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Phase 2 of the Reserve Bank Act Review  
The Treasury  
Wellington

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## Phase 2 of the Reserve Bank Act Review – Consultation 2

The Institute of Directors (IoD) appreciates the opportunity to comment on [Consultation Documents 2A and 2B](#) as part of Phase 2 of the Reserve Bank Act Review aimed at safeguarding the future of New Zealand's financial system.

This is the second of three rounds of consultation within Phase 2, focusing on the Reserve Bank's role in financial policy including how it should be governed (Consultation Document 2A) and its tools, powers and approach (Consultation Document 2B). The IoD submitted on the first round of consultation within Phase 2 in January 2019.

Our submission focuses on governance related issues in the consultation documents. Notwithstanding our feedback here, the IoD may make further comments as the review progresses.

### About the Institute of Directors

The IoD is a non-partisan voluntary membership organisation committed to driving excellence in governance. We represent a diverse membership of over 9,000 members drawn from listed issuers, large private organisations, small and medium enterprises, state sector organisations, not-for-profits and charities. Many of our members serve on boards of entities regulated by the Reserve Bank.

The IoD's *Code of Practice for Directors* provides guidance to directors to assist them in carrying out their duties and responsibilities with high professional standards. All IoD members sign up to the Code.

Our Chartered Membership pathway aims to raise the bar for director professionalism in New Zealand, including through continuing professional development to support good corporate governance.

### Background

The Reserve Bank is an important and unique institution in New Zealand and it performs a number of vital roles in the financial ecosystem.

The two-phase review of the Reserve Bank of New Zealand Act 1989 began in 2018 to ensure that New Zealand's monetary policy and financial regulation frameworks are fit for purpose.

Phase 1 was completed in 2018. As a result, supporting maximum sustainable employment has been added to the economic objectives for the Reserve Bank and a Monetary Policy Committee (MPC) has been created with responsibility for formulating monetary policy.

Phase 2 of the Reserve Bank Act Review is a wide-ranging review of the financial policy provisions of the Reserve Bank of New Zealand Act, including those that provide the legislative basis for prudential regulation, supervision, and the crisis management framework. This phase of the Review also considers institutional matters such as the Reserve Bank's legislative objectives, broader governance arrangements and the funding model.

Consultation Document 2A seeks more detailed feedback concerning the issues raised by Consultation Document 1, including how the Reserve Bank should be governed.

Consultation Document 2B seeks views on a wide range of potential reforms including to the tools, powers and approach of the Reserve Bank to prudential regulation, policy enforcement, crisis management, policy coordination and resourcing.

## IoD Comments

Our comments are divided into the following sections:

- **General Comments:** high level observations regarding some thematic issues across both consultation documents
- **Director Accountability:** addressing certain matters raised in Chapter 1 of Consultation Document 2B and
- **Reserve Bank Governance Arrangements:** addressing certain matters raised in Chapter 3 of Consultation Document 2A
- **Director professionalism:** comments on strengthening director professionalism and recognising IoD Chartered Membership.

### General Comments

New Zealand's public institutions and the people who govern them are well regarded internationally. For example, New Zealand is ranked third by the World Economic Forum's *Global Competitiveness Report 2017/18* for the quality of its public institutions, and first for the efficacy of its corporate boards.

A key role of boards is to ensure effective compliance with regulatory environments. Boards are also ultimately accountable for what goes on in their organisations and they have a core role in risk governance.

The current prudential framework has, in the main, served New Zealand well, including during challenging times. Although some recent issues have emerged (such as those identified in the review of the supervision of CBL Insurance and ANZ's capital adequacy modelling) the underlying model appears sound. Some options to address issues in the financial sector in New Zealand intersect with other initiatives such as the Ministry of Business, Innovation and Employment's consultation on regulating the conduct of financial institutions (which the IoD has submitted on).

It is critical that any additional regulation of New Zealand's financial services sector is proportionate and designed to augment the existing framework. New Zealand should be cautious in adopting solutions of jurisdictions who have taken a different approach to prudential regulation unless there is clear evidence those measures have worked and would be effective and appropriate here.

To take the Australian example, since the collapse of HIH Insurance in 2001 Australia has steadily increased compliance obligations in the sector, the powers of its regulators and the nature and extent of liability imposed upon management and directors. The findings of several investigations and inquiries since<sup>1</sup> (including the most recent Hayne Royal Commission) suggest that approach has not delivered the desired outcomes. We are yet to see whether the new Australian Banking Executive Accountability Regime (BEAR) will prove the difference.

