Bank and role in maintaining price stability, while strengthening the Reserve Bank's decision-making.

The role of the Reserve Bank in making monetary policy decisions has received a great deal of attention lately, as new and alternative monetary policy tools are being deployed to mitigate the unprecedented economic effects of Covid-19. It is perhaps now more important than ever that the Reserve Bank can independently target the goals set by the Government and Parliament, free from political interference, but that there are appropriate avenues to ensure the interests of the democratically elected Government are reflected.

The focus of Phase 2 of the Review of the Reserve Bank Act

Phase 2 of the review of the Reserve Bank Act is focused on modernising the institutional settings of the Reserve Bank, introducing deposit insurance, and ensuring New Zealand's framework for the prudential regulation of banks for financial stability is fit for purpose. The review is being jointly run by the Treasury and the Reserve Bank, and I would like to thank the officials involved.

Since the lessons learned, at great cost for some, from the global financial crisis in 2007 and 2008, the best practice for the prudential regulation of banks has evolved. Banking regulators internationally have changed their approach – to recognise the public good of financial stability, and better supervise a complex and important sector.

Ultimately, the second phase, once completed, will accomplish a number of significant things – it will introduce a deposit insurance scheme for New Zealanders to have confidence in their bank accounts, it will unify and modernise the regulatory framework for banks and other deposit takers to cement financial stability, and it will strengthen the ability of the Reserve Bank to respond to crisis scenarios – empowering the Reserve Bank to manage the resolution of banks while protecting individual depositors. These will be implemented though the next piece of legislation, which I expect to introduce to the House late next year. The provisions of the 1989 Act dealing with the regulation of banks will remain in force until this new legislation comes into force.

Key changes in the Bill

The purpose of the Bill

The Bill modernises the governance and accountability arrangements of the Reserve Bank, as well as incorporating the monetary policy arrangements from Phase 1. The purposes of the Bill are to provide for the continuation of the Reserve Bank, and to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy.
The Bill introduces a new objective for the Reserve Bank of protecting and promoting the stability of New Zealand's financial system, which is relevant in its role as prudential regulator and supervisor of financial institutions. The primary objectives of monetary policy remain to achieve and maintain stability in prices and support maximum sustainable employment.

This Bill strengthens the institutional arrangements of the Reserve Bank

The powers and responsibilities of the Reserve Bank (other than those of the Monetary Policy Committee) will sit with the board rather than the Governor. Group decision-making will bring a breadth of skills and perspectives to support the decisions the Reserve Bank makes. The board will have functions, powers, and responsibilities similar to those of Crown entity boards. The Minister will continue to appoint the Governor.

The Bill establishes a more robust process for the Minister of Finance and the Reserve Bank to agree the Reserve Bank's funding. A portion of the Reserve Bank's costs for regulatory functions could then be recouped through levies, which fairly place the cost of regulation on the parties that benefit from it. The funding agreement will cover both the Reserve Bank's operating expenses and capital expenditure. The Finance and Expenditure select committee will continue to scrutinise the spending of the Reserve Bank.

The Bill increases oversight and accountability by allowing the Auditor-General and the Ombudsman to review the activities of the Reserve Bank. The Reserve Bank's reporting requirements will also be aligned more closely with the standards that apply to Crown entities. Whole-of-Government directions to Crown entities can now be directed to the Reserve Bank as well, with appropriate safeguards to maintain independence.

The Bill provides that the Treasury will formally monitor the Reserve Bank. The monitor will be able to seek information from, and review the operations of, the Reserve Bank. The Minister of Finance will provide the monitor with a notice setting out their expectations. This will ensure Ministerial oversight of the operations and performance of the Reserve Bank as an institution.

The Bill requires the Minister of Finance to issue a financial policy remit

The Bill requires the Minister of Finance to issue a financial policy remit to the Reserve Bank regarding prudential policy. The board must have regard to the remit when setting its strategic objectives in relation to financial stability, when making significant policy decisions about how to achieve these objectives, and when issuing and reviewing prudential standards.

The remit does not apply to operational decisions made by the Reserve Bank or to decisions in respect of particular entities, balancing democratic oversight with operational independence. The remit replaces the power of the Minister of Finance to direct the Reserve Bank to have regard to Government policies, thus enhancing independence while allowing the democratically elected Government of the day to signal its priorities.

The Bill will increase cooperation and coordination across the financial regulatory system

The Bill gives statutory recognition to the Council of Financial Regulators. The function of the council is to facilitate co-operation and co-ordination between members of the council to support effective and responsive regulation of the financial system in New Zealand. The Bill provides a function for the Reserve Bank to co-operate with other law enforcement or regulatory agencies that have a role in the regulation of the New Zealand financial system. The Bill provides the Reserve Bank with a power to share information with these agencies, and ensures that such information is appropriately managed during court proceedings.

This will ensure that the two regulators – the Financial Markets Authority and the Reserve Bank – responsible for the regulation of financial system conduct, and financial stability –work closely together to ensure New Zealand's financial system serves the needs and interests of New Zealanders. We learned the importance of a coordinated approach to regulating banks from the Australian Royal Commission.

The Bill provides better accountability and transparency of Reserve Bank's financial risk management and use of foreign reserves

The Bill requires the Minister of Finance and the Reserve Bank to agree to the Reserve Bank's management and use of foreign reserves. This will provide greater clarity and transparency as to the Reserve Bank's objectives and management of foreign exchange reserves and allow for co-ordinated actions between the government and the Bank when necessary, such as in the case of market disorder. The Minister will retain the ability to direct the Reserve Bank to deal in foreign exchange within guidelines.

The Bill will enable the Reserve Bank to regulate to ensure public confidence in the cash system

The Bill also allows the Reserve Bank to set standards for devices that check the authenticity or quality of a bank note in preparation for its distribution to the public. These standards will apply to automated note dispensers such as ATMs and automated self-check-outs, as well as note counters and sorters used by cash handlers, banks, and large retailers to test the fitness of bank notes before they are distributed by machine or over-the-counter.

Providing for these standards will support public confidence in bank notes and coins by preventing worn, damaged, or counterfeit notes from staying in circulation, and lower the costs of bank note quality management and counterfeit detection.

This is an important Bill. It strengthens the institutional and governance arrangements of the Reserve Bank. It provides much greater public accountability, while ensuring it can act independently in delivering on the objectives to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy. And this Bill will enable the Reserve Bank to maintain independence while taking into account the views of the democratically elected government of the day.

This Bill also lays the groundwork for the next stage of legislation which will enhance our regulatory framework for banks and other deposit takers, ensure we have robust laws to promote financial stability to forestall harm to the public, promote the soundness of individual institutions, and build confidence in our financial system.