

**Statement of
Prudential Policy**

**Tauākī mō ngā Kaupapa
Here Whakaheke Mōrea**

22 September 2022



**Reserve Bank
of New Zealand**
Te Pūtea Matua





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Introduction

Kupu Whakataki

Te Pūtea Matua, the Reserve Bank of New Zealand, is kaitiaki to the financial system of Aotearoa.

The purpose of the Reserve Bank's governing legislation – the Reserve Bank of New Zealand Act 2021 (the Act) – is to promote the prosperity and wellbeing of New Zealanders and contribute to a sustainable and productive economy, Toitū te Ōhanga, Toitū te Oranga.

We further this purpose by pursuing our objectives of:

- achieving and maintaining stable consumer price inflation while supporting maximum sustainable employment;
- protecting and promoting the stability of New Zealand's financial system;
- otherwise acting as New Zealand's central bank, including by:
 - meeting the cash needs of the public;
 - operating payment and settlement systems for New Zealand's financial institutions; and
 - providing liquidity facilities to manage liquidity in the financial system or to protect or promote the stability of the financial system.

Our aspiration is to be a transparent, flexible and proactive regulator with leading-edge tools and technology and the capability to use these to fully enable our evolving responsibilities, legislative powers and expectations.

Statement of Prudential Policy

Tauākī mō ngā Kaupapa Here Whakaheke Mōrea

This Statement of Prudential Policy outlines:

- how we act, or propose to act, in relation to Ngā Pekanga
 - our regulated entities: registered banks, licensed insurers and non-bank deposit takers (NBDTs) and financial market infrastructures (FMIs) when:
 - carrying out prudential supervision
 - imposing prudential standards or other requirements
 - monitoring and investigating compliance with our prudential framework; and
 - taking appropriate action in respect of persons who have contravened, are contravening or are likely to contravene our prudential framework or are otherwise in financial or other difficulties
- how these prudential functions relate to our purpose and why this matters
- the principles we consider when undertaking this mahi.

This statement of Prudential Policy has been prepared in accordance with the Act and our prudential legislation (Annex A).

Why is Prudential Policy important and what is our role?

He aha i hira ai ngā Kaupapa Here Whakaheke Mōrea, ā, he aha te wāhi ki a mātou?

As kaitiaki to the financial system of Aotearoa, we are the prudential regulator and supervisor of Ngā Pekanga, our regulated entities, in New Zealand. We act as prudential regulator and supervisor to enable and maintain a healthy and vibrant financial system, which supports a sustainable and productive economy, contributing to New Zealand's prosperity and wellbeing. This gives the public confidence in our banks, insurers, NBDTs and FMIs and enables New Zealanders to participate in the New Zealand economy.

Prudential regulation means the statutory powers we apply to protect and promote the stability of the financial system. They include, licensing conditions, regulatory standards and guidance for our regulated entities.

Prudential supervision means our monitoring of and engagement with regulated entities to ensure they adhere to their prudential requirements and adopt prudent practices; and the identification of prudential risks to both entities and the financial system.

Regulatory and supervisory framework

Te anga rekureihana, āta tirotiro hoki

Our prudential legislation enables us to set the rules and expectations for our regulated entities, and gives us the powers to supervise regulated entities, and, as necessary, take enforcement action and resolution action. Each sector that we regulate – banking, insurance, NBDTs, FMIs¹ – has its own prudential legislation, with its own regulatory requirements.

We monitor regulated entities against these requirements and take action as appropriate in order to meet our purpose and objectives in the manner outlined in this Statement of Prudential Policy. The actions we take will vary according to the nature of the regulated entity, the particular circumstances, and our risk appetite for the financial system. We distinguish between those risks that are consistent with a dynamic and efficient financial system and those that need to be more closely managed in order to achieve our financial stability objective. For example, it can be particularly important for us to take action where a regulated entity's non-compliance with prudential requirements might undermine our purpose or objective, have serious implications for depositors, policyholders, and ultimately taxpayers and society. We aim to take a transparent and consistent view on these risks with our regulated entities and stakeholders.

We expect entities to comply with both the spirit and intent of our policies and respect our supervisory assessment of their prudential position, including their financial position, governance and risk management. Each entity's compliance forms an important part of our holistic view of what we are seeking to achieve as kaitiaki to the financial system.

