THE TREASURY
Kaitohutohu Kaupapa Rawa

Reference: 20150372

22 October 2015

Michael Reddell
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Dear Michael Reddell

Thank you for your Official Information Act request, received on 27 August 2015. You requested the following:

> *"any papers done or held by Treasury on possible reforms to the statutory governance provisions for the Reserve Bank. This request covers papers generated since 1 July 2013. To be specific, I am requesting:*
> *• any papers (draft or otherwise) provided to Reserve Bank or the Minister of Finance on these issues;*
> *• any comments on Reserve Bank papers, provided to the Reserve Bank*
> *• any papers provided to the Governor or the Governing Committee on these issues*
> *• any file notes or other records of discussions on these issues between the Governor of the Reserve, the Secretary to the Treasury and/or the Minister of Finance."*

On 18 September 2015 we extended the time limit for deciding on your request by an additional 20 working days. We subsequently transferred responsibility to the RBNZ for making decisions about some documents within scope of your request.

Information Being Released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	July 2014	Untitled background paper on monetary policy decision making	Release in part
2.	23 February 2015	RBNZ decision-making comparators across the State Sector	Release in full
3.	23 February 2015	Table of comparators for above paper	Release in full
4.	24 February 2015	Governance: Multiple roles & Committee Structure	Release in part
5.	24 February 2015	Financial stability decision making in countries where central banks are not the financial supervisors	Release in full
6.	5 June 2015	Aide Memoire: Reserve Bank Statement of Intent (2015-2018)	Release in part

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I have decided to release the relevant parts of the documents listed above, subject to information being withheld under one or more of the following sections of the Official Information Act, as applicable:

- names and contact details of junior officials and certain sensitive information, under section 9(2)(g)(i) – to maintain the effective conduct of public affairs through the free and frank expression of opinions, and

- advice still under active consideration, under section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials.

Information Publicly Available

The following information is also covered by your request and is publicly available on the Productivity Commission website:

Item	Date	Document Description	Website Address
7.	15 September 2014	Extracts from the Productivity Commission Report, Regulatory Institutions and Practices	http://www.productivity.govt.nz/inquiry-content/1788?stage=4

Accordingly, I have refused your request for the documents listed in the above table under section 18(d) of the Official Information Act – the information requested is or will soon be publicly available.

Information to be Withheld

There are additional documents covered by your request that I have decided to withhold in full under one or more of the following sections of the Official Information Act, as applicable:

- section 9(2)(ba)(i) – to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied,

- section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials, and

- section 9(2)(g)(i) – to maintain the effective conduct of public affairs through the free and frank expression of opinions.

Some of these documents have been withheld because advice is still being developed and has not yet been tendered to the Minister.

Document number 4 contains an extract from a Memorandum of Understanding between the Treasury and the Reserve Bank. This was signed in mid 2012, and some of the material in this extract is now out of date.

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This fully covers the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Mark Vink
Manager, Macroeconomic and Fiscal Policy

Information Being Released
OIA 20150372

Summary:

This paper is an input into a broader process within Treasury reflecting on the governance arrangements of the Reserve Bank of New Zealand (RBNZ) as part of our general post-election preparedness. It builds on previous advice that there may be some advantages from moving to a committee decision-making model. In particular, it looks at arrangements for monetary policy decision-making, the objectives of a good decision-making framework and the types of committees best suited to those objectives.

The paper finds that the type of committee chosen should be based on the objectives you are trying to achieve. There are advantages and disadvantages to each of the arrangements discussed in this paper. The choices are finely balanced and interlinked.

This paper reviews the relevant literature and selected international experience. It has focused only on monetary policy decisions within the current monetary policy framework. Some arguments for changes to monetary policy decision-making may be applicable to decision-making in the Bank's other work areas, such as financial stability. More work is needed to understand any implications for governance arrangements in those areas.

The paper considers three broad types of committee structure that have been identified in the literature – although, as always when categorising complex phenomena, the boundaries between different committees are somewhat fluid (e.g. Blinder):

- Genuinely collegial – decisions are made by consensus after strenuous debate behind closed doors (could include vote)
- Individualistic – members speak and act on their own opinions through a majority vote
- Autocratically collegial – chairperson dominates proceedings and has a strong influence in the final decision

The table below summarises the trade-offs faced between the alternative committee types.

History of Monetary Policy Decision-making since Independence in New Zealand

	Individualistic e.g. BOE	Genuinely-Collegial[1] e.g. ECB	Autocratically - Collegial[2] e.g. FOMC
Good Decisions Made	Best	Better	Limited
Support transmission mechanism	Worst	Better	Best
Democratic legitimacy	Good	Good	Good
Implementation practical	Probable	Possible	Easiest

[1] A genuinely-collegial committee is one where the group argues the issues before coming to a consensus decision.
[2] An autocratically collegial committee is one where the Chairperson dominates proceedings, potentially coming to the meeting with the decision already made. There may be debate but the final 'consensus' revolves around the chairperson's preference.

Since the RBNZ's independence, monetary policy decision-making has been formulated within a single decision-maker framework, as set out in the Reserve Bank Act 1989. The Governor is held responsible for monetary policy decisions. New Zealand and Canada are the only two developed countries using this model. Informally, both countries are moving away from this model in the practice of their decision-making even though the legislation has not changed.

In Canada, decisions are made by a Governing Council (the Governor, Senior Deputy Governor and four Deputy Governors) through consensus, although the Governor retains the right of veto. This Council is supported by a Monetary Policy Review Committee which includes members of the Governing Council plus five or six advisors, one or two special advisors, the chiefs of the four economic departments, the heads of Montreal and Toronto regional offices and other senior personnel. The Deputy Governors brief the media following monetary policy decisions prior to a press conference with the Governor.

In New Zealand, a similar process has evolved. The first Governor following RBNZ independence set up a Monetary Policy Committee (MPC), which discussed information about the economy, forecasts and policy decisions and provided comprehensive policy advice to the Governor. Following the Independent Review of the Operation of Monetary Policy in 2001, an Official Cash Rate Advisory Group (OCRAG) was set up composed of the Governor, Deputy Governor(s), Assistant Governor(s), the Head of the Economics Department, and several other senior staff from the Economic and Financial Stability Departments. It also included two external advisors (from the business community). This advisory group became more formalised over the years with members submitting written advice to the Governor outlining their views on the projection, the upside and downside risks, their recommended policy decision and any issues they see in communicating that decision. However, these groups had an advisory rather than a decision-making capacity.

In 2013, the Governor made a major management change. The MPC was disestablished with OCRAG becoming the new MPC. The Governor formalised a further group – the Governing Committee – with an expressly decision-making purpose. Decisions on monetary and financial policy are now made through this group with an aim of reaching consensus. The Governor, however, retains right of veto in line with formal accountability remaining vested in the Governor. This group receives the written advice provided from the MPC (formerly OCRAG) which used to be provided solely to the Governor. This committee also decides policies for all the other areas the Reserve Bank acts in (such as financial stability), not just monetary policy.

The monitoring environment is related to the decision-making framework. At the moment New Zealand's accountability arrangements for monetary policy reflect the individual decision-maker model with the Governor being held responsible for the performance of the Bank in achieving the PTA. The Governor's performance is reviewed by the Board of Directors which may give advice to the Governor and if the Governor is found wanting, the Board must advise the Minister of Finance and may recommend that the Governor be removed. There is no legislative requirement for the Governor to use a Committee to reach decisions, so no requirement for a future Governor to maintain use of the Governing Committee. Establishing the Governing Committee as a legislative body would be a first step to ensuring that this arrangement is enduring.

In summary, although both Canada and New Zealand's Central Banks legislatively have a single decision-maker model, the practice is much more reflective of the formal committees used in other countries to make decisions.

The Problem with the Current Situation

Errors of judgement by the Governor have the potential to significantly impact New Zealand living standards by impacting the economy. New Zealand is a small country and as such has a limited pool of candidates for the role of Governor. As such, there is a risk that at some point a candidate will be chosen who does not have the skills needed in all areas (a good chief executive does not necessarily have the technical skills required to make policy decisions).

Given the weight on monetary policy in the legislation, the Board of Directors are likely to place significant weight on monetary policy skills when nominating a Governor. However, it is possible that these skills may come at the cost of having a good quality chief executive or one with the necessary expertise in other areas of the Banks functions such as financial stability. This risk has increased as the Bank's mandate has widened.

It is important to note that though Canada's Central Bank Governor also has sole decision-making power, the size of the role is substantially narrower than in New Zealand. Canada's Central Bank has a much narrower mandate which does not include supervision of banks and only limited prudential policy functions. The country itself is also larger, increasing the pool of qualified candidates.

There is also a growing body of literature that looks into effective decision-making as highlighted by Blinder (2009).[3] It suggests that decisions made by groups are, on a case by case basis, more accurate than all but the best individual in the group. When the average is analysed the committee's decisions are more effective than even the best individual's average. Errors of judgement are, thus, minimised by making decisions by committee, if that committee functions well. The reasons behind better group than individual decisions include insuring against potentially extreme preferences, pooling knowledge (particularly in an uncertain environment such as the one in which monetary policy functions), and different information processing and decision-making processes of individuals.

Despite the legislative focus on the Governor's sole accountability, the RBNZ already seeks to garner the benefits of committees in reducing errors of judgement. Advisory committees help to increase access to information. More recently the Governing Committee is supposed to function in all respects as the decision-making group.

These arguments have previously led us to recommend that on balance, we think there would be benefits to moving towards a monetary policy committee in future, although the potential benefits would depend on committee design [T2012/886]. However, there remain a number of outstanding questions such as how effective the Governing Committee is in the current legislative environment, which decision-making framework would be most effective, and what criteria underpin that judgement?

To answer these questions this paper first looks at what objectives we could measure the effectiveness of different decision-making frameworks against. It then considers the types of settings which compose a committee decision-making framework and the

[3] Alan Blinder (2009). Making Monetary Policy by Committee. *International Finance* 12 (2), 171-194.

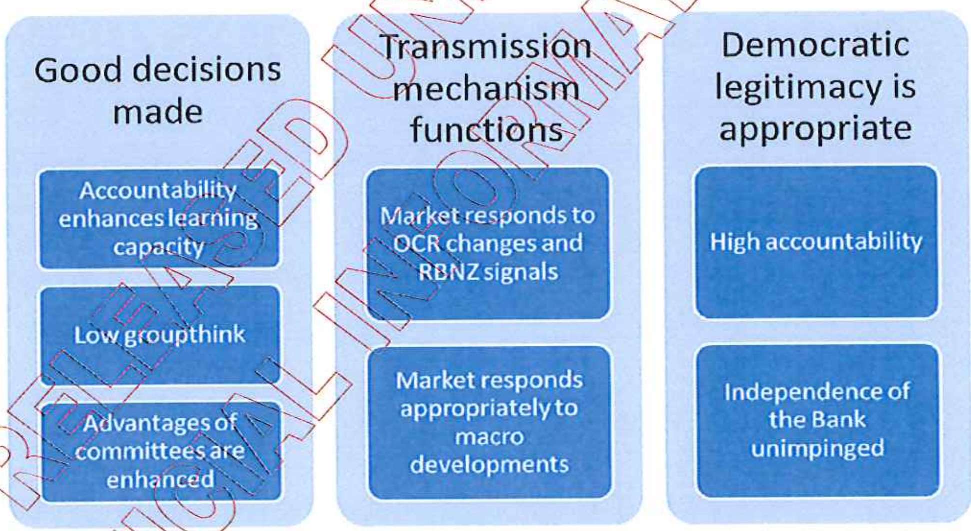
costs and benefits associated with those settings. Finally, it looks at what influence different accountability arrangements and other settings would have on meeting the different objectives.

Objectives to measure effectiveness of decision-making frameworks

Identifying the objectives of a good decision-making framework is an important first step for identifying which settings should be chosen for the framework.

Three overarching objectives are highlighted here, each with their own sub-components (see Figure 1). These objectives and their sub-components are not necessarily compatible. Changing the settings to improve effectiveness via one objective sometimes implies a trade-off against another. Each of the objectives is elaborated on below.

Figure 1: Framework Objectives



The primary objective of the decision-making framework should be to ensure that good decisions are made consistently. For a framework that is based on committee decision-making there are two components that help ensure the benefits of committees are realised: low groupthink and accountability settings which enhance the learning capacity and effectiveness of the committee.

Groupthink is a concept originally articulated by Janis as "a mode of thinking people engage in when they are deeply involved in a cohesive in-group, when the members striving for unanimity override their motivation to realistically appraise alternative courses of action."[4] There are myriad cases used as examples of groupthink leading to poor decision-making leading to bad outcomes.[5] Janis outlined three types of antecedent conditions which encourage groupthink: cohesion of the group; organizational structural faults (group insularity, biased leadership, lack of methodical

[4] Janis (1982). *Groupthink* (2nd ed.). Boston: Houghton Mifflin. P.9
[5] The Bay of Pigs fiasco is a classic example.

procedures, homogeneity etc); and situational factors (stress from external threats; low self-esteem from recent failures, excessive difficulties, moral dilemmas etc).[6] As such, the framework within which the committee functions has a significant impact on the likelihood of groupthink occurring.

