

**Reserve Bank Governance and Decision-making
Summary of discussions with the Governors and Board of the Reserve Bank**

14 March 2017 – Reserve Bank of New Zealand Governors

Attendees

Graeme Wheeler, Grant Spencer, John McDermott, Roger Perry, Mike Hannah (all Reserve Bank); Gabriel Makhoul, Felicity Barker, Ben Gaukrodger (all Treasury); Iain Rennie.

Discussion

- Gabriel Makhoul opened, acknowledging the change in decision-making processes that has occurred under Graeme Wheeler's leadership, and the difference between New Zealand and other central banks.
- Gabriel Makhoul also set out the process for the Treasury's work, stating that Iain Rennie was writing a consultant report for the Treasury, and that following that the Treasury would develop its own position. Consistent with protocol, the Treasury would intend to inform the Minister of the work before the election, but not give advice until after the election. If the Minister decided to pursue the work, the Treasury expects to work up a formal proposal in 2018 and any legislation would follow in 2019.
- The Governors then set out their views on the Reserve Bank's existing decision-making model:

Current Governing Committee (GC)

- The GC reflects public sector reforms, there are checks and balances, which help with accountability.
- It has become important to focus more on the Reserve Bank as an institution, rather than just on the Governor, as the Reserve Bank has taken on more and more responsibilities over time.
- Discussed different overseas models, including strengths and weaknesses of different approaches.
- The approach to decision-making and communications needed to be consistent with the Reserve Bank's approach (e.g. must be appropriate in the context of forward guidance).

Codification of the Committee Structure

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- Codification's advantage was that it could prevent a future Governor from moving back to a single decision-maker. However, that hasn't been a problem in Canada, and it would be difficult for a Governor to roll the current committee approach back.

Effectiveness

- The cohesion of the GC and the cooperative nature were identified as the most important factors in its success. The GC was relatively informal with collective responsibility, and that worked well.
- Discussed how the current committee operated, and some strengths and weaknesses of the approach.
- Discussed the effectiveness of different options for decision-making and communications design, such as voting and minutes (neither supported).

Appointments

- Discussed the current process for choosing GC members, and other potential appointment processes.

Policy Targets Agreement

- Discussed different options relating to the PTA (including whether the PTA needed to remain quite tightly connected to the appointment of the Governor) and ability to remove Governor for not meeting targets.

Externals

- Discussed the potential for including externals, and their need to keep up with the issues when only part-time. Noted that internals bring strong institutional knowledge.

Reviews

- Value in periodic targeted reviews of arrangements, but important not to have a situation where the reviews might risk undermining independence.

15 March 2017 – Reserve Bank of New Zealand Board of Directors

Attendees

Wellington: Neil Quigley (Chair), Mike Hannah (Board Secretary); Felicity Barker and Ben Gaukrodger (both Treasury); Iain Rennie.

Via video link: Rod Carr; Bridget Coates; Jonathan Ross; Kerrin Vautier.

Also includes comments from a separate session held with Keith Taylor on the same day, which was arranged given that Mr Taylor was unable to attend the earlier meeting.

Discussion

- Felicity Barker opened, setting out the process for Treasury's work, consistent with the explanation to the Governors.
- Following this, the session was an opportunity to get the Board's views:

The Governing Committee

- Discussed the changes the Governor has introduced in respect of governance/decision-making process, including the governing committee. This discussion included how the approach works in practice and the strengths and weaknesses of the approach.

Legislative Change

- Discussed the advantages and disadvantages of amending legislation to codify a committee approach and change governance, including reduction in flexibility, increased costs, risk of destabilising the organisation, putting independence at risk.

Appointments

- Discussed approach to appointments and the advantages and disadvantages in the context of the organisation as a whole.

Expansion of the Role of the Reserve Bank

- Discussed the expansion of the Reserve Bank's role, including the implications thereof.

Stewardship

- The Board has actively worked on stewardship.

