

MEMORANDUM FOR Macro-Financial Committee

FROM Bernard Hodgetts, Financial Markets Department

DATE 18 January 2013

SUBJECT **PUBLIC CONSULTATION ON THE
MACRO-PRUDENTIAL POLICY
FRAMEWORK**

FOR YOUR **Information**

Background

1. As has been discussed at recent MFC meetings, the next key step in the Bank's development of the macro-prudential policy framework is to engage in a formal public consultation process on the proposed package of macro-prudential instruments and our implementation framework.¹ We formally advised the Minister of Finance of our intention to undertake a consultation process in a memorandum on 21 December 2012. Following the completion of the consultation, we would expect that the Bank and the Minister would be in a position to sign a Memorandum of Understanding to formalise governance arrangements (a draft MOU is currently with the Minister).
2. This brief note provides a sketch outline of the expected contents of the consultation paper along with an indicative timeline for the consultation process.

Proposed Structure of the Consultation Paper

Section 1	Background	A preamble on macro-prudential policy. Some international context would be provided.
Section 2	Objectives	This section would outline the purpose of macro-prudential policy and its intended objectives i.e. to increase the resilience of the financial system to shocks and potentially dampen the extremes of the financial cycle. We would note the scope for macro-prudential policy to support monetary policy (whilst noting that this is not its primary purpose).
Section 3	Instruments	This section would outline the Reserve Bank's proposed set of macro-prudential tools: A. The Countercyclical Capital Buffer (on which we have already consulted and reached a policy position); B. Sectoral Capital Requirements (and adjustments to capital requirements on high LVR lending); C. The Core Funding Ratio; and

¹ Note that the Reserve Bank has already consulted on and finalised its policy on the Counter-Cyclical Capital Buffer as part of its Basel III policy development during 2012.

		<p>D. Quantitative Restrictions on High Loan-to-Value Ratio Lending (this would include the option of restrictions on the <i>share</i> of high LVR lending as well as outright restrictions on such lending.</p> <p>The second part of this section would describe the expected impact of each of the tools and would draw on Lamorna's recent work setting out the transmission channels.</p> <p>We would expect to comment on the effectiveness of the various tools (drawing on international evidence where available) to help condition expectations about what they might and might not realistically be able to achieve.</p>
Section 4	Powers	<p>The Bank's legal powers under which each of the above instruments could be used would be described.</p> <p style="text-align: center;">s9(2)(h).</p>
Section 5	Decision-Making Process	<p>This section would describe the decision-making process under which macro-prudential policy tools would be deployed. Sub-topics to be covered would include:</p> <ul style="list-style-type: none"> - A generic description of the various indicators (statistical and evidential) that we use to assess the macro-prudential environment and the need for macro-prudential interventions. - Instrument selection. - Notice periods. - Expected consultation with the Minister of Finance/Treasury. - The mechanisms we will use to communicate and account for our decisions. - The expected role of the MOU with the Minister.
Section 6	Costs and risks	<p>In this section we would consider the potential costs and risks of the various macro-prudential instruments including:</p> <ul style="list-style-type: none"> - Compliance and avoidance issues - Equity and distributional impacts - Impact on financial system efficiency - The risks of disintermediation <p>We would attempt to outline the approaches we will use to try and mitigate these risks (eg relatively infrequent use of tools; monitoring credit flows when tools are applied for evidence of disintermediation etc.)</p>
Section 7	Timetable and a List of Issues and Questions	<p>This section could list the various issues and questions on which we would be seeking submissions. (although we may choose to append these to the individual sections.)</p> <p>We would also set out our expected timetable for development and finalisation of the framework:</p>

		<ul style="list-style-type: none"> - Four week period for submissions - Expectation of agreement of an MOU with the Minister following consultation and finalisation of our policy position. - Acknowledgement that the framework established here relates to the banking system and that we may consider extension of the framework at a later date if that appears to be required.
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Indicative Process Timeline

3. The following is a suggested timeline for the consultation process. The dates around the finalisation of our policy position and the signing of an MOU are necessarily indicative. In particular I have made no allowance for the possibility that the Minister might wish to take a paper on the proposed framework to Cabinet prior to signing the MOU. This would obviously lengthen the timeline.

Indicative Dates

January	22	Preparation of draft public consultation paper begins
February	19	MFC considers preliminary draft of consultation paper
	26	Draft consultation paper to FSO
March	5	Consultation paper to Minister of Finance for feedback
	28	Paper released for public consultation (4 week submission period)
April	26	Call for submissions closes
May	8	May 2013 FSR released
June	4	Analysis of submissions and final policy document presented to MFC
	5	Synopsis of final policy position to Minister of Finance
	late	Memorandum of Understanding signed
	late	Final policy paper released

