Impact Summary: Further Changes to the Institutional Framework for the Reserve Bank

Section 1: General information

Purpose
This analysis and advice has been produced to inform policy decisions to be taken by Cabinet on potential amendments to the governance arrangements in the Reserve Bank of New Zealand Bill (RBNZ Bill), which is currently before the Finance and Expenditure Committee. The Treasury is solely responsible for the analysis and advice set out in this Regulatory Impact Statement (RIS), except where explicitly mentioned. The Treasury's analysis is based on Phase 2 of the Review of the Reserve Bank Act (the Review), which is being jointly led by the Treasury and the Reserve Bank.

Key Limitations or Constraints on Analysis
Evidence of the problem Evidence of the problem in relation to the Reserve Bank's institutional arrangements is based primarily on qualitative assessments of the risks associated with the decision-making structure and potential performance issues associated with the governance framework set out in the RBNZ Bill. These assessments have been informed by reference to international best practice at central banks and lessons learned from the operation of alternative monetary policy (AMP) under the current legislative framework. ***Scope of options*** We have considered options that are broadly consistent with the overall governance framework outlined in the RBNZ Bill, which was the subject of an earlier RIS. ***Assumptions and quality of data underpinning impact analysis*** We have generally not sought to quantify costs and benefits due to the difficulty of doing so in relation to changes to governance and other institutional arrangements. Assessments reflect a judgement about the relative impact of options against established criteria.
Responsible Manager (signature and date):
Tamiko Bayliss Director, Reserve Bank Act Review – Phase 2

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
The Treasury
Quality Assurance Assessment:
A quality assurance panel with representatives from the Regulatory Impact Analysis Team at the Treasury and the Ministry of Business, Innovation and Employment has reviewed the Regulatory Impact Statement "Further Changes to the Institutional Framework for the Reserve Bank" produced by the Treasury. The panel considers that it **meets** the Quality Assurance criteria.
Reviewer Comments and Recommendations:
The higher criteria weighting placed on effective governance, effective policy coordination and in particular the ability to practicably deliver on the changes within the current legislative process (and therefore less weighting on clarity and other criteria) explain the preference for the Governor as a board member option relative to the statutory Financial Policy Committee option. There is some uncertainty in how the proposed arrangements would work in practice. There is also flexibility afforded to the board in delegating financial policy decisions to sub-committees (while remaining accountable). This emphasises the importance of monitoring the proposed arrangements to ensure that risks and unexpected issues are identified and addressed.

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

The RBNZ Bill introduces a new governance model for the Reserve Bank, shifting from what is predominantly a single decision-maker model to a collective decision-making model. The governance board will be responsible for all of the Reserve Bank's functions other than formulating monetary policy. The scope of the new board's responsibilities will therefore include financial policy matters.

As part of the consultation process for the Review a number of governance options were considered including the composition of the board and whether to establish a statutory Financial Policy Committee (FPC). After considering the strengths and weaknesses of the alternatives and public submissions, Treasury recommended having a fully non-executive board responsible for financial policy and for governance of the Reserve Bank, including monitoring the Reserve Bank's management and the Monetary Policy Committee (MPC). A RIS for the Bill as a whole can be found at: https://treasury.govt.nz/publications/information-release/reserve-bank-act-review-phase-2-july-2020-proactive-release.

The rationale for a non-executive board centred on the accountability and oversight benefits of providing a clear split between governance and management responsibilities. Governance literature tends to suggest that fully non-executive boards are more effective in providing oversight of management. Executive members can struggle to detach themselves enough from their management responsibilities to take a fully independent perspective and hold management (including themselves) to account.

Another drawback of having one or more executives on a state sector agency board would ordinarily be that these executives would then be appointed by the Minister, which could result in ambiguity around who they owe their duties to. However, (as outlined below) this trade-off already exists under the governance model in the Bill, under which the Governor would be appointed by the Minister (on the advice of the board), partly reflecting the Governor's role as chair of the Monetary Policy Committee (MPC).