Collaborative working

Our regulatory and supervisory framework recognises that there is an important role for both us and our regulated entities in ensuring that the financial system is sound and stable, delivers services to New Zealand individuals, households and businesses that support their prosperity, and contributes to a sustainable and productive economy.

Internally, we work collaboratively across our policy, supervision, enforcement and resolution teams, to establish and operate our regulatory and supervisory framework.

As a proactive regulator and supervisor, we engage with industry and relevant stakeholders in a diligent and timely manner. We keep communication open and work with regulated entities, so they know how to meet our regulatory expectations.

We aspire to build and maintain the best 'regulator/regulated' supervisory relationships possible. We are committed, and expect our regulated entities to be committed to, clear, consistent, targeted and timely communication with one another. We expect our regulated entities to work openly and constructively with us to achieve sound and efficient outcomes.

We also engage with our regulatory counterparts in New Zealand, such as The Treasury and at the Council of Financial Regulators (CoFR), for legislative and policy development, and strategic issues, and in Australia on Trans-Tasman issues, with a view to enhancing coordination.

The Council of Financial Regulators

The Council facilitates co-operation and co-ordination between us, the Treasury, the Ministry of Business, Innovation and Employment, the Financial Markets Authority, and the Commerce Commission, to support effective and responsive regulation of the financial system.

¹ FMIs are the infrastructures which allow electronic payments and financial market transactions to occur. The Reserve Bank and the Financial Markets Authority are the joint regulators of designated FMIs under the Financial Market Infrastructures Act 2021.



Our approach to policy

Tā mātou titiro ki te ao kaupapa here



Why Prudential Policy making matters

We set policy that addresses prudential risks and market failures, and that promotes a financial system that is strong, competitive and inclusive. This is important because we all rely on and benefit from financial stability – whether we are financial institutions, or individual depositors and policyholders. Financial crises can have significant implications, not just for financial institutions, depositors and policyholders, but also taxpayers and society.

Our prudential policies seek to protect and promote the stability of New Zealand’s financial system and to avoid significant damage to the financial system that could result from the failure of a regulated entity. A financial crisis could have significant and long lasting implications for the real economy and the wellbeing of New Zealanders.

Our approach to policy making

The Reserve Bank is responsible for Prudential Policy advice under our prudential legislation (Annex A) and operates on a regular review cycle.

We undertake research and consult widely to inform policy development. This includes research that supports our strategic priorities such as climate change, access to capital, fintech innovation and financial inclusion.

Our policy-making approach includes:

- considering sectoral objectives and secondary principles in relevant legislation on how we should exercise our powers, including making regulatory policy;²
- applying The Treasury’s model for ‘Best Practice Regulation’³ wherever possible;
- developing specific sets of principles for major pieces of policy work;
- consulting and engaging widely with industry and the public;
- collaborating and consulting with other regulators and government agencies, domestically and internationally; and
- applying the Regulatory Impact Analysis (RIA) framework.

