Rounding up 80 years
The Reserve Bank of New Zealand presents events from our history.
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Māori & European barter

Māori were adept at bartering with the first Europeans, and were eager for European goods. Many early European settlements initially depended on Māori for food and provisions for their ships, and timber and flax for export. By the mid-1800s, British coins, United States dollars and Spanish reales began to circulate.
1840
Governor’s statement

Central banks across the world have found the post-
Global Financial Crisis years to be a challenging time for
conducting policy. Globally, corporate and household
deleveraging has taken longer and been more difficult than
anticipated – especially in the euro area.

Over the past year, growth in the developing countries has
slowed and global economic growth has averaged around
3 percent, despite the most accommodating monetary
conditions the world has ever known. In some of the
advanced economies experiencing more rapid growth,
there have been puzzles around low wage inflation, weak
productivity growth, and sluggish business investment.
In asset markets, we have seen bond and equity prices at
historic highs, while house prices in many countries have
risen rapidly.

Our economy has performed much better than many
advanced economies in recent years. GDP growth for the
year to March 2015 was 2.6 percent, and employment
increased by 3 percent with labour force participation at
historically high levels. International forces have had
a major influence on our economy. We experienced large
decreases in commodity prices, net immigration reached
record levels, our long-term interest rates declined to low
levels, and strong capital inflows meant that our exchange
rate has been overvalued relative to long-term economic
fundamentals. Our terms of trade were at a 40-year high in
June 2014 but, as at August 2015, global dairy prices have
fallen 65 percent since February 2014.

Like most of the advanced economies, headline and
underlying inflation have been lower than we would prefer.
Since the December quarter 2014, annual Consumer Price
Index (CPI) inflation has been below the 1 to 3 percent
target band, primarily due to the 52 percent decline in
oil prices since June 2014, and the continued strength of
the exchange rate for much of the year. Non-tradables
inflation remained relatively low and stable, averaging
under 2.5 percent, reflecting the impact of strong factor
accumulation that has expanded capacity, and enabled
strong demand growth to be met without increased
inflation pressures.

With inflation below the target range, and the exchange
rate not adjusting sufficiently to the decline in dairy prices,
we amended our policy signals. We lowered the projected
interest rate path, discussed circumstances where interest
rate cuts might be appropriate, and, in June 2015, cut
the Official Cash Rate (OCR). Statistical data revisions
suggested that capacity pressures were less than forecast.
The decision to cut interest rates was aimed at buffering the
decline in the terms of trade and contributing to moving
inflation back towards the mid-point of the target range.
We are conscious of the impact that low interest rates and
aggressive lending competition among banks can have
on housing demand and its potential to feed into house
price inflation. We remain concerned about the financial
stability risks and risks to the broader economy that
would be associated with a major correction in Auckland
house prices.

Although a strong supply response over several years is
needed to address Auckland’s housing imbalance,
we felt that macro-prudential policy could help to reduce
the financial stability risks arising from pressures in the
Auckland housing market. The proposed loan-to-value ratio
(LVR) measures and the Government’s policy initiatives
that it announced in the 2015 Budget should begin to ease
the impact of heightened investor activity, and help lower
the financial and economic risks while important regulatory
and infrastructure issues are addressed and additional
investment in new housing takes place.

Our May 2015 Financial Stability Report (FSR) focussed
on the imbalances in the housing market, the implications
of recent developments in the dairy sector for farmer
indebtedness, and loose global financial conditions.
These will be important themes in the months ahead.

Striving to be a high-performing central bank

The activities of the Bank affect people’s lives in many
ways other than through decisions on monetary policy and
macro-prudential policy. We provide currency to meet the
public’s cash needs, we regulate prudential requirements for
banks, other financial institutions and insurance companies,
and we provide services to allow financial institutions to
settle payments between one another. We recognise that
the community must have confidence that we perform to
a high standard.

The Annual Report outlines our vision and strategic
direction, our core functions, the Bank’s 10 strategic
priorities, and the work programmes that flow directly from
them. The report discusses success measures, and whether
our goals were met.

As was the case last year, we continued to invest heavily
in order to strengthen our management, knowledge and
technical capability to deliver on our strategic priorities.
We invested extensively in our:

— Human resources, and especially managerial and
  leadership development, and in strengthening the
  adaptive, collaborative and innovative culture.
— Information systems and data gathering. This included
developing new databases, better quality assurance and
  risk management practices.
— Projects. We have several major projects underway.
  These include the design and production of new Series
  7 Brighter Money banknotes, with the $5 and $10
  banknotes due for release to the public in October 2015,
  followed by the $20, $50 and $100 banknotes in April
  2016. We undertook major project work to improve
  our physical and IT security, renew our payments
  system infrastructure, and substantially enhance our
  treasury management systems. We also undertook work
  preparing for the possible sale of the NZClear securities
  settlement system.
During the year, we made considerable effort to enhance understanding of our role and policies. In particular, the Bank maintained an active speech programme—we made 118 presentations, including 17 on-the-record speeches, covering the length and breadth of the country. We delivered briefings to political caucuses and key media, and conducted an extensive stakeholder survey using external consultants. The results of the survey were encouraging while also offering insights into how we might achieve even greater levels of familiarity and trust among stakeholders.

Going forward, the Bank will have a tight budgetary framework. The Five-year Funding Agreement with the Minister of Finance, which commenced on 1 July 2015, provides for an annual increase of 1.3 percent in funding levels. In order to prepare for this tight budget, the Bank reviewed its staffing levels and a net 15 positions were made redundant early in 2015.

It has been a challenging but highly rewarding year for the Bank in undertaking policy and delivering on our strategic priorities. I wish to thank the Board for its support and advice, and particularly Dr Rod Carr for his strong leadership.

I also wish to thank my fellow Governors for their support, guidance, and excellent teamwork, and colleagues throughout the Bank for their dedication and professionalism in helping to ensure that the Bank performed to a high standard in meeting its responsibilities.

Graeme Wheeler
Governor
25 August 2015
Six banks all issue their own notes

By the late nineteenth century, six banks were operating in New Zealand. Each bank issued its own banknotes which meant there was no consistency.
1863
Board of Directors’ report for the year ended 30 June 2015

Role
The Reserve Bank’s Board of Directors is responsible for reviewing the performance of the Bank and of the Governor across all Bank functions. The Board is a unique governance body in the government sector, having limited decision-making power, but provides advice and monitors the performance of a key agency in the New Zealand economy. Directors bring expertise from a wide range of backgrounds, and apply this to evaluate, on behalf of the Minister of Finance, whether the Bank meets its statutory obligations under the relevant Acts (see page 16 for a list of the legislation from which the Bank derives its functions and powers).

While the Governor is responsible for decisions with respect to the Bank’s functions, the Board has a major role in appointing the Governor and Deputy Governors, and in ensuring that the Governor and the Bank carry out their mandated functions and powers to a high standard. This includes assessing whether the Governor has met the obligations contained within the Policy Targets Agreement (PTA).

At least once a year, the Board meets with the Minister of Finance, without executives, to discuss the Bank’s performance. The Chair meets with the Minister from time to time as required. The Board’s formal review of the Bank’s performance is included in the Bank’s Annual Report.

Membership
The current membership consists of seven non-executive members (details are on page 22). The Board annually elects its own Chair, who appoints a Deputy Chair from their number for a one-year term, on advice from fellow directors. There were no changes to the Board for the year.

Meetings
The Board may meet as often as necessary, but must meet at least six times each financial year. In 2014-15, the Board held 11 meetings. The Board met six times in Wellington, as well as in South Auckland (twice), Dunedin, Christchurch and Palmerston North.

With most Board meetings, the Board hosts a small meeting with key business and community leaders. Outside Wellington, and once a year in Wellington, the Board also hosts a larger evening function to engage with representatives of many local businesses and organisations, and to enhance our understanding of local economic developments and issues.

At these functions, the Governors give a brief off-the-record presentation on the economy consistent with the latest Monetary Policy Statement (MPS) or OCR review, and open the floor to questions. This outreach is a longstanding practice of the Board to ensure visibility of its role among the wider community, and to facilitate directors’ understanding of local economic developments, and the wider public’s understanding of the Bank’s policies.

Committees
The Board takes special interest in the Bank’s risk management policies and practices. The Board’s sole committee is its Audit Committee. This met four times and held a teleconference during the year to review the Bank’s financial statements, and internal and external audit activity, and reported back to the Board.

Keith Taylor chairs this committee, which included Kerrin Vautier and Bridget Coates. The Bank consults the Board on its recommendation of a dividend to the Government. This annual recommendation is first reviewed by the Audit Committee. The Minister takes into account the Board’s views before determining the amount of the dividend.

Business
The Board’s meetings and activities are directed towards meeting our responsibilities under the Reserve Bank of New Zealand Act 1989. The Act requires the Board to keep under constant review the performance of the Bank in carrying out:

i. its primary function (i.e. monetary policy aimed at price stability);

ii. its functions relating to promoting the maintenance of a sound and efficient financial system; and

iii. its other functions.

The Board must keep under constant review the performance of the Governor:

— in discharging the responsibilities of that office; and

— in ensuring that the Bank achieves the policy targets agreed to with the Minister.

The Board is also required to determine whether the Bank’s MPSs are consistent with the Bank’s primary function and the policy targets agreed to with the Minister. In addition, the Board monitors the use of the Bank’s resources.

The Board may give advice to the Governor on any matter relating to the performance of the Bank’s functions and the exercise of its powers.

Directors place strong emphasis on the monetary policy and financial stability functions. A large proportion of the Board’s meeting time is devoted to formal assessments of the Bank’s OCR decisions and the six-monthly assessments of the FSRs. At each meeting, it also discusses new information, including recent policy developments, which affect the Bank’s responsibilities and performance in these two functions. The Board has assigned two directors to provide a focussed non-executive perspective of each of the MPSs and FSRs to assist the Board in assessing whether the Bank is meeting its statutory objectives.
Monetary policy

As required by the Act, the Board’s monetary policy assessments are informed by the PTA. This has a forward-looking focus, specifically to “keep future CPI inflation outcomes between 1 percent and 3 percent on average over the medium term with a focus on keeping future average inflation near the 2 percent target midpoint”. The PTA allows for specific conditions that might push annual CPI inflation outside the target range. This is a forward-looking target and the Board is required to make an assessment of whether current decisions are consistent with achieving that future outcome. Of course, after the fact, it is always possible to observe the actual inflation outcome. While history may assist in understanding if current decisions are likely to achieve the future inflation outcome, outcomes may not necessarily determine if the Governor’s decisions at the time were or were not consistent with the PTA.

The Board has access to the full documentation used by the Governor in reaching his decisions, and his advisers in advising him, as well as webcasts of press conferences, and transcripts of the Bank’s hearings before the Finance and Expenditure Committee. It also has access to the individual written advice on the OCR provided to the Bank’s Governing Committee by the 13 members of the Monetary Policy Committee, including the two externally appointed members. Directors also receive copies of on-the-record speeches when delivered, and confidential reports from Bank participation at major international and regional meetings.

The Board monitored and discussed the Bank’s policy decisions as events unfolded, from the start of the year, when New Zealand’s terms of trade were at a 40-year high, demand conditions were strong, and higher inflation was widely expected. Throughout the year, the Board discussed the economic and financial implications of the sharp decline in oil and dairy prices, the movement in the exchange rate, the impact of record net immigration, and the analysis and judgements that led to the subsequent easing in monetary policy.

Annual CPI inflation has been below the target range since the December quarter 2014. In evaluating the Bank’s and the Governor’s performance, the Board considers more than just the inflation outcomes, because these outcomes are affected by events that cannot always be fully anticipated. For example, the 52 percent decline in oil prices since June 2014 that resulted in negative CPI inflation in the December 2014 and March 2015 quarters, and very low annual inflation in late 2014 and the first half of 2015. In addition, the Bank is a flexible inflation targeter that typically aims to restore any deviations from its inflation target in a gradual manner, so avoiding (as required under the PTA) instability in output, interest rates and the exchange rate.

In making any judgement, the Board needs to assess the general quality of the information the Bank had at the time monetary decisions were made, and what more could have been done, if anything, to improve that quality.

The Board also needs to assess how well that information was used in the Bank’s deliberations. We noted the Bank’s consideration of external forecasts and market pricing in the course of its forecast processes and policy deliberations. Noting considerable correspondence of views, where relevant we explored the Bank’s explanation of differences in forecasts (private sector forecasters generally forecast higher inflation than the Bank).

In the Board’s view, the Governor’s decisions, in light of information available at the time they were made, have been consistent with the PTA, which allows for temporary deviations from the target range arising, for example, from large commodity price changes. We judged that, on the basis of information available to the Bank, the Governor made appropriate monetary policy decisions, and each MPS met the requirements laid out in section 15 of the Reserve Bank Act.

More broadly throughout the year, the Board discussed and offered advice to the Bank on the economic and financial environment, as the Bank developed monetary and financial stability policy. Directors are free to attend conferences organised by the Bank, and last year this included the joint RBNZ/International Journal of Central Banking (IJC) Conference in December 2014 on Reflections on 25 Years of Inflation Targeting.

Financial stability

During the year, the Board probed the Bank’s thinking as it identified and sought to address financial stability risks, especially those arising from: strengthening house price inflation, particularly in Auckland; dairy sector leverage combined with falling dairy prices; and liquidity risks arising from volatility in the global financial markets.

The Board reviewed the potential impact of extending LVR measures to Auckland property investors, after the LVR announcement was made, and sought information on overseas experience. The Board remains confident that the Bank’s macro-prudential policy is consistent with the financial stability responsibilities contained in the Reserve Bank Act and in the Memorandum of Understanding on Macro-Prudential Policy agreed between the Minister of Finance and the Governor, and is helping to reduce potential financial stability risks associated with high house price inflation.

Following a review of the Board’s own process for assessing FSRs, it will have an opportunity around the start of the development of each FSR to advise on high-level issues, without getting involved in the development of analysis. This will facilitate the Board’s review after publication.

The Board concluded that the FSR provided a detailed analysis of the financial system environment and issues, and that it met the Bank’s statutory obligations. The Board encouraged the Bank to continue its efforts to analyse and explain the importance of efficient financial markets, to bring more regulatory analysis to the Board, and to broaden its efforts in expanding its outreach on the FSR.
**Other functions**
Management provided papers proactively, as well as in response to the Board’s requests, keeping the Board well informed across policy and operational developments, especially the Bank’s core functions, and its 10 Strategic Priorities set out in the *Statement of Intent (SOI)*.

The Board believes that the Bank has managed its financial responsibilities prudently, with a view to identifying and mitigating its balance sheet and business risks appropriately.

The Board also receives a regular report from the Trustees of the Bank’s Superannuation Fund, on which Keith Taylor represents the Board, and Deputy Governor Geoff Bascand represents the Governor.

**Funding Agreement**
The Board monitored the Bank’s progress in developing and negotiating a new Funding Agreement for 1 July 2015 to 30 June 2020. The Board recognised that the Bank was required to prepare its five-year budget taking into account a more constrained fiscal environment than five years ago, while aiming to meet its vision of being a high-performing central bank, and the strategic priorities set out in its SOI. This resulted in several staff redundancies, and while the Board supported the Bank’s approach, it advised on the importance of ensuring that the Bank had adequate resources to implement its broad operational and policy responsibilities.