In the time since the introduction of the RBNZ Bill in July 2020, potential issues with the governance model in the Bill have been identified. These issues have been highlighted by the recent work on the financial consequences of alternative monetary policy (AMP), alongside further testing of the governance model as part of preparation for the select committee process. AMP tools can generate different fiscal impacts to conventional monetary policy. For example, asset purchase and lending programmes can alter the composition of the Crown balance sheet, exposing the Crown to different interest rate and credit risks.

Monetary policy decision making and implementation

The current Bill presents a risk of conflict and disagreement between the MPC and the board over the implementation of monetary policy decisions. In particular, the use of the Reserve Bank's balance sheet for monetary policy purposes (particularly in relation to AMP) creates a potential tension between the MPC's responsibility for formulating monetary policy and the board's responsibilities for balance sheet, financial policy and operational matters. It is currently unclear in the Bill how disagreements of this kind would be resolved and how the board should balance its obligation to implement monetary policy (as formulated by the MPC) against its broader financial responsibility duties.

The fiscal risks of AMP are currently managed by the Reserve Bank requesting an indemnity from the Minister of Finance. Granting these requests removes the risk of conflict between the MPC and the board's responsibilities (because the indemnity means that the financial risks of AMP are borne by the Crown rather than the Reserve Bank), but it would remain if the request was declined or the MPC decided to use a tool without an indemnity. Further, asking for an indemnity contains other risks for the Bank, particularly in terms of operational independence and creating obligations to the Crown.

Policy coordination

The current Bill does not provide for an explicit mechanism for the coordination of monetary and financial policy making, on the presumption that this coordination would occur at an executive level and be reflected in the advice being provided to the MPC and the board.

Recent engagement with the International Monetary Fund (IMF) has highlighted concerns that this model may not be sufficiently robust as there is no formal role for the Governor or other executives in board decision making and no cross-membership between the MPC and the board. The IMF has recommended we reconsider executive membership on the board, emphasising that a fully non-executive board with policy making responsibilities is atypical from an international central bank perspective. IMF guidance states that a "robust substantive and procedural role for the central bank's executive management in public policy formulation is critical".[1]

[1] While the recent IMF working paper 'The Role of Board Oversight in Central Bank Governance: Key Legal Design Issue' strongly advocates a majority of non-executive members on central bank boards, it only contemplates fully non-executive boards where the board's function is limited to a supervisory (i.e. not

Status of the Governor

The Governor is appointed by the Minister but has no independent statutory authority or powers, other than as chair of the MPC. In this role the Governor has one of seven votes, the casting vote when votes are tied and certain functions under the charter. In all other respects the Governor is under the direction of the board, who decides the extent it wishes to delegate further powers to the Governor. The board is responsible for the performance of the Reserve Bank and while it is responsible for recommending the appointment and removal of the Governor, these decisions ultimately lie with the Minister (the Governor's remuneration is set by the Remuneration Authority).

This model creates risks in terms of blurred accountabilities for the Governor and the potential for tensions between the Governor and the board, and in particular with the chair. These issues could be associated with challenges in coordinating monetary policy, financial policy and the balance sheet (as outlined above), but could also extend to whether the chair or the Governor would be seen as the head of the Reserve Bank, responsible for communicating and 'fronting' financial policy decisions of the board. In addition, the Governor and board lack employment duties to each other (such as good faith and trust and confidence) and nor does the Governor have any relevant statutory duties (except as MPC chair).

2.2 Who is affected and how?

The above problems present risks to the overall effectiveness of the Reserve Bank's operations under the new governance regime, including risks to the operation of financial and monetary policy, with flow on impacts to the New Zealand economy more generally. Any blurring of responsibilities between the Governor, MPC and board may also undermine the ability of the monitor, Minister and Parliament to effectively hold the Reserve Bank to account.