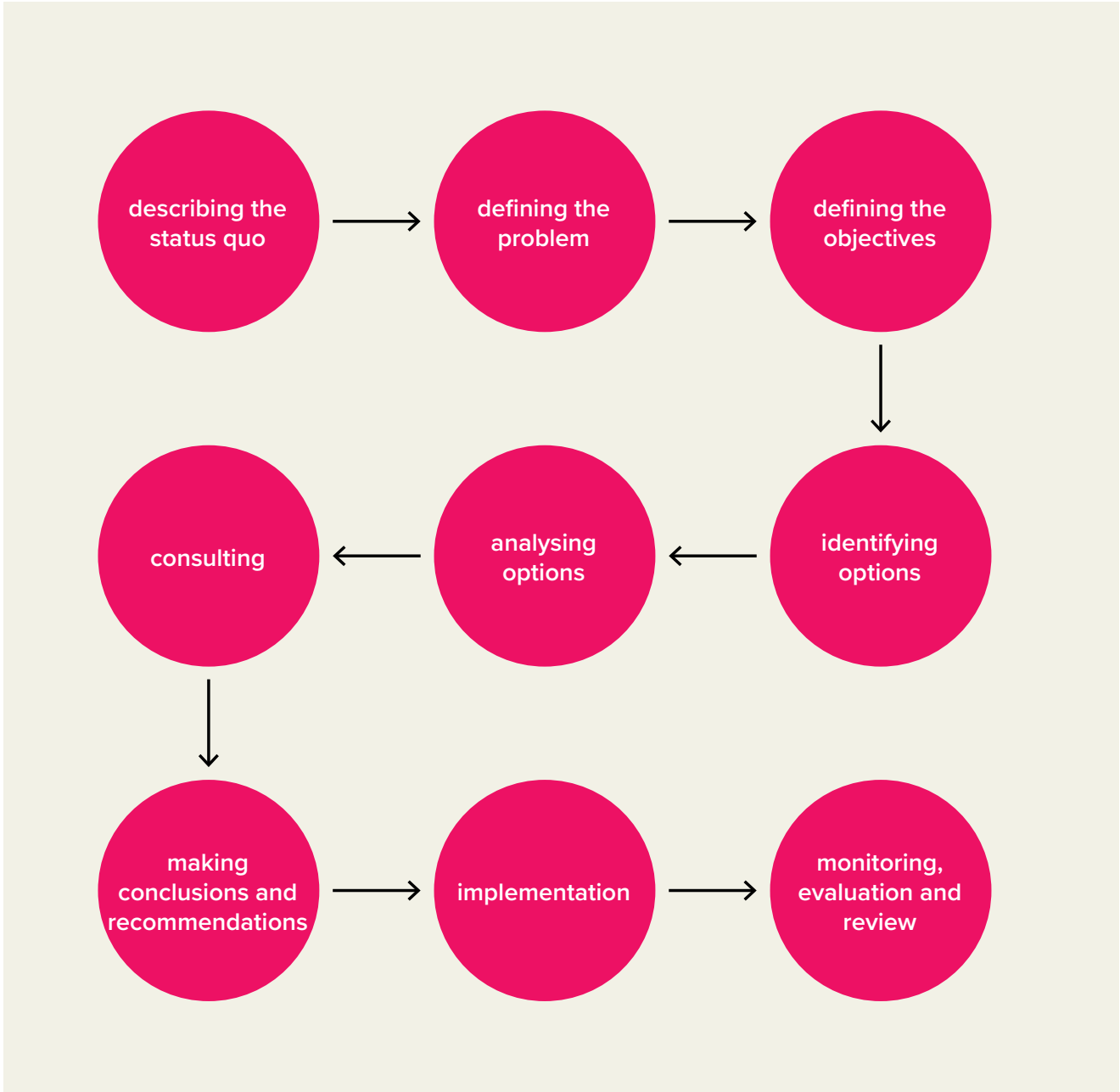
The RIA framework is a systematic approach for critically assessing:

- the positive and negative effects of proposed or existing interventions; and
- that the total benefits of those interventions to our society exceed the total costs.

Comparisons may be made using cost benefit analysis (CBA) where a CBA is practicable and warranted.

² See section 8 of the NBDT Act and section 4 of IPISA.

³ The Treasury’s model for ‘Best Practice Regulation’



Further detail can be found in our 'Statement of Policy-making approach'.⁴

⁴ Our Statement of Policy-making approach

The principles we consider when undertaking policy making

We consider a broad range of issues when developing policy. These may be brought to our attention through:

- changes in international standards and best practice;
- gaps in, or problems with, existing regulatory policy or settings that are identified by our staff and/or stakeholders;
- engagement with CoFR, industry and other stakeholders across the financial system;
- identifying emerging risks or trends;
- planned policy reviews; and
- Government requests for work where Cabinet would be making a decision (eg, in relation to developing primary legislation or regulations and working to support other public policy making agencies).

We prioritise work based on our assessment of benefits of any particular policy proposal and risks to our financial system, and an assessment of the importance of the work relative to the purposes and objectives of the prudential legislation, its urgency and the availability of resources relative to other priorities.

We have a low risk appetite for events that have the potential to materially damage financial system stability. We seek to limit any uncertainty and ensure risks are identified and mitigated before they crystallise. We are prepared to manage those risks should the worst happen despite our efforts.

However, we do not run a zero-failure regime – we are prepared to tolerate risks that may lead to the failure of regulated entities where the impact on the financial system is understood and manageable, or may be characterised as medium risk.

For FMIs, we have a low risk appetite for systems unavailability. We welcome new entrants, and designate FMIs, who can meet the required prudential standards and who can be appropriately supervised. We are open minded, informed and contribute to central bank and industry innovation in relation to opportunities for financial technology innovation in the Payments area.

Government

The Minister has issued a financial policy remit dated 1 July 2022⁵ that outlines matters the Minister considers desirable for us to have regard to as we seek to achieve our financial stability objective and perform our functions as a prudential regulator and supervisor.