Relationship with Minister and Treasury

- Discussed the relationship between the Governor and the Minister, and the implications of this on the Board, and changes in the relationship over time.
- Discussed the relationship between the Board and (i) the Minister; and (ii) the Treasury.

Role of the Board

- Discussed the role of the Board, including how the Board's role is set out in legislation, Board responsibility, the skills of the Board, and the Board's monitoring and advisory functions.

30 March 2017 – Reserve Bank Board

Attendees

Neil Quigley, Kerrin Vautier, Rod Carr, Bridget Coates, Jonathon Ross, Tanya Simpson, Keith Taylor, Graeme Wheeler, Grant Spencer, Geoff Bascand, John McDermott, Mike Hannah; Felicity Barker, Ben Gaukrodger; Iain Rennie.

Discussion

- The meeting began with an outline of the process: Iain Rennie would be writing his report over the next few weeks, before it went to peer review. After comments from peer reviewers were received the report would be updated. Treasury would then consider the report and use it to inform our advice to the incoming Government.
- Following this Iain Rennie outlined his approach to the report and his likely recommendations to the Treasury:

Status Quo and Problem Definition

- Does not see the status quo as a broken model – it has produced materially better outcomes than were seen before 1989. It has also evolved over time, and we want it to continue to evolve.
- Over the next 20 years, wants the Reserve Bank decision-making model to support good decision-making to help maximise welfare for New Zealanders. Also wants the Reserve Bank to maintain a strong social licence to operate. The Reserve Bank has visible, significant and

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pervasive tools, and there is a need to ensure there is confidence in the Reserve Bank's use of those tools.

- Also worth considering the political dynamic. Change can happen quickly in New Zealand if trust in the Reserve Bank is lost, so it is appropriate to make change early to guard against that risk.

Recommendations

His review:

- Is supportive of codification of a committee, but suggest a permissive approach. Don't want to be overly prescribed, need to allow continual evolution.
 - Strongly endorses a committee approach for a few reasons:
 - Committees help to build licence for the institution by depersonalising decisions.
 - Research suggests better outcomes.
 - Benefits of accountability from a single decision-maker have not proven as big as first imagined.
 - The model is unusual internationally and within the New Zealand state sector.
 - Recognises that not all committees will be an improvement, and that there is no single committee design that will be perfect. Design needs to balance objectives.
 - Wants a system where individual members are empowered and encouraged. Transparency settings would aim to get the benefits of diversity and challenge but maintain a cohesive approach overall.
 - Will recommend having objectives clearly defined, with a shift of the PTA from being person dependent to time dependent. This would allow external engagement and more Reserve Bank input in setting objectives, as per the Canadian model. A Government Policy Statement (GPS) for Financial Policy would support the Reserve Bank in decision-making as well.
 - Sees the Board's prime role as performance monitoring for the Minister of Finance. Wants to think through how the Board provides assessment of performance and advice.
- Iain Rennie clarified that the intention of a GPS for financial policy would be to give more guidance about objectives than the high-level drafting of the Act

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currently provides. Not intended as a challenge to the Reserve Bank's operational independence.

- Following this outline from Iain Rennie, there was a discussion with the Board. Key points were:
 - Iain Rennie maintained that a social licence relied on competence and public engagement. There was no obvious failing, but the expansion of the Reserve Bank's remit to cover more in terms of financial policy meant that there was a greater risk now than in 1989.
 - The benefits of the Canadian model for setting objectives were discussed, Rennie noting the greater public support that results from external consultation.
 - The Board cautioned about losing sight of the Reserve Bank's reputation, both nationally and internationally, and the risks inherent in reform when recommending changes.
 - Rennie noted tensions between independence and accountability, necessary to secure a social licence. This was discussed. Credible performance was likely to be the greatest determinant of social licence.
 - It was noted that the best organisations always evolve, and that the changes needed to leave space for evolution.
 - There was sympathy for the idea that an increased mandate for the Reserve Bank has increased the risk to the institution.