Accountability is a diffuse term and there are many different perspectives on what it should be trying to achieve. There are also many different settings which can affect accountability levels. Thus, it is very important to be clear what objectives you are trying to achieve when changing the accountability settings. For instance, accountability settings can affect the likelihood of groupthink occurring. Accountability measures can also contribute to good decisions outside of their impact on groupthink levels by fostering an environment which enhances learning capacity and incorporation of feedback into the decision-making process.

Finally, there are a number of reasons why committees might outperform individuals. The best decision-making framework to replace the individual decision-maker model will minimise the disadvantages of having an individual decision-maker and enhance the advantages of having a committee (see p.3).

As well as good decisions, the decision-making framework needs to maintain the effectiveness of the transmission mechanism. Clear and credible communication can help the market to respond in the desired way. The framework settings can have an impact on this objective. On the other hand, transparency about the level of uncertainty and alternative views may also help the markets to respond appropriately.

The final objective asks whether the framework ensures the Bank has legitimacy within the political system as a whole. Strong democratic accountability needs to be balanced against the importance of central bank operational independence for monetary policy decisions, which can involve trade-offs.

Committee Settings

The previous section highlighted some of the objectives for a monetary policy decision-making framework. This section looks at what settings could be useful in meeting those objectives. The various settings are very much interlinked to each other. If you are going to have one committee type then a different type of accountability and transparency is probably necessary to another type of committee.

There are three committee types highlighted in the literature on monetary policy committees: individualistic, autocratically-collegial and genuinely-collegial.[7] In an autocratically-collegial committee the decision is made by the chairman/Governor who tells the group what the consensus position is. This may or may not involve listening to debate first. In contrast, in a genuinely-collegial committee, members reach a compromise only after strenuous debate behind closed doors. Each member then takes ownership of the decision. In both collegial styles members agree that differences of opinion are subordinated to the common good. With an individualistic committee, members speak and act on their own opinions through a majority vote. Unanimity is not expected or necessarily attempted.

[6] Rose (2011). Diverse Perspectives on the Groupthink Phenomenon, *Emerging Leadership Journeys* 4 (1), 37-57.
[7] Alan Blinder (2006). Monetary Policy by Committee: Why and How? *DNB Working Paper #92.*

Each of these committees has a different impact on whether good decisions are made and whether the transmission mechanism remains effective. It is important to consider carefully the advantages and disadvantages of each committee type here because some of these committee typologies may require legislative change.

Autocratically-collegial

An autocratically-collegial committee is closest to the current New Zealand situation given the Governor's legislative right to dominate proceedings (even if in practice the decision-making is more genuinely collegial). In most autocratically-collegial committees the Governor "lacks the *de jure* authority to *force* his committee members to accept his position. The strong desire for *de facto* consensus therefore empowers the rest of the committee to serve as a kind of check on the chairman, who cannot easily pursue extreme policies, follow highly idiosyncratic procedures, or base policy on controversial theories that the rest of the committee do not accept".[8] Thus, at least some of the advantages of committees are realised here, including pooling information and different processing methods.

This is not the case in New Zealand where the Governor does have the *de jure* authority. The Governor has veto power over the committee as a consequence of the legislation holding him solely responsible for Bank performance. As a consequence, there is a question over whether it significantly alters the likelihood of human error and if the group ever had any real decision-making power.[9] The advantages of committees in the current situation are only realised if the personalities of committee members enable them to be realised.

Where an autocratically-collegial committee's impact on good decision-making is relatively weak, it does have a positive impact on the other objectives relative to the other committees. An autocratically-collegial committee will find it relatively easy to ensure OCR decisions have the desired impact on market behaviour because communication is easier. The committee is much more likely to present a unified front, to provide detailed reasoning for its decision and forward-looking information than the other committees.

An autocratically-collegial committee also improves democratic legitimacy over a sole decision-maker model. There are two reasons for this. Firstly, it reduces the power of a single unelected official. Secondly, it can increase the Board's understanding of how decisions are made.

The operational independence of the Reserve Bank resulted in shifting of power away from elected representatives to unelected officials. Concentrating that power in a single, unelected official is particularly problematic given the influence monetary policy has on the living standards of New Zealanders. Dispersing the RBNZ's decision-making power across a group of individuals has the effect of reducing the power of a single individual and minimising the problems related to legitimacy.

The Board's understanding of how decisions are made at the RBNZ may be enhanced over an individual decision-maker model if it has access to the Governing Committee's discussions either through written minutes or verbal summary. Such extra information

[8] Alan Blinder (2006). Monetary Policy by Committee: Why and How? *DNB Working Paper #92. P.19*

[9] Elliot Jaques (1991). In praise of hierarchy (108-118). In Markets, Hierarchies and Networks: The Coordination of Social Life. Edited by Grahame Thompson, Jennifer Frances, Rosalind Levacic and Jeremy Mitchell. Sage Publications Ltd: London. 110

would aid the Board in assessing the Governor's performance and holding the Governor to account. Such increased accountability would come at very little cost to the independence of the Reserve Bank as its simply enhancing the effectiveness of the accountability settings currently in place.

Individualistic

An individualistic committee is the type of committee advocated by Lars Svensson in his review with each member having one vote with attributed votes and non-attributed minutes published two to three weeks after the fact.[10] The Bank of England's MPC functions like this currently.

The committee captures the benefits of a committee structure to the greatest degree. The major reason for this is that a well-functioning individualistic committee encourages the free expression of different opinions and analysis, widening the web of information considered – one of the key benefits of a committee. The members' different 'decision heuristics' will also be utilised to a substantial degree. Furthermore, the majority voting method makes extreme positions less likely to be adopted acting as a significant check against idiosyncratic theory, methodology or ideology.[11] Finally, there is some theoretical evidence by Gerlach-Kristen (2006) that voting outperforms consensus decisions whenever there is uncertainty in the state of the economy.[12] Because there is always a degree of uncertainty about the economy Gerlach-Kristen's analysis suggests voting would almost always outperform consensus decision-making.

However, an individualistic committee may create risk around the objective of ensuring the transmission mechanism functions if communications are not clear. The value placed on individual accountability and the airing of disagreements in individualistic committees means that the central bank can at times appear to speak with multiple voices, potentially confusing the market. A high degree of uncertainty over a prolonged period could affect confidence in the central bank and affect the way markets react to decisions.

Blinder suggests that this risk can be mitigated by "teaching the markets to 'think like the central bank' – for doing so will enable the central bank to manage expectations of future monetary policy better and, in particular, to keep them in line with its own thinking."[13] Furthermore, an individualistic committee, unlike the other committee types can provide the markets with a true reflection of the level of uncertainty about the economy and the alternative views. Such information may be beneficial for them in responding to the RBNZ but also in their every-day decisions.

Nevertheless, forward-looking information, as produced currently in New Zealand, may be difficult to produce with an individualistic committee.

Genuinely collegial

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[10] Lars Svensson (2001). Independent Review of the Operation of Monetary Policy in New Zealand: Report to the Minister of Finance.

[11] Alan Blinder (2006). Monetary Policy by Committee: Why and How? *DNB Working Paper #92*. P.16

[12] Gerlach-Kristen, P (2006), 'Setting Monetary Policy: The Role of the Chairman', Mimeo, Swiss National Bank.

[13] Alan Blinder (2006). Monetary Policy by Committee: Why and How? *DNB Working Paper #92*. P.17

A best practice genuinely-collegial committee will mimic the debates held in an individualistic committee, retaining all the advantages of being in a committee that an individualistic committee has. Furthermore, the problems with the market reaction objective are less significant. This is because, the principle of the common good for the committee overrides individual preference differences so debate does not spill over into the public arena. As a consequence, the issues relating to public confidence in the Bank and communication are not nearly as significant for a genuinely-collegial committee than for an individualistic committee. However, an autocratically-collegial committee does even better on this objective because detailed statements and forward looking information are much easier to produce.

Committee comparison
The table below compares the different committee typologies against the objectives, highlighting the trade-offs inherent in choosing one typology over another along with the practicality of implementing it.

Table 1: Committee typologies and their trade-offs

	Individualistic e.g. BOE	Genuinely-Collegial[14] e.g. ECB	Autocratically - Collegial[15] e.g. FOMC
Good Decisions Made	Best	Better	Limited
Support transmission mechanism	Worst	Better	Best
Democratic legitimacy	Good	Good	Good
Implementation practical	Probable	Possible	Easiest

Table 2 gives examples of the various settings that might be expected to accompany each committee type.

[14] A genuinely-collegial committee is one where the group argues the issues before coming to a consensus decision.
[15] An autocratically collegial committee is one where the Chairperson dominates proceedings, potentially coming to the meeting with the decision already made. There may be debate but the final 'consensus' revolves around the chairperson's preference.

Table 2: Examples of settings for committee type

	Individualistic	Genuinely-Collegial	Autocratically-Collegial
Decision method	Vote e.g BOE	Consensus (could include vote) e.g. ECB	Consensus (could include vote) eg. FOMC
Transparency	High – attributed minutes and votes published e.g. RiksBank	High – unattributed minutes published (BOE). If votes taken they too should be published (BOE attribute votes).	High – unattributed minutes published and if votes taken they too should be published.
Accountability	Individual e.g. BOE	Group e.g. ECB	Individual (on autocrat)
Members' histories	Internal (if Governor is removed from recruitment/ performance processes of other members) otherwise mix of external/internal experts (BOE).	Internal if transparency is high and Governor removed from recruitment/performance processes of other members) – otherwise mix of external/internal experts.	External members would ensure that a diverse range of views is heard by the Governor (Norges Bank).
Size	Larger group increases knowledge pooling (5-10) e.g BOE.	Smaller groups make consensus easier (closer to five) – note: this hasn't prevented ECB reaching consensus (23 members).	Larger group would increase the amount of information provided to the Governor e.g FOMC.

What do other countries do?

In theory, the vast majority of countries have some form of voting system to make monetary policy decisions – suggesting an individualistic committee style. However, in practice, some of them operate as autocratic or genuinely collegial committees. And it is very rare for the Chair of the committee to lose a vote (it has happened only twice in the most individualistic committee at the Bank of England).

An example of a central bank that votes but functions in a collegial manner is the USA's Federal Open Market Committee (FOMC). Members of FOMC vote on decisions, but it is very rare for any member to vote against the Chairman's preference. Particularly during the years Alan Greenspan was Chairman, the committee functioned as a classic autocratically collegial committee (it may have become less so since Bernanke became Chairman in 2006). Blinder also suggests that Australia's Board functions like an autocratically-collegial committee.[16]

On the other hand, in practice, the ECB functions as a genuinely collegial committee. Norway and Switzerland's Central Banks also function on the basis of consensus. In emerging markets with committees composed similarly to New Zealand's Governing Committee, Brazil aims to reach consensus but Mexico's Central Bank appears to place little emphasis on reaching consensus.

The range of committee typologies used by central banks around the world suggests that there is little international consensus on what is most effective and what is possible to implement. In fact, it is likely that the best committee typology for a country will depend on its own cultural and historical background and current social values. This is particularly the case when considering between a genuinely collegial and individualistic committee as the advantages and disadvantages of each are finely balanced. In contrast, an autocratically collegial committee does not go as far as to ensure good decisions are made, which should be the primary objective of a decision-making framework.

[16] Alan Blinder (2006). Monetary Policy by Committee: Why and How? *DNB Working Paper #92.*

In practice, it may be difficult to prescribe the committee type as to some extent the functioning of the committee is likely to depend on the personalities of people on the committee, the historical context and culture. Nevertheless, the formal settings will influence committee practice, increasing or decreasing the likelihood that a committee functions in a particular manner.

Impact of different settings

This section looks at the settings that can affect whether a committee is likely to achieve the objectives set out above.

Accountability

The discussion on committee types discussed the concepts of individual versus collective accountability. This section looks in more detail at what accountability actually is, what role it can play and how it can impact on the objectives identified above in the context of different committee types.

Accountability is a conceptually ambiguous term so defining what it is becomes important when making policy decisions about accountability settings. There are two streams of accountability thought. The first sees accountability as a personal attribute to evaluate the performance of an actor or organisation against. It's about whether an entity *acts* in an accountable manner. The second stream of thought suggests that accountability is a 'social mechanism' whereby an actor is held to account by a forum through an institutional relationship or arrangement.[17]

In the context of the Reserve Bank decision-making framework, accountability is generally thought of in the second context i.e. what mechanisms are available to hold the Reserve Bank or individuals within to account ex post facto by accountability forums.

Accountability arrangements influence the objectives for the decision-making framework in three ways. Firstly, accountability has an impact on groupthink levels and, therefore, on whether good decisions are made. Secondly, they have an impact on enhancing feedback mechanisms for the decision-making body, increasing good decision-making through maximising the advantages of group decision-making. Finally, accountability arrangements impact the democratic legitimacy of the organisation and its independence. The accountability arrangements appropriate for each of the objectives are outlined below.