Our Board must have regard to the remit as it makes significant policy decisions about how to achieve our prudential objectives, and in future when it issues and reviews standards.

We keep the Government informed of our regulatory policy agenda via regular engagement with the Minister of Finance, and through the preparation of accountability documents such as the Statement of Intent. We share consultation papers with the Minister of Finance's office prior to their release, as well as RIAs. Our RIAs must contain a statement that explains how our governance Board has had regard to the financial policy remit issued by the Minister of Finance in preparing the proposed policy.

Our policy role is dynamic

The financial system is constantly evolving, as are the prudential risks and challenges faced by the financial system. This means that our requirements and expectations of regulated entities evolve as well.

Our strategic priorities take into account new and evolving risks like climate change and cyber resilience. Another priority is the challenge of the Māori economy's access to capital, and embedding our Te Ao Māori strategy in our consultations and policy development activities.

Our approach to prudential regulation has expanded and become more intensive since the IMF's Financial Sector Assessment Program in 2016/17. We continue to modernise our regulatory framework, bringing it closer to international practice and engaging more actively with regulated entities. We expect this trend to continue.

In the near term, we will be implementing significant changes to our legislative and regulatory framework as a result of:

- the future Deposit Takers Act and the new prudential standards for the banking and NBDT sectors, including changes to the resolution framework, and introduction of the depositor compensation scheme;
- our review of the Insurance (Prudential Supervision) Act 2010, and new solvency standards for insurers; and
- the coming into force of the Financial Markets Infrastructure Act 2021, and the development of prudential standards for designated FMIs.



Our approach to supervision

Tā mātou titiro ki te āta tirotiro



Why prudential supervision matters

Prudential supervision seeks to ensure that regulated entities adhere to minimum requirements and adopt prudent practices so that other entities and the public can have confidence in them.

Identifying prudential risks – whether they be financial, operational or behavioural – enables us to respond effectively in a timely manner, and manage the potential impacts of financial distress or failure on our financial system, and on depositors, policyholders, and society as a whole.

We are also a supervisor under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML Act). AML/CFT supervision seeks to ensure that regulated entities comply with requirements under the AML Act, and that appropriate action is taken for non-compliance, so that we can all be confident that our financial system is not facilitating money laundering or financing terrorism. These requirements include: carrying out an AML/CFT risk assessment; putting in place a compliance programme; and identifying and reporting any suspicious activity to the appropriate authorities. We conduct ourselves as AML/CFT supervisor in a way that is mutually supportive to our function as prudential supervisor.

Our approach to prudential supervision

We carry out the licensing and supervision of our regulated banks, insurers and FMI. We also regulate and licence NBDTs and work with the trustee companies that supervise NBDTs' compliance with their trust deeds. This involves:

- supervising compliance with requirements under prudential legislation (Annex A),
- monitoring prudential risks to individual entities, and
- contributing insights to system-wide assessments.

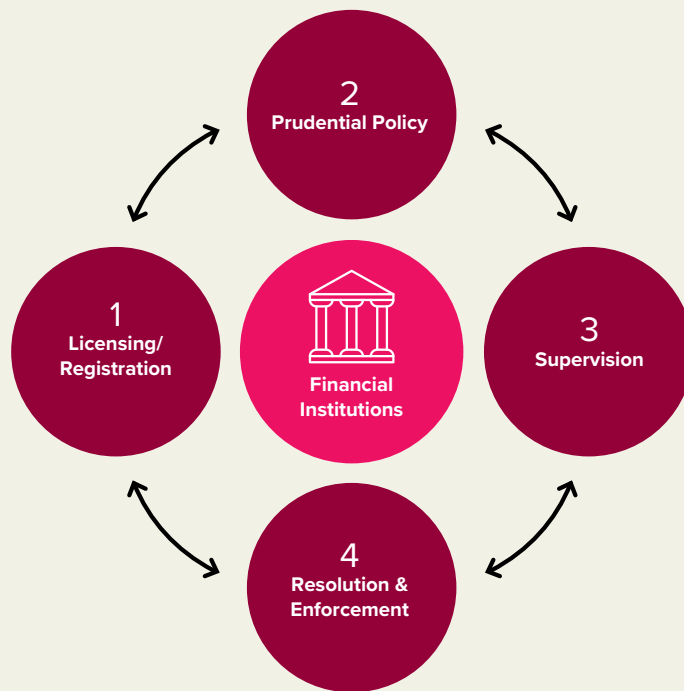
The principle of 'te whakatōpū' (bringing together, consolidating and combining our efforts) underpins the Reserve Bank's Relationship Charter with our regulated entities⁶. This commits us to a mutual understanding of best practice for regulator / regulated relationships and ensures the relationships are constructive and allow us to carry out our role.