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<sup>1</sup> See, for example, the *Senate Economic References Committee Report into the Performance of the Australian Securities and Investments Commission* dated June 2014 and the *Financial System Inquiry Report* (Commonwealth), November 2014.

### ***Increasing trend of more director personal liability***

The increasing trend of laws and regulations extending director personal liability is deeply concerning. We are seeing this across different regimes and on a piecemeal basis. Accountability is critical to corporate governance and director personal liability has its place. For instance, the IoD has supported reform where directors could be civilly or criminally liable in appropriate circumstances (eg under the Health and Safety at Work Act 2015). However, increasing responsibilities and liability on directors can have a cumulative impact on directors and organisations including deterring directors from seeking board roles.

It is vital that boards of regulated entities in New Zealand continue to attract well qualified, experienced directors with a diverse range of perspectives. In our 2018 [Director Sentiment Survey](#), one-third of directors said that the scope of director responsibilities was more likely to deter them from taking on governance roles. Please see our [submission](#) to the Ministry of Business, Innovation and Employment on regulating conduct and culture for further concerns with introducing a BEAR regime.

Against this background, the IoD generally supports targeted improvements to the current prudential model and liability framework over systemic change (in effect an enhanced status quo where that option is suggested).

### **Director Accountability (Chapter 1, Consultation Document 2B)**

The Reserve Bank has been delegated a range of regulatory tools and powers by Parliament to detect and protect the financial system against risks (through regulation and supervision). In that context, Chapter 1 discusses, amongst other issues, the breach reporting and liability framework and the arguments for and against New Zealand adopting a BEAR framework, which would increase the responsibilities and accountabilities of an entity's senior executives and directors. The comments that follow focus primarily on those issues.

The IoD supports a requirement for regulated entities to report material breaches of the rules to the Reserve Bank as soon as practical. We discuss the broader liability framework below, in the context of director accountability (noting there is some overlap in this regard with the issues raised in Chapters 1 and 3 of Consultation Document 2B).

The current attestation regime creates a form of director accountability for registered banks by requiring individual directors to attest to the bank's compliance with Conditions of Registration and systems of risk management. Directors can be exposed to criminal liability under this regime without proof of fault, unless they can establish a defence.

The 2017 review of the attestation regime by Deloitte<sup>2</sup> confirmed it is 'largely effective' both in focusing the minds of individual directors and the risk culture it has created. However, Deloitte identifies some threats to its effectiveness including:

- reliance on high quality directors
- the openness of bank culture generally and
- the role of the Reserve Bank in verification of attestations.

The IoD considers that the current attestation regime could be improved in line with '*Option1: Enhanced status quo*' in Consultation Document 2B, including increased supervisory engagement by the Reserve Bank. This should be done in a manner that encourages high quality directors to remain involved in the sector and which includes a process to audit or verify attestations by the Reserve Bank.

The IoD supports the existing liability framework for prudential regulation which focuses on the regulated entity supported by broader legal duties on directors. The case for a BEAR regime seems

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<sup>2</sup> Deloitte, *Reserve Bank of New Zealand Review of the bank directors' Attestation Regime*, August 2017

to be based on the introduction of similar regimes overseas and an implication that more intense regulation leads to more effective outcomes.

The current criminal liability for directors in the absence of fault under the attestation regime is disproportionate and inconsistent with good practice. However, replacing that liability with personal (civil) liability for directors should, in our view, be approached cautiously and with due regard to the broader liability framework already applying to directors. There should be a significant materiality threshold before personal liability applies.

In relation to the broader liability framework, company directors in New Zealand are already subject to a duty to exercise reasonable care, diligence and skill under the Companies Act 1993. The Australian BEAR regime duplicates that duty. Another existing duty under the Companies Act requires directors to act in good faith and in the best interests of the company. It is difficult to see how conduct lacking in integrity could be consistent with that duty. These existing duties are enforceable in various ways and by multiple parties. We also encourage Treasury to consider potential director personal liability under other legislation, including the Financial Markets Conduct Act 2013, the Financial Reporting Act 2013 and Fair Trading Act 1986 in their analysis.

Any new duties should be carefully considered and imposed only to the extent necessary. Any further personal liability imposed should only respond to conduct not already addressed under existing laws and regulatory powers. We encourage Treasury to take a system-wide view of board and director responsibility and personal liability in analysis of this area.