2.3 What are the objectives sought in relation to the identified problem?

The aim of the changes is to minimise conflicts between board and the MPC over the implementation of monetary policy, to improve coordination across the Reserve Bank's formulation of monetary and financial policy, and to clarify the status of the Governor in relation to the board, both in terms of employment status and in relation to the board, as the decision maker for financial policy.

decision-making) role. The IMF is also "cautiously supportive" of having a non-executive chair for boards that are not responsible for public policy formation. See IMF Working Paper WP/19/293, 'The Role of Board Oversight in Central Bank Governance: Key Legal Design Issues', December 2019, https://www.imf.org/-/media/Files/Publications/WP/2019/wpiea2019293-print-pdf.ashx.

Section 3: Options identification

3.1 What options have been considered?
Cabinet has previously agreed to move from the Reserve Bank's current single decision-maker model to a board structure, which will be responsible for governance of the Reserve Bank and for financial policy. The proposed board will be fully non-executive, while the Reserve Bank Governor will be chair of the MPC. As noted above this structure may create problems over the implementation of monetary policy and for the coordination of monetary policy and financial policy. Several alternative structures are considered. It should be noted that the options, other than options 2 and 3, are not mutually exclusive. So, for example, the Governor could be a member of the board (Option 2) and a statutory FPC could be also established (Option 4). **1: Status Quo** This is the option implemented in the RBNZ Bill. The non-executive board would be responsible and accountable for the Reserve Bank's governance and for all of its functions – other than those given to the MPC to formulate monetary policy, which would be chaired by the Governor. This would include responsibility for financial policy matters (i.e. micro-prudential and macro-prudential policy), meaning that the board would have significant policy-making responsibilities in relation to prudential standards, as well as responsibility for the supervision and enforcement of regulated entities. Financial policy decision making could be delegated by the board, for example, to a subcommittee. **2.: Governor as a board member** This option would have the Governor as an executive member of the board, although the chair would remain a non-executive member. As in the status quo, the board would retain responsibility for governance and financial policy. The Governor would not be involved in the board's monitoring of the MPC (given their role as chair of that committee). As with the fully executive board, financial policy decision making could be delegated. **3: Governor as chair** This option would have the Governor as chair of the board. Further changes to the board's oversight role and overall monitoring arrangements would likely be required to support this option, such as providing for a statutory non-executive sub-committee to oversee the performance of the Governor, the MPC and the Bank. **4: Statutory Financial Policy Committee** This option would transfer decision-making responsibility for financial policy matters to a legislatively established FPC. The make-up of the FPC would be similar to the current MPC model for monetary policy, with the Governor and other key executives as members, alongside independent external members with expertise in prudential policy matters. The board's role under this model would be to oversee the corporate and central banking functions of the Reserve Bank and to ensure that the organisation is well placed to deliver on the policy decisions made by the two policy committees.

5. Clarify the board's monetary policy obligations

This option would involve making it clear that the board will determine how much exposure it is prepared to take onto its balance sheet to support monetary policy. This change is likely to involve providing that the board's obligation to implement monetary policy is subordinate to its financial responsibility duties.

In practice, this would likely mean that the board would provide guidance to the MPC on how much balance sheet exposure it is prepared to take on in implementing monetary policy. The MPC would continue to make monetary policy independently from the board. If the MPC decides that a larger intervention is needed than what can be accommodated on the Reserve Bank's balance sheet, then the board may wish to seek either an indemnity or a capital injection from the Crown.

3.2 What decision-making criteria have been used?

We have used the following decision-making criteria to assess the options:

- *Clarity* – provides clarity on the objectives, status, roles and responsibilities of decision makers and how any overlaps or tensions will be managed or resolved.
- *Effective governance and oversight* – provides for cohesive and effective governance of the Reserve Bank and clear organisational strategy and direction, and promotes accountability through effective checks and balances.
- *Policy coordination* – provides for effective coordination within the Reserve Bank of monetary and financial policy and balance sheet management, and coordination outside of the Reserve Bank with fiscal and broader government policy.
- *Appropriate independence from political authorities* – avoids the politicisation of the Reserve Bank's functions.
- *Balanced composition* – ensures a breadth of expertise, experience, and perspective in decision making bodies.
- *Efficient decision-making* – balances timeliness with quality to enable the Reserve Bank to discharge its responsibilities and to meet its objectives.
- *Practicable* – able to be delivered via the current Bill process while maintaining quality and managing risks.