We believe in transparency, accountability, and having good working relationships with our regulated entities.

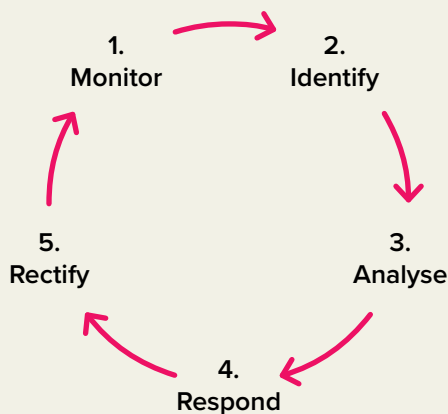
We take a risk-based approach to our supervision and enforcement activities that is proportionate, collaborative, and consistent.

Our supervisory approach is to:

- support a sound, competitive and diverse financial system;
- support market participants' ability to make informed choices about risk;
- encourage sound management of institutions by directors and managers;
- not seek to eliminate risk, but to provide for risk levels to be well-signalled and for the risk of high-impact failures to be acceptably low; and
- in the event of major difficulties at a regulated entity, to minimise the impact of those difficulties on the wider economy, the financial system and on depositors/policyholders.



Supervision Risk Monitoring and Mitigation Process



We develop and maintain a good working knowledge of the regulated entities we are supervising, and of the sorts of risks they are managing. We do this through engaging with the entities, and by receiving and reviewing public and private data and reports.

We also work closely with The Treasury, other regulatory authorities, in particular the Financial Markets Authority (FMA), but also the Australian authorities for the supervision of entities with trans-Tasman activities or links.

The principles we consider when undertaking prudential supervision

We take a risk based, proportionate and consistent approach to our supervision activities in accordance with our supervisory framework.

We have a low risk appetite for outcomes which impair the health of the financial system, undermine economic wellbeing and affect public confidence.

Achieving financial stability does not mean eliminating all risks. This would create inefficiencies of its own – it would potentially stifle new entrants, and remove the incentives for growth, innovation and healthy risk-taking.

When undertaking prudential supervision we:

- use insights, data, and analysis to anticipate the impact of current and emerging risks;
- take a risk-based and forward-looking approach;
- challenge, verify, and use our regulatory tools as necessary;
- intervene promptly and escalate non-compliance as appropriate in the circumstances;
- provide ongoing support to stakeholders to help them meet our regulatory expectations
- are proactive, open, and constructive in engaging with industry and stakeholders; and
- educate and encourage compliance to minimise the impacts of non-compliance, poor conduct and entity failure.

What the future holds

Our approach to prudential supervision has continued to evolve from the light supervisory model that was established in the 1990s, to one that meets current day expectations and seeks greater alignment with international best-practice. We want our approach to become more intensive.

This will mean:

- less reliance on regulated entities telling us when there are issues (although this will remain important), and instead a “trust but verify” approach where we proactively confirm compliance;
- greater utilisation of data to allow us to identify issues early, take action and target our resources to areas of potential highest risk;
- improved transparency in terms of actions we are taking, through more disclosure obligations and public reporting;
- leading-edge tools and technology to fully enable our evolving responsibilities, legislative powers and expectations; and
- ongoing transformation to ensure we have a fit for purpose operating model, culture and capabilities.



