

LETTER OF INDEMNITY

21 March 2020

To

Adrian Orr
Governor
Reserve Bank of New Zealand
PO Box 2498
Wellington 6140

Dear Adrian

A memorandum of understanding between the Minister of Finance on behalf of the Crown (the **Minister**) and the Reserve Bank of New Zealand (**Reserve Bank**) recognises that the Reserve Bank may from time to time need to use alternative monetary policy tools. In particular, the Monetary Policy Committee of the Reserve Bank (**MPC**) is considering large scale asset purchases of New Zealand domestic government bonds (**Programme**) as a monetary policy tool.

The Minister supports the use of the Programme by the MPC as a monetary policy tool to reduce borrowing costs for New Zealand businesses and households, boost credit and lower the value of the New Zealand dollar - all of which is intended to stimulate investment and boost demand for New Zealand goods and services.

In order to enable the Reserve Bank to undertake the Programme, the Crown has agreed to provide this letter of indemnity to cover losses which the Reserve Bank may incur as a result of operating the Programme for the next 18 months. This letter of indemnity is intended to apply only to losses resulting from large-scale asset purchases of New Zealand domestic government bonds acquired by the Reserve Bank at the direction of the MPC as part of the exercise of alternative monetary policy tools. The Crown acknowledges that the speed and scale of asset purchases is a matter for the MPC and the Reserve Bank to decide.

Indemnity

With effect from Sunday 22 March 2020, the Crown agrees to indemnify the Reserve Bank in respect of all Losses which the Reserve Bank incurs in respect of the Indemnified Bonds.

The Crown may terminate its obligations under this letter of indemnity at any time after 30 September 2021 (**Termination Date**) by giving one day's notice to the Reserve Bank. Otherwise, obligations under this letter of indemnity may be terminated by agreement between the Crown and the Reserve Bank if they both believe the Programme is no longer needed as a monetary policy tool.

Termination of this indemnity will not release the Crown from any liability in respect of Losses occurring after the termination date in respect of the Indemnified Bonds.

For the purposes of this section:

- Indemnified Bonds means all New Zealand domestic government bonds purchased by the Reserve Bank under the Programme prior to the Termination Date and any New Zealand domestic government bonds purchased as a reinvestment of those bonds up to the Cap;
- Cap means \$30 billion or such other amount agreed between the Minister and the Reserve Bank from time to time as the maximum amount of Indemnified Bonds that can be held by the Reserve Bank in respect of which the Crown will indemnify the Reserve Bank for Losses; and
- Losses means
 - (i) the amount by which any of the interest expense incurred on funding the amount invested in Indemnified Bonds, exceeds the interest income earned on the Indemnified Bonds during a calendar month; and
 - (ii) the amount of realised losses less any realised gains on disposal of any Indemnified Bonds during that month.

Losses shall be calculated for each calendar month in accordance with generally accepted accounting practice.

Claims under the indemnity

The Reserve Bank may claim under this indemnity within 10 days of the end of each month for Losses incurred in that month by giving a notice of the amount (**Notice**) accompanied by its monthly accounts.

The Crown will, in absence of manifest error by the Reserve Bank, pay the full amount of the claim for Losses to the Reserve Bank within one business day of having received the Notice.

If the Reserve Bank make a gain on the Indemnified Bonds in any month (calculated using the same principles and accounting practice as is used to calculate Losses), it must notify the Crown within 10 days of the end of the month and pay an amount equal to that gain to the Crown within one day.

Exclusions from the Indemnity

This indemnity only applies to interest rate risk on New Zealand domestic government bonds. It does not apply to consequential risks such as operational risks in purchasing or holding New Zealand domestic government bonds.

This indemnity does not apply to other aspects of alternative monetary policy such as large-scale purchases of private sector assets, large-scale purchases of foreign currency assets, interest rate swaps or term lending.

Crown expectations of the Programme

The Reserve Bank should endeavour to ensure that the Programme is designed to minimise disruption in the New Zealand government bond market, given the importance of this market. To help achieve this, the Reserve Bank must cooperate with Treasury's Capital Markets unit when designing the Programme.

Both parties agree to act in a co-ordinated manner and in a way that does not intentionally undermine the objectives of debt management, in the case of Treasury, and alternative monetary policy, in the case of the Reserve Bank.

The Reserve Bank must establish, and act in accordance with, a risk control framework, to be agreed with Treasury, which applies to operations conducted under the Programme and which sets out how the Reserve Bank will manage the potential risks covered by this letter of indemnity. The Reserve Bank recognises the importance of the risk control framework and will work to finalise the risk control framework to the reasonable satisfaction of Treasury in the next 7 days.

Monitoring of potential Losses

As part of the risk control framework, the Reserve Bank will provide the Crown with an initial estimate of potential Losses and any other fiscal risks associated with the Programme.

The Reserve Bank will notify the Crown if the fiscal risks associated with the Programme differs materially from the initial estimate and, in particular, will update the Crown on significant market events.

Accountability and transparency expectations

The Reserve Bank must closely monitor the impact of the Programme on financial markets more broadly and on risks to the financial system.

The Reserve Bank must run the Programme in a transparent manner and is accountable for its operation. The MPC will be accountable for decisions in respect of the Programme in the same way that it is for its decisions on the level of the OCR. It will still be required to explain its monetary policy decisions through the Monetary Policy Statement and provide its evidence to the Finance and Expenditure Committee.

The Reserve Bank must develop and publish frequent public reports on the transactions under the Programme, provided that such publication does not compromise the efficacy of the Programme. Aggregate information on the scale of operations, and the associated gains or losses, should be published in the Reserve Bank's annual report.

The Reserve Bank of New Zealand Act 1989 and Reserve Bank Board Charter require the directors of the Reserve Bank to prepare, for each financial year, a report setting out its assessment of the performance of the Reserve Bank, the Governor and Deputy Governor, the performance of the MPC, and the use of the Bank's resources (**Report**). The Report should cover the performance of the Programme. The Board will make itself available to meet with the Minister at least annually to brief the Minister on the Board's assessment as outlined in the Report.

Additional reporting

The Reserve Bank will report monthly to the Crown (through Treasury) on transactions undertaken as part of the Programme.

The Bank also agrees to provide to the Crown (through Treasury) such information as it may reasonably require from time to time to understand its liability or potential liability under Indemnified Bonds.

SIGNED by the Sovereign in Right
of New Zealand, acting by and
through the Minister of Finance



Hon Grant Robertson
Minister of Finance

AGREED by



Adrian Orr
Governor of the Reserve Bank of
New Zealand