There are trade-offs between these assessment criteria and there will be a range of views on their relative weighting. The Treasury places somewhat greater weight on providing effective governance and oversight, effective policy coordination and the ability to practicably deliver on the changes within the current legislative process.

These criteria have been revised from those used in relation to Reserve Bank governance in in the earlier Regulatory Impact Statement to make them more directly relevant to the problem definition and policy objectives, for example highlighting the importance of providing for effective coordination and the need for any changes to be delivered via the current process for the Bill.

3.3 Impact analysis

The identified options have been separately assessed against the criteria, in comparison to the status quo.

Key:
++ much better than doing nothing/the status quo
+ better than doing nothing/the status quo
0 about the same as doing nothing/the status quo
- worse than doing nothing/the status quo
- - much worse than doing nothing/the status quo

	1: Status Quo	2: Governor as a board member	3: Governor as chair	4: Statutory Financial Policy Committee	5: Clarify the board's monetary policy obligations
Clarity	0	+ There would be greater clarity around the accountabilities of the Governor, who currently has no statutory duties other than chairing the MPC. It also resolves the Governor's status both in terms of duties and providing clarity that the Governor is expected to take a visible role in formulating and communicating policy, in line with international practice. However, there would be some tension with the board's role in monitoring and providing oversight of the Reserve Bank's management.	0 Having the Governor as Chair would create clarity in terms of having one identifiable spokesperson for monetary and financial policy, as is expected internationally for central banks that have these dual responsibilities. However, compared to Option 2, having the Governor as chair of the board would reduce clarity between the board's role in overseeing Reserve Bank management and the MPC and the Governor's role as Chief Executive and chair of the MPC.	+ A statutory FPC would have a clearly defined role and responsibility for formulating financial policy. This would allow the board to focus on corporate and central bank functions of the Reserve Bank. The Governor would have a clear role to lead the formulating and communications of both financial and monetary policy, as chair of both the FPC and MPC. However, there would be challenges in practice clearly delineating the role of the board and the FPC in relation to implementing financial policy.	+ + This option would clarify the extent of the board's obligation to implement monetary policy and the board's control of risk taking on its balance sheet.
Effective governance and oversight	0	- Having the Governor on the board would mean that there would no longer be a clear split between Reserve Bank governance and management. Governance literature tends to suggest that fully non-executive boards are more effective in providing oversight of management. The Governor would need to be excluded from the board's role in monitoring the MPC, given their role as chair of that committee.	- - Having the Governor as chair would risk further undermining the effectiveness of board oversight of Reserve Bank management and the MPC. Further changes would be required to address this conflict, such as specifying a subcommittee in legislation composed of non-executives to monitor management of the Reserve Bank, which would complicate the accountability framework.	+ A committee focussed on financial policy could ease the decision-making burden on the board, enabling them to give more attention to their other responsibilities and allow the right expertise to be brought to bear.	+ This option would strengthen accountability for balance sheet management (by making it clear that the board has overall responsibility for this). .
Policy coordination	0	+ Having the Governor on the board would provide for an overlap in the membership of the board and the MPC. This should improve coordination of financial policy formulation and balance sheet management with monetary policy formulation by the MPC.	+ + Having the Governor as chair of both the board and the MPC would further improve coordination between financial policy, monetary policy and balance sheet management.	+ + An FPC would improve policy coordination through partly overlapping membership (the Governor and other executive members of the Reserve Bank) with the other decision-making bodies (the board and the MPC).	+ Role clarity supports coordination of monetary policy and balance sheet management by reducing scope for MPC/board conflict.
Appropriate independence from political authorities	0	0 No impact.	0 No impact.	+ A specialist FPC, with an executive majority, may be more insulated from political pressure when making difficult or controversial policy decisions.	0 No impact.
Balanced composition	0	+ Having the Governor on the board would provide more balanced composition between the general governance expertise of the external non-executive members and the specialist institutional knowledge of an executive member such as the Governor.	+ Similar to Option 2.	+ + A statutory FPC can provide a greater level of expertise than the status quo and allow for more specialised and focussed expertise than a full board and can enhance the quality of an organisation's decision-making. This option also allows for the board to specialise and focus on governance issues.	0 No impact.