**Special topics**
Continuing the process that the Board initiated in 2013-14, the Board requested papers on several topics of special interest to help it fulfil its advisory role. The discussions around these papers are designed to engage the Board with the Bank’s thinking early in the cycle of forming policy. Topics covered in 2014-15 included:

- **Depositor protection**: The Bank provided perspectives on various types of depositor protection in the context of the Bank’s Open Bank Resolution (OBR) policy and the international environment.

- **OBR**: We noted that this policy is one of several options available to the Minister of Finance in the event of a bank failure, and is designed to place responsibility on banks’ creditors, and minimise the call on taxpayers’ funds, while allowing a bank to re-open speedily. The Board discussed aspects relating the operation of the policy and stressed the need for communication to bank customers.

- **The anti-money laundering regime**: The Bank explained how it had implemented the regime, as an AML supervisor, including onsite inspection of all registered banks. Most registered banks showed good levels of compliance. The Board noted that the compliance burden of the regime was balanced by the important crime-reduction objective.

- **The output gap**: The Board explored the differences in methodologies in calculating and assessing the output gap.

- **Developments in global dairy markets**: The Board received an analysis of demand- and supply-side factors, across a range of global markets, affecting dairy prices. It discussed this analysis before meeting in Auckland with Fonterra directors and a senior executive for a discussion on the outlook for the sector.

- **The Bank’s efficiency mandate**: The Bank has responsibility under its Act for both soundness and efficiency in respect of the financial system, and the Board considered how the Bank balanced its responsibilities for both elements. We noted the Bank’s intention is to ensure that regulatory settings are effective, while minimising distortions and achieving soundness.

- **Regulatory stocktake**: The Bank’s stocktake of its prudential regulations is timely. There has been considerable regulatory expansion in recent years affecting the NBDT and insurance sectors, as well as AML responsibilities, and it is important to consider whether long-standing regulations are still fit for purpose. We noted that the Bank is keeping a wide range of agencies informed, especially through the Banking Forum (see page 47 for more information on the Forum).

- **Payment system review**: The Board sought progress reports on the Bank’s strategic review of the payments and settlement systems that it owns and operates, as the Bank tests the market for a new operator for NZClear and for procuring a new Real-Time Gross Settlement system.
The Board agreed to focus some of its external engagements on specific sectors, while maintaining an interest in regional economic developments. During the year, it met with the Chief Executive of Fletcher Building and other senior executives in Auckland for another insight into the challenges faced by the residential construction sector.

The Board considered it an honour for the Bank to receive the Central Bank of the Year award by London-based Central Banking Publications. This was recognition of the Bank’s innovative work to enhance its contribution to the New Zealand economy, to moderate financial stability pressures from the housing market, take on broader responsibilities for prudential supervision of insurance companies, and initiate a programme to enhance the security of New Zealand’s banknotes. The award also mentioned that the Bank had broadened its communication and engagement with the community, enhanced staff development, refined its governance, and strengthened its enterprise risk management.

On behalf of the Board, we would like to thank the Governors and all the staff of the Bank for the professionalism and commitment shown to continuously review and improve all aspects of the Bank’s operations and discharge of its responsibilities.

On behalf of the Board of Directors:

Rod Carr  
Chair  
25 August 2015

Keith Taylor  
Deputy Chair  
25 August 2015
Historic timeline
New Zealand didn’t have a single central authority to issue banknotes until August 1934, when the Reserve Bank was established, and our first official banknotes were issued.
Governance

The Reserve Bank of New Zealand is the nation’s central bank. An agency of the New Zealand Government, the Bank performs functions and exercises powers across the financial sector that are derived from several pieces of legislation.

Under the Reserve Bank of New Zealand Act 1989 (‘the Act’), the Bank is responsible for formulating and implementing monetary policy, promoting a sound and efficient financial system, and carrying out other functions and exercising other powers as set out in the Act.

The Act provides for the appointment of the Bank’s Board of Directors, Governor and Deputy Governors, and its corporate powers.

It also provides for the Bank’s powers and functions in respect of banking supervision, and payments and settlement systems.

The Bank has powers and functions under other legislation:

- the Non-bank Deposit Takers Act 2013 (NBDT Act): The Bank acts as the prudential regulator and licensing authority for non-bank deposit takers (NBDTs).
- the Insurance (Prudential Supervision) Act 2010 (IPSA): The Bank issues licences to insurers carrying on insurance business in New Zealand and undertakes prudential supervision of licensed insurers.
- the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT): The Bank supervises banks, life insurers, and NBDTs for compliance with measures to detect and deter money laundering and terrorism financing.

These Acts, and regulations made under these Acts, can be viewed electronically on the New Zealand Legislation website.

Under the Reserve Bank of New Zealand Act 1989, the Bank exercises its authority consistent with the:

- PTA, a written contract between the Minister of Finance and the Governor detailing the monetary policy outcomes that the Bank is required to achieve (RBNZ Act 1989 s9);
- Bank’s Funding Agreement, a five-yearly agreement between the Governor and the Minister of Finance that specifies how much of the Bank’s income can be retained by the Bank to meet its operating costs (RBNZ Act 1989 ss159-161);
- SOI, an annual three-year statement provided to the Minister of Finance covering the Bank’s operating environment, functions, objectives and strategies for the three years, and projected income and expenditure for the first financial year (RBNZ Act 1989 ss162A-162E);
- Annual Report, an annual accountability document, including presentation of financial statements (RBNZ Act 1989 ss163-165); and

- Memorandum of Understanding (MOU) with the Minister of Finance in respect of macro-prudential responsibilities.

The Bank also receives an annual Letter of Expectations from the Minister of Finance setting out his expectations of the Bank’s engagement with the Minister through the year.

The Reserve Bank Act confers day-to-day operational autonomy to the Bank, an important role for the Minister of Finance in some key decisions, and a robust accountability structure in which the Bank’s Board, the Minister and Parliament all have formal roles. The Bank’s activities are scrutinised by Parliament’s Finance and Expenditure Select Committee. Typically, hearings are held covering the quarterly MPSs, the six-monthly FSRs, and the Bank’s annual financial performance. For a description of how the Bank’s performance is monitored, see the Bank’s SOI 2012-2015, pages 33-35.

The Minister

The Minister of Finance has the following functions and powers under the Reserve Bank of New Zealand Act:

- appointing and removing a Governor on the recommendation of the Board;
- agreeing with the Governor the PTA;
- agreeing with the Governor a five-year funding agreement and any variations to it;
- various powers under Part 5 of the Reserve Bank of New Zealand Act, such as approval of any deregistration of or direction to a registered bank, and advising the Governor-General to place a registered bank into statutory management.

Subject to procedures intended to ensure appropriate checks and balances, the Minister of Finance can also:

- put in place a different monetary policy economic objective;
- direct the Bank to intervene in the foreign exchange market;
- direct the Bank to have regard to government policies relating to the Bank’s prudential functions under the RBNZ Act, IPSA and the NBDT Act.

Board of Directors

Section 53 of the Act specifies the duties of the Board, among other things, as being to:

a. keep under constant review the performance of the Bank in carrying out—

   i. its primary function [monetary policy]; and

   ii. its functions relating to promoting the maintenance of a sound and efficient financial system; and

   iii. its other functions under this Act or any other enactment:
b. keep under constant review the performance of the Governor in discharging the responsibilities of that office;

c. keep under constant review the performance of the Governor in ensuring that the Bank achieves the policy targets agreed to with the Minister (the PTA);

d. determine whether policy statements made pursuant to section 15 [Monetary Policy Statements] are consistent with the Bank’s primary function and the policy targets agreed to with the Minister;

e. keep under constant review the use of the Bank’s resources.

Section 53 also specifies that the Board may provide advice to the Governor on any matter relating to the performance of the Bank’s functions and the exercise of its powers.

The Board’s Audit Committee reviews the Bank’s financial statements and internal and external audit activity. Each year, the Board writes an assessment of the Bank’s and the Governor’s performance, which is provided as advice to the Minister of Finance and made public later in the Bank’s Annual Report.

The Board makes recommendations to the Minister on the appointment or reappointment of the Governor. The Minister can appoint only a Governor recommended by the Board. The Board can recommend to the Minister that the Governor be dismissed if the Board believes that the Governor’s performance or conduct has been inadequate or inappropriate. The Board appoints the Deputy Governors on the Governor’s recommendation.

The Board typically meets nine times a year, with provision for additional meetings. In the 2014–15 year, the Board had seven non-executive directors (see details on page 22). Board members are appointed for five-year terms and are eligible for reappointment.

Conflicts of interest

The Bank maintains policies and practices to avoid or manage conflicts of interest among all Bank personnel, including Governors and directors. The policy requires that all personnel act honestly and impartially, and in no circumstances reveal or make private use of confidential, market-sensitive information. The policy states that personnel must avoid situations where their integrity might be questioned, and that their best protection is full disclosure of any potential conflicts.

Governors and departmental managers are required to give the Bank quarterly updates about their personal interests so that any potential conflict of interest is recorded. If any other personnel have a particular concern, they can also record their interests in the same way.

Personnel must not be involved, directly or indirectly, in regular trading in wholesale financial markets in which the Bank has, or might have, a significant influence. Bank staff cannot own or control shares in entities (or their parent companies) that the Reserve Bank regulates, or use inside information to benefit when depositing or withdrawing funds from financial institutions, or purchasing or selling bonds or shares, or when changing between fixed and floating rates for a loan. It is unacceptable to use inside information whether to avoid losses or to make gains.

Under section 56 of the Reserve Bank Act, the Minister must have regard to the likelihood of conflict of interest in appointing a director to the Board. On appointment to the Board, directors sign a declaration that they will observe confidentiality in relation to the affairs of the Bank and will not use any confidential information they may acquire regarding Bank operation. They also provide lists of their other directorships and major interests to enable the Board Chair and the Governor to determine whether any Board papers should be withheld from them.

Financial disclosure of the Governor

As the Bank has extensive responsibilities, and in the interests of promoting sound organisational governance and transparency, there is merit in reporting the Governor’s financial disclosure. This is reported in each Annual Report and any changes made during the previous 12 months are highlighted.

Reserve Bank Governor financial disclosure as at 24 July 2015

1. Marketable securities, real estate, rights, proprietary and other interests, business and other assets owned during 2014-15 and valued above NZ$10,000.

Real property:
— Family home, Wellington*
— Section, Coromandel Peninsula*
— Section, Coromandel Peninsula*
— Holiday home, Coromandel Peninsula*

*Purchased prior to joining the Reserve Bank.

Deposits and marketable securities:
— Deposit at Bank-Fund Staff Federal Credit Union (Washington DC)
— Deposit at Westpac Bank
— KiwiSaver Employee and Employer Contribution

2. Sources of non-Bank income over NZ$5,000 during 2014-15 (other than from listed investments)
— World Bank Group Pension

3. Liabilities over NZ$50,000 owed during 2014-15
— Mortgage with Westpac Bank

4. Trading in foreign currency or in financial instruments
— None

5. Positions held outside the Reserve Bank
— None.

1. All assets and liabilities are jointly owned with spouse.
Financial management overview

Balance sheet overview and funding of the Bank’s operations

The Bank receives no direct funding through the Parliamentary appropriation process. Instead, the Bank’s main source of income is the return on the substantial investments the Bank holds, which are funded by the issue of currency and by the Bank’s equity. Currency in circulation is a liability on which no interest expense is incurred. The funds received when currency is issued are invested and earn interest income, which is known as seigniorage.

The nature and extent of the Bank’s principal activities that affect its balance sheet are described in the financial statements on pages 70-114.

Foreign reserves management, New Zealand dollar liquidity management, and currency operations materially affect the size and structure of the Bank’s balance sheet. The Bank’s financial performance is also influenced by: changes in both foreign exchange rates and interest rates; the extent of available funds in the form of equity; and currency in circulation. The Bank’s reported net income will fluctuate from year to year, primarily because the Bank’s unhedged foreign currency reserves will generate profits and losses as foreign exchange rates change.

Under the Reserve Bank Act, the Minister and the Governor may enter into a five-year funding agreement to specify the amount of the Bank’s income that may be used to meet operating expenses in each of the next five financial years. Capital expenditure is funded by the Bank, with depreciation of fixed assets included in annual operating expenses.

The 2010-2015 Funding Agreement ended on 30 June 2015 and the Governor and the Minister of Finance signed a new funding agreement for the next five years from 1 July 2015 to 30 June 2020, which was subsequently ratified by Parliament.

Annual distributions paid by the Bank

Under the Reserve Bank Act, the Bank must publish in its SOI the principles upon which its annual dividend is recommended to the Minister. The principles are as follows:

Statement of dividend principles

The Bank should maintain sufficient equity for the financial risks associated with performing its functions. Equity in excess of that required to cover those risks will be distributed to the Crown.

In general, unrealised gains should be retained by the Bank until they are realised in New Zealand dollars. However, the Bank may recommend the distribution of unrealised gains where the Bank believes that the probability of the gain being realised is high.

The amount of the dividend to be paid to the Crown is determined by the Minister of Finance each August on the recommendation of the Bank, having regard to the views of the Board of Directors and any other relevant matters.

Accounting standards

From 1 July 2014, the Bank adopted Public Benefit Entity International Public Sector Accounting Standards (PBE IPSAS). Before then, the Bank applied New Zealand International Financial Reporting Standards (NZ IFRS). This change was mandated by the New Zealand Accounting Standards Board of the External Reporting Board. The change in financial reporting framework has not had a significant impact on the Bank’s financial reporting, although IPSAS and IFRS could diverge over time.