Our approach to enforcement and resolution



Tā mātou titiro ki te whakahau me te whakatau take

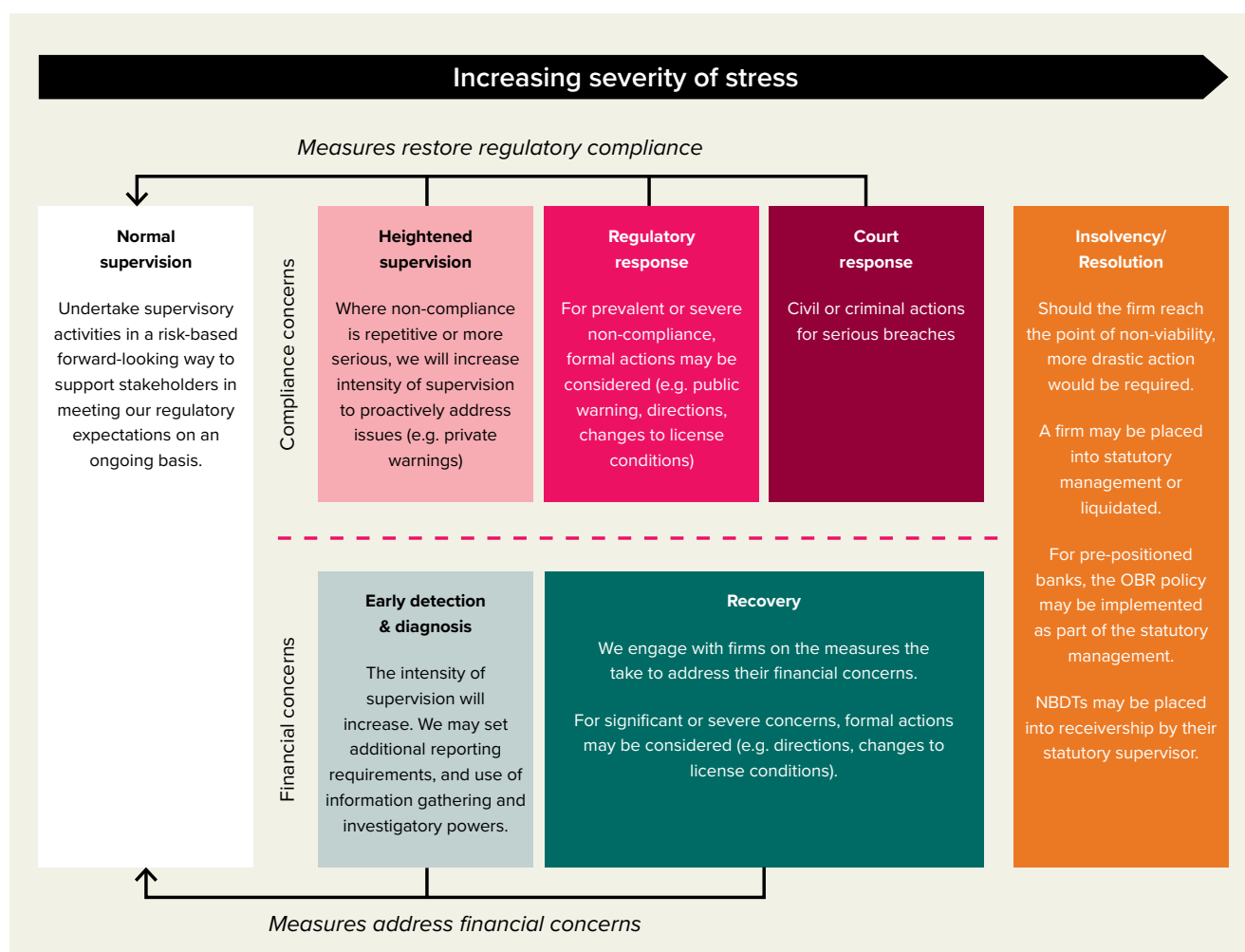
Why enforcement matters

Where serious non-compliance is identified our legislation allows us to investigate and take enforcement action where appropriate. Enforcement gives regulated entities and the public confidence that our regulatory and supervisory framework is being implemented, in line with our approach to achieving our purpose and objectives. It supports regulatory discipline and in so doing provides incentives for self- and market-discipline to operate effectively.

Our approach to enforcement

We take a risk-based approach to ensure our enforcement resources have the most impact and prioritise the issues that are likely to have a greater bearing on our objectives, a high risk of error, or support our credibility as a regulator and ability to achieve appropriate supervisory outcomes.

Our response may range from heightened supervision to civil or criminal action. The diagram below illustrates our regulatory response model for enforcement (and resolution):



The principles we consider when undertaking enforcement

We make enforcement decisions in accordance with our published enforcement framework⁷. Our enforcement framework sets out the considerations that apply when we select matters for investigation, conduct investigations, and ultimately take decisions relating to enforcement matters. Our framework ensures we are consistent, robust, and transparent in our decision-making processes.

Our enforcement framework includes our Enforcement Principles and Criteria Guidelines and our Enforcement Guidelines. The Principles and Criteria Guidelines set out the considerations that apply throughout the enforcement process and our Enforcement Guidelines set out in greater detail, how the principles and criteria are applied when considering an enforcement response.