Accountability arrangements and groupthink

Kroon, Hart and Kreveld (1991) found experimental evidence that accountability makes a measurable difference to the level of groupthink. It does so through increasing the level of debate and stimulating group members to try and influence the outcome. Members have a much bigger incentive to vote based on their true beliefs and try to

[17] Bovens, Schillemans and Hart. (2008). Does public accountability work? An assessment tool. *Public Administration*, 86 (1), 225-242.

increase the quality of discussion and remain critical.[18] As such, accountability provides a buttress to 'information cascades' - "increasing reluctance to dissent, and the mounting incentives to hide one's private information, as more and more speakers express identical opinions."[19]

In the same paper, the effectiveness of different types of accountability are also considered. Individual accountability was more effective than collective accountability in ensuring influence is exerted by group members and is also more equally shared amongst individuals. Therefore, groupthink levels were lower in groups where members were also held individually to account. The conclusion drawn is that good decisions will be made more of the time in a committee where individual accountability is strong than in one where accountability is concentrated at the group level.

Such findings have important implications for the type of committee chosen. Individual accountability is really only possible with an individualistic style committee. In a collegial committee the emphasis is on the common good, subordinating individual differences of opinion to that goal. Thus, voting procedures in an individualistic committee provide much better evidence about individual preferences. Such evidence is important if individuals are to be held to account.

A move towards committee decision-making also raises questions about current legislative arrangements and their effectiveness in reducing groupthink. One of the most visible aspects of the current accountability arrangements is the power of the Minister of Finance to remove the Governor on advice of the Board for inadequate performance. The intent is to ensure individual accountability is high.

This accountability mechanism makes sense in the context of a sole decision-maker model. Placing accountability solely on the shoulders of the Governor enhances the Governor's already considerable control over decision-making, a result of their agenda-setting powers. This is sensible in a sole decision-maker model where the Governor makes the final decision. But it does not provide any formal mechanism to hold other committee members to account.

If the committee is supposed to make decisions together then the Governor's sole accountability may become a hamper to good decisions. Such power does not encourage the sort of free and open decision-making process customary of either genuinely collegial or individualistic committees, which can help reduce groupthink. It may still occur, but it becomes far more dependent on personalities and culture. As such, to reduce groupthink the influence of the Governor should be offset and diffused through the committee members.

However, there may be some difficulties with diffusing that power while still providing strong accountability. As discussed earlier, group accountability is very difficult to realise relative to individual accountability. Simply changing the legislation to remove the committee as a whole for poor performance is problematic. The threshold for removing the Governor is very high and it is very difficult to do so given the emphasis on outcomes. Removing a committee in its entirety is almost unheard of.

[18] Kroon, M., Hart, P., & Kreveld, D (1991) "Managing Group Decision Making Processes: Individual Versus Collective Accountability and Groupthink" *The International Journal of Conflict Management* 2 (2), 91-115. P.99
[19] Alan Blinder (2009) "Making Monetary Policy by Committee" *International Finance,* 12 (2) 171-194. P. 178.

Accountability and learning capacity

There are various perspectives on what accountability is aiming to achieve. Bovens, Schillemans and Hart breakdown accountability measures into three groups based on what the objectives are: democratic, constitutional and learned accountability.

Democratic accountability aims to ensure executive actions are open to control by voters; constitutional accountability aims to ensure that the concentration and abuse of power is minimised; and learned accountability aims to increase effectiveness and efficiency in achieving goals. Note that accountability measures that might be perceived as beneficial through one perspective could be perceived as detrimental by another.

This section focuses on learned accountability. As identified in the objectives, accountability arrangements which enhance the learning capacity of the decision-making body have a positive impact on whether good decisions are made.

Boven's et al. (2008), suggest that to evaluate whether accountability arrangements enhance learning capacity the focus should be on how stimulated the committee is to consistently achieve the desired outcome. Evaluation questions are whether performance can be evaluated accurately and timely; whether arrangements support genuine communication and feedback between the decision-maker(s) and the performance evaluators; and whether the forum is strong enough to sanction yet the environment safe enough to reduce defensive routines so the feedback is taken on board.

In the case of monetary policy, accurate and timely performance evaluation of the outcome of the decision made is almost impossible. Monetary policy decisions occur in a complex environment of high uncertainty and it is many months before it is obvious whether the decision had the desired effect even if it was controversial. Even then, the desired outcome might not have eventuated but the decision could still have been the right one.

However, the process used to reach the decision can be accurately measured in a timely manner. Meetings of the Board can take place shortly after each OCR decision is made to analyse the process used to reach that decision and provide feedback before the next OCR decision. Poor processes for one decision will not have a significant impact on the economy if able to be rectified prior to the next decision due to the time lag between monetary policy decisions and outcomes.

Furthermore, the literature on accountability suggests that outcome accountability (such as removing the Governor for poor monetary policy decisions) can be ineffective in achieving better decision-making because it increases commitment to a prior course. Such commitment is a problem when a swift correction in the chosen course is needed. In contrast, process accountability enhances accuracy and tends to lead to more even-handed evaluation of alternatives.[20]

In New Zealand, there is already some recognition of the accuracy and timeliness evaluation problem and the role process accountability has in resolving the issue. The

[20] Lerner, J and Tetlock, P. (1999). Accounting for the effects of accountability. *Psychological Bulletin,* 125, 255-275.

legislation directs the Board to look at the performance of the Governor *in pursuit* of the policy targets. Failure to meet the targets is not in and of itself a demonstration of poor performance.

Nevertheless, the Board does still look at the outcome in terms of whether the inflation targets are met and in some way the process is judged on the basis of meeting those targets.

There are other aspects of monitoring practice that help ensure the accuracy and timeliness of evaluation. The RBNZ's Board's main role is to monitor the performance of the Governor and the Bank. Review is, therefore, constant ensuring that feedback can be provided promptly and, if necessary, during the decision-making process.[21]

Transparency between the decision-making body and the monitoring body (Board of Directors for the RBNZ) is also important to ensure genuine communication and feedback occurs. This is, perhaps, where New Zealand's current legislative arrangements and Board practice excels. The RBNZ's Board has wide powers to get the information it needs to provide feedback to the decision-making body. In practice information the Board receives to perform its monitoring function include:

- Publicly available documents such as the quarterly *Monetary Policy Statement* (MPS); brief policy comments halfway between each MPS; forecasts for inflation, GDP, interest, and exchange rates.
- Background documents that the Bank's Monetary Policy Committee uses in the formal process leading up to OCR decisions (including material on the views of markets and other commentators).
- Presentations after each MPS explaining the background to the relevant OCR decision
- Written advice provided to the Governor independently from each member of the MPC is also anonymously provided to the Board.
- Material on the Bank's budget etc, providing it with information on (and opportunity to question) resources devoted to the monetary policy functions.
- Comments of outside experts engaged by the Governor to peer review the forecast week process are provided to the Board who can also choose to meet separately with the experts.
- Copies of many of the supporting or interpretative pieces of analysis prepared for the MPC between forecast rounds (including those, for example, on the comparative accuracy of the Bank's forecasts).
- The Deputies and Assistant Governors are almost always present at Board meetings enabling the Board to ask questions directly and gauge the relationships between the different committee members

A further piece of information which would be useful for the Board to have access to should the committee be formalised is the minutes of committee meetings. It is not known if they already have access to this information.

The final question is whether the forum is strong enough to sanction yet the environment safe enough to reduce defensive routines so feedback is taken on board. Getting the balance right here is difficult. Bovens et al., suggest a number of settings to ensure the right balance.

[21] Reserve Bank of New Zealand Act 1989, Section 53 (2).

- The Board should receive information half-way through the decision-making process – not just afterwards – as this helps reduce defensiveness and closure on the institution's part;
- Ongoing and substantial dialogue with clients and other stakeholders about performance feedback;
- A combination of strong outside actors and 'safe' sanctioning culture; and
- Commitment to continuous improvement through dialogue (see table 4 p.238 in Bovens et al.).[22]

In relation to the bullet above about strong outside actors and 'safe' sanctioning culture' perhaps one of the most significant current settings with an impact on the safety and sanctioning culture of the RBNZ is the ability of the Minister of Finance to remove the Governor on recommendation of the Board of Directors for inadequate performance in ensuring the policy targets are met. If it were practical to implement the removal of the Governor/Committee, it would reduce the 'safeness' of the sanctioning culture contributing to defensive routines and reducing learned accountability. This is fine if the emphasis of accountability arrangements is on checking the powers of the agent, but not so much if the focus is on "continuous improvement and outcome achievement." *Withheld under s9(2)(g)(i)*

To ensure that there are strong outside actors, public transparency is key to ensuring that the reputations of the various committee members are at stake. New Zealand already has one of the most transparent central banks in the world. Some of the documents it puts out into the public domain include the quarterly MPS and comments between MPSs, an annual Statement of Intent; and forecasts for inflation, GDP, interest and exchange rates. The Governor and Deputy Governors also give a number of speeches each year (not all relating to monetary policy) and that number is set to rise. Finally in the lead up to the OCR decisions, stakeholders, including in the business community, are consulted extensively.

However, the current transparency arrangements say little about the function of the current Governing Committee. No minutes are published or votes recorded. It is uncertain whether the Board is given access to these either.

Withheld under s9(2)(g)(i)

The benefit of publishing minutes is sometimes questioned and indeed, unlike the move to decision-making by committee, there is no significant trend towards or away from publication of minutes.[23] Nevertheless, the literature holds much more of a

[22] Mark Bovens, Thomas Schillemans and Paul 'T Hart, (2008). Does public accountability work? An assessment tool. *Public Administration*, 86 (1), 225-242.

[23] See the appendix for a table on who publishes minutes and who doesn't.

consensus on the benefits of publishing minutes for the sake of transparency. Transparency on this matter is important because it not only provides an explanation for why certain decisions are made, but it also helps to ensure decisions are made in the right way.[24]

The cost of publishing them is that, potentially, it creates the perception that the committee is not unified or convinced about its decision (particularly when the environment is particularly uncertain). However, the threshold for refusing to release minutes on the grounds of preserving a sense of cohesion must be very high (such as in the case of the ECB which must manage the political environment of the European Union).

An alternative to the publication of minutes from a transparency perspective is the publication of a highly detailed statement on the decision a short time later. This loses some of the benefit of determining whether the decision process was ideal. Nevertheless, it retains the information about why the decision was made. Such a Monetary Policy Statement is already released in New Zealand on a quarterly basis.

However, Blinder is of the belief that an individualistic or genuinely-collegial committee would find it difficult to formulate a statement of sufficient depth to compensate for the lack of minutes due to the differing opinions of the group (even where they manage to come to consensus). In any case he thinks they both add value. Where the minutes provide transparency around the decision-making process, the statement provides a show of unity. Blinder created a table of transparency mechanisms important for each type of committee. [Blinder's table showing transparency models for each committee type?]

In terms of the other settings Bovens et al., suggest, New Zealand is already doing quite well. That the RBNZ Board's main role is to monitor the performance of the Governor and the Bank helps ensure the Board has an on-going stream of information about the decision-making process. Review is, therefore, constant ensuring that feedback if necessary can be provided during the decision-making process.[25]

In Svensson's 2001 Independent Review of Monetary Policy in New Zealand, he noted that the RBNZ goes through an extensive process of ongoing and substantial dialogue with stakeholders in the business community. Prior to the dissolution of OCRAG a couple of external experts were also included in the MPC discussions. I am unsure whether external experts are still included.

Democratic accountability

Central banking literature sometimes refers to a trade-off between independence and democratic accountability. This is because a high degree of democratic accountability generally involves closer involvement from government, which reduces independence.

Since the end of the 1980s, the RBNZ has been kept at arm's length from government. The RBNZ has operational independence but not goal independence, which means that the objective of monetary policy is set by Parliament, operational objectives are agreed between the Governor and the Minister (via the PTA), and the RBNZ has

[24] What is the right way? Decisions made based on agreements about environment not outcome.
[25] Reserve Bank of New Zealand Act 1989, Section 53 (2).

operational independence to achieve those objectives. The focus of the legislation has been in promoting the Reserve Bank's independence, with some ability for Ministers to direct the Bank to follow alternative objectives provided this is done in a publicly transparent way.

Other central banks have followed a similar path on the evidence that independence leads to better inflation outcomes and following the literature around time-inconsistency of decisions.[26] The degree of independence differs, with some central banks having both operational and goal independence.

Nevertheless democratic oversight remains important given the significant influence RBNZ decisions have on well-being. As such, through the Minister of Finance and the Board of Directors (an agent of the Minister of Finance), the executive has certain levers to ensure it has the information they need to know if the Bank is doing a good job. The legislature, through the Finance and Expenditure Committee, also has certain powers at its disposal. These levers help to maintain the link between the Bank and the people, ensuring the Bank retains legitimacy. The levers are outlined below.

