

Submission

to the

Treasury and Reserve Bank of New Zealand

on the

Consultation document: Safeguarding the future of our financial system – The role of the Reserve Bank and how it should be governed

4 February 2019

About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.
2. The following seventeen registered banks in New Zealand are members of NZBA:
 - ANZ Bank New Zealand Limited
 - ASB Bank Limited
 - Bank of China (NZ) Limited
 - Bank of New Zealand
 - MUFG Bank, Ltd
 - China Construction Bank
 - Citibank, N.A.
 - The Co-operative Bank Limited
 - Heartland Bank Limited
 - The Hongkong and Shanghai Banking Corporation Limited
 - Industrial and Commercial Bank of China (New Zealand) Limited
 - JPMorgan Chase Bank, N.A.
 - Kiwibank Limited
 - Rabobank New Zealand Limited
 - SBS Bank
 - TSB Bank Limited
 - Westpac New Zealand Limited

Background

3. NZBA welcomes the opportunity to provide feedback to Treasury on its consultation as part of Phase 2 of the Reserve Bank Act review: *Safeguarding the future of our financial system – the role of the Reserve Bank and how it should be governed (Consultation)*. NZBA commends the work that has gone into developing the Consultation.
4. If you would like to discuss any aspect of the submission further, please contact:

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Introduction

5. NZBA and its members wish to reiterate their strong support for a broad and comprehensive review of the Reserve Bank of New Zealand Act 1989 (**Act**). NZBA supports a focus on financial stability and current governance and accountability settings to ensure these arrangements remain appropriate and relevant for New Zealand today.

Part A: What role should RBNZ play in safeguarding New Zealand's financial system?

What high-level financial policy objectives should RBNZ have?

Should “soundness” remain a high-level policy objective or is “financial stability” more appropriate?

6. Following Phase 1 of the Review, the Act was amended to include an overarching purpose statement; that is, “to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy”. Having regard to that purpose statement, we consider that the two limbs of RBNZ's existing high-level financial policy objective continue to be broadly appropriate, that being, promoting the maintenance of a ‘sound’ and ‘efficient’ financial system. However, we agree that both of those terms would benefit from some refinement and/or clarification to ensure they clearly reflect how this objective should be interpreted and work in practice.
7. RBNZ currently has financial stability as a key focus. For example, it publishes regular ‘Financial Stability Reports’, rather than reporting on financial soundness. RBNZ appears to focus on financial stability in practice and its objective should reflect this.
8. We therefore consider that the objective should reference ‘financial stability’ (which can be better interpreted to encompass both stability and resilience) as opposed to the more limiting word ‘sound’.
9. Additionally, we consider that ‘financial stability’ is more appropriate than soundness as it:
 - (a) is consistent with objectives of other central banks;
 - (b) is more easily understood and can be performance measured; and
 - (c) more closely aligns with the priorities of a prudential regulator.

Should “efficiency” remain a high-level objective?

10. NZBA considers that efficiency should remain an objective of the Act in order to ensure that RBNZ's regulatory interventions are targeted and create a net benefit for society (and therefore are consistent with the recently introduced overarching purpose of the Act, referred to at paragraph 6 above).
11. It is important to ensure that financial stability is not pursued as an absolute objective. The efficiency objective is an important moderator of the financial stability objective. Efficiency costs of RBNZ's actions in pursuance of financial stability must

be carefully considered; there are increasing degrees of financial stability which can be attained, however that has an opportunity cost.

12. Please refer to banks' individual submissions for further detail on this aspect of the Consultation – in particular, the hierarchical level that the 'efficiency' objective should sit at, and whether it is given a narrow or broad interpretation.

Should RBNZ be given additional high-level policy objectives?

13. NZBA does not support the explicit inclusion of any other additional high-level financial policy objectives such as consumer protection, public confidence or competition in RBNZ's mandate.
14. We consider that the inclusion of any additional high-level policy objectives in the Act could compromise RBNZ's focus on achieving its fundamental financial policy objectives. These objectives are critical elements of the financial system and directly support the purpose of the Act (as noted in paragraph 6).
15. Additionally, we note that consumer protection, public confidence and competition are the direct responsibility of other agencies and regulatory mechanisms. Giving RBNZ additional policy objectives which are similar to those of other agencies may complicate the regulatory landscape and result in overlap with the objectives of other regulators. We consider that those agencies responsible for New Zealand's financial markets regulatory system will be most likely to achieve their core objectives if they are focused responsibilities. The achievement of those objectives by individual agencies will, in turn, reinforce the objectives as a composite group. For example, financial stability supports public confidence in the financial system and consumer protection.