Reserve Bank Governance and Decision-making Summary of discussions with the BIS and various central banks

Background

Between 15 and 24 March 2017 discussions were held with representatives from the Bank for International Settlements and various overseas central banks to obtain their views on, and experiences with, different central bank decision-making models and governance.

The representatives were:

- Bank for International Settlements – David Archer (Head of Central Banking Studies)
- Reserve Bank of Australia – Anthony Dickman (Secretary)
- Bank of England – John Footman (Secretary)
- Bank of Israel – Daniel Hahishvili (Chief of Staff to the Governor); Yoav Soffer (Spokesperson and Head of Economic Information); Esther Schwartz (Secretary of the Monetary Committee)
- Bank of Canada – Stephen Poloz (Governor)

Summary of discussions

The representatives from the central banks discussed the decision-making and governance models employed at each of their respective central banks.

The following key points were also raised in the discussions:

- *International trends*

Given the depth of powers of central banks, and more recognition about the ability to get things wrong, there is political discomfort internationally with the limitations on holding central banks to account.

Countries are struggling with financial policy. There is a trend towards interagency financial stability councils with unclear powers. There is recognition within central banks that there is an issue that needs to be dealt with, but generally speaking action on this has been limited.

- *Multiple committees*

The law has been changed to create specialist policy committees in some countries. Specialist members are there to help executives. This separation doesn't just reflect specialisation, but also conflicts of interest between policy

areas. That is, there is a potential tension between policy domains in certain circumstances.

- *Appointments*

One view expressed was that if pursuing an individualistic model, then statutory backing is necessary for the individual – through appointment process etc.

One central bank noted that there is a strong public service regime for picking candidates in its jurisdiction. Candidates are interviewed by a panel that includes members from the central bank, the treasury, and from the wider public service. The panel makes recommendations to the appointer who then decides.

At one central bank external members get a training programme at the start of their term to ensure they are up to speed. They also get a research assistant, plus access to the central bank's information and data. Externals tend to send questions to staff, which isn't a particularly formal process. Externals can call staff members to discuss work, but couldn't commission new research. External members' time commitment is roughly 2/3 days per week. There are weekly meetings at least, plus materials to go through.

- *Accountability*

A view was expressed that accountability relies on ongoing enquiries. The efficacy of parliamentary committees varies internationally. Alternatives include the auditor general, as well as external enquiries. For example, in Sweden, there is an enquiry into policy every four years. An annual review of performance is likely too frequent. In the United Kingdom the Independent Evaluation Office has explicit legal authority to commission reviews.

Codes of conduct tend to focus on conflicts of interest (real and perceived). Members cannot be involved in financial institutions.

One central bank noted that there are various mechanisms for transparency, but they have found that questioning by parliament is still the most effective.

- *External members*

For most banks when members are inducted, they are briefed and meet with key staff. In some cases new members have struggled at the outset, but that is unavoidable for a while at least.

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Central banks have had different experiences with external members and in past there has been resistance, but this has passed in time.

The literature talks about the value of information gathering and information processing is stressed most strongly. The view was expressed that external's biggest value was in providing different ways of thinking: our knowledge of how the economy works is pretty weak, so being able to bring different models to the debate is crucial. When things begin to go badly, you need to be able to think more flexibly about the legitimate alternatives, and external members help with that.

Views were expressed that externals test the central bank, challenge the central bank's thinking, and clearly make a difference to decision-making under uncertainty. It helps to have people who aren't bound to the central bank. Low quality external members is a risk, but also rare. Composition has sometimes not been highly diverse, but it does bring different skillsets beyond economics. A committee of career central bankers risks groupthink. For example, the quality of the forecasts is more likely to be criticised by those who have seen different approaches elsewhere. External members were thought to broaden the perspective of the central bank.

External members need to have technical capability and be used to challenging the intellectual frameworks in play. Later career appointees are less likely to be interested in grandstanding. These requirements narrow the field, but should be prepared to have international appointees. The purpose is to reassure the public that a range of views are being sought, which means you can't only have overseas appointees, but you can have some.