2. No interest is paid on currency in circulation. When notes and coins are issued to a registered bank, the registered bank will pay for the currency that is issued by paying funds to the Reserve Bank from that bank’s exchange settlement account with the Reserve Bank. The Reserve Bank invests the proceeds it receives, and the earnings on those investments are known as ‘seigniorage’.
Management structure

Governor
Graeme Wheeler

Assistant Governor
Head of Economics
Dr John McDermott

Deputy Governor
Head of Financial Stability
Grant Spencer

Deputy Governor
Head of Operations
Geoff Bascand

Head of Prudential Supervision
Toby Fiennes

Head of Risk Assessment & Assurance
Steve Gordon

Head of Macro-Financial Stability
Bernard Hodgetts

Head of Communications
Board Secretary
Mike Hannah

Head of Financial Markets
Mark Perry

Chief Information Officer
Tanya Harris

Head of Currency, Property & Security
Brian Hayr

Head of Human Resources
Lindsay Jenkin

Chief Financial Officer
Mike Wolyncewicz
meet Mr DOLLAR
10 July 1967 was ‘DC’ day – New Zealand adopted decimal currency over pounds, shillings and pence, and the Reserve Bank issued the new currency to the nation. Imperial money, which had the pound divided into 20 shillings and a shilling into 12 pence, was relatively complex to deal with. Sums involving fractions of the 100 cents in the dollar were so much simpler. ‘Mr Dollar’ was used to promote the change to New Zealanders.
Our board

Dr Rod Carr  
— Chair, Reserve Bank of New Zealand Board of Directors — from 19 September 2013  
— Vice-Chancellor, University of Canterbury

Keith Taylor  
— Deputy Chair, Reserve Bank of New Zealand Board of Directors — from 19 June 2014  
— Chair, Reserve Bank of New Zealand Board of Directors’ Audit Committee  
— Company director

Professor Neil Quigley  
— Vice-Chancellor, The University of Waikato

Tania Simpson  
— Company director

Jonathan Ross  
— Barrister and solicitor

Bridget Coates  
— Company director

Kerrin Vautier CMG  
— Consulting research economist

Graeme Wheeler  
— Governor

Mike Hannah  
— Board secretary

Non-Executive

Corporate interests:
— Joint Research Consultants (NZ) Limited/Director  
— Canteri Ltd/Director  
— Lyttelton Port Company Limited/Director  
— Waingawa Forest Corporation Limited/Director

Other interests:
— Canterbury Employers’ Chamber of Commerce/Director  
— Christchurch Earthquake Appeal Trust/Trustee  
— University of Canterbury Trust Funds/Vice-Chancellor  
— UC International College/Director  
— University of Canterbury Foundation/Trustee

First appointed 16 July 2012 — current term expires 15 July 2017

Non-Executive

Corporate interests:
— Butland Management Services Limited/Director  
— Gough Gough & Hamer Limited/Chair  
— Port Marlborough Limited/Director

Other interests:
— Annuitas Management Ltd/Chair  
— Earthquake Commission/Deputy Chairman  
— Government Superannuation Fund Authority/Chair  
— Reserve Bank Superannuation Fund/Trustee  
— Southern Cross Medical Care Society/Director  
— Southern Cross Health Trust/Trustee

First appointed 1 July 2009 — current term expires 30 June 2019

Non-Executive

Corporate interests:
— Marlborough Lines/Director

Other interests:
— Panel of Recognised International Market Experts in Finance (The Hague): Panel of experts’ member  
— Rhodes Scholarships for New Zealand/Director

First appointed 12 August 2015 — term expires 11 August 2018

Non-Executive

Corporate interests:
— White Cloud Dairy Innovation Ltd/Chairperson and CEO

Other interests:
— Fahrenheit Partners NZ Ltd/Director  
— 212 Equity LLC (US private equity investment)/Director  
— Arc Angels (angel investment network)/Chairperson  
— BRAC USA (global non-profit)/Director  
— University of Auckland Business School Advisory Board/board member

First appointed 1 October 2013 — term expires 30 September 2018

Non-Executive

Corporate interests:
— AgResearch/Director  
— Kowhai Consulting Ltd/Director  
— Mighty River Power/Director

Other interests:
— Global Women, Director  
— King Tuheitia’s Council/Member  
— Radio Maniapoto/Trustee  
— Ta Trust/Trustee  
— Waitangi Tribunal/Member

First appointed 16 June 2014 — term expires 15 June 2019

3. Retired as director from Mighty River Power in May 2015
Vision & values

Vision
The Reserve Bank’s vision is to promote a sound and dynamic monetary and financial system.

Values
It endeavours to achieve this vision by being a high-performing small central bank, with values of:

Integrity
— Being professional and exercising sound judgement

Innovation
— Actively improving what we do

Inclusion
— Working together for a more effective Bank.

Goal

The Bank contributes to the Government’s goal of improving New Zealand’s economic performance by targeting three outcomes.

Outcomes
These are designed to foster confidence and stability in New Zealand’s financial system by:
— maintaining stability in the general level of prices;
— maintaining a sound and efficient financial system; and
— providing legal tender to meet the currency needs of the public.

Functions
To achieve these outcomes, the Bank’s functions cover:
— monetary policy formulation;
— financial market operations;
— macro-financial stability;
— prudential supervision;
— settlement services; and
— currency operations.

These functions, the links between them through the outcomes targeted, and the measures used to evaluate performance are shown in the following pages.
The Reserve Bank first operated from ‘temporary’ premises in the Dominion Farmers’ Institute building on Featherston Street in central Wellington - complete with a replica moa in the foyer. This was the Bank’s home for 38 years. Work finally began in the mid-1960s on a purpose-built building on the corner of The Terrace and Bowen Street, diagonally opposite Parliament. It has been the Bank’s home since 1972.
Reserve Bank goal and outcomes 2014-15

Goal
Improved economic performance.

Outcomes
— Price stability maintained
— Sound and efficient financial system maintained
— Currency needs of the public are met.

Functions

Monetary policy formulation
Stability in the general level of prices.

Success measures
— Reserve Bank forecasts of CPI inflation should be comfortably within the target range in the second half of our forecast horizon, and near the 2 percent target midpoint.
— Measures of underlying inflation should generally remain within the target range.
— Unnecessary instability in output, interest rates and the exchange rate should be avoided.
— Monetary Policy Statements are informative and accurately assess the Bank’s performance in meeting the objectives of the Policy Targets Agreement.

Financial markets
— Adequate banking system liquidity
— Short-term interest rates consistent with monetary policy
— Confidence in the efficient functioning of New Zealand financial markets
— Foreign reserves available for efficient foreign exchange intervention and crisis management.

Success measures
— Short-term wholesale interest rates are maintained at levels close to the OCR.
— No evidence of payment disruptions due to a shortage of settlement cash in the system, e.g., persistent accessing of the Overnight Reverse Repo Facility.
— Over the medium term, domestic market operations generate a positive return.
— Foreign reserves are maintained at target levels, with liquidity and credit standards met throughout.
— The Foreign Reserves Management portfolio yields a net return on assets that meets or exceeds the benchmark portfolio.
— The foreign exchange open position is managed such that:
  a. the bulk of active foreign exchange purchases (sales) are undertaken around peaks (troughs) in the exchange rate cycle; and
  b. the net return on the non-core open foreign exchange position is positive over the cycle.
Macro-financial stability
Financial stability, promoted by:
— Increased resilience of the financial system during periods of extreme credit growth and rising leverage or abundant liquidity; and
— Dampening of excessive growth in credit and asset prices.
Success measures
— Significant risks to domestic financial systems stability are identified and monitored.
— Appropriate and effective policy instruments to counter risks to financial stability are deployed in a timely manner, and any potential impacts on monetary policy are understood.
— An assessment of the soundness and efficiency of the financial system is published twice yearly in the Financial Stability Report, including the reasons for, and the impact of, any use by the Bank of macro-prudential policy instruments.
— Information on the risk assessment framework, including the macro-prudential indicators that are used to guide policy settings, is published in a manner that assists the assessment of financial stability.
— Statistics are collected that enable an appraisal of the soundness and efficiency of the financial system, and are published in accordance with the dates published on the RBNZ website.

Prudential supervision
Success measures
— The bank, non-bank deposit taker and insurance regulatory regimes, and in particular the regulatory changes implemented during the year, promote the soundness and efficiency of the financial system in a cost-effective manner, as demonstrated by sound regulatory impact analysis.
— The Reserve Bank’s prudential oversight of banks, non-bank deposit takers, insurance companies and payment systems identifies emerging financial stresses in a timely manner; and the Bank is prepared, where necessary, to effectively resolve institutional failures in conjunction with Government.
— The Bank demonstrates a consultative and transparent approach to its policy development, supported by robust analysis that is understood by regulated institutions and stakeholders.

Currency operations
Legal tender that meets the currency needs of the public.
Success measures
— All orders for notes and coins from banks that meet the Reserve Bank’s guidelines are supplied within agreed times.
— Notes and coins in general circulation are of a good quality as indicated by surveys of the condition of currency in circulation.
— The number of counterfeit notes in circulation should be fewer than 10 per million notes in circulation.
— Stakeholders are well informed and prepared for the introduction of Series 7 banknotes.
In 1984, the Government initiated an extensive economic liberalisation programme, including removal of interest rate controls. The following year, on 4 March, it floated the New Zealand dollar. This meant the market set the dollar’s value against other currencies. In the years since, the floating exchange rate regime has helped New Zealand to weather the ups and downs of business cycles and major market events such as the Global Financial Crisis.
Rounding up 80 years

Historic timeline

1985
1. Continuing to strengthen the RBNZ’s performance

**Priority**
The Bank will continue to refine its decision-making processes and structures to support high quality decision making. With growth in the Bank’s regulatory responsibilities, and the establishment in 2013 of the Governing Committee comprising the Bank’s four Governors, managers are conscious of the need to coordinate policies and processes. The Bank has therefore been reviewing decision-making responsibilities and processes for all committees. This year the Bank’s policy committees will operate with new terms of reference, membership, and expectations on how best to contribute to the Bank’s decisions. Management committees, including the Senior Management Group, have also been reviewed and will be tasked with strengthening communication inside and outside the Bank.

**Outcome**
Since its establishment in 2013, the Governing Committee has been operating well. After the formal review of all Bank committees in the wake of the Governing Committee’s establishment, informal assessment by committee chairs indicates committees are functioning effectively, with improved quality of discussions providing good scrutiny of the Bank’s policy development and overall operations. A particular focus for the management committees has been enhanced internal communication of strategic initiatives and decisions by sharing committee meeting minutes, regular staff updates, and through other formal and informal means. An organisational review established an additional Senior Manager Supervision position in Prudential Supervision to strengthen external engagement and enable the Head of Department to increase oversight of policy. Analytical work examined governance arrangements in other central banks.

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2. Continuing to improve performance culture

**Priority**
The Bank’s senior management places considerable emphasis on developing managers’ leadership capability and performance. Managers will use the clear performance objectives and the Bank’s competency framework to monitor staff performance and provide appropriate development opportunities. The links between performance and remuneration will continue to be strengthened. The Bank’s recent Staff Engagement Survey gives management further insight into what is needed to raise staff engagement levels and be a high performing workplace. Three key areas of focus, which are Feeling valued, Feeling connected and Being able to perform and grow, have been identified and seven key actions will be implemented in these areas. These actions will be highlighted and tracked through the Bank’s internal communications programme and completed by the end of December 2014.

**Outcome**
To achieve its goals, the Bank focuses on opportunities to engage and develop its people and to best utilise staff capability. A change management programme ‘Evolving as a Central Bank’ was initiated this year, with a strong focus on change leadership skills and business transformation to achieve a more cost-effective, innovative and high-performing workforce. The initial phase of business transformation was successfully completed in April 2015. This was supported by ‘Working Adaptively with Change’ workshops for managers and staff. The emphasis on staff engagement, leadership and performance management over the year had a positive impact on the level of staff engagement in the key target areas of Feeling valued, Feeling connected and Being able to perform and grow. A second Staff Engagement Survey confirmed these results and provided insight into more opportunities to further strengthen staff engagement. The engagement action plan and the change management programme are providing Bank staff with opportunities to work to their strengths across different areas, connect directly with senior management on key priorities, and contribute to the high-performance culture by working collaboratively with colleagues on innovative projects and improvement initiatives.
3. Communicating on a broader front

**Priority**
The Bank will ensure that it communicates clearly and effectively to improve understanding of and support for its policy choices. It will further expand its programme of on- and off-the-record speeches by a wider range of speakers, to many sectors and regional audiences, as well as briefings, media interviews, and videos on the Bank’s operations and policy statements. The Bank will build its understanding of stakeholders’ perceptions of the Bank’s roles, policy decisions and performance through many sources, including audience feedback to the large off-the-record speech programme, the news media, a biannual stakeholder survey, and potential online engagement channels. The production and release of a new series of banknotes will be a particular focus for clear, effective and proactive communication.

**Outcome**
The Bank’s efforts to enhance understanding of its role and policies continued through a wide range of channels, including our statutory accountability documents, the MPS and FSR, 118 presentations (17 on the record) to regional and metro audiences across New Zealand, stakeholder briefings, media interviews, website videos and animated graphics, and public inquiries.

We use on-the-record speeches to explain our thinking and policy frameworks. Our off-the-record engagements allow us to engage in wider discussions with less risk of dialogue triggering a reaction in financial markets. Most of our presentations were on the economy, inflation and wider monetary policy, and financial stability. We covered other specialist topics, from risks associated with housing market imbalances to macro-prudential policy responses, to New Zealand’s banknote evolution.

The Bank launched the Brighter Money Series 7 banknote designs, and planned an education campaign in advance of the October 2015 release. We co-ordinated the launch of New Zealand’s first coloured circulating coin, an Anzac coin, commemorating the centenary of the Anzac landings on the Gallipoli Peninsula.

Our first external stakeholder engagement survey provided a significant measurement of our communications impact, telling a positive story while offering insights for the Bank to achieve even greater levels of stakeholder trust.

The Reserve Bank Museum & Education Centre continues its economic literacy outreach programme targeting school students and the general public, and enjoyed about 20 percent growth to 9000 visitors.

2. Developing a more integrated approach to the Bank’s policy

**Priority**
The Bank will continue a programme of research to increase its understanding of the linkages between monetary and financial stability policies, and the implications for decision making across these two policy functions. Aspects of the work programme will include policy coordination, the impact of interest rates on financial stability and the modelling of the interactions between monetary policy, prudential policy instruments, and the economy. The work will also seek to draw insights for internal policy processes within the Bank. This research programme will be a joint initiative led by the Economics Department and the Macro-Financial Department.

**Outcome**
The Bank has deepened its understanding of the linkages between monetary and macro-prudential policy. Public communications have clarified that monetary and macro-prudential policies are set with differing objectives, respectively price and financial stability. However, each policy area can have significant effects on the other’s objective and should have regard to these effects. The Bank has analysed and communicated the implications of the speed limit on high LVR lending for monetary policy, and has an ongoing research programme to extend macroeconomic models to formally study the linkages between the two policies. A conference in October 2014 brought together domestic and international researchers and policymakers to discuss the topic. The Bank will continue to consider the interactions between these policy areas, while ensuring that each policy is consistent with its own primary objective.
5

Reviewing, streamlining and improving the prudential regulatory framework

Priority
The Bank will complete a stocktake of prudential regulations for banks and NBDTs, and of the insurance solvency standards. Following the stocktake the Bank will consult on enhancements that it considers will improve the efficiency, clarity and targeting of the Bank’s prudential standards.

Outcome
The Bank has carried out extensive work to identify possible improvements in its prudential regulations for banks and NBDTs. This work was helped by a series of workshops with registered banks and has culminated in a consultation paper that sets out several proposals for ways in which prudential requirements can achieve their intended outcomes at lower cost, can be made clearer or can be better targeted. The paper includes options to make the bank disclosure regime more cost-effective, and sets out detailed plans for a major restructuring of the Banking Supervision Handbook. The Bank is proposing only minor changes for the NBDT sector, as the stocktake follows closely on a major review in 2013 of the regulation and supervision of that sector.

For the insurance sector, the Bank completed a revision of the Insurance Solvency Standards, which included revisions for reinsurance, guarantees and the quality of capital. Several amendments also clarified the intended application of the standards. A solvency standard for variable annuities was issued during the year.

6

Developing a comprehensive stress-testing framework for the New Zealand banking system

Priority
The Macro-Financial and Prudential Supervision departments will undertake a programme of work to develop a comprehensive stress testing framework that can be used to gauge the resilience of the banking system to a broad range of economic and financial shocks. As part of this initiative, the Bank will work this year with the domestically-owned banks to complete stress tests of their credit portfolios; and with the Australian Prudential Regulation Authority and the major Australian banks to stress-test their balance sheets. The latter exercise further develops earlier stress tests undertaken in collaboration with the Australian Prudential Regulation Authority in 2010 and 2012.

