Reserve Bank of New Zealand Bill: Legislative Statement

Third Reading

Prepared in accordance with Standing Order 272.

Introduction

The Reserve Bank of New Zealand Act 1989 (the Reserve Bank Act) has not been comprehensively reviewed in over 30 years. Over that time the role of the Reserve Bank has changed substantially, and we have new expectations for prudential regulation and monetary policy making. The financial system and economic context have changed significantly, and local and international best practice has evolved. The review of the Reserve Bank Act is an opportunity to update and modernise the Reserve Bank's institutional arrangements.

The Bill's purpose is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy. The Bill:

- strengthens the Reserve Bank's institutional arrangements,
- enhances the Bank's role as a prudential regulator,
- and increases co-ordination in the regulation of the financial sector.

Background

The Bill is part of the review of the Reserve Bank Act. It follows the Reserve Bank of New Zealand (Monetary Policy) Amendment Act 2018, which introduced maximum sustainable employment as an objective of monetary policy (alongside price stability) and created the Monetary Policy Committee (the MPC).

The focus of the Bill is to modernise the overall governance and accountability arrangements of the Reserve Bank, while retaining the changes made through the 2018 Amendment Act.

The Bill repeals and replaces the parts of the Reserve Bank Act that provide for the Reserve Bank's institutional form, governance and accountability arrangements, and central bank powers.

The remainder of the Reserve Bank Act, which creates a framework for the registration and supervision of banks, remains in force but would be renamed the Banking (Prudential Supervision) Act 1989. This Bill will be followed by a 'Deposit Takers Bill' which will replace the Banking (Prudential Supervision) Act and is expected to be introduced in the next year.

This version of the Bill incorporates recommendations from the Finance and Expenditure Committee (the Committee). The Committee's amendments address issues raised by submitters and further Government policy developments.

The Bill strengthens the Reserve Bank's institutional arrangements

To strengthen the institutional arrangements of the Reserve Bank, the Bill:

- creates a new governance board for the Reserve Bank, to be appointed by the Governor-General on the recommendation of the Minister of Finance. The powers and responsibilities of the Reserve Bank (other than those of the MPC) will sit with the board rather than the Governor. Collective 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.
- 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 will be able to be recouped through levies. The funding agreement will cover both the Reserve Bank's operating expenses and capital expenditure.
- increases oversight and accountability by bringing the Reserve Bank within the scope of the Ombudsmen Act 1975 and the Public Audit Act 2001, 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.
- provides for a department to have a formal role as the monitor of the Reserve Bank. The Bill allows the Minister of Finance to delegate powers to the monitor – such as the power to seek information from, and review the operations of, the Reserve Bank. The Minister of Finance will provide the monitor with a notice of expectations setting out how this role should be performed.

The Bill enhances the Reserve Bank's role as a prudential regulator

As New Zealand's prudential regulator, the Reserve Bank has significant powers and independence. It is critical that the Reserve Bank's empowering framework sets out clear objectives for the exercise of these powers, which will contribute to the government's economic objectives while protecting the independence of the Reserve Bank. As such, the Bill:

- reframes the financial policy objective: the Reserve Bank's mandate will be to protect and promote the stability of New Zealand's financial system. This removes the concept of efficiency, which will instead be reflected in the decision-making principles of sectoral legislation such as the Deposit Takers Bill and the Insurance (Prudential Supervision) Act. The Bill retains the current economic objectives of supporting price stability and maximum sustainable employment, which were updated in 2018.

- sets out the functions of the Reserve Bank, most importantly to act as central bank and prudential regulator and supervisor. The Reserve Bank must perform these functions consistently with the above objectives.
- requires the Minister of Finance to issue a Financial Policy Remit to the Reserve Bank. 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 authorise the Minister of Finance to require the performance of a particular act or a certain result in respect of a particular person, balancing democratic input with operational independence. The Remit replaces the power of the Minister of Finance in the current legislation to direct the Reserve Bank to have regard to a government policy relating to the Reserve Bank's functions.

The Bill increases co-ordination in the regulation of the financial sector

Because New Zealand's financial system is regulated by different agencies with different objectives, the Bill puts in place provisions to increase co-ordination in the regulation of the financial sector, by:

- giving statutory recognition to the Council of Financial Regulators. The function of the council which is made up of the Reserve Bank, the Financial Markets Authority, the Commerce Commission, the Ministry of Business, Innovation and Employment and the Treasury, 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.
- providing 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, and with equivalent overseas agencies where it may assist them with its functions. The Bill provides the Reserve Bank with a power to share information with these agencies, subject to any conditions imposed by the Reserve Bank. This provision does not preclude the Reserve Bank from being able to share information through other mechanisms.

Other matters covered by the Bill

Foreign exchange reserves are managed by the Reserve Bank and can be used for Reserve Bank or government objectives. The Bill introduces a foreign reserves management and coordination framework, to be agreed between the Reserve Bank and the Minister of Finance. This will provide greater clarity and transparency as to the Reserve Bank's objectives for and management of foreign exchange reserves, and allow for co-ordinated actions between New Zealand Debt Management and the Reserve Bank when necessary, such as in the case of market disorder. The Minister of Finance will retain the ability to direct the Reserve Bank to deal in foreign exchange within guidelines.

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 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.

Key changes to the Bill recommended by the Finance and Expenditure Committee

As outlined above, the Bill provides for a collective decision-making model for financial policy and Reserve Bank governance by replacing the Governor with a board. The Governor remains a statutory appointment with a function as chair of the MPC and chief executive of the Reserve Bank. To address some potential issues, such as ensuring coordination between monetary and financial policy, the Committee recommends that the Governor be an ex officio member of the board. This will provide greater clarity as to the Governor's role, while retaining the benefits of the collective decision-maker model.

The Committee recommends a number of changes to reflect the Governor's role on the board. For example, the Governor will now be appointed by the Governor-General on the recommendation of the Minister of Finance, after being nominated by the board. The Minister of Finance will be required to consult with representatives of other political parties before making a recommendation. This aligns the appointment process of the Governor with the appointment process for board members.

The Committee also recommends changes to the board's duties to clarify that the board is not required to implement monetary policy if that would conflict with the board's duty of financial responsibility.

In addition, the Minister of Finance will have a power to direct the Reserve Bank to maintain a minimum level of capital and to convey the Minister of Finance's expectations as to the Reserve Bank's financial risk management, and define capital and specify other matters relating to the calculation of the minimum capital required. This is to allow the Crown to appropriately manage its fiscal exposure, while preserving Reserve Bank's operational independence within that envelope.

The process for changing the MPC Remit should also be changed to remove the requirement that a Remit can only be replaced prior to the expiration of the current remit via an Order in Council. The Reserve Bank will be required to provide Remit advice at least every five years.

The Committee recommends that the power of the Minister of Finance to direct the Reserve Bank to perform additional functions can only be issued at the request of the Reserve Bank, in order to protect operational independence.

The Bill as introduced does not make any specific provision for currency being affected by technological innovation such as the emergence of cryptocurrencies. The Committee recommends that the Bill should include a provision stating that monitoring the impact of technological innovation on the needs of the public for bank notes and coins is a part of the Reserve Bank's currency function. This would clarify that technological innovation is captured by the Reserve Bank's function to monitor the financial system.

The Government supports all of the changes to the Bill recommended by the Committee, and considers that they are consistent with the objectives of the review of the Reserve Bank Act.