The Minister of Finance

- Signs a Policy Target Agreement when the Governor is appointed or re-appointed;
- Appoints and can dismiss the Governor (on the recommendation of the Board);
- May commission a performance audit
- Sends a letter of expectations every year which is expected to influence the Bank's annual Statement of Intent; and
- The Treasury provides regular briefings to the Minister on monetary policy
- Can direct the Bank to formulate and implement monetary policy for a different economic objective for a time (section 12)

Parliament

- Can scrutinise each Monetary Policy Statement for consistency with the Policy Targets Agreement through the Finance and Expenditure Committee;
- Can commission investigations into the activities of the Bank through the Office of the Auditor General; and
- Approves the five yearly Funding Agreement enabling it to scrutinise resource allocation choices

A shift towards group accountability may impact democratic legitimacy by weakening the Minister of Finance's ability to remove the decision-makers from their position. Withheld under s9(2)(g)(i) [redacted]

Other Settings of Significance to the Objectives

Aside from accountability, there are several settings relating to the structure of the committee which have an impact on the objective particularly relating to making good decisions. Size, composition and length of term are of significance. Of these three,

[26] Kloomp, Jeroen and Haan, Jakob (2010). Inflation and central bank independence: A meta-regression analysis. *Journal of Economic Surveys,* 24 (4), 593-621.

composition is the most important. Composition covers whether the members of the committee are appointed from within the bank or a external to the bank as well as whether they are experts in monetary policy.

Size:
A larger group has more resources so *potential* decisions are of better quality making best use of the committee advantages. However, a very large committee may lead to motivational losses and coordination failure. Sibert suggests that optimal size for a committee is five.[27]

Currently, the Reserve Bank's Governing Committee is a little bit smaller (at four) – primarily because the Governing Council is made up of the Governor, deputies and assistant Governors. Most other countries have larger monetary decision-making committees than this, even in countries with an executive council making the decisions. This is primarily because most countries have a larger executive than New Zealand does. In those Monetary Policy Committees that aren't an executive council, the larger size may be due to the presence of external committee members.

When considering the size of a committee, perhaps the most important consideration is the type of committee chosen. A committee based on an individualistic committee is likely to be able to function better with a large committee than a committee based on collegiality. This is simply because the bigger the group, the more difficult coming to a consensus will be. However, it is important to note that large size has not prevented the ECB from functioning on the basis of consensus.

The breadth of mandate may also be relevant for size e.g. whether the committee is focused only on monetary policy or whether it covers other functions.

Composition:
In Svensson's 2001 report, the question of whether there should be externals on the Monetary Policy Committee had some prominence. Svensson thought that a completely internal committee was optimal for New Zealand, due mainly to the difficulty of maintaining a supply of competent external experts without conflicts of interest. The reasons for choosing an external committee in the literature range from enhancing political accountability to increasing the diversity of experiences on the committee.

Three main downsides have been identified with a wholly internal committee. First, because the Governor has power over the other committee members in the form of performance appraisal and promotion, an individualistic committee may not be possible, particularly if it involves speaking out in public with different voices.

Secondly, an internal committee is more likely to be autocratic than genuinely collegial, although this will depend on the personalities on the committee.

These problems may be mitigated by the appointment of externals to the committee on a fulltime basis (effectively becoming internal members who are not accountable to the Governor but to the Board). Appointing them to the committee on a full-time basis also avoids many of the conflict of interest problems, but not the supply problem.

The other alternative is to reduce the Governor's involvement even further in the recruitment and performance appraisal of his Deputies and any other internal members

[27] Sibert, Anna (2006). Central Banking by Committee. *DNB Working Paper*, (91)

with a position on the committee. However, this may reduce the ability of the Governor to be an effective Chief Executive. And, given that currently, the Governor's involvement in the appointment of the Deputies is limited to making a recommendation to the Board of Directors the disadvantages may outweigh the advantages.

Perhaps more seriously, the literature suggests that committees of internal experts tend to fall victim to groupthink, especially when the world is uncertain. External committee members play a role in counterbalancing the likelihood of groupthink occurring due to their greater diversity of background. This would be particularly important for a central bank with a dual mandate which by necessity would need to make trade-offs between inflation and, for example, unemployment. Such trade-offs can only be made on the basis of subjective opinion so diversity of opinion will increase the likelihood of all alternatives being canvassed.

External committee members also affect the behaviour of internal members through the illusion of supervisory scrutiny.[28] However, if external members are appointed purely for their supervisory function, they may be less necessary if public transparency is very high. Increased transparency will increase the belief in outside scrutiny irrespective of the membership of the group.

Withheld under s9(2)(g)(i)

Finally, committees with external members may help improve democratic legitimacy further by appearing more representative of society than an internal committee. This is particularly so if the external members are non-experts in monetary policy. There would also likely be greater conflict in such a committee with non-experts (further reducing chances of groupthink but also decreasing the likelihood of consensus). On the other hand, the technical nature of the current monetary policy decisions may mean that degree of representation is unnecessary and the usefulness of non-experts on the committee questionable.

Length of term:

The length of term of committee members may also have an influence on the performance of the group. A shorter term reduces the depth of camaraderie between committee members and, therefore, the likelihood of groupthink (which increases with higher cohesiveness). Most of the literature also suggests staggering the terms of office to maintain continuity through time.

Some central banks, such as Israel, also limit the Governor to two terms. This limit may help to reduce the amount of control the Governor can harness over the decision-making process built up through understanding of institutional knowledge and long tenure.

[28] Central Bank Governance Group. (2009). Issues in the Governance of Central Banks: A Report from the Central Bank Governance Group. *Bank for International Settlements.* 87.

Conclusion:

A committee structure for the purposes of deciding monetary policy reduces the risk of errors of judgement in theory. However, in practice, the structure of the committee has a profound effect on the likelihood of reaping its benefits. The discussion above suggests that, for New Zealand, a move to committee is a good idea [redacted] Withheld under s9(2)(g)(i) because an institutional framework should be designed for the bad times and poor/limited recruitment choices.

The best decision-making framework is very much dependent on the objectives it is trying to achieve. This paper outlines three objectives each with underlying sub-components. Firstly, we want good decisions to be made which relies on accountability enhancing learning capacity, low groupthink and enhancing the advantages of committees. Secondly, we want to make sure the transmission mechanism functions by ensuring the markets respond as expected to the decision made. Finally, democratic legitimacy levels need to be appropriate which needs to balance accountability levels against central bank independence.

There are trade-offs involved in meeting these objectives and the right framework will be based on what weight you place on each of these objectives. The table below outlines some of the decision-making frameworks possible which would meet the objectives

	Individualistic	Genuinely-Collegial	Autocratically-Collegial
Decision method	Vote e.g BOE	Consensus (could include vote) e.g. ECB	Consensus (could include vote) eg. FOMC
Transparency	High – attributed minutes and votes published e.g. RiksBank	High – unattributed minutes published (BOE). If votes taken they too should be published (BOE attribute votes).	High – unattributed minutes published and if votes taken they too should be published.
Accountability	Individual e.g. BOE	Group e.g. ECB	Individual (on autocrat)
Members' histories	Internal (if Governor is removed from recruitment/ performance processes of other members) otherwise mix of external/internal experts (BOE).	Internal if transparency is high and Governor removed from recruitment/performance processes of other members) – otherwise mix of external/internal experts.	External members would ensure that a diverse range of views is heard by the Governor (Norges Bank).
Size	Larger group increases knowledge pooling (5-10) e.g BOE.	Smaller groups make consensus easier (closer to five) – note: this hasn't prevented ECB reaching consensus (23 members).	Larger group would increase the amount of information provided to the Governor e.g FOMC.
Objective Weights – **Good decisions made**	Very high	High but more potential for groupthink than individualistic committee	Moderate
Objective Weights – **Transmission mechanism functions**	Less weight placed on this – though may not be problematic	Much better than individualistic committee	Very high
Objective Weights – **Democratic legitimacy**	Good	Good	Good

The discussion above is based solely on monetary policy decision-making with a clear focus on price stability. Of course, in New Zealand, the Governing Committee focuses on decisions over the breadth of the Reserve Banks mandate, including financial stability. Thus, future work looking at the most appropriate arrangements in relation to the other functions of the Reserve Bank will be needed and how well they mesh with the conclusions of this paper. Future work will also be needed on whether it is appropriate for one committee to make decisions for all of the Bank's services. This work should be done regardless of whether the type of committee suggested as best for these functions aligns with the recommendations of this paper for monetary policy decision-making.

If the mandate of the Reserve Bank were to change, this paper should also be revisited. This is because a broader set of objectives would increase the potential trade-offs between different goals, which may involve greater subjective judgements, increasing the persuasiveness of the argument for the inclusion of external members to diversify the decision-making process.

Finally, if the decision is made to move to a framework with a formal committee decision-making body, more work will be needed to work out the practicalities. For example, the function of the PTA will need to be revisited given its current position within the employment contract of the Governor.

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Appendix

Table 3 International comparison of monetary policy committees

Central Bank Elements	Eurosystem	Norges Bank	Sveriges Riksbank	Swiss National Bank	Bank of England	Reserve Bank of Australia	Bank of Canada	Bank of Japan	Reserve Bank of New Zealand	Federal Reserve System
Name of the monetary policy committee	Governing Council	Executive Board	Executive Board	Governing Board	Monetary Policy Committee (MPC)	Reserve Bank Board	Governing Council	Policy Board	Governor	Federal Open Market Committee (FOMC)
Size of the committee										
Voting members	21	7	6	3	9	9	6	9	1	12
Other members	0	5 are external members	0	0	4 are external members	6 are external members	0	0	0	7 non-voting presidents
Appointment of members										
Appointment by	Heads of State or Government (hearing by Parliament)	The King	General Council	Federal Council	The Chancellor	The Treasurer	Minister of Finance	The Cabinet	Minister of Finance	the President (confirmation by Senate)
Terms of office	8 years, non-renewable for EB members, minimum 5 years for NCB governors, renewable	6 years for full-time members, 4 years for other members, renewable	6 years, non-renewable	6 years, renewable	Fixed term up to 5 years, renewable	7 years for full-time members, 5 years for other members, renewable	7 years, renewable	5 years, renewable	Fixed for the length of a Policy Target agreement, renewable	14 years, non-renewable or unexpired term, renewable up to 14 years
Monetary policy decisions										
Strategy	Based on two pillars	Inflation targeting	Inflation targeting	Based on three elements	Inflation targeting	Inflation targeting	Inflation targeting	Based on two perspectives	Inflation targeting	Eclectic strategy
Numerical goal for price stability	Quantitative definition: "below, but close to 2%" (HICP)	Inflation target approx. 2.5% (CPI)	Inflation target 2% (CPI) with fluctuation margin	Quantitative definition: "below 2%" (CPI)	Inflation target 2% (CPI)	Inflation target 2-3% (CPI)	Inflation target control range 1-3% (CPI)	Quantitative definition: "under-standing of 0-2%" (CPI)	Inflation target 1-3% (CPI)	No numerical value
Important contributions	Economic and monetary analysis	Inflation forecast	Inflation forecast	Inflation forecast	Inflation forecast	Inflation forecast	Inflation forecast	Broad range of indicators	Inflation forecast	Broad range of indicators
Voting rule										
Decision rule	Consensus	Consensus	By majority, governor has casting vote	Consensus	By majority	By majority	Consensus	By majority, chairman has casting vote	By the governor	By majority, chairman has casting vote
Collective responsibility	YES	YES	YES	YES	NO	YES	YES	YES	NO	YES
Announcement of decisions										
Press release	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Minutes published?	NO	NO	YES	NO	YES	YES	NO	YES	NO	YES
Voting records published?	NO	NO	YES	NO	YES	NO	NO	YES	YES, implicitly	YES
Committee substructures										
Committees that report directly to the decision-makers	YES (15)	YES (1)	YES (1)	YES (4)	NO	YES (3)	YES(6)	YES (2)	YES (5)	YES (3)

RBNZ Decision-making comparators across the state sector

This note summarises the key themes of decision-making structures across the state sector relative to the RBNZ governance structure. Refer to the table that outlines the structure of each entity in the following doc: (Table of Comparators for RBNZ Decision-Making Work:3115875)

There are a number of agencies and individuals across Government that have independent responsibilities at arm's-length from the government:

- Several examples of individual decision-making positions with some independent statutory functions e.g. Police Commissioner, Tax Commissioner, and Commissioner of Crown Lands. Independent Crown entities such as the Commerce Commission and Financial Markets Authority (FMA) have much clearer independence regarding their core functions and are not subject to government direction.
- All are accountable to their respective Minister in some capacity regarding operational and financial management as well tendering policy advice and responding to the government's interests.
- The State Services Commission (SSC) ensures that chief executives (CEs)/commissioners meet their responsibility to the Minister as outlined in section 32 of State Sector Act.
- Independent Crown entities are individually and collectively accountable to Ministers through their output agreements and statement of intents e.g. the Commerce Commission must report regularly on a quarterly basis to the Minister of Commerce and Minister of Communications and Information Technology via MBIE.