Outcome
The Bank completed a stress test of the major New Zealand banks in 2014 and an initial stress test of other New Zealand incorporated banks earlier in 2014. Since that test, we have gathered further information on the methodologies used by major banks in conducting stress tests, which we will use to create a discussion document on best practice stress-testing methodology. In conjunction with the Australian Prudential Regulation Authority, we supplied a scenario to the four largest New Zealand banks to use in their internal stress-testing process this year. We will analyse the results of this test, and the methodologies used to generate them, when they are available.
3. Improving infrastructure and reducing enterprise risk

**Priority**

Given the range of currencies in which the Bank’s foreign reserves are held, managed and traded, the Bank requires excellent relationships and timely and accurate market intelligence. The Bank will review whether its solely New Zealand-based operating model is the optimal operating structure, and in particular will assess if offshore infrastructure can enhance risk management and returns, alongside improved market intelligence and enhanced professional development.

**Outcome**

Consideration of an offshore office was delayed due to operating budget constraints and a primary focus on improving the treasury systems operating environment. The Bank reviewed its overall research capability, and addressed the need for improved market intelligence and international economic and financial market analysis. During the year, the Bank also expanded its network of offshore market contacts.

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**Priority**

The Bank operates payment systems that are critical to the operation of the economy, and also operates an internal treasury system that supports decision making and accounting for transactions undertaken for the foreign reserves, domestic markets, and currency functions. The effectiveness of these systems is affected by developments in international settlement norms and valuation methodologies, changes to the settlements landscape in New Zealand, and rapid technological change. The Bank will develop a set of options for changes to the architecture of these systems, including a roadmap for future investment and support. In the case of payment systems, the Bank will consult with users.

**Outcome**

The Bank has developed a preferred roadmap for changes to the architecture of treasury and associated financial systems that will result in a robust, future-orientated operating platform. The Bank has formally requested vendors to submit proposals for development of a systems solution that will address the high priority areas of trade valuation, position and collateral management. Once these proposals are assessed, a formal business case for implementation will be developed.

We received Request for Proposal (RFP) responses from shortlisted vendors of Real Time Gross Settlement (RTGS) systems, and began vendor evaluations. Expressions of interest were received from potential operators of securities settlement systems, and these are being assessed with a view to shortlisting prospective bidders, who will then receive a detailed information memorandum and be invited to submit formal bids. The RTGS systems procurement and NZClear divestment programmes are proceeding to plan.
Delivering New Zealand’s new banknotes

### Priority

The release of Series 7 banknotes in 2015 remains an important priority for the Bank. After securing a printing contract and confirming print schedules and subsequent release dates, the banknote upgrade project will move into its third major phase. This will involve banknote development, print trials, quality assurance, and production. It will also involve increased public awareness, extensive communications, stakeholder engagement and industry preparedness through 2015. The Bank will be concurrently refurbishing its Wellington processing facilities and plant to manage the significant growth in activity from 2015 through to 2018.

### Outcome

The Series 7 Brighter Money $5 & $10 banknotes were in production by year’s end and development of the $20, $50 & $100 notes was in line with expectations. The Bank invited cash-handling industry participants to attend three banknote upgrade meetings and, in June, we issued them with production-quality notes to calibrate currency equipment and ensure their preparedness before launch.

Planning is well advanced for a public launch event of the $5 and $10 notes in September 2015, supported by the updated Brighter Money website that will promote the new security features. Planned communications were focused on educating the public about how to identify genuine banknotes as well as highlighting the personalities, flora and fauna in the Brighter Money series. Collateral was also being created for stakeholders, such as the retail sector, banks and visually impaired member organisations.

Refurbishment of processing facilities at the Bank’s Wellington premises was completed ahead of the arrival of the Brighter Money banknotes.

The Brighter Money banknotes will be issued as Series 6 banknotes are withdrawn from circulation. The $5 and $10 notes will be released to the public from October 2015; $20, $50 and $100 notes are scheduled for release in April 2016. Each release will be supported by a media campaign.

Developing a plan for optimising the facilities management and logistics for currency

### Priority

The Bank will re-evaluate its long-term requirements and plans for processing facilities and property, to support the custody, reserves management, distribution and logistics of currency. The Bank has reviewed risks associated with its vaults in the Wellington building and identified a need to replace them. Due to design constraints, it is impractical to upgrade the facility. This risk has been magnified with last year’s [2013] seismic activity. Over the next five years, as the Bank introduces the new Series 7 banknotes, it will be transitioning currency reserves between eight sites, including Wellington and five offshore sites. The complexity of managing currency in multiple sites, and the impact on enterprise risk, operational efficiency and effectiveness, will be incorporated into the planning for new facilities.

The Bank has developed a new currency reserves policy to mitigate these enterprise risks. This year, planning will focus on developing longer term facilities options and business cases, if required, for inclusion in the Bank’s five-year funding proposal.

### Outcome

Analysis was conducted to understand the Bank’s and New Zealand’s future requirements. We are continuing to assess possible technologies and solutions that could fulfil these requirements. Similarly, the Bank continued to assess New Zealand’s current vaulting capability while being mindful of future regional requirements. In 2016, we will initiate consultation to find a solution that will best meet New Zealand’s interests, and those of the Bank and industry participants.
The year in review

Monetary policy formulation

The objectives of the monetary policy formulation function are:
To achieve and maintain stability in the general level of prices. The current PTA between the Minister of Finance and the Governor requires that the Bank “keep future CPI inflation outcomes between 1 and 3 percent on average over the medium term, with a focus on keeping future average inflation near the 2 percent target midpoint”. It also requires that: “In pursuing its price stability objective, the Bank shall ... seek to avoid unnecessary instability in output, interest rates and the exchange rate.”

In our 2014-2017 Statement of Intent, we undertook to deliver the following:

Outcome
Stability in the general level of prices.

Initiatives and strategies

1. Macro-prudential and monetary policy interface: undertake analysis and develop frameworks to better understand the interaction between macro-prudential and monetary policy.

2. Best-practice institutional frameworks: undertake analysis to inform on best-practice institutional arrangements governing monetary and macro-prudential policies.

3. Support the formulation of monetary policy: understand how events such as a construction and housing boom, fiscal consolidation and international developments will shape the next business cycle.

4. Monetary policy research: undertake analysis to improve the Bank’s understanding of the New Zealand economy and key monetary policy issues.

5. Exchange rate analysis: reviewing the Bank’s frameworks for assessing the long-term sustainable level of the exchange rate and analysis on the cyclical impact of the exchange rate on New Zealand economic activity and inflation.

Our performance would be measured by:

Success measures

— Reserve Bank forecasts of annual CPI inflation should be comfortably within the target range in the second half of the forecast horizon, and near the 2 percent target midpoint.
— Measures of underlying inflation should generally remain within the target range.
— Unnecessary instability in output, interest rates and the exchange rate should be avoided.
— Monetary Policy Statements are informative and accurately assess the Bank’s performance in meeting the objectives of the PTA.
Environment

The New Zealand economy grew by 2.6 percent in the year to March 2015. Construction activity increased in the year, driven by stronger activity in Canterbury and Auckland. Net immigration grew to record high levels, boosting GDP growth and the labour force. High prices for New Zealand’s commodity exports in 2013 and the first half of 2014, particularly for dairy products, supported demand over the second half of 2014.

The international economic environment has remained challenging even though growth in New Zealand’s trading partners has been moderate. Central banks across most of the developed world have policy interest rates close to zero, and many major central banks are relying on unconventional measures to support demand. Strong economic conditions in New Zealand relative to the rest of the world resulted in the NZD exchange rate remaining high over much of the year.

International developments have contributed to a sharp decline in international dairy prices since early 2014. Dairy production has increased in most major dairy-producing nations, and dairy imports to China have fallen due to heavy stockpiling. Lower dairy prices have contributed to a decline in New Zealand’s terms of trade, which will weigh on domestic incomes in coming years.

House price inflation increased rapidly in Auckland, mainly due to supply shortages, but was subdued in the rest of New Zealand.

What we did – success measures

The Bank’s quarterly MPS is the key assessment and accountability document for our monetary policy performance, as required by the Act. Each MPS describes the Bank’s judgement in respect of economic conditions, inflationary pressure and the reasons behind OCR decisions.

In the second half of 2014, inflationary pressure in the economy began to soften. Headline CPI inflation fell to 0.3 percent in the year to June 2015. International crude oil prices fell sharply in late 2014, contributing to a large decline in domestic petrol prices. Falling petrol prices were a major factor behind annual inflation going below the 1 to 3 percent target range. The elevated exchange rate and low global inflation also dampened tradables inflation.

Non-tradables inflation has remained steady in recent years, despite strong economic growth. This reflects strong growth in the supply potential of the economy, in part due to high net immigration. Survey measures of inflation expectations have fallen, and are now at a level that is more consistent with CPI inflation settling at 2 percent in the medium term. This decline in inflation expectations also contributed to subdued growth in nominal wages and non-tradables prices.

The Bank moved from projecting further increases in the OCR to an explicit neutral stance in the March 2015 MPS. This shift contributed to declines in fixed mortgage rates. Subsequently, the Bank signalled OCR reductions were possible if the outlook for demand and inflationary pressures eased further. In June 2015, the Bank reduced the OCR by 25 basis points to 3.25 percent, and signalled that it was likely to lower the OCR further.

The June MPS projects CPI inflation to return to the target range in early 2016, and to reach the 2 percent midpoint later in the year. The NZD exchange rate has depreciated sharply since the Bank shifted its policy stance in April 2015, and this is expected to contribute to an increase in tradables inflation over the next year. Lower interest rates and the lower exchange rate will support economic growth, contributing to an increase in non-tradables inflation over the medium term.

What we did – initiatives and strategies

The Bank conducted research on a range of topics and progressed initiatives to support monetary policy formulation.

We researched the causes of current low inflation in New Zealand. Our findings, which supported decision makers in their deliberations and communication of monetary policy, were disseminated in research papers, speeches and in the MPS.

We continued our research into the interaction between monetary and macro-prudential policies, and issues related to the exchange rate. In December 2014, the Bank expanded the number of currencies used to calculate the official Trade-Weighted Index measure of the New Zealand dollar exchange rate from five to 17.

Enhancements to our programme of regular meetings with business and other organisations during 2014 helped us to better understand broader economic developments and the performance of key industries.

The Bank worked to improve its communication about monetary policy and strengthen its engagement with external stakeholders. In particular, the Bank published a range of on-the-record speeches relating to monetary policy, and continued to publish a wide range of analysis and research. The Bank refreshed the design of its key documents, including the Bulletin and the MPS. Bank research staff presented their research at conferences in New Zealand and overseas, and the Bank hosted presentations by visiting international researchers. In December 2014, the Bank jointly hosted a conference with the International Journal of Central Banking on reflections on 25 years of inflation targeting.
The year in review

Rounding up 80 years

Chart 1
Consumer price inflation
Annual % change, excluding GST

Chart 2
OCR, 90-day rate, TWI
1989

Reserve Bank Act & inflation targeting

The Reserve Bank of New Zealand Act 1989 defined the Bank’s modern role and functions. New Zealand became the first country to introduce inflation targeting and, in the 25 years since, this tool has successfully delivered price stability while supporting long-term growth. Inflation targeting is now standard in most developed economies.
The year in review

Financial markets

The objectives of the financial market operations are:
To support the implementation of monetary policy; to assist in the efficient functioning of New Zealand’s financial system; to manage official foreign reserves; to implement the Bank’s foreign exchange market intervention policy; to manage the Crown’s financial liquidity; and to maintain crisis intervention capability.

In our 2014-2017 Statement of Intent, we undertook to deliver the following:

Outcomes
— Adequate banking system liquidity.
— Short-term interest rates consistent with monetary policy.
— Confidence in the efficient functioning of New Zealand’s financial markets.
— Foreign reserves available for efficient foreign exchange intervention and crisis management.

Initiatives and strategies
— Review whether the Bank’s solely New Zealand-based operating model for managing foreign exchange reserves is the optimal operating structure. In doing so, it will assess whether risk management and returns can be enhanced through a full-time European presence.
— Develop a set of options for changes to the architecture of treasury and associated financial systems that will result in a robust, future-orientated operating platform.
— Develop and implement further financial tools and instruments to improve management of the financial risks to which the Bank is exposed, with specific consideration of whether to set up a stand-alone collateral management desk.

Our performance would be measured by:
Success measures
— Short-term wholesale interest rates are maintained at levels close to the OCR.
— No evidence of payment disruptions due to a shortage of settlement cash in the system, e.g., persistent accessing of the Overnight Reverse Repo Facility.
— Over the medium term, domestic market operations generate a positive return.
— Foreign reserves are maintained at target levels, with liquidity and credit standards met throughout.
— The Foreign Reserves Management portfolio yields a net return on assets that meets or exceeds the benchmark portfolio.

— The foreign exchange open position is managed such that:
  a. most active foreign exchange purchases (sales) are undertaken around peaks (troughs) in the exchange rate cycle; and
  b. the net return on the non-core open foreign exchange position is positive over the cycle.

Environment
Global financial market volatility increased during the year as critical economic policy events combined to cause substantive shifts in currencies, commodities and other asset prices. A stronger USD was evident as expectations of a tightening in US monetary policy increased. The European Central Bank entered another significant programme of quantitative easing in March 2015, buying a range of European sovereign bonds, which led to historically low or negative interest rates in many European countries. With historically low global interest rates, equity and property prices continued to rise, reaching new highs in some jurisdictions. In contrast, partly in response to supply factors and subdued global economic growth, commodity prices, particularly oil, fell sharply in the second half of 2014. New Zealand’s economic performance was relatively strong over 2014, in contrast to most of the developed world. However, sharply lower commodity prices, especially dairy, reduced New Zealand’s growth prospects, and the combination of this with weaker inflation in non-traded sectors has led to more accommodative domestic monetary policy in 2015.

What we did – success measures
Domestic Markets
The Domestic Markets team seeks to maintain short-term wholesale interest rates at levels close to the OCR.
While short-term local interest rate markets remained reasonably stable throughout the financial year, the foreign exchange (FX) swap market was more volatile as the depreciating NZD resulted in greater funding pressures. This was against a backdrop of declining market liquidity, caused by a reduced risk appetite and the evolving global regulatory landscape, which saw reduced market-making by banks. Domestic Markets assumed a greater intermediating role during times of high market volatility, and used FX swaps, repurchase agreements (repos) and Reserve Bank bills to manage this volatility. The Bank saw increased interest in its regular Reserve Bank bill programme. This was a particularly effective tool, and most market participants were quick to adopt it in their portfolio of primary liquid assets.
Domestic Markets also successfully managed the liquidity of three prominent Crown debt flows – two larger-than-normal issuances of new government bonds via syndication and,
The year in review

Rounding up 80 years

Chart 3
Financial Markets

Implied rate %
Exchange rate %

NZD USD Spot (RHS)
Overnight forward rate (LHS)
OCR (LHS)

Chart 4
TWI/NZD purchases

TWI-17 (RHS)
Net NZD purchased or sold (LHS)
in conjunction with the New Zealand Debt Management Office, the maturity of the April 2015 nominal bond. Domestic Markets recorded revenue of $13.6 million before operating expenses on its operations for the year, primarily through increased market intermediation activity.