Who does RBNZ regulate and how should the regulatory perimeter be set?

16. NZBA agrees that New Zealand should move to an authorised deposit-taking institution (**ADI**) framework.
17. We consider that an ADI framework has a number of benefits:
 - (a) It ensures a level playing field for all entities and activities that could influence financial stability.
 - (b) It allows innovation by new sectors.
 - (c) It would simplify the regime.
18. NZBA also agrees that RBNZ should have designation powers to capture all entities and activities that could threaten financial stability (similar to the FMA's designation powers). Compliance requirements should be aligned with the risk associated with, and scale of, the entity or activity.
19. We consider that that would enable RBNZ to efficiently protect against potentially systemically important sectors (for example, the non-bank deposit taking lending sector) rapidly growing/evolving and exposing the financial system to risk, as well as offering flexibility and future proofing the regime.

20. Additionally, consideration must be given to how non-ADIs will be supervised. Without appropriate supervision, there is a real risk of regulatory arbitrage, financial system instability and negative impacts for consumers.

Should there be depositor protection in New Zealand?

21. NZBA's members have different views on whether depositor protection should be introduced in New Zealand.
22. However, we note that the current prudential regulatory requirements and supervision framework of New Zealand banks/deposit takers – including the Open Bank Resolution regime, and in conjunction with bank risk appetite and governance settings – make the likelihood of bank failure and the consequent threat to depositors remote.
23. Additionally, the introduction of depositor protection, over and above the protections already in place, is likely to impact market behaviour. These impacts should be closely considered when determining whether depositor protection is necessary, and, if so, the design of that protection.
24. If introduced, depositor protection should be considered in the broader context of current prudential regulatory requirements, and other bank failure resolution and bank resilience policies in order to ensure that they remain relevant and effective if depositor protection is introduced. A holistic review of bank resilience and crisis management policies should be undertaken alongside any consideration of depositor protection.
25. Careful consideration should also be given to the design to reduce the cost of the deposit insurance scheme (by increasing the likelihood that the scheme will recover amounts paid out) without inhibiting the ability of financial institutions to raise wholesale funding.
26. Finally, we note that RBNZ is currently undertaking a review of New Zealand banks' capital requirements. *Capital review Paper 4: How much capital is enough?* proposes that banks' minimum regulatory capital levels should be increased by between 20 and 60 per cent so that banks may withstand a one-in-200-year event. That equates to roughly 70 per cent of the banking sector's expected profits over the next five years. The interaction between RBNZ's proposals and the introduction of depositor protection should, in our view, be closely considered through an allocative efficiency lens.
27. If depositor protection is ultimately introduced, NZBA would appreciate the opportunity to engage closely on the design of the regime to ensure that it does not have negative or unintended consequences for the market.

Should prudential regulation and supervision be separated from RBNZ?

28. NZBA's members have different views on whether prudential regulation and supervision should be separated from RBNZ. Please refer to members' individual submissions on this issue.

Part B: How should RBNZ be governed?

What should be the scope of the RBNZ operational independence?

29. NZBA agrees that Treasury (or another suitable, independent administrator) should become the administrator of the Act. We agree with the benefits outlined in the Consultation. In particular, we consider that appointing Treasury (or another suitable, independent administrator) as administrator of the Act would help to avoid conflicts of interest and would be likely to protect RBNZ's independence.

How should RBNZ be structured?

30. In respect of RBNZ's organisational structure, NZBA prefers a Crown entity-style board model.
31. The board would take responsibility for all RBNZ's functions (except monetary policy) and would be responsible for oversight of RBNZ's performance. Corporate functions would be delegated to the Governor as CEO and financial policy and prudential functions (if they remain with RBNZ) to the Governor, senior staff and/or internal committees. This would allow better internal checks and balances on regulatory decision-making than the current single member decision-maker model of RBNZ.
32. If a board model is not adopted, NZBA considers that, at a minimum, an independent supervisory council should be created to hold the Governor to account.
33. NZBA considers that an effectively functioning board would not have a detrimental effect on the Governor's ability to act decisively, particularly in times of crisis.

How should RBNZ be monitored and held to account?

34. NZBA agrees that the optimal model for external monitoring of RBNZ will be dependent on its ultimate governance and accountability arrangements. If the current setting of a single decision-maker model governance structure is retained, a well-resourced and independent supervisory council to oversee RBNZ's performance would be critical, as the current structure of the monitoring agent (eg the existing RBNZ Board) is not resourced appropriately and does not provide sufficient independence. If a board structure is adopted which offers more robust internal accountability mechanisms than the current arrangements, then choosing Treasury (or another suitable, independent monitor) as a monitoring agent is likely to be sufficient.