### ***Director safeguards***

Under New Zealand's bank crisis management framework, directors may be directed to take certain actions, or suspend normal continuous disclosure (or other) obligations in order to resolve matters threatening the financial viability of the business they govern. As proposed in Consultation Document 2B, we support the introduction of clear legal protections for directors to address conflicting requirements of prudential and financial market conduct regulation.

### **Reserve Bank's Governance Arrangements (Chapter 3, Consultation Document 2A)**

Consultation Document 2A sets out the Minister's in principle decisions to:

- establish a new governance board with statutory responsibility for all Reserve Bank decisions (except those reserved for the MPC)
- not establish a Financial Policy Committee and
- make Treasury responsible for assessing the Reserve Bank's performance.

Having set out the rationale for those decisions, the Consultation Document seeks more detailed feedback concerning the proposed governance arrangements.

Consultation Document 2A notes that the proposed new board governance model is used by New Zealand Crown entities, is well understood domestically and internationally, and is underpinned by robust legal and corporate governance frameworks. It also notes that given the new board model and monitoring arrangements share common features with Crown entities' governance arrangements, there may be merit in reclassifying the Reserve Bank as an independent Crown entity.

It is essential that the Reserve Bank retains sufficient independence from Government and there are several dimensions to this (eg institutional, regulatory and supervisory independence).

There are opportunities for greater independence from the current model including by ensuring:

- board members are non-executive directors
- the Governor/CEO is not a member of the board
- the board is responsible for appointing and managing the Governor/CEO.

The director appointment process is a key part of ensuring a balanced board and can also assist independence. There needs to be a transparent and robust appointment (and reappointment) process based on high quality analysis of the knowledge, skills and experience the board requires now and in the future. The board chair should have a core role in this process.

### **Director professionalism**

In 2014, the IoD launched its Chartered Membership pathway to raise professional standards for directors in New Zealand and to enable the recognition of Chartered Members and Chartered Fellows<sup>3</sup> who reach those standards.

The Chartered designation offers stakeholders an assurance that the Member has met professional standards of knowledge and skill in alignment with the IoD's [Director Competency Framework](#) and has committed to continuing professional development. New Chartered Members are required to:

- complete the IoD's Company Directors' Course (or equivalent)
- pass the Chartered Member assessment, which is comprised of a computer-based 75 minute examination and a comprehensive and detailed written assignment
- make an annual commitment to uphold the principles of the [Charter](#)
- attest that they are of good character and a fit and proper person through an annual confirmation of good character<sup>4</sup> and
- complete an average of 20 continuing professional development points each year (60 points over their three year foundation period).

We encourage Treasury to recognise the designation of Chartered Membership by directors of regulated entities in their disclosures as an effective measure to support their attesting to their ongoing suitability as a director. There is also an opportunity when appointing new board members to the Reserve Bank board to include Chartered Members. They can bring professionalism and a commitment to continuing professional development to the board.

### **Conclusion**

Changes to the prudential framework should build on current foundations. Similarly any regulatory reform needs to be proportionate and augment the existing legal framework. New Zealand should be cautious in adopting measures from other jurisdictions unless there is clear evidence they have worked and will be effective and appropriate here. The IoD considers that the current attestation regime could be improved in line with '*Option1: Enhanced status quo*' in Consultation Document 2B, including increased supervisory engagement by the Reserve Bank. This should be done in a manner that encourages high quality directors to remain involved in the sector and which includes a process to audit or verify attestations by the Reserve Bank.

It is essential that the Reserve Bank retains sufficient independence from Government. There are opportunities for greater independence from the current model including by ensuring:

- board members are non-executive directors
- the Governor/CEO is not a member of the board
- the board is responsible for appointing and managing the Governor/CEO.

The board chair should have a core role in succession planning and nomination of new board members.

We also encourage Treasury to recognise the designation of Chartered Membership by directors of regulated entities in their disclosures as an effective measure to support their attesting to their ongoing suitability as a director. There is also an opportunity when appointing new board members

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<sup>3</sup> Chartered Members and Chartered Fellows are referred to collectively as Chartered Members.

<sup>4</sup> See the annual confirmation at [iod.org.nz/charteredmember](http://iod.org.nz/charteredmember)

to the Reserve Bank board to include Chartered Members. They can bring professionalism and a commitment to continuing professional development to the board.

We appreciate the opportunity to comment on behalf of our members and would be happy to discuss this submission with you.

Yours sincerely



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