Foreign reserves management
The Bank refined its foreign reserves allocation and benchmarking criteria. Foreign reserves assets are now aligned more closely with our liability structure, and split between hedged and unhedged reserves. Previously our reserves assets were structured as one pool, with no specific link to how they were funded. Moving to two pools of reserves will simplify operational procedures and help improve return measurement and attribution analysis.

Hedged reserves are funded by foreign currency borrowing and invested primarily in short-dated government instruments of the United States, Europe and Japan. Interest rate risk and currency risk are minimised.

Unhedged reserves are funded by the Bank’s NZD liabilities (through the sale of NZD), and invested mostly in government bonds with about two years’ duration. This creates both currency and interest rate risk. Unhedged reserves are benchmarked against an international 1-3 year bond index and held in a basket of six currencies (USD, EUR, JPY, GBP, CAD and AUD).

Our investments continue to be in a mix of high-quality and liquid government or near-government bonds. This limits returns, especially for unhedged reserves, as many major bond markets have experienced very low returns and, in some cases, negative yields. Despite this, the Bank was able to minimise costs through its hedged portfolio, generating positive returns from its liability management, funding mostly through the cross-currency basis swap market.

The Bank’s unhedged foreign exchange position increased as the NZD moved further away from fair value, reaching new post-float highs against the AUD, EUR and against the New Zealand Trade Weighted Index (TWI). The unhedged FX position stood at Special Drawing Right (SDR) 1.6 billion at the end of June 2015 against its long-term benchmark of SDR 1.0 billion. A correction in the NZD from April 2015 saw a noticeable improvement in the mark-to-market return of the unhedged FX position.

What we did – initiatives and strategies
Following a review of its research capability, Financial Markets added resources in market intelligence, and international economic and financial market analysis.

The Bank developed a roadmap for preferred changes to the architecture of treasury and associated financial systems that will result in a robust, future-orientated operating platform. The Bank invited vendors to submit proposals for the development of a systems solution that will address the high priority areas of trade valuation, position and collateral management. Once these proposals are assessed, we will develop a formal business case for implementation.

We completed documentation for new Credit Support Annex agreements with all major systemically important counterparties. This enabled the Bank to access cost-effective funding for its hedged foreign reserves, and to mitigate the default risk of any particular counterparty (as we hold collateral against unrealised profits). Similarly, the Bank moved all major Domestic Markets counterparties to an updated (2011) version of a Global Master Repurchase Agreement that brings New Zealand in line with global market best practice. It also gives the Bank added protection when dealing with Bank counterparties in repo transactions.
The objectives of the macro-financial stability function are:

To promote a sound and efficient financial system that facilitates the effective performance of the economy; to increase the resilience of the domestic financial system and counter instability in the domestic financial system arising from credit, asset price or liquidity shocks; and to analyse and report on the soundness and efficiency of the financial system.

In our 2014-2017 Statement of Intent, we undertook to deliver the following:

Outcome

— A sound and efficient financial system that supports the functioning of the economy.
— International and local confidence in New Zealand’s financial system.

Initiatives and strategies

— Continue to develop the implementation framework for macro-prudential policy by researching the circumstances when the deployment of other macro-prudential instruments might be appropriate.
— Complete the programme of work to understand the linkages between monetary and macro-prudential policies, and the implications for decision making across the two policies.
— Develop a comprehensive stress-testing framework for the New Zealand banking system that can be used to gauge the resilience of the system to a broad range of economic and financial risks.
— Monitor the effectiveness of the loan-to-value restrictions, and advise on their withdrawal when judged appropriate.
— Continue to enhance the reporting of financial system stability and efficiency, and the assessment of policy, as contained in the Financial Stability Report and other reports.
— Expand the collection of financial market statistics, including developing an insurance sector statistical survey; enhancing the collection of managed funds data; developing a New Zealand securities database; and completing the implementation of new balance sheet data for the banking sector.

Our performance would be measured by:

Success measures

— Significant risks to domestic financial systems stability are identified and monitored.
— Appropriate and effective policy instruments to counter risks to financial stability are deployed in a timely manner, and any potential impacts on monetary policy are understood.
— An assessment of the soundness and efficiency of the financial system is published twice yearly in the Financial Stability Report, including the reasons for, and the impact of, any use by the Bank of macro-prudential policy instruments.
— Information on the risk assessment framework, including the macro-prudential indicators that are used to guide policy settings, is published in a manner that assists the assessment of financial stability.
— Statistics are collected that enable an appraisal of the soundness and efficiency of the financial system, and are published in accordance with the dates published on the RBNZ website.

Environment

The Bank employs macro-prudential instruments to reduce risks to the financial system stemming from unsustainable growth in credit and asset markets. The use of these tools is governed by a Memorandum of Understanding signed with the Minister of Finance in May 2013.

The New Zealand financial system is sound, with banks maintaining significant capital and liquidity buffers above minimum requirements. Stress tests of the banking system were conducted during 2014 and suggested that banks could maintain capital above minimum requirements under stress scenarios.

However, developments in the Auckland housing market pose risks to financial stability. While the Auckland housing market slowed immediately following the introduction of LVR restrictions in October 2013, market activity and house price growth increased significantly from late 2014. An increase in leveraged investor activity in the Auckland market appears to be one factor contributing to this resurgence. A significant correction in the Auckland housing market could place strain on the banking system and broader economy. Such a scenario would exacerbate macroeconomic weakness, especially given the high levels of household indebtedness.

High levels of debt in the dairy sector are another key vulnerability for the New Zealand financial sector. Dairy commodity prices fell significantly in late 2014 and early 2015. This is placing some dairy farmers under financial stress and is likely to put some pressure on bank asset quality.
The year in review

What we did – success measures

The Bank regularly communicated the evolving nature of risks stemming from the Auckland housing market, including in the FSR and in several speeches. The November 2014 FSR discussed the possible case for easing LVR restrictions, with the risk of a significant housing market resurgence being a decisive factor in not easing restrictions at that time. The May 2015 FSR, and a subsequent consultation paper in June, outlined the rationale for tightening LVR restrictions for Auckland investor lending, and easing restrictions outside Auckland.

The Bank completed work on understanding the linkages between monetary and macro-prudential policies, with key conclusions presented to an October 2014 conference. Work has also progressed on developing a comprehensive stress-testing framework, with a discussion document expected to be released to industry later in 2015.

The Bank produces and publishes comprehensive statistics on the soundness and efficiency of the financial system. The Bank has released several new statistics over the past year, providing insights into the drivers of changes in household credit, trends in household wealth, and a more comprehensive understanding of the managed funds industry.

What we did – initiatives and strategies

In June 2015, the Bank publicly consulted on proposed changes to LVR restrictions in response to increased financial stability risks from housing market developments in Auckland. The proposals include restrictions on lending to property investors in the Auckland region at LVRs above 70 percent. The Bank also proposed an easing of restrictions on high-LVR lending outside Auckland, in light of more subdued housing market conditions since LVR restrictions were first imposed.

The Bank conducted stress tests of New Zealand’s Australian-owned banks in conjunction with the Australian Prudential Regulation Authority in 2014, and reported on the results of this exercise in the November 2014 FSR. We also reviewed stress-testing methodologies at major banks, which will form the basis of a discussion document on best-practice stress testing.

The Bank enhanced its reporting on financial system stability by engaging more with industry experts in the commercial property and dairy sectors. We increased our outreach programme to ensure this analysis was more widely disseminated among financial and other professional audiences. We developed new statistics to improve understanding of financial system developments:

- We implemented a new survey of investment funds jointly with Statistics New Zealand, and new statistics were published in November 2014.
- We developed a comprehensive collection of insurance sector data, and we expect quality insurance sector statistics will start to be published in the first half of 2016.
- We began developing a securities database that collates information on all the debt and equity securities issued in the New Zealand market, and statistics will be published from this database in early 2016.
- We began the second stage of our redevelopment of the banking sector data collection. This will focus on improved coverage of bank balance sheet information and enable us to better monitor and report on the health of the banking sector.

### Chart 5

House price growth and Auckland investor share of purchases
The objectives of the prudential supervision function are:
To provide prudential supervision so as to promote a sound and efficient financial system; to limit damage to the system that could arise from institutional failure or other financial system distress; and to contribute to public confidence in the financial system.

In our 2014-2017 Statement of Intent, we undertook to deliver the following:

Outcomes
— A sound and efficient financial system that supports the functioning of the economy.
— International and local confidence in New Zealand’s financial system.

Initiatives and strategies
— Develop and complete a comprehensive stress-testing framework for New Zealand banks, and coordinate with the Australian Prudential Regulatory Authority on Australian-owned banks.
— Complete a stocktake of prudential regulations for banks and non-bank deposit takers, and of the insurance solvency standards, then consult on enhancements to improve the efficiency, clarity and targeting of prudential standards.
— Increase supervisory engagement with executives and directors of regulated banks.
— Complete the review of banks’ outsourcing arrangements and consider merits of changing the policy settings.
— Initiate amendments to the statutory management powers in the Reserve Bank of New Zealand Act 1989 to clarify aspects of the legislative framework for OBR.
— Assess and determine licence applications for non-bank deposit takers under the Non-bank Deposit Takers Act 2013, and progress changes recommended by the review of the prudential regime for Non-bank Deposit Takers that was completed in 2013.
— Work on proposals for a modified framework for the formal oversight of payment and settlement systems that are of systemic importance.
— Develop and implement the supervisory regime for insurers.

Our performance would be measured by:
Success measures
— The bank, non-bank deposit taker and insurance regulatory regimes, and in particular the regulatory changes implemented during the year, promote the soundness and efficiency of the financial system in a cost-effective manner, as demonstrated by sound regulatory impact analysis.
— The Reserve Bank’s prudential oversight of banks, non-bank deposit takers, insurance companies and payment systems identifies emerging financial stresses in a timely manner; and the Bank is prepared, where necessary, to effectively resolve institutional failures in conjunction with Government.
— The Bank demonstrates a consultative and transparent approach to its policy development, supported by robust analysis that is understood by regulated institutions and stakeholders.
— In its decisions on whether to grant licences to new applicants, the Bank takes a consistent approach within the legislative framework, without successful challenges.
— The Bank’s Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) supervisory activities demonstrate an appropriate risk-based approach to supervision of reporting entities within the Bank’s sector.
— The FSRs provide a comprehensive assessment of the health of the New Zealand financial system.

Environment
The banking system remains sound and significantly capitalised. Bank profitability and interest margins were steady, on the back of moderately low impaired-asset expenses and improving operating efficiency.

All locally incorporated banks maintained a conservation buffer of 2.5 percent above the minimum capital requirement (introduced 1 January 2014) to avoid restrictions on dividend distributions. Bank lending continued to grow at a moderate pace, and credit growth was again largely funded through deposit growth.

Overall, the system core funding ratio remained well above the minimum regulatory requirement of 75 percent for locally incorporated banks, and liquidity mismatch ratios also remained above the regulatory minimum. Banks were comfortably below the 10 percent high-LVR residential mortgage lending speed limit through the year.

After the NBDT Act 2013 came into force, 33 entities submitted licence applications to the Bank. Of those, 31 were licensed as NBDTs. The other two initiated the licensing process but exited the NBDT sector (through merger and restructure, respectively), before the interim
licensing period ended on 1 May 2015. The Bank monitors the sector, and engages with trustee supervisors on NBDT regulatory compliance and prudential matters.

The Bank continues to deal regularly with applications to approve the transfer of insurance business between insurers. Most transfers consist of insurers transferring small books of business that do not fit their areas of focus to specialist insurers in those insurance lines. Examples are life insurance being transferred from primarily non-life insurers to life insurers, and health insurance being transferred to specialist health insurers. Settling Canterbury earthquake claims remains a focus for the relevant insurers.

New Zealand’s financial market infrastructures operated effectively. There was no significant disruption to transaction processing.

What we did – success measures

The prudential oversight of banks, NBDTs, insurance companies and payment systems provides the Bank with early warning indicators of emerging financial stresses. During the year, the Bank maintained a high degree of engagement with supervised entities and stakeholders, and this positioned it well to identify and respond to any emerging stresses. The Bank continues to highlight the importance of a consultative and transparent approach to its supervision to encourage broad acceptance of a robust framework of rules.

This year was the Bank’s second year of AML/CFT supervisory activities. The Bank directed its attention to banks and NBDTs as, of all the Bank’s reporting entities, these represent the highest inherent risk of money laundering and financing of terrorism. The Bank conducted some desk-based reviews, but its preference was to use on-site inspections as the primary method of assessing reporting entities’ compliance with AML/CFT obligations. The Bank aims to be transparent about its policy-making process, and views stakeholder consultation as a key element. All new regulations and policies, except for some minor and technical changes to existing rules, are accompanied by regulatory impact analysis that complies with guidance as issued by the Treasury. The Bank coordinates with other New Zealand regulators regarding policy development and upcoming industry engagement. The Bank continues to receive new licence applications and has maintained a consistent approach towards licence assessments without any being challenged. The FSRs provide a comprehensive assessment of the health of the New Zealand financial system.

What we did – initiatives and strategies

The Bank undertakes an annual engagement plan with each registered bank. The plan is risk-based, with the greatest focus given to the largest entities. Last year, the Bank increased its engagement by meeting with the independent directors of the 10 largest, locally incorporated banks for an open, two-way flow of information. These meetings were in addition to annual/six-monthly meetings the Governor has with bank Chairs. The Bank intends to retain the independent director meetings.

All year, as part of the regulatory stocktake project, we worked to identify possible improvements in our prudential regulations for banks, helped by a series of workshops with registered banks. We recently published a consultation paper that sets out a number of proposals, in which prudential requirements can achieve their intended outcomes at lower cost, can be made clearer, or can be better targeted. The paper includes options to make the bank disclosure regime more cost-effective, and details plans for a major rationalisation of the Banking Supervision Handbook.

We are proposing only minor changes for the NBDT sector, as the regulatory stocktake follows closely on a major review in 2013 of the regulation and supervision of that sector.

We issued a revision to the Insurance Solvency Standards, which included amendments for reinsurance, guarantees, and the quality of capital. It incorporated several other amendments to clarify the intended application of the Standards, update them for other legislative changes, and enhance disclosure requirements. A solvency standard for variable annuities was also issued, and the Bank held seminars during the consultation.

The Bank recently concluded a second round of public consultation on modified proposals for the oversight of designated financial market infrastructures. The Bank will finalise the proposals after analysing the submissions. Following the Bank’s 2014 stress testing of the major New Zealand banks, and subsequent review of the banks’ stress-testing methodologies, Prudential Supervision is working with the Macro-Financial department to analyse the results for a discussion document on best-practice stress testing.

The Bank undertook a stocktake of major banks’ outsourcing arrangements. Following this, the Bank initiated a fundamental review of the outsourcing policy that applies to ‘large banks’ (defined as those banks whose New Zealand liabilities, net of amounts due to related
The year in review

Parties, exceed $10 billion. The Bank expects to consult on possible revisions to the policy in the second half of 2015.

The 12-month period for NBDTs to be licensed ended on 30 April 2015. In that time, the Bank granted licences to 31 NBDTs. The assessment of each licence application was undertaken in accordance with documented procedures, and there were no challenges to any NBDT licensing decision. We have refined some of the detailed technical issues associated with the implementation of the recommendations made as part of the NBDT review. Work on implementing these recommendations has been delayed slightly due to the overlap with the regulatory stocktake, but is expected to resume in the third quarter of 2015.