Appointment and dismissal process can vary across these comparators:

- CEs/commissioners are appointed and have their performance monitored by SSC. Appointments require sign-off by Cabinet and the Governor-General.
- SSC can recommend the dismissal of most C.E's with the agreement of the Governor-General. This is similar to how the Reserve Bank Board operates i.e. Board can recommend the removal of the Governor to the Minister of Finance. One exception is the Police Commissioner who can be removed at the sole discretion of the Governor-General.
- Board members of independent Crown entities are appointed and dismissed by the Governor-General on the advice of the respective Minister.

The Commerce Commission and FMA are the only clear examples of committee structures that implement policy independently:

- These boards/committees have multiple functions to carry out and can establish divisions to address policy issues covered by their legislation.
- Associate board members can be appointed and removed at the discretion of the Minister from time to time. These members are only able to work on a matter or class of matters they were appointed for.
- The Minister cannot override decisions implemented by these entities.

External experts can be involved in policy implementation and appointments:

- Associate members are appointed to the Commerce Commission and FMA on certain matters and many of the Board members are appointed from outside the organisation who have worked in related industries.
- The appointment of CE's under the State Sector Act requires a panel which requires an external expert.

Areas where the RBNZ governance structure is unique:

- Clear policy target set out in employment contract (PTA) and a greater degree of independence in achieving its mandate.
- Compared with other independent committee decision-making entities, those in the governing committee at the RBNZ are appointed internally by the RB Governor and are not collectively accountable to the RB Board or the Minister of Finance. Only the Governor can be held accountable given the single-decision making model of the RBNZ.
- Other CE's and independent Crown entities have a clear set of objectives where outcomes can be measured against a rule of law, in particular if individuals and entities in the public domain are unhappy with decisions, they can ask for a judicial review. Monetary Policy decisions are very difficult to assess ex-post and there is no clear framework to measure against except for CPI inflation.
- No clear comparators where an individual is expected to make a policy-implementation decision on the one hand which could be in disagreement to their boss, while at the same time are accountable to their boss for general employment. One exception is the Commissioner of Crown Lands who is appointed and monitored by the Chief Executive but reports directly to the Minister regarding their statutory powers and duties.

Role/Agency	Description	Area of Independence	Appointment Process	Accountability/ Performance Monitoring	Disputes Resolution/ Dismissal	Other Points of Relevance
Format	*Brief description of the entity/position, what it does, etc*	*Outline what functions it has independence on*	*Outline how people are appointed to the role – who legally appoints them, on the advice/nomination of who, how long is the term for, etc.*	*Describe accountability arrangements – who are they legally accountable to, who monitors their performance, any transparency/reporting requirements, etc*	*Outline the process for reviewing their decisions (e.g. if a Minister can request a review of performance/decisions in cases of particular concern) and for dismissal if required*	*For example, do they have any need or a tendency to consult with external experts? Do any have substantially dual functions – e.g. dual mandates for separate but overlapping areas with dual policy levers, akin to monetary policy and financial stability?*
Police Commissioner	The Police Commissioner manages the administration of Police services and carries out law enforcement decisions under section 16 of the Policing Act (2008)	Under section 16(2), the Commissioner must act independently of any Minister of the Crown regarding the maintenance of order in relation to any individual or group of individuals, the enforcement of the law in relation to any individual or group of individuals and the investigation and prosecution of offences, and decisions about individual Police employees. Reduce interference of Minister to use Police as a tool	The Governor-General may, on the recommendation of the Prime Minister appoint a person as the Commissioner for a term not exceeding 5 years. SSC is responsible for managing the process for the appointment of the Commissioner and providing advice on nominations to the Prime Minister and the Minister.	Although the Police is not covered by the State Sector Act, the Police Commissioner is expected to fulfil their role to the Minister of Police under section 16(1) of the Policing Act 2008 as if Police was a public service department under the State Sector Act. Section 16(1) is similar to the general responsibilities of other CEs set out in section 32 of the State Sector Act e.g. carrying out duties and functions, tendering advice to ministers, and economic management. This also means that performance management and annual reviews are carried out by the State Services Commissioner.	The Commissioner holds office at the pleasure of the Governor-General. SSC manages dismissal at the discretion of Governor General.	

Tax Commissioner	Responsible for the care and management of the taxes covered by the Inland Revenue Acts. It is the duty of the Commissioner to collect over time the highest net revenue that is practicable.	The Governor-General may by Order in Council issue directions to the Commissioner in relation to the administration of the Inland Revenue Acts. However, this does not authorise the giving of direction concerning tax affairs of individual taxpayers or the interpretation of tax law.	Chief Executive appointed by the State Services Commissioner in accordance with section 35 of the State Sector Act (1988). Appointed for a term not more than 5 years. Needs to be agreed with Cabinet and signed off by Governor-General	The Commissioner is responsible to the Minister of Inland Revenue regarding operational and economic management of the Inland Revenue department as outlined in section 32 of State Sector Act. State Services Commissioner has the rights, powers, and duties of an employer in relation to the chief executive. Conditions of employment are finalised after the Prime Minister and Minister of State Services have been consulted. The State Services Commissioner is responsible to the Minister of Inland Revenue for reviewing the performance of the Tax Commissioner.	The State Services Commissioner may, with the agreement of the Governor-General in Council, for just cause or excuse, remove the chief executive of a department or departmental agency from office. Decisions are subject to judicial review if Minister doesn't believe the Commissioner has acted in accordance with its statutory functions.	Section 35(4) requires that a panel be established to assess an applicant before he/she is recommended to the Minister for appointment. The panel comprises of: the Commissioner or Deputy Commission as chairperson; and the Deputy Commissioner or an employee of the Commissioner; and 1 or more persons to be appointed by the Commissioner after consultation with the appropriate Minister. The panel therefore requires external experts to be consulted.
Government Statistician	To oversee the operations of Statistics NZ e.g. advice the Minister on statistical policy matters, compile and publish official statistics, taking the census, promoting approved statistical standards across other government departments	The Statistician has the sole responsibility for deciding the procedures and methods employed in the provision of any statistics produced or to be produced. However, the Minister can request the Statistician to collect	Appointed by the State Services Commissioner in accordance with subsections (2) to (5) of section 35 of the State Sector Act (1988). Appointed for a term not more than 5 years. Needs to be agreed with Cabinet and signed off by Governor-General	State Services Commissioner has the rights, powers, and duties of an employer in relation to the chief executive. In the Government Statistician's case, the State Services Commissioner does not require the agreement of the Prime Minister and	The State Services Commissioner may, with the agreement of the Governor-General in Council, for just cause or excuse, remove the chief executive of a department or departmental agency from office.	In accordance with section 35(4) (see above).

	etc.	or cease collection of statistics of any kind provided for by the Statistics Act (1975).	The Commissioner may from time to time reappoint the Government Statistician for a further term without first notifying the impending vacancy or examining other applicants.	Minister of State Services to finalise the conditions of employment. Section 32 of the State Sector Act 1988 outlines the general responsibilities of CEs to the appropriate Minister.	Decisions are subject to judicial review if Minister doesn't believe the Commissioner has acted in accordance with its statutory functions.	
Commerce Commission	The Commission is an independent Crown entity established under section 8 of the Commerce Act (1986). It enforces legislation that promotes competition in New Zealand markets and prohibits misleading and deceptive conduct by traders. It also enforces a number of pieces of legislation that promotes competition in certain markets including the telecommunications, dairy, electricity, gas pipelines and airport sectors. The Commission must have between 4 and 6 members and may also have associate members from time to time. The members are appointed for their knowledge and experience in areas relevant to the Commission's interests.	The Commission acts independently in performing its statutory functions and duties, and exercising its statutory powers, under the Commerce Commission Act (1986). The Commission is not subject to direction from the government in carrying out its enforcement and regulatory control activities. The Commission must follow general government policy unless it breaches its statutory powers and functions.	No less than 3, and no more than 5, of the members, of whom at least 1 must be a barrister and solicitor of at least 5 years' standing, must be appointed by the Governor-General on the recommendation of the Minister of Commerce. One of the members must be appointed by the Governor-General as Telecommunications Commissioner on the recommendation of the Minister for Communications and Information Technology. The Minister may from time to time appoint any person to be an associate member of the Commission. An associate member shall be appointed only in relation to a matter or a class of matters to be specified in that member's notice of	Collectively and individually, the Commission is accountable to the Minister of Commerce and Associate Minister of Commerce for its performance. The Commission delivers outputs under an Output Agreement with the Minister of Commerce and the Minister of Communications and Information Technology. The Commission's performance is measured against a very detailed set of Output Measures, which are agreed with MBIE. A SOI is produced annually setting out their future work programme and is reported against on a quarterly basis to the government via MBIE, and annually to the government and taxpayers of New Zealand via the Annual Report.	The Governor-General may, at any time for just cause, on the advice of the responsible Minister given after consultation with the Attorney-General, remove a member of an independent Crown entity from office. The Minister may remove any associate member from office on the same grounds and in the same manner as the Governor-General. Minister cannot override decisions.	The Minister must not recommend a person for appointment as a member unless that person is qualified for appointment, having regard to the functions of the Commission, by virtue of that person's knowledge of or experience in industry, commerce, economics, law, accountancy, public administration, or consumer affairs. The chairperson may, by writing signed by him, direct that the powers of the Commission under this Act or any other Act in relation to any matter or class of matter, shall be exercised by separate Divisions of the Commission. A Division of the Commission may exercise powers of the Commission.

			appointment, and for such period, not exceeding 5 years. They can only vote at a meeting of the Commission relating to the matter or class of matters specified in that member's notice of appointment.	An obligation to disclose conflicts of interest.		
Financial Markets Authority	The FMA is an independent Crown entity who enforces securities, financial reporting, and company laws as we well as regulating security exchanges, financial advisers and brokers, trustees and issuers. The governance structure consists of a board which the chief executive reports to. The board of the FMA consists of not fewer than 5, and not more than 9, members.	The FMA must act independently in performing its statutory functions and duties, and exercising its statutory powers. The FMA must follow general government policy unless it breaches its statutory powers and functions.	Board members are appointed by the Governor General on the recommendation of the Minister of Commerce and Consumer Affairs. Members are appointed for 5 year terms. The Minister may appoint any person to be an associate member of the board of the FMA after consulting the chairperson. The associate member is appointed only in relation to a matter or a class of matters, similar to those appointed to the Commerce Commission.	Collectively, the board of a statutory entity must ensure that the entity acts in a manner consistent with its objectives, functions, current statement of intent, and current statement of performance expectations. Collectively and individually they are responsible to the Minister of Commerce for carrying out their duties and functions. The Performance and Remuneration Committee (a sub-committee of the board) handles the assessment of performance and remuneration measures across the FMA and especially for the chief executive. An obligation to disclose conflicts of interest.	The Governor-General may, at any time for just cause, on the advice of the responsible Minister given after consultation with the Attorney-General, remove a member of an independent Crown entity from office. The Minister may remove any associate member from office on the same grounds and in the same manner as the Governor-General. Minister cannot override decisions.	The FMA or chairperson may determine that the powers of the FMA in relation to any matter or class of matters may be exercised by separate divisions of the FMA.
CERA within DPMC?	CERA is a departmental agency of DPMC and oversees operations, strategy, and information	No independent statutory power. Purely a governance relationship.	Appointed by the State Services Commissioner under the State Sector Act (1988).	CERA is responsible to the Minister of Earthquake Recovery for its operations, but the host department	The State Services Commissioner may, with the agreement of the Governor-General in	

	dissemination/ reporting of the earthquake recovery in Christchurch. The functions, duties, and powers of CERA are determined by the Minister of Earthquake Recovery in conjunction with the Minister of DPMC (the Prime Minister).			(DPMC) is responsible for strategy, employment and staff, and financial management. SSC monitors the Chief Executive of CERA's performance.	Council, for just cause or excuse, remove the chief executive of a department or departmental agency from office.	
Commissioner of Crown Lands	Management of Crown Lands on behalf of the Crown (through delegation) e.g. Prevent unlawful trespassing or intrusion, defining limits and boundaries, enforcing contracts. The Board also assigns other duties from time to time. All actions and proceedings by or on behalf of Her Majesty respecting Crown land.	Makes decisions on behalf of Land Settlement Board and the Crown. Ministers cannot intervene directly.	Appointed under the State Sector Act (1988) but appointed by the Chief Executive of LINZ, not the State Services Commissioner.	The Commissioner must report directly to the Minister on the exercise and performance of the Commissioner's statutory powers and functions. Chief Executive monitors performance	Chief Executive of LINZ is the employer. Decisions are subject to judicial review if Minister doesn't believe the Commissioner has acted in accordance with its statutory functions.	