The enforcement principles are a set of values that guide the direction of our investigation and enforcement strategy and inform our approach to applying our enforcement discretion. Our three enforcement principles are: risk-based, proportionality, and transparency.

The enforcement criteria are specific considerations which will be worked through and weighed against the available evidence when deciding on the appropriate enforcement response to non-compliance. Our four enforcement criteria are: seriousness of conduct, responsiveness, public trust and confidence, and efficacy.

Why resolution matters

While we target a low incidence of failure of regulated entities, we do not run a zero-failure regime (ie, we allow regulated entities to fail where the risks to the financial system are understood and can be managed) and this provides the incentives for self- and market-discipline to operate effectively. When firms do fail, we will use our regulatory tools towards ensuring this occurs in a controlled and managed fashion and to avoid significant damage to the financial system that could flow from that failure.

⁷ Our Enforcement approach and framework

Our approach to resolution

We develop appropriate policies and procedures which deal with the recovery and resolution of distressed entities including pre-positioning of options (eg, Open Bank Resolution).

We maintain close working relationships with other organisations with interests in recovery and resolution matters, including the Treasury and the FMA, as well as CoFR and relevant regulators. We plan and co-ordinate with these departments and agencies to minimise the potential financial stability impacts of a failure. We also co-ordinate our responses with overseas regulators when appropriate, for example where there is trans-Tasman ownership of a regulated firm.

We will support private sector solutions where possible and in light of our objectives as kaitiaki to the financial system. When these are unavailable or not effective, we use statutory powers to take action in response to issues, or to directly manage the resolution of distressed entities.

The key elements of our resolution approach (illustrated in the regulatory response model in the diagram above):

- we use our powers under prudential legislation to act pre-emptively;
- we do not operate a zero failure regime
- direction and statutory management powers are the main recovery and resolution tools that apply to registered banks and licensed insurers; direction powers are the main tools that apply to NBDTs.

The principles we consider when undertaking resolution

We consider a broad range of issues when making resolution decisions including:

- avoiding significant damage to the financial system
- ensuring that regulated entities can be resolved in an orderly manner;
- maintaining public confidence in the operation and soundness of the financial system;
- maintaining the continuity of essential services provided by regulated entities;
- minimising calls on public funds;
- resolving as quickly as possible the difficulties of an entity in resolution; and
- to the extent not inconsistent with wider financial stability, dealing with distressed entities with a view to preserving value for creditors (and shareholders), and maintaining their ranking.

In doing so we have regard to the importance of minimising the costs of failure and disruption to the broader economy, and prioritising protections for vulnerable consumers, depositors and public funds.



Annex A – Our Prudential Legislation Āpitihianga A – Ō tātou ture whakaheke mōrea

We carry out our prudential functions with the objective of protecting and promoting the stability of New Zealand’s financial system (the financial stability objective); and in accordance with the other purposes and objectives of the prudential legislation (defined below) for different sectors.

- For banks, NBDTs the purposes include avoiding the significant damage to the financial system that could result from the failure of a regulated entity.
- For insurers, the purposes include promoting public confidence in the insurance sector.
- For FMIs, the purposes include:
 - promoting the maintenance of a sound and efficient financial system, and avoiding significant damage to the financial system that could result from problems with an FMI that threaten the stability of, or confidence in, the financial system;
 - promoting the confident and informed participation of businesses, investors and consumers; and
 - promoting and facilitating fair, efficient and transparent financial markets.

For the purposes of this statement of Prudential Policy, “prudential legislation” means the:

- Banking (Prudential Supervision) Act 1989;
- Insurance (Prudential Supervision) Act 2010;
- Non-bank Deposit Takers Act 2013;
- Financial Market Infrastructures Act 2021; and
- secondary legislation made under any Act referred to above.

We also perform and exercise functions or powers conferred on the Reserve Bank by the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML Act), in accordance with the purposes of the AML Act.

The Reserve Bank is 1 of 3 agencies in New Zealand tasked with supervising, monitoring and enforcing obligations under the AML Act. The Reserve Bank is the designated AML/CFT supervisor for banks, NBDTs and life insurers.

⁸ We jointly regulate and supervise settlement systems with the Financial Markets Authority.



**Reserve Bank
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Te Pūtea Matua

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PO Box 2498
Wellington
New Zealand