Work began on amendments to the crisis management powers in the Reserve Bank of New Zealand Act 1989 to enable Cabinet consideration in the second half of 2015. The amendments include: clarifying the legal status of customer payment instructions on a bank’s entry into statutory management; exemption from criminal or civil liability for bank directors when complying in good faith with a direction from the Reserve Bank; providing the Bank with the power to require a bank to issue additional shares in a crisis situation; and other minor technical amendments.

Work is also underway on reviewing whether changes are required to governance arrangements when government funds are at risk (including, for example, the role of the Minister of Finance); and whether some form of depositor protection is warranted, and if so, what form the arrangements might take.

The Bank has almost completed its implementation steps for collecting regular data from insurers, following consultation with the sector. The Insurance Oversight team has been restructured into two teams to provide a risk-based approach to supervision. One team is responsible for an allocated group of insurers, and the other supervises the remaining insurers whose stress or failure is considered less of a risk to the sector. A risk-based insurer contact programme has also been developed and a risk-based assessment framework is close to completion.

The Bank continued to chair the Banking Forum, a subcommittee of the Council of Financial Regulators, which seeks to better coordinate the work of its member agencies. Other permanent members are The Treasury, Financial Markets Authority and Ministry of Business, Innovation and Employment, and associate members are the Ministry of Justice and Inland Revenue Department. The Forum meets quarterly to discuss regulatory initiatives and identify possible areas for cooperation and coordination.
Electronic payment systems, vital to modern commerce, began in New Zealand in 1998 when the Reserve Bank introduced electronic payments between banks using the exchange settlement accounts (ESA) that each bank holds with us. This makes the Reserve Bank ‘banker to the banks’.
The settlement system
The Exchange Settlement Account System (ESAS) and the NZClear securities settlement system are among the specialised financial services the Bank provides, mainly to financial institutions. Most of these institutions have a NZD cash account with the Bank, known as exchange settlement accounts, and they use the accounts to make payments to each other in real time.

ESAS is a designated payment system under the Reserve Bank Act. Designation provides legislative backing to the finality of payments made, meaning that once a payment has been processed in ESAS, it cannot be reversed. This provides certainty to the recipients of those payments, which is important since typically $25 billion or more is paid through this system each day.

An account holder in ESAS is Continuous Linked Settlement Bank (CLS), an international institution that processes the majority of foreign exchange payments made in major economies. By making payments through CLS, financial institutions can achieve simultaneous settlement of both legs of foreign exchange transactions.

The CLS service eliminates settlement risk for foreign exchange transactions – the risk that one party makes a payment of one currency, but the other party fails to pay the other currency.

NZClear allows buyers and sellers of securities to settle transactions efficiently and securely. The system provides for buyers of NZD-denominated equities and bonds to receive those securities at the same time as payment of cash is made for those purchases. Each transaction is settled individually.

NZClear also allows financial institutions to make payments of cash to each other. Once a settlement is effected in NZClear, the settlement may not be reversed. NZClear is also a designated settlement system, and is subject to joint regulation by the Financial Markets Authority and the Bank’s Prudential Supervision department. Institutional arrangements are in place to ensure that dealings between the Financial Services group, which operates NZClear and ESAS, and the Prudential Supervision department, occur at arm’s length.

The Bank administers securities on behalf of NZClear system members, with a total value of more than $202 billion, and each day settlements valued at more than $7 billion are made by NZClear members. ESAS and NZClear, together with CLS, provide certainty to financial institutions in processing their high-value transactions. This is particularly important during periods of financial instability.

The objective of the settlement services function is:
To ensure that payments system infrastructure services support the functioning of the economy, are provided efficiently and reliably, and meet international standards.

In our 2014–17 Statement of Intent, we undertook to deliver the following:
Outcome
An efficient, reliable and secure payments system that supports the smooth functioning of the economy.

Initiatives and strategies
— Upgrade the interface between the SWIFT system and the Bank’s system.
— Consult with the payments industry on their service and systems requirements of the Bank’s payment operations, and develop a roadmap for the design and delivery of the Bank’s payment and settlement services and systems.

Our performance would be measured by:
Success measures
— Availability of ESAS/NZClear during core hours is at least 99.90 percent, as measured over a year.
— Customer satisfaction with operations and with system development is demonstrated through an annual customer survey in which an approval level of 90 percent or more is achieved.
— All risks are well managed, as demonstrated by external audits for ESAS and NZClear.
— International standards for payment and settlement systems are complied with, subject to variations for local New Zealand conditions.
What we did – success measures

Tables 1–3 set out key statistics for the operation of ESAS and NZClear. NZClear settlement volumes continue to grow and reflect strong trading volumes on the New Zealand share market. The system was available to users 99.87 percent of core hours, which was slightly under the target of 99.90 percent. This was largely due to two incidents during which members were unable to access the system. However, automated processing was able to continue, and the impact of these outages was limited, requiring no extensions to processing deadlines. A thorough post-incident process ensures that the root cause is understood, and actions, such as systems or process changes, are agreed and implemented.

In the annual customer survey, users of ESAS and NZClear continued to report very high levels of satisfaction, with a satisfaction rating of 100 percent in 2015 (2014: 100 percent).

On the Auditor-General’s behalf, PricewaterhouseCoopers undertakes system reviews of NZClear. This involves auditing the internal controls for NZClear once a year, and each quarter reviewing the Bank’s securities reconciliation processes for NZClear. The auditor also performs an annual external audit of the internal controls for ESAS. All external audit reports are reviewed by the Bank’s Audit Committee. All opinions expressed by PricewaterhouseCoopers were unqualified. Improvements to enhance the management of risk associated with operating these systems are made regularly.

What we did – initiatives and strategies

In November 2014, a new messaging interface between the Society for Worldwide Interbank Financial Transactions (SWIFT) and the ESAS/NZClear systems was put into production. The upgrade replaced a middleware product approaching the end of its support life.

The Bank consulted the industry on: its vision, principles and core requirements for the ESAS/NZClear payment and settlement services; the strategic issues affecting the future provision of those services; and potential options to address the strategic issues. The Bank then began work to identify an appropriate replacement technology solution for ESAS, and a business or replacement technology solution for NZClear. This work will determine the roadmap for the payment and settlement systems that the Bank will operate in the future.

We received Request for Proposal (RFP) responses from shortlisted vendors of Real Time Gross Settlement (RTGS) systems and began vendor evaluations. Expressions of interest were received from potential operators of securities settlement systems, and these are being assessed with a view to shortlisting prospective bidders, who will then receive a detailed information memorandum and be invited to submit formal bids. The RTGS systems procurement and NZClear divestment programmes are proceeding to plan.

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<th>Table 1</th>
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<td><strong>Key ESAS statistics</strong></td>
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<td>2011</td>
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<td>Average daily transaction volumes</td>
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<th>Table 2</th>
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<td><strong>Key NZClear statistics</strong></td>
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<td>2011</td>
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<tr>
<td>Average daily transaction volumes</td>
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<td>Average daily transaction values</td>
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<td><strong>Key ESAS-NZClear statistics</strong></td>
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<td>2011</td>
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<td>ESAS-NZClear System availability during core hours</td>
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In August 2014, the Reserve Bank marked its 80th year of operations, a period in which the Bank’s functions underwent significant growth and complexity to reflect the profound transformation of New Zealand’s society and economy.

The Reserve Bank is 80
The objective of the currency function is:
To meet the currency needs of the public by ensuring, as the sole issuer of currency, the supply and integrity of banknotes and coins.

In our 2014-2017 Statement of Intent, we undertook to deliver the following:

Outcome
Legal tender that meets the currency needs of the public.

Initiatives and strategies
— Continue to plan for the release and distribution of the new banknote series.
— Communicate and engage with stakeholders on the release of the Series 7 banknotes.
— Prepare the Wellington site for Series 7 banknotes.
— The Bank will re-evaluate its long-term requirements and plans for processing facilities and property, to support the custody, reserves management, distribution and logistics of currency.

Our performance would be measured by:

Success measures
— All orders for notes and coins from banks that meet the Reserve Bank’s guidelines are supplied within agreed times.
— Notes and coins in general circulation are of a good quality as indicated by surveys of the condition of currency in circulation.
— The number of counterfeit notes in circulation should be fewer than 10 per million notes in circulation.
— Stakeholders are well informed and prepared for the introduction of Series 7 banknotes.

Environment
The Bank meets the currency needs of the public by arranging the procurement, secure storage and issue of New Zealand banknotes and coins, as well as maintaining the quality, and verifying the authenticity, of currency in circulation.

Cash remains an important means of undertaking transactions in New Zealand, and continues to grow at a rate in excess of nominal GDP. The value of currency in circulation grew by 7.6 percent to $5.25 billion in the year to 30 June 2015. Over the 10 years to June 2015, currency in the hands of the public rose by 76.1 percent.

What we did – success measures
During the year, the Bank met all currency orders on schedule and in the denominations requested.

The number of counterfeit banknotes in New Zealand remains low by international standards. There were 111 counterfeits (an increase from 73 in the prior year) found in circulation by the Bank, cash-in-transit companies, banks and the Police. This represented 0.7 counterfeits per million notes in circulation. This was well below the upper limit of 10 per million specified in the success measures.

What we did – initiatives and strategies
The print trial phase of two Brighter Money banknote denominations ($5 and $10 notes) has begun, and the design of the three remaining denominations ($20, $50 and $100 notes) continues to progress in line with expectations. The new Brighter Money notes are scheduled for progressive release, by denomination, from October 2015. For a period of time, both the current series and Brighter Money banknotes will be legal tender. Eventually, the old banknotes will be withdrawn and only Brighter Money banknotes issued.

To date, the Bank has invited cash-handling industry participants to attend three Brighter Money banknote upgrade meetings. We have also been communicating with banks, equipment manufacturers, retailers and organisations for the visually impaired.

Significant work has been undertaken to upgrade the Wellington site to prepare for the introduction of the Brighter Money banknote series.

We conducted an internal review of the currency-operating model and associated facilities requirements, and began an assessment of possible solutions that could meet New Zealand’s long-term needs.
Chart 7
Banknotes in circulation - $billions (June year)

Chart 8
Value of notes in circulation to GDP (to June 2014)
People and culture

Senior management places considerable emphasis on developing a high-performance culture at the Bank. Continuing to invest in manager and leadership development is a critical element of this strategic priority. The Bank undertook several training initiatives, 360-degree assessments and differentiated its compensation arrangements to better reflect relative performance during the year.

All Bank colleagues have the opportunity to attend relevant training, and undertake assignments or projects to develop and enhance their skills and experience. The Bank’s Development Portal, which was designed by Bank staff, provides individuals with the tools to drive their own development.

Staff engagement is surveyed annually and provides a valuable insight into the Bank’s performance culture. Survey responses are over 90 percent. Targeted actions aimed at raising staff engagement levels led to improved outcomes in the second engagement survey undertaken during 2014.

A change management programme, ‘Evolving as a Central Bank’, was initiated this year, with a strong focus on change leadership skills and business transformation to achieve the goal of a more cost-effective, innovative and high-performing workforce. The initial phase of business transformation was successfully completed in April 2015. This was supported by ‘Working Adaptively with Change’ workshops for managers and staff.

The ongoing engagement action plan and change management programme are giving Bank staff greater opportunities to work across different areas, connect with senior management on key priorities, and collaborate on innovative projects.

 Remuneration

Staff

The Reserve Bank spent $35 million on personnel in 2014-15. This included all forms of remuneration, direct expenditure on training, and redundancy payments. Table 4 shows the number of staff who received more than $100,000 in total remuneration, in bands of $10,000.

Table 4
Remuneration in 2014-15

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<tr>
<th>Total remuneration</th>
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<tbody>
<tr>
<td>100,000 to 109,999</td>
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</tr>
<tr>
<td>Total staff receiving $100,000 or more</td>
<td>150</td>
</tr>
</tbody>
</table>

4. Total remuneration includes the annual cost to the Reserve Bank of all elements of contracted remuneration (salaries, any benefits provided, fringe benefit tax, superannuation), plus any bonuses or redundancy payments. The information in Table 4 sets out the amount unconditionally earned during the financial year. The remuneration of the Governor is set by the Minister of Finance on the recommendation of the Board’s non-executive directors, who also determine the remuneration of the two Deputy Governors. The Bank’s remuneration policy is to pay all staff on the basis of performance on the job, while having regard to prevailing market conditions based on salary surveys and assessments made by an independent remuneration consultant.
Non-executive directors’ remuneration & meeting attendance

Non-executive directors’ remuneration consists of directors’ fees for services to the Bank. Certain non-executive directors receive additional remuneration due to their involvement in the Audit committee or for special duties such as being FSR or MPS reviewers. All remuneration paid to non-executive directors is included in the following table. No fees are paid to the Governor, who is an executive director of the Bank. There were 11 Board meetings in the 2014-15 year.

<table>
<thead>
<tr>
<th>Table 5</th>
<th>2014</th>
<th>2015</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-executive directors</td>
<td>$</td>
<td>$</td>
<td>Attendance</td>
</tr>
<tr>
<td>A Grimes (Chair)⁵</td>
<td>11,087</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>R Carr (Chair)⁶</td>
<td>45,457</td>
<td>51,000</td>
<td>11</td>
</tr>
<tr>
<td>C Eichbaum⁶</td>
<td>2,317</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>N Quigley</td>
<td>31,500</td>
<td>31,500</td>
<td>11</td>
</tr>
<tr>
<td>S Sheldon (Deputy Chair)⁶</td>
<td>28,297</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>K Taylor (Deputy Chair)⁶</td>
<td>31,710</td>
<td>40,130</td>
<td>11</td>
</tr>
<tr>
<td>K Vautier²</td>
<td>28,000</td>
<td>30,818</td>
<td>9</td>
</tr>
<tr>
<td>J Ross</td>
<td>22,590</td>
<td>25,500</td>
<td>11</td>
</tr>
<tr>
<td>B Coates²</td>
<td>19,191</td>
<td>27,500</td>
<td>10²</td>
</tr>
<tr>
<td>T Simpson²</td>
<td>1,051</td>
<td>25,500</td>
<td>10</td>
</tr>
<tr>
<td>Total non-executive directors’ remuneration</td>
<td>221,200</td>
<td>231,948</td>
<td></td>
</tr>
</tbody>
</table>

Insurance and indemnity arrangement

Section 179 of the Reserve Bank Act provides that every officer, employee or director of the Bank is not personally liable for acts done or omitted to be done in the exercise or performance in good faith of that person’s functions, duties or powers under the Act. Under section 179A of the Act, the Crown provides an indemnity to every officer, employee or director of the Bank and certain other persons for any liability arising as a result of exercising or failing to exercise any power conferred under the Act, unless the exercise or failure to exercise the power was in bad faith.

The Bank also provides income protection insurance to specified senior executives. For other staff, it provides insurance that extends the cover available from the Accident Compensation Corporation for work-related accidents.

Communications

The Bank continues its efforts to enhance understanding of our role and policies through a wide variety of channels. In addition to our statutory accountability documents, the MPS and FSR, we delivered 118 presentations, covering many regional audiences, and including 17 on-the-record speeches. We also delivered briefings to political caucuses and key media. We responded to hundreds of public and media enquiries.