Governance: Multiple roles & Committee Structure

Scope & Purpose

The purpose of this paper is to provide background information on the nature of the RBNZ's roles as background *Withheld under s9(2)(g)(i)*

The paper looks at the

- The RBNZ's roles
- Differences between these roles;
- The interaction between functions; and
- Potential international comparators.

A summary of the RBNZ's Roles

Operational Functions

The RBNZ co-locates the following operational functions;

- Monetary Policy
- Macro Prudential
- Supervision & Regulatory Activities
- Payment Systems
- Other operational duties

The scope and weight put on these functions has evolved over time, with the RBNZ taking on a growing role in the financial stability space since the RBNZ Act was first drafted in 1989. The scope of RBNZ regulation has evolved alongside regulatory practice and the scope of entities regulated has expanded in recent years.

Policy Functions

Alongside the traditional central bank operational duties, the RBNZ is relatively unusual in taking on a strong policy role that includes the management of changes to primary legislation.

Interagency Coordination

The need for operational independence for monetary policy and prudential regulation is well established.

Separate work is currently underway to try and define how the RBNZ and Treasury deliver on areas requiring a more collaborative approach under their *Memorandum of Understanding* (refer figure one), notably with respect to areas where the two organisations have recognised a joint lead (i.e. crisis management and framework changes).

Figure One: Treasury–RBNZ Memorandum of Understanding

WORK AREA	RESPONSIBILITY	WHAT THIS MEANS IN PRACTICE
MONETARY POLICY	RBNZ (on formulation and implementation) Joint lead: monetary policy framework/PTA	The Bank has an independent role in formulating and implementing monetary policy consistent with the PTA. The Treasury and the Bank each provide advice to the Minister on matters relating to the PTA and the framework within which the Bank implements monetary policy.
CRISIS RESOLUTION Including pre-positioning	Joint Lead	Coordinate work programmes and work together in a collaborative and iterative manner through the relevant stages of policy development. Each has right to initiate engagements with Minister of Finance
FINANCIAL STABILITY FRAMEWORK For example structural changes to the Reserve Bank Act, institutional coverage, * interaction between resolution and regulation, and costs to the system	Joint Lead	Coordinate work programmes and work together in a collaborative and iterative manner through the relevant stages of policy development. Each has right to initiate engagements with the Minister of Finance
PRUDENTIAL SUPERVISION Developing and implementing prudential standards (Basel III, liquidity, disclosure etc.) and supervision/monitoring of banks	RBNZ Lead, Treasury Challenge Role	RBNZ determine work programme and initiate engagements with Minister Early consultation with Treasury around emerging thinking and around key decision points.
MACRO PRUDENTIAL	RBNZ Lead, Treasury Challenge Role	Under development, but currently a joint work programme to determine appropriate governance arrangements. This means sitting together at the table to determine how this will work.

Differences between individual functions

1. The nature of the roles and functions.

	Monetary policy	Regulation and Supervision
Target/Objectives	Single measurable output - Inflation – that is measured by a well understood index with a clear methodology around its construction.	Dual objectives with potential tradeoffs - stability vs. Efficiency. Both objectives are difficult to measure or even, perhaps, define (i.e. efficiency) and could be assessed by a wide range of interrelated metrics. The RBNZ targets systemic soundness – there is no objective way to measure this risk objectively in terms of a numeric target.
Tools	Single tool (OCR)	Many tools with different trade-offs against RBNZ objectives and others the government of the day may have.
Decisions	Every six weeks	As required based on identification of weaknesses. - Policy changes may be infrequent and made based on identification of risks. - Supervision intensity changes within a risk based approach.
Data Availability	*Public* and able to be externally monitored and critiqued. There is active debate about the appropriateness of monetary policy.	*Public* – disclosure statements *Private*, supervisory data and conversations creating sensitive information that is more difficult to monitor.
Data regularity	Regular release of data to test internal judgements and provide feedback on decisions.	Quarterly disclosure documents and private material based on supervisory relationship inform internal assessments of risk within the system.
Communication	**MPS** – an accountability document and monetary/communication tool *i.e. Used to set expectations and signal changes.*	**FSR** – primarily accountability may become more anodyne as confidence weakens.
Government Input	Sets the PTA which forms part of the Governor's contract	**Non binding**: Minister can communicate policy Govt objectives (s68b) , RBNZ only to have regard to directives
Fiscal and economic Impacts	Diffuse effects that affect a range of interests in a variety of different ways (Beck and Gros , 2012). Savers and borrowers affected differently, although the effects are cyclical over the long term. The Government faces an indirect fiscal effect through the cost of borrowing or tax, although this has a large cyclical component.	Large direct effects. Regulated entities face an immediate direct cost. The effects on the sovereign (tax payer) are implicit and need to be probability weighted, although this is hard to do in practice. Fiscal costs are long-lasting and permanent with significant inter-generational implications.

** = Information withheld under s9(2)(f)(iv)*

2. The degree of independence

The level and degree of independence differs between the respective functions. The IMF (Tuladhar, 2005) divide central bank independence into three levels of decision making (i) goal, (ii) target, and (iii) instrument.

Figure Four: Types of independence.

	Monetary Policy	Financial Stability
Goal	Legislated	Legislated
Target	Numerical target defined by agreement in the PTA	Not Defined
Instrument	RBNZ discretion, but currently uses the OCR	RBNZ discretion over a range of tools, ratios, or guidelines. Ministerial involvement in more invasive tools, such as directions.

3. Options to provide for ex-post accountability and review

The IMF (Hupkes *et al.* 2005) note that the principal-agent relationships in the supervisory area are more complex than those around monetary policy and that regulatory accountability is multi-faceted responding to a range of affected parties.

A summary of the key aspects of accountability within the IMF framework has been included below. The table below suggests differences, although differences may in many cases relate to a difference in philosophy as to how legislation is drafted. Most accountability factors cited by the IMF can be observed in New Zealand. However, for example, US and UK legislation often involves a lot more procedural requirements. Thus, the RBNZ may have, for instance, no formal requirement to consult, but may do so extensively in practice.

More recent post crisis literature has questioned whether the regulatory accountability channels need to be strengthened given the complexity and asymmetric nature of supervisory information (Levine, 2011).

Accountability to Whom	Content and Form	Type of Arrangements	Assessment
Legislative Branch	Regular (annual) report to assembly or committee	Ex-post - explanatory	**Yes** – the Governor presents the financial stability report to FEC,
	Ad hoc questioning and oral presentations	Ex-post - explanatory	**Yes** – FEC inquiry, Minister can request advice
	Ad hoc presentations of proposals for new laws	Ex-post - explanatory	**Yes** – presentation to committee if required.
	Presentation of budgetary outcomes	Ex-post - explanatory	**Yes** – report to MoF/House (s163)
	Audit Report	Ex-post - explanatory	annual financial audit (s166), no provision for routine performance audit except by Ministerial request.
Executive Branch	Regular report to the Minister	Ex-post - explanatory	**Yes** – annual reports, monetary statements, FSR.
	Ad hoc formal presentations, information on sectoral developments	Ex-post - explanatory	The RBNZ holds a financial system issues meeting every two months
	Review of proposals for new regulations	Ex-ante explanatory	The Minister/Cab has delegated regulation powers. Thus, conditions of registration do not receive scrutiny by Cabinet Regulation Review Committee etc.
Judicial Review	Judicial Review	Ex-post – amendatory,	**Yes,** although judicial review does not

		procedural	include a merits review and is not amendatory per se.
	Supervisory liability for faulty supervision	Ex post – amendatory and substantive accountability	**Yes** – the RBNZ can be taken to court But Crown indemnifies the RBNZ against any liability. (S179a) RBNZ staff indemnified against personal loss (s179a). **No** –limited explicit legal safeguards around statutory powers allowing an override of the (s121) hierarchy of creditors differs from FSB recommendations.
Supervised Industry	Consultation on new regulations	Ex-ante and ex-post – explanatory, amendatory	No formal requirement, but the RBNZ consult at their discretion. Informal internal processes in place within the bank.
	Regulatory impact statements	Ex ante and ex-post – explanatory	required under S162AB, but the review process for RBNZ RIAs differs from that for other types of regulation e.g. on Preliminary assessments etc.
	Information on regulatory practice on the website, annual reports, press conferences, public statements	Ex-ante or ex-post depending on the issue – explanatory	**Yes** –RBNZ publishes a regulatory banking handbook, is active in publishing articles, speeches to industry, etc.
Customers and public at large	Mission statement		**No (?)** - Unclear what this involves or an example, but the Act has clear objectives.
	Information on regulatory and supervisory practices, annual reports, press conferences, and public statements		Regular publishing of articles and bulletins on regulatory practice, although targeted at a technical audience, no formal requirement.
	Consumer education		No requirement to do this. FMA surveys suggest the regulatory approach to consumer protection is poorly understood after the removal of the DGS.
	Ombudsman schemes and consumer grievance Board.		Not relevant.

4. Group think and decision making biases

Statutory requirements (above) define a framework for ex-post accountability, although the cost of policy mistakes may have been already been realised at this point. Internal or external challenge ex-ante underpins the expectation that group decision making may outperform individual decision making over time. Namely that challenge offers a safeguard against decision making biases.

Decision making biases affecting the quality of decisions are common to any decision. Relevant biases could include:

- **Groupthink**: a psychological phenomenon that occurs within a group of people, in which the desire for harmony or conformity in the group results in an irrational or dysfunctional decision-making outcome.

- **Confirmation bias:** the tendency to search for, remember, or interpret ambiguous information in a way that confirms one's beliefs or hypotheses.

- **The recency effect:** a tendency to remember (overweight) more recent information.

The risks of groupthink or other forms of bias may differ between functions given the nature of the role and risks. These biases may also increase as the scope of the role increases as decision makers may move to depend to a greater extent on heuristics, rules of thumbs, or unchallenged assumptions.

Monetary policy's relative target transparency, measurability of inflation, and regular release of data provides feedback to decision makers. By way of contrast, systemic risk builds gradually, is difficult to measure, and can crystallise rapidly in an unpredictable fashion, which may lead to collective blind spots (Haldane, 2014)

The solutions around functions may differ as a result. There has been a move towards greater transparency around monetary policy abroad, which may support external debate to test the appropriateness of policy. Achieving the same degree of external challenge around regulatory or supervisory functions may be more difficult as:

- assessments of risks rely, in part, on supervisory work and private information.
- Banks have an incentive to lobby against regulation;
- The nature of risks may be difficult to quantify objectively;
- Any assessment depends on a preference for risk.

Governance arrangements that support internal debate as may occur on a committee(s) are being trialled abroad in countries such as the UK or at the ECB.

Interaction between Functions

Much of the literature covering central bank or supervisory governance discusses the interaction between collocated functions rather than governance of the individual functions themselves. The debate considers a range of factors that include:

- **Policy Synergies:** information sharing especially in times of crisis can be important. Prudential tools are increasingly used for stabilisation purposes within macroprudential policies.

- **Conflicting objectives:** policy decisions to pursue price stability vs. financial stability may conflict at different points in the cycle (refer Dunstan/RBNZ, 2014).

- **Priority and senior management attention:** supervisory activities may decline in perceived importance or may be delegated down over time suggesting more limited management oversight than would be the case in a standalone agency.

- **Competition for resources:** relative de-prioritisation of supervision could lead to reduced supervisory resource overtime (noted in the UK peer review).

- **Scope of roles and the need for specialist expertise:** Consideration of the makeup of a committee(s) should consider whether specialist experience is required[1] or whether general governance and decision making skills are sufficient.

- **Decision biases:** The scope for groupthink, overuse of heuristics, or rules of thumb may increase as the scope of roles increases. Complexity and the risk of information overload increase as the scope of roles increase.

- **Reputational risk:** the failure of a registered bank may lead to a loss of confidence in monetary authorities during times of market distress.

- **Interaction with external parties:** the BIS governance group notes that relationships and nature of interaction with external parties may differ by central bank function.

[1] Influential with the 1997 Australian 'Wallis' inquiry which recommended the establishment of APRA. See Commonwealth of *Australia Financial System Inquiry: Final Report (1997), also discussed in the UK arrangements.*

International Governance Comparators

Direct governance comparators: Central banks with monetary policy and supervision
Source: BIS http://www.bis.org/regauth.htm , Table lists countries where the central bank is listed as the sole prudential authority.