				A committee can provide more 'corporate memory' over time on policy areas within its mandate.	
Efficient decision-making	**0**	+ Having the Governor on the board should assist in coordination between the MPC and the board in decision making. The Governor could also add corporate memory to the board, which could ensure greater consistency in the board's decision-making over time.	+ Similar to Option 2.	- - The introduction of an FPC could make the Reserve Bank less efficient at making decisions due to the coordination, information, resourcing, and administration requirements, including between the board and the Committee. A statutory committee is inherently less flexible with its mandate prescribed in legislation. Consideration would also need to be given to the interaction between any statutory committees and cross-agency regulatory coordination and cooperation mechanisms such as Council of Financial Regulators.	+ Role clarity should support efficient decision making, reducing the scope for conflict or disagreement between decision makers.
Practicable	**0**	**0** Limited legislative complexity allowing it to be progressed within current select committee timeframes.	- Additional policy and legislative complexity, given the potential need to re-examine the adequacy of overall monitoring and oversight arrangements. Difficult to progress in current select committee timeframes.	- - Significant additional policy and legislative complexity, given the need to establish relative roles and responsibilities of the board, MPC and FPC. Very difficult to progress in current select committee timeframes.	**0** Limited legislative complexity allowing it to be progressed within current select committee timeframes.
Overall assessment	**0**	+ On balance, the Treasury considers that the benefits in terms of facilitating coordination and promoting role clarity would outweigh the costs of any additional complexity required to address conflicts of interest.	- The Treasury considers the tensions created by having the Governor as chair of the board and the complexities in clarifying accountability outweigh any potential benefits of more balanced composition and improved coordination and decision-making.	- While the Treasury sees merit in the establishment of an FPC in terms of role clarity and composition, on balance we think these are outweighed by the additional complexity involved and the risks of attempting to accommodate this within the governance model at this late stage in the legislative process.	+ Clarifying the relationship and relative obligations of the board and the MPC should reduce the risk of conflict between decision makers and promote accountability.

3.2 Which of these options is the proposed approach?
The Treasury considers Option 2 (having the Governor on the board) and Option 5 (clarify the board's monetary policy responsibilities) would together provide the best response to the identified problem. Option 2 would provide benefits in terms of facilitating coordination and promoting role clarity, as the Governor being a member of both the board and the MPC would promote communication and coordination between the two decision makers, while providing a clear role for executive expertise in financial policy decision making. These benefits would outweigh any reduction in the effectiveness of governance and oversight, noting that the Governor's role as a Ministerial appointee under the current Bill also raises some of the same concerns. It would also bring the status of the Governor more into line with typical international practice for central banks, reinforcing the Governor's role in leading policy development and acting as a spokesperson for the Reserve Bank. Option 5 (clarify the board's monetary policy responsibilities) would reduce the risks of conflict between the board and the MPC in terms of monetary policy formulation and implementation and improve coordination between monetary policy and balance sheet management. This option would be beneficial regardless of which of the other governance options is adopted. The Treasury does not support Option 3 (having the Governor as chair of the board) as the risk of less effective board oversight and the tensions and complexities created in terms of accountability would outweigh any possible benefits in improving policy coordination and decision-making processes. The Treasury sees merit in Option 4 (having a statutory FPC), but considers that the benefits in terms of role clarity and composition would be outweighed by both the complexity associated with establishing another decision making committee within the Reserve Bank and the risks of making such a substantive change to the governance model at this stage of the legislative process. The Reserve Bank supports the proposed approach. The Reserve Bank notes that some of the benefits of an FPC (with the Governor as FPC chair and the option of external members to provide expertise and challenge) can be delivered under the proposed model by a delegation by the board to the Reserve Bank's existing (non-statutory) Financial Stability Committee. External members can be appointed to the Reserve Bank's Financial Stability Committee as and when needed. We note that the key differences between a statutory FPC and a delegation to a committee is that under the latter model the board would determine the nature and scope of any such delegation and would remain accountable for financial policy decisions taken under the delegation (and could overrule the committee on any decisions taken under the delegation).