We use on-the-record speeches to explain our thinking. Our off-the-record engagements allow us to engage in wider explanatory discussions with less risk of dialogue triggering a reaction in financial markets. While most of our presentations were on the economy, monetary policy and financial stability, we also covered other specialist topics.

We launched the new Brighter Money banknote designs, and began planning a public education campaign for the October 2015 release of $5 and $10 banknotes. We co-ordinated the launch of New Zealand’s first coloured circulating coin, an Anzac coin, commemorating the centenary of the Anzac landings on the Gallipoli Peninsula.

Table 6

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total staff at 30 June (FTE)¹⁰</td>
<td>250</td>
<td>250</td>
<td>258</td>
<td>272</td>
<td>247</td>
</tr>
<tr>
<td>Average years of service at 30 June</td>
<td>8.0</td>
<td>8.8</td>
<td>8.3</td>
<td>8.3</td>
<td>8.1</td>
</tr>
<tr>
<td>Annual staff turnover</td>
<td>12.4%</td>
<td>13.7%</td>
<td>15.1%</td>
<td>11.3%</td>
<td>10.8%</td>
</tr>
</tbody>
</table>

5. Term expired on 18 September 2013
6. Appointed Chair from 19 September 2013
7. Term expired on 31 July 2013
8. Term expired on 30 April 2014
9. Appointed Deputy Chair from 19 June 2014
10. Appointed FSR Reviewer from 1 April 2014
11. Appointed on 12 August 2013 for a five-year term
12. Appointed on 1 October 2013 for a five-year term
13. Attended four meetings via teleconference
14. Appointed on 16 June 2014 for a five-year term
15. The decrease in 2015 is due to a restructure.
We refreshed the design of the Bank’s key documents, including the Bulletin, SOI, MPS, and FSR. We expanded the financial education resources on our website, with two animated videos on money and the economy, and animated graphics explaining concepts from monetary policy to loan-to-value ratios.

The Bank completed its first external stakeholder engagement survey. This told a positive story while offering insights for the Bank to achieve even greater levels of stakeholder trust.

The Reserve Bank Museum & Education Centre continues its economic literacy outreach programme targeting school students from Years 6 to 13. About 9000 people visited the Museum, an increase of 20 percent on the previous year. Taupo-nui-a-Tia College won the Bank’s Monetary Policy Challenge competition, in which senior secondary teams decide on an appropriate setting for the OCR. Other finalists came from Auckland, Wellington, Christchurch and Invercargill.

Internal financial services
We continued to enhance the systems and processes needed to manage the Bank’s complex balance sheet, and to support the Bank’s operations.

We developed a roadmap for the design and architecture of our treasury systems. The Bank has issued a Request for Proposal to vendors of trade valuation systems, and anticipates starting implementation of systems changes early in 2016.

We completed an upgrade to our payroll and human resources administration system, and began preparations to upgrade Financial Management Information System software in the next financial year. We also enhanced the processes we use to report financial forecasts and results to the Crown, which supported our negotiations for the new Funding Agreement.

Knowledge services
Knowledge Services Group supported several of the Bank’s priorities, including the payments systems review, treasury systems roadmap, and Brighter Money banknote upgrade. These will continue to be a focus for the department in the coming financial year. In addition, we completed a large programme of upgrades and refreshes across our infrastructure and software, to maintain our modern technology platform.

The department has enhanced its IT security practices and IT security awareness programme, and established a five-year asset management plan. We are currently replacing the Bank’s web content management system.

The Programme Management Office continues to build organisational capability, provide project support, and develop a consistent approach to the management of programmes and projects. The Bank’s business continuity programme (BCP) practices have been reviewed, and an in-depth BCP exercise was completed with the Bank’s senior management group and management team.

We are also refreshing our ICT strategy and roadmap with a focus on enabling productivity, improving alignment with business requirements, and ensuring a high level of uninterrupted service.

Risk assessment and assurance
Risk Assessment and Assurance continued to ensure enterprise risk management practices are adopted across the Bank, so that the Bank manages risks in a proactive, coordinated, prioritised and efficient manner.

The internal audit plan, developed at the outset of the year, provided comprehensive assurance over the control frameworks that manage key risks. This was undertaken as planned, and any material issues were reported to management.

The Bank continued to make extensive use of services provided by in-house legal counsel in support of all its functions. In this regard, the legal function provided advice across a broad range of legal matters of a prudential, operational and commercial nature.

Property/security
The Bank owns its building in Wellington, and maintains business continuity services by leasing a small office in Auckland, and domestic and offshore facilities for banknote and coin reserves. The Bank also manages security operations to ensure it has secure and appropriate accommodation at all sites.

A significant programme is under way and on track to prepare the Bank’s property and security for the new Brighter Money banknote series.

International activities
The Bank regularly engages with a wide range of international organisations, including central banks, prudential regulators and international financial institutions.

Its engagement with EMEAP (Executives’ Meeting of East Asia Pacific) central banks and monetary authorities involves collaborating on key economic and financial issues affecting the region, and the development of local currency capital markets in Asia. Deputy Governor Grant Spencer has chaired several EMEAP committees this year. The Bank also engages directly with the IMF and OECD on a range of issues. In March 2015, Mr Spencer was appointed chair of the OECD’s Committee on Financial Markets.

The Bank also engaged frequently with other central banks and prudential regulators on a range of issues and work streams. In March 2015, the Bank held a joint workshop with the Reserve Bank of Australia in Sydney. The Bank also collaborated closely with APRA, including on bank stress-testing exercises.
Financial highlights

Key points

Highlights

— Foreign currency intervention capacity $9.8 billion at year end.
— The 2015 surplus of $624 million was a significant increase from the $56 million surplus in 2014 and is the second largest in the Bank’s history, resulting mainly from a lower NZD.
— A dividend of $510 million will be paid to the Government in September 2015.
— The Bank remains well capitalised with equity of $2.8 billion.
— Cumulative net operating expenses over the last five years were $6.4 million below expenditure set in the Funding Agreement.

Table 7

<table>
<thead>
<tr>
<th>Key indicators</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign currency intervention capacity</td>
<td>9,846</td>
<td>8,217</td>
</tr>
<tr>
<td>Currency in circulation</td>
<td>5,255</td>
<td>4,883</td>
</tr>
<tr>
<td>Equity</td>
<td>2,799</td>
<td>2,499</td>
</tr>
<tr>
<td>Surplus for the year</td>
<td>624</td>
<td>56</td>
</tr>
<tr>
<td>Net operating expenses</td>
<td>60.5</td>
<td>53.3</td>
</tr>
<tr>
<td>Dividend payment to the Government</td>
<td>510</td>
<td>20</td>
</tr>
</tbody>
</table>

Chart 9

Foreign currency assets and foreign currency intervention capacity

Chart 10

Equity
Financial highlights

Highlights

— Deposits and loans from banks and the Government $16.7 billion.
— Currency in circulation increased 7.6 percent to $5.3 billion.
— Foreign currency assets $25.4 billion.
— Open foreign currency position up $1 billion to $3.5 billion.

Comments

Liabilities and equity

The Bank is funded from deposits from banks, deposits and loans from the Government, notes and coins issued to the public, and the Bank’s equity.

Deposits from banks averaged $8 billion over 2015. They are maintained at a level that ensures there is sufficient liquidity in the banking system to facilitate daily interbank payments, and ensure that short-term interest rates align closely with the OCR.

Deposits from banks and the Government vary day to day, and result in a fluctuating level of funds available for investment.

Most of the Bank’s funding is denominated in New Zealand dollars.

The Bank issues currency through banks, as required to meet demand from the public. Currency in circulation increased 7.6 percent in 2015, continuing the trend of yearly increases.

The proceeds from the issuance of currency are invested by the Bank, producing investment income known as seigniorage. Income from seigniorage in 2015 was $214 million, up from $173 million in 2014, because of the increase in currency in circulation and higher short-term interest rates.

Assets and investment

The Bank invests most of the proceeds of its funding into foreign currency assets.

Investments mainly comprise government and near-government securities, which are both very liquid and of high-credit quality, allocated across six major currencies.

The Bank also holds a portfolio of New Zealand Government bonds, and owns its Wellington office building.

Readily liquefiable foreign currency assets, less foreign currency liabilities that fall due in the next 12 months, form the Bank’s foreign currency intervention capacity. This is maintained should the Bank need to support the country’s foreign currency market in a crisis.
Managing the foreign currency position

Most of the Bank’s NZD funding is converted into foreign currencies using financial derivatives contracts, such as foreign currency swaps, before being invested in foreign currency assets. As at 30 June 2015, there were $18.2 billion of outstanding foreign currency swap commitments. These reduce the Bank’s foreign currency exposure, and provide the Bank with a rate of return based on New Zealand, rather than foreign, interest rates.

Some of the NZD funding is invested directly in foreign currency assets, creating an open foreign currency position. The open foreign currency position enables the Bank to respond more effectively in the event of a crisis, and to smooth more extreme exchange movements.

The open foreign currency position at 30 June 2015 was $3.5 billion, an increase of $1.0 billion on 2014, arising from a combination of foreign currency purchases and depreciation of the NZD.

The open foreign currency position gives rise to revaluation gains and losses as foreign exchange rates change, resulting in volatility of reported profits.

Risk management

The Bank has a comprehensive approach to managing risk. Strong and effective financial and operational risk management disciplines are in place, and operate within an enterprise risk management framework, which spans all functions in the Bank.

The Bank’s foreign reserves management and domestic markets operations face several types of financial risk, including credit risk, liquidity risk and market risk.

To manage credit risk and liquidity risk, the Bank sets limits on the types of investments it holds, the counterparties it trades with, and the duration of investments it makes. These limits seek to maintain the highest credit quality and liquidity of investments.

The Bank also takes and gives collateral as security to minimise the credit risk associated with the market value of financial derivatives contracts.

The principal market risks the Bank manages are foreign currency risk and interest rate risk.

Unhedged foreign currency positions, which arise as part of the Bank’s activities to support monetary policy, and to maintain orderly markets, operate in accordance with the Reserve Bank of New Zealand Act 1989, and under a Memorandum of Understanding with the Minister of Finance.

The Bank’s actively managed portfolios operate within limits that manage exposure to gains and losses arising from changes to foreign exchange and interest rates.

During the year, the Bank refined its foreign reserves allocation and benchmarking criteria. Foreign reserves assets are now aligned more closely with the Bank’s liability structure and managed in two pools, hedged reserves and unhedged reserves.
Financial highlights

Net assets/equity

Highlights

— Capital requirement unchanged at $2.3 billion.
— Equity at 30 June 2015 $2.8 billion.
— A dividend of $510 million will be paid to the Government in September 2015.

Comments

Capital management

The Bank assesses the amount of capital required to cover the financial risks inherent in undertaking its functions, over a range of potential risk scenarios, at $2.3 billion, unchanged from 2014. This assessment is a guideline for the Bank’s capital requirement, including the level of equity the Bank will seek to retain after the impact of the surplus for the year, revaluations and dividend payments.

Equity

The Bank’s equity at 30 June 2015 was $2.8 billion, which includes unrealised profits not eligible for distribution as dividends. The change in equity during the year is shown in Table 8.

Dividend

Surplus equity is paid to the Government as a dividend. The Bank provided for a significantly increased dividend of $510 million in the financial statements, and will pay this in September 2015.

The dividend is calculated and sourced from realised earnings in line with the dividend principles set out on page 18. The dividend in 2015 is larger than in previous years because of the significant increase in the Bank’s surplus.

In prior years, realised gains had been retained in equity to offset unrealised losses. During 2015, the substantial foreign exchange gains reversed the losses previously recorded and allowed realised earnings which had been retained in 2014 to be distributed as part of the dividend for 2015.

Table 8

<table>
<thead>
<tr>
<th>Changes in equity</th>
<th>2015 $m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Surplus for the year</td>
<td>624</td>
</tr>
<tr>
<td>Movements in reserves (see note)</td>
<td>186</td>
</tr>
<tr>
<td>Total comprehensive revenue for the year</td>
<td>810</td>
</tr>
<tr>
<td>Dividend payable</td>
<td>(510)</td>
</tr>
<tr>
<td>Change in equity for the year</td>
<td>300</td>
</tr>
<tr>
<td>Equity at 1 July 2014</td>
<td>2,499</td>
</tr>
<tr>
<td>Equity at 30 June 2015</td>
<td>2,799</td>
</tr>
</tbody>
</table>

NOTE: Gains and losses relating to revaluation of certain assets are recorded directly in equity rather than being included in net profit. These assets include the Bank’s holdings of New Zealand Government bonds and its investment in the Bank for International Settlements, which are designated “Available for Sale”, and the Bank’s Wellington building.

Chart 15

Dividend payment to Government
Financial highlights

Financial performance

Highlights

— The surplus for the year to 30 June 2015 was $624 million, an increase of $568 million from 2014.
— A lower NZD resulted in a $379 million gain from foreign exchange rate changes on the Bank’s open foreign currency position as at 30 June 2015, compared with a $198 million loss in the June 2014 financial year.

Comments

The Bank’s surplus or deficit for the year is largely an outcome of decisions made in undertaking its policy functions in financial markets. The primary focus is to carry out these activities in the most efficient manner rather than to maximise profit in all circumstances.

Net investment revenue and operating expenses are the main components of the Bank’s surplus or deficit. (Operating expenses are covered on the next page.)

The main components of net investment revenue are net interest revenue, gains and losses from fair value changes of financial instruments, and gains and losses from foreign exchange rate changes. In 2015:

— Net interest revenue increased by $18 million. This was mainly due to increased seigniorage revenue of $41 million, offset by higher costs of carrying the open foreign currency position.
— Gains from changes in the fair value of financial instruments were $19 million lower in 2015 than 2014.
— The TWI depreciated by 13 percent, resulting in a $379 million gain from foreign exchange rate changes on the open foreign currency position, a $577 million increase from 2014.

The significant volatility experienced in recent years in foreign exchange rates and the fair value of financial instruments has resulted in volatile net investment revenue over time.

Table 9

<table>
<thead>
<tr>
<th>Surplus</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net interest revenue</td>
<td>271</td>
<td>253</td>
</tr>
<tr>
<td>Gains (losses) from changes in fair value of financial instruments</td>
<td>30</td>
<td>49</td>
</tr>
<tr>
<td>Gains (losses) from changes in foreign exchange rates</td>
<td>379</td>
<td>(198)</td>
</tr>
<tr>
<td>Dividend income</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Net investment revenue</td>
<td>681</td>
<td>105</td>
</tr>
<tr>
<td>Other operating revenue</td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td>Total operating revenue</td>
<td>694</td>
<td>116</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>(70)</td>
<td>(60)</td>
</tr>
<tr>
<td>Surplus for the year</td>
<td>624</td>
<td>56</td>
</tr>
</tbody>
</table>

Chart 16

Net Investment revenue
Financial highlights

Operating expenses

Highlights

— Total operating expenses in 2015 were $70.6 million.
— $6.7 million was provided for obsolete banknote inventory in 2015.
— Net operating expenses for 2015 were $4.1 million more than the Funding Agreement, but $6.4 million less than the provision for cumulative expenditure over its full five-year term.