***STEP ONE: Exclude Small or Emerging Markets** –too small, or underdeveloped to consider as role models. Countries, such as Argentina, excluded on governance grounds.*

Algeria	*Cyprus*	*Lithuania*	*Seychelles*
Albania	*Croatia*	*Macedonia*	*Sierra Leone*
Angola	*Egypt*	*Madagascar Malawi*	*Solomon Islands*
Argentina	*Eritrea El Salvador*	*Maldives*	*Sri Lanka*
Aruba	*Ethiopia*	*Mauritius*	*Sudan*
Azerbaijan	*Fiji*	*Moldova*	*Suriname*
Bahamas	*The Gambia*	*Morocco*	*Swaziland*
Bahrain	*Georgia*	*Mozambique*	*Syria*
Bangladesh	*Greece*	*Myanmar*	*Tajikistan*
Barbados	*Ghana*	*Namibia*	*Tanzania*
Belarus	*Guinea*	*Nepal*	*Thailand*
Belize	*Guinea Bissau*	*Oman*	*Tonga*
Bermuda	*Guyana*	*Pakistan*	*Tobago*
Bhutan	*Haiti*	*Palestine*	*Tunisia*
Botswana	*Hungary*	*PNG*	*Turkmenistan*
Bulgaria	*Indonesia*	*Paraguay*	*Uganda*
Burandi	*Iran*	*Philippines*	*Ukraine*
Cape Verde	*Jamaica*	*Portugal*	*Uruguay*
Cayman Islands	*Jordan*	*Romania*	*Uzbekistan*
Congo	*Kenya*	*Rwanda*	*Vietnam*
Costa Rica	*Kosovo*	*Samoa*	*Zambia*
Cuba	*Kuwait*	*San Marino*	*Zimbabwe*
Curacao and Sint Maarten	*Kyrgyz*	*Saudi Arabia*	
Lesotho	*Lebanon*	*Serbia*	
	Libya		

STEP THREE: Consider other small central banks

Possible comparators with a single board

New Zealand – Proposed Single Governing Committee

Czech Republic – single Board

Small countries with multiple Boards.

Israel - (policy and administrative committee)

STEP TWO: exclude banks with significant policy constraints on monetary policy

European Central Banks – *excluded* as they only implement (ECB) monetary policy decisions. Financial regulation set by European Banking Authority (EBA), and Single Supervisory Mechanism (SSM) (i.e. not sole ownership of prudential policy standards)

- Spain, Italy, Greece, Ireland (dual board), Netherlands, Slovakia, Slovenia.

Smaller Central banks with limitations on monetary policy
Hong Kong (no legislation around how the HKMA works)

Macao – n/a is a currency board

Singapore – managed float, single board chaired by Minister of Finance

STEP FOUR: Consider other major central banks

Major Central Banks with multiple boards

UK – MPC, FPC, Prudential Regulation Authority (PRA) is a legally separate and has its own board.

ECB –Supervision is separated and reports to the separate Supervisory Board.

Russia - (twin monetary/financial supervisory boards)

Brazil - (twin monetary/financial supervisory board structure)

India - (twin monetary/financial supervisory boards)

Direct comparisons – small central banks

Direct International comparisons are difficult as the scope of the RBNZ's scope functions remains broad compared to most other central banks (see table above). The table above narrowed down by:

- **Scope** – exclude all central banks with no supervisory duties (i.e. narrow central banks with a monetary focus);
- **Development status** – exclude LICs, underdeveloped countries, or other countries where governance may be at issue.
- **Operational/Policy Restrictions** – exclude all Euro Area central banks as the scope of operations is limited by ECB policy and European regulatory standards. Similarly exclude central banks with currency boards or currency pegs;

This leaves a set of small or larger central banks we could consider.

Small central banks

Three central banks could be considered as direct comparators to the current governing committee in all cases:

- the central banks either release or could be required to release full transcripts and minutes;
- the Board includes external members.
- In the Czech Republic the Minister of Finance sits on the Board as an observer.

This may suggest smaller central banks with significant autonomy and wide policy scope have tended to have input from outside the organisation and relatively high levels of transparency. The Czech republic, for example, releases full transcripts of board meetings with a six year lag.

There is a mix of dual or single boards – although in all cases policy decisions were made by a single board.

	Single Board	Banking	Insurance	Monetary Policy	Minutes	Full Transcripts	Externals	Other
Israel – moved from a single decision maker to Board in 2010	No – Policy Board and Administrative Council	Y	No	Y	Y – two week lag	No	Yes	
Czech	Yes	Y	Y	Y	Y – ratio of votes	Y – six year lag	Yes	MoF sits on Board as an Observer

Large Central Banks

Larger central banks with the scope of functions (i.e. include regulatory duties) observed in New Zealand tend to have specialist regulatory and monetary policy boards often with overlapping memberships.

	Single Board	Banking	Insurance	Monetary Policy	Minutes	Full Transcripts	Externals	Other
Brazil	Yes	Y	Yes	Y	Yes	No	No - internal monetary committee – externals on the	Financial Stability Committee (advisory) -Minister sits on Board

							supervisory comittee	
ECB	**Three -** ECB Board and Supevisory Board, Payments council	Y	No	Y	N	No	Yes (?) – NCB Governors	Chinese walls between parts of the ECB
India	**Three...** -Central Board -Financial Stability Board -Payments Board	Y	N	Y	Y – summary of discussion	N	Yes	
Russia	**Two** – Executive Board and National Financial Board	Y	N	Y	No	No	No on Executive Board (monetary) Yes – on financial board	
U.K	**Three** – monetary board, prudential board, financial stability board	Y	N	Y	Y – released immediately	Y – published with an eight year delay	Yes	Tsy Observer on the MPC and FPC.

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Financial stability decision making in countries where central banks are not the financial supervisors

This note surveys features of financial stability policy decision making arrangements in few countries where authorities other than the central banks regulate and supervise the financial system. In particular, we examine the role played by the key regulators in financial stability in five countries in Latin America, Canada, the United States and Australia. Some common features emerging from the cross-country survey are as follows:

- The central banks are addressing financial stability through their central banking functions – namely, liquidity provision for the financial institutions and oversight of the payment and settlement systems.
- Financial supervisors are incorporating a system-wide approach in their micro-prudential frameworks to implicitly address financial stability.
- Neither the central banks nor the financial supervisors have included the financial stability objective in their statutes. The explicit target for the central banks continues to be price stability, while financial supervisors are responsible for ensuring soundness of individual financial institutions.
- Countries are creating financial stability committees to explicitly address the financial stability objective. The regulatory agencies including financial supervisors and central banks are members. However, in Chile the Governor of the central bank is not a member of the financial stability committee as this could constrain the central bank's independence in targeting price stability. Mostly, these committees have recommending powers while the regulators are the final decision makers and implementing authorities of financial stability policies.
- Financial stability committees are mostly headed by the government representatives. While having government support helps in undertaking legal changes, at times this may hinder pushing measures involving deceleration of economic activity particularly during electoral periods.
- The role of the Government is more active in the US in financial stability. The Treasury department coordinates policies of independent regulators of the financial institutions and markets. The legal changes in the US have constrained the Fed's authority to carry out emergency measures. Under the new law, the Fed must get approval from the Treasury Department before exercising its extraordinary lending authority. In addition, the Fed may extend credit only under a program with broad eligibility. It can't create programs designed to support individual institutions.

Latin American countries (Chile, Mexico, Columbia, Costa Rica and Peru)

Role of central banks in financial stability decisions

The central banks in five Latin American countries[1] (Chile, Mexico, Columbia, Costa Rica and Peru) do not supervise the financial system. They target price stability under their legislative mandates, while financial stability is not explicitly stated as an objective. In some countries (Chile, Columbia, Mexico and Peru), mandates of the central banks are legislated

[1] In three other countries not covered in this note (Argentina, Brazil and Uruguay), the central banks are also in charge of financial supervision and regulation, although the objective of price stability has priority.

in their Constitutions making it difficult for them to formally include the financial stability objective. For instance, the Governor of the central bank of Chile is not a member of the Financial Stability Committee so as to avoid any conflict of independence for the central bank that targets only price stability. Nonetheless, the central banks give inputs to financial stability policy making, and contribute to financial stability through preserving monetary stability and normal functioning of internal and external payment systems. They regulate reserve requirements for banks, and in Chile and Mexico, they also stipulate limits on exposures of banks to the inter-bank market, which contribute towards financial stability.

Role of financial supervision agencies in financial stability decisions

In all the five countries, authorities separate from the central banks supervise the financial system (Table 1). The financial supervisors in these countries only implicitly refer to financial stability with the focus being on ensuring safety of deposits or consumer protection (*Jácome, et. al, 2012)*. In particular,

- in Chile, the *Superintendency of banks and financial institutions (SBIF)* supervises banks and financial institutions aiming at protecting the depositors;
- in Columbia, *Financial Superintendence* focuses on preserving public confidence and consumer rights;
- in Peru, the mandate for the *Superintendence of Banks, Pension Funds and Insurances* focuses on protecting depositors, insured, and pensioners is prescribed in the Constitution;
- in Costa Rica, the *General Superintendence of Financial Entities* aims to preserve stability, strength and efficient functioning of the financial system; and
- in Mexico, the *National Commission of Banks and Securities* focuses on inclusive development in the context of the stability and integrity of the financial system.

Table 1: Authority for Supervision of Banks, Insurances, and Securities

	Banks	Insurances	Securities
Chile	Banking authority	Securities and Insurance Supervisor	Securities and Insurance Supervisor
Columbia	Banking authority	Banking authority	Banking authority
Costa Rica	Banking authority	Insurance Supervisor	Securities regulator
Mexico	Banking authority	Insurance Supervisor	Banking authority
Peru	Banking authority	Banking authority	Securities regulator

Source: *Jácome, L.I, E. Nier, and P. Imam (2012),* 'Building blocks for effective macroprudential policies in Latin America: Institutional considerations', *IMF Working Paper WP/12/183*, IMF, Washington.

These supervisors regulate the financial system by various instruments (dynamic provisioning, exceptional capital buffers, exposure limits to inter-bank market and loan-to-value ratio (LVR) limits on financial institutions) which also impact systemic financial stability. Since regulatory decisions of both central banks and financial supervisors could impact financial stability, some countries have established financial stability committees to coordinate policy decisions.

Role of Financial Stability Committees

The five countries now have committees/councils coordinating information exchange/policies across the financial regulators. Chile and Mexico have created Financial Stability Councils (FSCs) that explicitly monitor systemic risks, recommend policies to the central banks and financial supervisors and secure a consistency in financial stability efforts. However, the central banks and the financial supervisors are the final authorities to decide and implement the policies. FSCs do not have decision making powers and are not accountable for the policies. Mexico's FSC also has financial crisis management powers, while in Chile the crisis management is vested with the individual institutions. In Chile, FSC recommends the criteria for the determination of budget for the financial supervisory agencies.

FSCs in Mexico and Chile are headed by the Minister of Finance and comprise the heads of financial supervisory agencies as members. Unlike in Mexico, the Governor of the central bank is not a member of FSC in Chile so as to avoid any conflict of independence for the central bank. Chile's FSC meets every month, while Mexico's FSC meets every quarter.

In Costa Rica, the National Council of Financial System Supervision (CONASSIF) coordinates financial sector policies in general rather than from a financial stability perspective. Peru has an informal committee and Columbia has a formal committee, but they are mainly for exchanging financial sector information and do not have recommending powers.

Role of Government in Financial Stability

The role of the government varies across the countries. In Chile, Mexico and Costa Rica, the Government plays a key role since MoF acts as a chair of the financial stability/coordinating committees. However, the central banks and the financial supervisor are autonomous decision making and implementing authorities as per their statutes. In Chile, the Superintendent of the SBIF is appointed by the President of the Republic and is a single decision making independent authority although it relates to the Government through the Ministry of Finance. In Costa Rica, MoF is a member of CONASSIF and can influence macroprudential policies. In Colombia, the Government plays a more active role as MoF is in charge of financial sector regulation as the financial supervisory authority legally reports to MoF. On the other hand, in Peru, the Government plays no role in financial stability.

Canada

In Canada, the central bank's main role is to conduct monetary policy and maintain price stability, while financial regulatory and supervisory authorities are housed separately. Supervisory responsibility for financial sector is divided among Federal Government, the provincial governments, and a group of agencies within Federal Government:-

- the *Office of the Superintendent of Financial Institutions* (OSFI) regulates and supervises federally registered banks and insurers, trust and loan companies, cooperative credit institutions, fraternal benefit societies, and private pension plans;
- the *provincial governments* supervise securities dealers, mutual fund and investment advisors, credit unions, and provincially incorporated trust, loan and insurance companies;

- *Minister of Finance* oversees incorporation of banks, permitting foreign bank branches, and reviews large bank mergers;
- *Canada Deposit Insurance Corporation* operates the federal system of deposit insurance;
- The *Financial Consumer Agency of Canada* (FCAC) informs and protects consumers of financial products and services.

Role of the central bank in financial stability

The Bank of Canada coordinates with the other agencies for efficient and safe functioning of the financial system. While financial stability is not an explicit objective, the Bank ensures efficient and safe functioning of the financial system through provision of liquidity, giving policy advice on the design and development of the financial system, oversight of clearing and settlement systems and provision of banking services to the institutions and systems. The central bank also publishes semi-annual *Financial Systems Review* which covers issues relating to financial stability.

Role of the federal financial supervision authority in financial stability

The Office of the Superintendent of Financial Institutions (OSFI) supervises and regulates federally registered financial institutions. The OSFI's primary goal is to safeguard depositors and policyholders of these institutions from loss on account of risks associated with significant activities of the institutions. The OFSI designates a relationship manager (RM) for each institution who writes a letter annually to the institution about the latter's overall risk-rating and the measures required to be taken by the institution.