Where there is diversity in a group, the tensions in decision-making become clearer. It also makes it more likely that the tension is known more outside the institution.

Independence is critical. Supported by not just having faceless bureaucrats, with external members well known people in the community. Having high profile external members means that they could credibly challenge the central bank. The flipside of having well known externals is that if they raise political issues in another context, it can create challenges for the central bank.

One central bank changed enormously as a result of adding externals. It is less hierarchical, and much more collegial. Work is socialised more, which has a positive impact on the quality of the work.

In one country the law requires significant experience and education, which means that people are seriously established. Someone who is not an academic would find it hard to join, given conflict of interest restrictions.

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Externals for financial policy and prudential regulation are more helpful again given experience in the markets, but conflicts of interest is an issue.

- *Transparency and communications*

Views varied on the value of individualistic vs consensus communications.

One argued against consensus communications on the basis that you need a mechanism to make people put effort in, which speaks to having input made public. This is an essential ingredient of accountability. There are different models. Complete minutes are good but full transcripts create problems, although they are handy for reviews. The forward guidance model in New Zealand makes this difficult, with very high levels of scrutiny from the markets. Coupled with this, there is also a concern about creating confidence in the institution, which can result in more certain communication than may be justified. A drive to try and put forward a confident view can in turn lead to a coalition of views amongst decision-makers. This isn't easily solved structurally, but it is necessary to think about how crisp and clear communications should be.

One central bank noted that it has had a mixed experience. A collegial approach got the committees to bond quite well, but that depends on individuals. Committees have worked well even where there are different views, because the objective is clear. It is reasonable for members to disagree about how to best achieve the goal of low and stable inflation. Members of the committee dealing with monetary policy can speak externally, and members have been good at doing that without causing problems for the central bank. Moreover, with a committee of high profile individuals, telling them not to give speeches will not work.

In one jurisdiction differences of view are publically communicated, but not attributed. In public, members will take the majority view and speak with one voice. This is not in law, but simply the standard of the committee, but seen as very important. Communications focus on the fact that decisions are those of the committee. Nevertheless, the reporting still focuses on the governor.

One central bank noted that where the committee members do not all agree, it is very rare for it to go in the minutes. Disagreement is seen as a vote of no confidence. Given that the decision will be revisited in a month, committee members tend to take the view that consistent communications are more important.

Another central bank noted that it was a significant moment the first time the Governor was in the minority in a decision for the committee on monetary policy. But it worked quite well, and showed that the central bank and the committee works – sometimes the governor is wrong. Before the committee the governor

was always right, even when they were wrong. The governor is the face and driver of the committee.

One central bank expressed a dislike of minutes given the risk that people just start working around the minutes through informal side conversations. Press conferences are used to give a lot of colour to decision – more information can be given in 5 minutes of dialogue than there could be in a written document. All speeches are consistent with group decisions. This is by protocol rather than legislation.

- *Legitimacy*

One central bank noted that having ‘heavyweights’ as externals helps create legitimacy and stand up to public scrutiny.

Another central bank noted that it has become stronger with the introduction of the committee model. Having committee members of high standing helps. Also, the governor is no longer asserting his/her own view and they can also point to the support of the committee.

The ability of a governor to override a decision of a committee can create potential for a legitimacy issue, which could have consequences.

- *Committee process/dynamic*

One central bank noted that where there is a majority/minority split, it has not been along external/internal lines as expected. Typically the split has been mixed whenever there has been one.

In one central bank interest rate decisions are taken after a full day of presentations of research from central bank staff, with the committee challenging the presentations. There is then a discussion that is limited to committee members. It has not seen much of a change internally after codifying a committee given that there was already an advisory committee, but processes became more orderly and arguments became more robust given the need to convince a committee. The process also became more formal.

Another central bank noted that there is often a spectrum of views around the table. Never polar opposite views, but there can be differences between whether there should be action or not, along with nuances in how people justify decisions.

Access to research resources and other resources makes a difference to dynamics and efficiency. Need to think about this in the context of the Chair’s powers.