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties *(identify)*	**Comment**: nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks	**Impact** *\$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts*
Additional costs of proposed approach, compared to taking no action		
Regulated parties		
Regulators	Some potential costs in terms of reducing the effectiveness of the board's monitoring of Reserve Bank management.	Low
Wider government		
Other parties		
Total Monetised Cost		
Non-monetised costs	Some potential costs in terms of reducing the effectiveness of the board's monitoring of Reserve Bank management.	Low
Expected benefits of proposed approach, compared to taking no action		
Regulated parties	Benefits associated with improved policy coordination.	Medium
Regulators	Benefits associated with improved policy and balance sheet coordination and role clarity.	Medium
Wider government		
Other parties		
Total Monetised Benefit		
Non-monetised benefits	Benefits associated with improved policy and balance sheet coordination and role clarity.	Medium

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

There were two rounds of public consultation on the governance model for the Reserve Bank as part of the Review process. While submitters were broadly in favour of the board being at least majority non-executive, there were a range of views on whether the board should have any executive members, with a number of submitters noting that the Governor being on the board would have some benefits and be in line with international practice.

The majority of submitters were in favour of the board having responsibility for financial policy decisions, rather than establishing a separate FPC. These submissions tended to focus on the board as a conventional group decision-making structure with robust internal accountability. Some submissions noted the flexibility inherent in a board model including the use of delegations and internal committees. While most submissions favouring a board model did not argue against the FPC model, those that did tended to focus on the increased complexity, novelty and inflexibility associated with the FPC model. Those submitters favouring the FPC model tended to note the complexity associated with financial policy, suggesting that decisions on financial policy would benefit from focussed expertise.

Twenty one submissions were received by the Finance and Expenditure Committee on the Reserve Bank of New Zealand Bill. Of these, two argued strongly in favour of the establishment of an FPC to provide greater specialist expertise, stronger external challenge and symmetry with monetary policy decision making.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

The changes are proposed to be given effect by amendments to the Reserve Bank of New Zealand Bill, which is currently before the Finance and Expenditure Committee. Subject to the Parliamentary process, we would expect the Bill to be enacted at some point in 2021.

This process will be led by the Treasury, and the legislation, once enacted, will be administered by the Treasury. The Treasury will also take on the role of monitoring the performance of the Reserve Bank on behalf of the Minister of Finance.

Risks associated with the implementation of the proposed changes to the Bill are relatively minimal, although there will be implementation pressures on both the Reserve Bank and the Treasury. In particular, the Treasury will need to expand its capacity and capability in this area in order to effectively undertake its role as monitor. These risks and resource requirements have already been highlighted to both agencies, who are planning to increase resourcing in effected areas.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

The new regime will establish the Treasury's role as monitor for the Reserve Bank and administrator of the new Reserve Bank of New Zealand Act. In accordance with the Public Service Commission's *Operating Expectations Framework for Statutory Crown Entities*, a formal monitoring delegation will need to be put in place from the Minister of Finance, and the Treasury will need to establish robust ongoing monitoring arrangements, including establishing regular requirements for information from the Reserve Bank, and working with the Reserve Bank to identify and assess relevant performance metrics.

7.2 When and how will the new arrangements be reviewed?
As part of its role in administering the new Reserve Bank of New Zealand Act and in addition to its ongoing monitoring role, the Treasury will review the institutional framework five years after it has come into force. This review will provide an opportunity to evaluate the effectiveness of the new institutional arrangements and to ensure no unexpected issues have arisen.