While the OSFI does not explicitly target financial stability, it continuously "scans the external environment" for both "institution-specific and system-wide concerns". It reports the issues concerning financial stability to the Financial Institutions Supervisory Committee (FISC), and, in turn, receives information from the Committee that may impact the individual institutions (OFSI, 2010).

The OSFI is an independent agency of the Government (housed outside the central bank) and reports to the Minister of Finance annually about the safety and soundness of the federally registered financial institutions and their compliance with the Government regulations.

Role of the Financial Institutions Supervisory Committee (FISC) and the Role of the Government

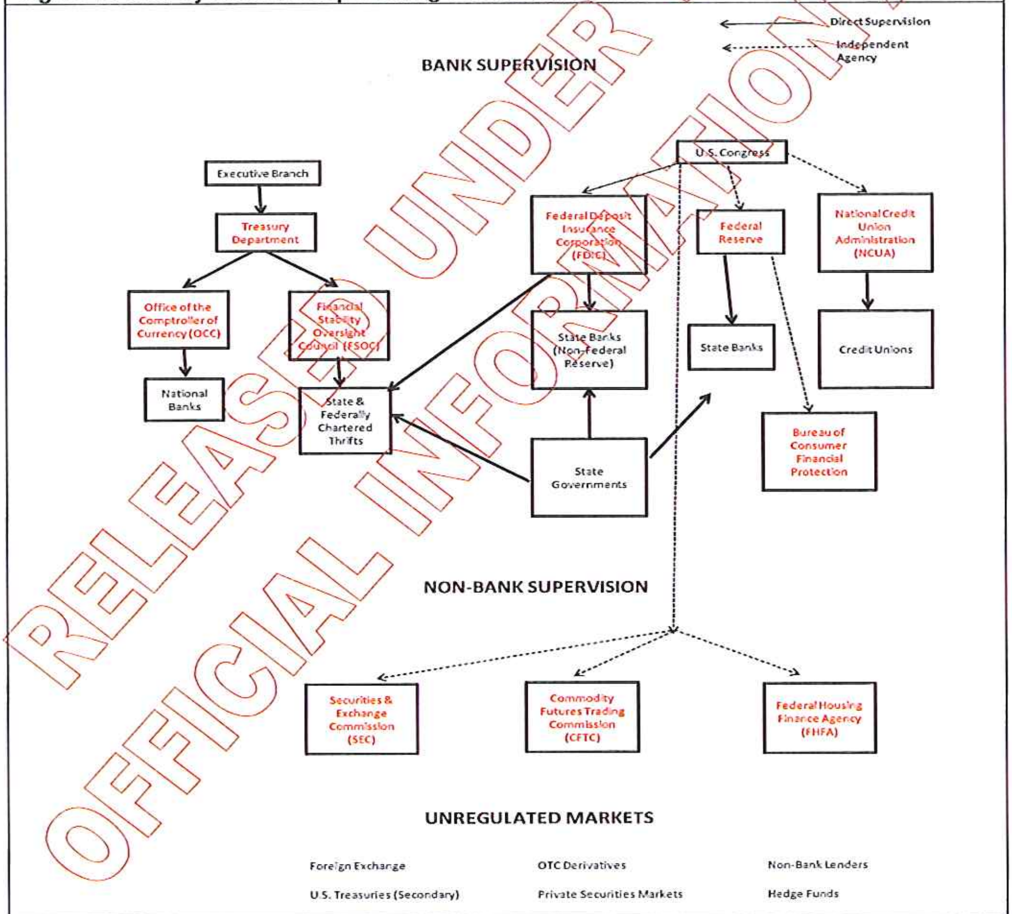
The Financial Institutions Supervisory Committee (FISC) is the chief coordinating body of five regulatory agencies, namely, the Department of Finance, OSFI, the Bank of Canada, the Canada Deposit Insurance Corporation (CDIC), and the Financial Consumer Agency of Canada. The five agencies report to the Minister of Finance, who is responsible to the Canadian Parliament.

The FISC meets at least every quarter to share information, coordinate actions, and advise Federal Government on financial system issues. It also conducts a legally mandated five-year review of the National Bank to ensure that federal regulatory legislation is modernised periodically.

United States

The US has a complex supervisory framework where regulatory jurisdictions of supervisory agencies overlap each other across banking supervision and non-banking supervision (Figure 1). After the Global Financial Crisis, the Government and the Congress have adopted the Dodd-Frank Wall Street Reform and Consumer Protection Act that has sought to rationalise the framework so as to address financial stability, consumer financial protection and consolidated bank supervision objectives.

Figure 1: U.S. System for Supervising Financial Markets



Source: Jackson, J (2013), 'Financial Market Supervision: Canada's Perspective', *CRS Report for Congress*.

The Financial Stability and Oversight Council (FSOC) was created to identify and respond to risks to financial stability. The Council comprises members from the Federal Reserve and eight other financial supervisory agencies. The Congress has created a number of independent agencies supervising different parts of the financial system, namely, the Consumer Financial Protection Bureau (CFPB) within the Federal Reserve to supervise various consumer financial products, the Federal Deposit Insurance Corporation (FDIC) to supervise state banks not supervised by the Fed, and the Office of Financial Research

(OFR) to gather and analyse data financial system-wide data from regulatory agencies to support the FSOC. The National Credit Union Administration supervises the many credit unions.

In the area of non-bank supervision, the Congress has chartered three independent agencies, namely, the Securities & Exchange Commission, Commodity Futures Trading Corporation and Federal Housing Finance Agency.

Role of the central bank in financial stability

Financial stability is not explicitly stated objective in the Federal Reserve's founding statute. The Fed supervises only banks and bank holding companies, while the predominant portion of financial system including non-banks and capital markets are regulated by other supervisors. Following the Global Financial Crisis, the Dodd Frank Act 2010 has made the Fed's role in financial stability more explicit. While the Fed continues to directly supervise only part of the financial system, the Fed has adopted a four-pillar strategy towards financial stability objective as set out below (Brainard, L, 2014):

I. Surveillance: created the Office of Financial Stability Policy Research (OFSPR) to identify system-wide financial vulnerabilities
II. Macroprudential policy: aims to strengthen less tested time-varying counter-cyclical tools to manage risks
III. Working with other regulators: networks with other supervisors through the FSOC as well as through joint rulemakings and joint supervisory efforts
IV. Monetary policy: recognises that monetary tools are too blunt to target sector-specific risks, and are best suited to only complement rather than substitute macroprudential tools.

The Fed has also created a Financial Stability Committee (headed with the Fed Vice-Chairman and including two Governors) that deliberates on the financial stability risks identified by the OFSPR and analyses how the central bank should respond.

Role of Federal Deposit Insurance Corporation (FDIC) in Financial Stability

The FDIC, an independent agency of the Federal Government, insures deposits of banks and thrift institutions (within a threshold limit) to preserve public confidence in the financial system. It regulates state banks not supervised by the Fed. The FDIC is managed by a five-person Board of Directors, all of whom are appointed by the President and confirmed by the Senate, with no more than three being from the same political party.

Role of Financial Stability and Oversight Council (FSOC)

The FSOC has 10 voting members and 5 non-voting members and brings together the expertise of federal financial regulators, state regulators, and an independent insurance expert appointed by the President. It has nine member agencies, namely, the Federal Reserve Board, FDIC, OCC, NCUA, SEC, CFTC, FHFA, CFPB and the Treasury. The Council meets every month.

Besides monitoring and coordinating policy responses to risks to the financial system, the FSOC has the authority to designate a non-banking financial company as a threat to financial stability and place it under the Fed's supervision. It is also authorised to designate a Financial Market Utility as systemically important institution whose failure can create significant liquidity and credit problems and subject it to special risk management standards and additional requirements set out in the Dodd-Frank Act.

Role of Government in financial stability

The role of the Government is more active in the US in financial stability. The Treasury department coordinates policies of independent regulators of the financial institutions and markets. The legal changes in the US have constrained the Fed's authority to carry out emergency measures. Under the new law, the Fed must get approval from the Treasury Department before exercising its extraordinary lending authority. In addition, the Fed may extend credit only under a program with broad eligibility. It can't create programs designed to support individual institutions (FRB, San Francisco, 2015).

Australia

Australia distributes financial stability responsibility across various regulatory agencies:-

- Australian Prudential Regulation Authority (APRA) sets prudential standards and supervises banks and financial institutions
- The Reserve Bank of Australia (RBA) as the central bank provides liquidity to the financial system and regulates the payment systems (including oversight of clearing and settlements systems)
- Australian Securities and Investments Commission (ASIC) works with the RBA to minimise systemic risks in clearing and settlement systems
- Australian Treasury advises the Government on financial stability issues, and the legislative and regulatory framework underpinning financial system infrastructure.

The Council of Financial Regulators (CFR) plays a central coordinating role and provides a platform where the four regulatory bodies meet to discuss trends in the financial system, examine the risks to financial stability and coordinate their policy actions to mitigate those risks. Australia subsumes the system-wide view within the prudential supervisory framework of individual financial institutions. The institutions which are found systemically risky are subject to stricter prudential requirements (like higher capital adequacy ratios) by APRA. APRA shares disaggregated data of individual institutions with the RBA, while the latter shares its system-wide analysis including information of non-financial entities. Based on both aggregated and disaggregated information, the two agencies examine the concentration of risks in parts of the economy and its capacity to mitigate the effects of particular shocks.

Role of the RBA in financial stability

The RBA implicitly pursues the financial stability through its originally mandated objectives of ensuring currency stability, maintaining full employment and contributing to economic welfare. In 2010, the Government and the RBA recorded a common understanding of the RBA's longstanding financial stability responsibility (RBA-APRA, 2012). Financial Stability Department in the RBA monitors and analyses financial stability developments which are discussed in the pre-Board and Board meetings of the Bank every month. This Department prepares a financial stability paper which is discussed in the RBA's March and September board meetings and publishes *Financial Stability Review* semi-annually. The RBA conducts studies as commissioned by the CFR every year.

Role of APRA in financial stability

APRA Act 1998 requires APRA to promote financial stability while "balancing the objectives of financial safety and efficiency, competition, contestability, and competitive neutrality"

(RBA-APRA, op.cit). APRA subsumes industry-wide risk management framework in its prudential supervisory framework for individual institutions. Within APRA, the Industry Analysis team maintains 'risk registers' on material concerns observed in more than one institution that could have an industry-wide impact. Industry groups of cross-divisional staff of APRA review these registers annually and also liaise with professional bodies to identify issues to be escalated for appropriate policy or supervisory response. Supervisors use risk registers to prepare Supervisory Action Plans (SAPs) based on risks that could be relevant to each entity.

APRA operates macroprudential tools mainly at four levels. It modulates the intensity of financial supervision by varying prudential tools (particularly capital requirements) to counter the risks arising from the economic cycle. It also sets prudential restrictions on exposures to certain sectors that are changed less frequently. It also influences behaviour of financial entities through suasion via communication with individual entities, industry-wide communication and open public messages. Finally, APR issues directions to individual entities.

Role of the CFR

The CFR is an inter-agency body of the four regulators which coordinates policies to achieve efficiency and effectiveness of regulation, and promote financial stability. It is a non-statutory body and has no regulatory functions separate from those of its members. The CFR is chaired by the Governor of the RBA and meets every quarter. The CFR provides a forum for discussion and resolution of issues between the regulators. It is also responsible for ensuring that there are appropriate coordination arrangements for responding to actual or potential instances of financial instability. The CFR had played an important role in coordinating policy responses of the regulatory agencies during the crisis.

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IN-CONFIDENCE

THE TREASURY
Kaitohutohu Kaupapa Rawa

Reference:	T2015/1182	MC-1-2
Date:	5 June 2015	
To:	Minister of Finance (Hon Bill English)	
Deadline:	None	

Aide Memoire: Reserve Bank Statement of Intent (2015-2018)

Not relevant to request

- The RBNZ is discontinuing its workstream on 'best-practice institutional frameworks'. The Treasury would prefer this workstream to continue.

Treasury Comment on the draft SOI:

Not relevant to request

A key change from the previous year's SOI is that a workstream on 'best-practice institutional frameworks' Withheld under s9(2)(g)(i) [redacted] has been dropped. In the Treasury's view, this workstream would be worth continuing Withheld under s9(2)(g)(i) [redacted] Nevertheless, we understand that the decision to drop this workstream is consistent with your feedback that the current decision making structure best supports accountability.

Not relevant to request [redacted]

Recommendation

Not relevant to request [redacted]

Note that the RBNZ is discontinuing its workstream on 'best-practice institutional frameworks'. The Treasury would prefer this workstream to continue.

Not relevant to request [redacted]

Withheld under s9(2)(g)(i) [redacted]

Tim Ng, Director, Macroeconomic and Fiscal Policy, 04 917 6124