Comments

Operating expenses

Total operating expenses increased by $10.1 million in 2015. The main changes from 2014 were:

— A $6.7 million provision for obsolete bank note inventory in advance of the issue of new Brighter Money banknotes.
— Restructuring costs of $1.0 million arising from a review of the structure and level of the Bank’s resourcing requirements.
— A $2.8 million gain in actuarial valuation of the defined benefit superannuation scheme. This was due to a requirement to change the basis of valuing the pension obligations of the scheme in 2015 to use a pre-tax rather than post-tax discount rate. The gain in 2014 was $3.6 million.

Funding Agreement

The Funding Agreement between the Bank and the Government sets out the expectations of the level of operating expenses, and certain items of income, within which the Bank is expected to manage its operations.

For the reasons already outlined, net operating expenditure was $4.1 million above the Funding Agreement for 2015. Net operating expenditure was cumulatively $6.4 million below the full five-year term of the Funding Agreement, which ended on 30 June 2015.

The Bank has agreed a new Funding Agreement with the Government for the five years from 1 July 2015. The new agreement holds the increase in net operating expenses excluding currency issuance costs to 1.3 percent per annum on average over five years, when compared with the 2014-15 budgeted net operating expenses, excluding one-off items.

Table 10

<table>
<thead>
<tr>
<th>Operating expenses</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>$m</td>
<td>$m</td>
<td></td>
</tr>
<tr>
<td>Staff expenses</td>
<td>34.8</td>
<td>31.6</td>
</tr>
<tr>
<td>Net currency-issued expenses</td>
<td>12.9</td>
<td>6.8</td>
</tr>
<tr>
<td>Asset management expenses</td>
<td>7.3</td>
<td>6.6</td>
</tr>
<tr>
<td>Other operating expenses</td>
<td>18.4</td>
<td>19.1</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>73.4</td>
<td>64.1</td>
</tr>
<tr>
<td>Actuarial loss (gain) on defined benefit superannuation scheme</td>
<td>(2.8)</td>
<td>(3.6)</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>70.6</td>
<td>60.5</td>
</tr>
</tbody>
</table>

![Chart 17](image-url)

Net operating expenses
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Management Statement

Pursuant to section 165 of the Reserve Bank of New Zealand Act 1989, we hereby certify that:

1. We have been responsible for the preparation of the annual financial statements and for the judgements used in them.

2. We have been responsible for establishing and maintaining a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of the Bank’s financial reporting.

3. In our opinion, the annual financial statements for the year ended 30 June 2015 fairly reflect the financial position and operations of the Bank.

Governor

Deputy Chief Executive
Independent Auditors’ report

to the readers of the Reserve Bank of New Zealand and Group’s Financial Statements for the year ended 30 June 2015

The Auditor-General is the auditor of the Reserve Bank of New Zealand and Group (the ‘Bank’). The Auditor-General has appointed me, Chris Barber, using the staff and resources of PricewaterhouseCoopers, to carry out the audit of the financial statements of the Bank on her behalf.

Opinion

We have audited the financial statements of the Bank on pages 70 to 114, that comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets/equity, statement of comprehensive revenue and expense and statement of cash flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information.

In our opinion the financial statements of the Bank:
— present fairly, in all material respects:
  — its financial position as at 30 June 2015; and
  — its financial performance and cash flows for the year ended; and
  — have been prepared in accordance with Public Sector Public Benefit Entity Standards.

Our audit was completed on 25 August 2015. This is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Governor and our responsibilities, and explain our independence.

Basis of opinion

We carried out our audit in accordance with the Auditor-General’s Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and carry out our audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

Material misstatements are differences or omissions of amounts and disclosures that, in our judgement, are likely to influence readers’ overall understanding of the financial statements. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

An audit involves carrying out procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the preparation of the Bank’s financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Bank’s internal control.
Audit Report

An audit also involves evaluating:
— the appropriateness of accounting policies used and whether they have been consistently applied;
— the reasonableness of the significant accounting estimates and judgments made by the Governor;
— the adequacy of the disclosures in the financial statements; and
— the overall presentation of the financial statements.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements. Also we did not evaluate the security and controls over the electronic publication of the financial statements.

We believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Responsibilities of the Governor
The Governor is responsible for the preparation and fair presentation of financial statements, in accordance with Public Sector Public Benefit Entity Standards.

The Governor’s responsibilities arise from the Reserve Bank of New Zealand Act 1989.

The Governor is also responsible for such internal control as he determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The Governor is also responsible for the publication of the financial statements, whether in printed or electronic form.

Responsibilities of the Auditor
We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you based on our audit. Our responsibility arises from section 15 of the Public Audit Act 2001 and section 166 of the Reserve Bank of New Zealand Act 1989.

Independence
When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the External Reporting Board.

In addition to the audit we have carried out assignments in the areas of payment systems audits and advisory services in connection with the Bank’s securities settlement services, which are compatible with those independence requirements. Other than the audit and these assignments, we have no relationship with or interests in the Bank.

Chris Barber
On behalf of the Auditor-General
Wellington, New Zealand

PricewaterhouseCoopers
Guide to the Main Functions of the Reserve Bank

The Reserve Bank’s role is defined by the Reserve Bank of New Zealand Act 1989 (the Reserve Bank Act).

For the year ended 30 June 2015, the Bank classified its outputs according to its main functions in the ways described below.

**Monetary Policy Formulation:**
Developing monetary policy to achieve and maintain price stability in line with the Policy Targets Agreement.

**Domestic Market Operations:**
Transacting with, monitoring and liaising with financial markets to manage aggregate liquidity in the New Zealand banking system. These actions are for the purpose of implementing monetary policy, facilitating payments and monitoring financial stability.

**Prudential Supervision:**
Registering and supervising banks, licensing and supervising insurers, regulating non-bank deposit takers, overseeing payment systems, and undertaking policy development in all of these areas. These actions are for the purpose of promoting a sound and efficient New Zealand financial system by limiting damage to the financial system that could arise from bank, non-bank deposit taker or insurer failure(s) or other financial system distress. Supervising banks, non-bank deposit takers and life insurers for compliance with their anti-money laundering obligations.

**Macro-financial Stability:**
Analysing and managing financial system risks to promote a sound and efficient system that supports the functioning of the economy.

**Currency Operations:**
Maintaining the supply and integrity of legal tender currency to facilitate cash transactions in the community.

**Foreign Reserves Management:**
Managing the Bank’s foreign reserves held to support monetary policy objectives and the maintenance of orderly markets. This includes execution of foreign currency intervention activities.

**Settlement Services:**
Providing New Zealand dollar settlement accounts to financial institutions and the New Zealand Government and providing securities settlement and depository services, mainly to financial institutions.
### Consolidated Statement of Financial Position

<table>
<thead>
<tr>
<th>As at 30 June</th>
<th>Note</th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Financial Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Balances</td>
<td>1(d)</td>
<td>6,742</td>
<td>2,637</td>
</tr>
<tr>
<td>Securities Purchased under Agreements to Resell</td>
<td>1(d)</td>
<td>4,436</td>
<td>3,388</td>
</tr>
<tr>
<td>Investments</td>
<td>1(d),3</td>
<td>13,727</td>
<td>11,771</td>
</tr>
<tr>
<td>Derivative Assets</td>
<td>1(d),4</td>
<td>347</td>
<td>1,358</td>
</tr>
<tr>
<td>Other Foreign Currency Assets</td>
<td>1(d),5</td>
<td>154</td>
<td>132</td>
</tr>
<tr>
<td><strong>Total Foreign Currency Financial Assets</strong></td>
<td></td>
<td>25,406</td>
<td>19,286</td>
</tr>
<tr>
<td>Local Currency Financial Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities Purchased under Agreements to Resell</td>
<td>1(d)</td>
<td>-</td>
<td>200</td>
</tr>
<tr>
<td>New Zealand Government Securities</td>
<td>1(d)</td>
<td>3,117</td>
<td>2,891</td>
</tr>
<tr>
<td>Other Local Currency Financial Assets</td>
<td>1(d)</td>
<td>496</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total Local Currency Financial Assets</strong></td>
<td></td>
<td>3,613</td>
<td>3,093</td>
</tr>
<tr>
<td><strong>Total Financial Assets</strong></td>
<td></td>
<td>29,019</td>
<td>22,379</td>
</tr>
<tr>
<td>Other Assets</td>
<td>1(e),6</td>
<td>88</td>
<td>82</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td></td>
<td>29,107</td>
<td>22,461</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Financial Liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term Foreign Currency Financial Liabilities</td>
<td>1(d),7</td>
<td>101</td>
<td>987</td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>1(d)</td>
<td>704</td>
<td>437</td>
</tr>
<tr>
<td>Derivative Liabilities</td>
<td>1(d),4</td>
<td>1,739</td>
<td>228</td>
</tr>
<tr>
<td>Term Liabilities</td>
<td>1(d)</td>
<td>1,127</td>
<td>1,541</td>
</tr>
<tr>
<td><strong>Total Foreign Currency Financial Liabilities</strong></td>
<td></td>
<td>3,671</td>
<td>3,193</td>
</tr>
<tr>
<td>Local Currency Financial Liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits</td>
<td>1(d),8</td>
<td>14,538</td>
<td>11,673</td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>1(d)</td>
<td>1,096</td>
<td>-</td>
</tr>
<tr>
<td>Reserve Bank Bills</td>
<td>1(d)</td>
<td>309</td>
<td>-</td>
</tr>
<tr>
<td>Currency in Circulation</td>
<td>1(d)</td>
<td>5,255</td>
<td>4,883</td>
</tr>
<tr>
<td>Other Local Currency Financial Liabilities</td>
<td>1(d),9</td>
<td>125</td>
<td>85</td>
</tr>
<tr>
<td>Term Liabilities</td>
<td>1(d)</td>
<td>800</td>
<td>101</td>
</tr>
<tr>
<td><strong>Total Local Currency Financial Liabilities</strong></td>
<td></td>
<td>22,123</td>
<td>16,742</td>
</tr>
<tr>
<td><strong>Total Financial Liabilities</strong></td>
<td></td>
<td>25,794</td>
<td>19,935</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>1(f),10</td>
<td>514</td>
<td>27</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td></td>
<td>26,308</td>
<td>19,962</td>
</tr>
<tr>
<td><strong>Net Assets/Equity</strong></td>
<td></td>
<td>29,107</td>
<td>22,461</td>
</tr>
<tr>
<td><strong>Total Liabilities and Net Assets/Equity</strong></td>
<td></td>
<td>29,107</td>
<td>22,461</td>
</tr>
</tbody>
</table>

The above statement is to be read in conjunction with the notes set out on pages 75 to 114. Derivative Instruments are used to manage the Bank’s exposure to foreign currency risk. The effective foreign currency exposure as at balance date is recorded in Note 18.
# Consolidated Statement of Changes in Net Assets/Equity

The above statement is to be read in conjunction with the notes set out on pages 75 to 114.
## Consolidated Statement of Financial Performance

For the year ended 30 June

<table>
<thead>
<tr>
<th>Description</th>
<th>Note</th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Revenue</td>
<td></td>
<td>704</td>
<td>520</td>
</tr>
<tr>
<td>Interest Expense</td>
<td></td>
<td>433</td>
<td>267</td>
</tr>
<tr>
<td><strong>Net Interest Revenue</strong></td>
<td>21</td>
<td>271</td>
<td>253</td>
</tr>
<tr>
<td>Net Gains from Fair Value Changes</td>
<td></td>
<td>30</td>
<td>49</td>
</tr>
<tr>
<td>Net Gains/(Losses) from Foreign Exchange Rate Changes</td>
<td></td>
<td>379</td>
<td>(198)</td>
</tr>
<tr>
<td>Dividend Revenue</td>
<td></td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total Net Investment Revenue</strong></td>
<td>21</td>
<td>681</td>
<td>105</td>
</tr>
<tr>
<td>Other Revenue</td>
<td></td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td><strong>Total Operating Revenue</strong></td>
<td></td>
<td>694</td>
<td>116</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>23</td>
<td>70</td>
<td>60</td>
</tr>
<tr>
<td><strong>Surplus for the Year</strong></td>
<td></td>
<td>624</td>
<td>56</td>
</tr>
</tbody>
</table>

The above statements are to be read in conjunction with the notes set out on pages 75 to 114.

## Consolidated Statement of Comprehensive Revenue and Expense

For the year ended 30 June

<table>
<thead>
<tr>
<th>Description</th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Surplus for the Year from the Consolidated Statement of Financial Performance</strong></td>
<td>624</td>
<td>56</td>
</tr>
<tr>
<td>Other Comprehensive Revenue and Expense</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Movement in Available-for-sale Revaluation Reserve Taken to Net Assets/Equity</td>
<td>159</td>
<td>(108)</td>
</tr>
<tr>
<td>Movement in Property, Currency and Artwork Collections Revaluation Reserve taken to Net Assets/Equity</td>
<td>13</td>
<td>-</td>
</tr>
<tr>
<td>Movement in Cash Flow Hedge Reserve Taken to Net Assets/Equity</td>
<td>14</td>
<td>(1)</td>
</tr>
<tr>
<td><strong>Total Other Comprehensive Revenue and Expense for the Year</strong></td>
<td>186</td>
<td>(109)</td>
</tr>
<tr>
<td><strong>Total Comprehensive Revenue and Expense for the Year</strong></td>
<td>810</td>
<td>(53)</td>
</tr>
</tbody>
</table>
# Consolidated Statement of Cash Flows

For the year ended 30 June

<table>
<thead>
<tr>
<th>Description</th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Flows from Operating Activities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Sources from Revenue</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Received:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Derivatives</td>
<td>(14)</td>
<td>(16)</td>
</tr>
<tr>
<td>Other</td>
<td>28</td>
<td>54</td>
</tr>
<tr>
<td>Local Currency:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Derivatives</td>
<td>497</td>
<td>349</td>
</tr>
<tr>
<td>Available-for-sale Securities</td>
<td>133</td>
<td>138</td>
</tr>
<tr>
<td>Other</td>
<td>25</td>
<td>5</td>
</tr>
<tr>
<td>Dividend</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td>Fees, Commission and Other Revenue Received</td>
<td>11</td>
<td>11</td>
</tr>
<tr>
<td><strong>Total Sources of Cash Flows from Revenue</strong></td>
<td>681</td>
<td>541</td>
</tr>
<tr>
<td><strong>Disbursements for Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Paid:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency</td>
<td>(7)</td>
<td>(6)</td>
</tr>
<tr>
<td>Local Currency</td>
<td>438</td>
<td>274</td>
</tr>
<tr>
<td>Payments to Suppliers and Employees</td>
<td>60</td>
<td>65</td>
</tr>
<tr>
<td><strong>Total Disbursements of Cash Flows from Expenses</strong></td>
<td>491</td>
<td>333</td>
</tr>
<tr>
<td><strong>Operating Cash Flows from Revenue and Expenses</strong></td>
<td>190</td>
<td>208</td>
</tr>
<tr>
<td><strong>Operating Cash Flows from Changes in Asset and Liability Balances</strong></td>
<td>2,988</td>
<td>(978)</td>
</tr>
<tr>
<td><strong>Net Cash Flows from Operating Activities</strong></td>
<td>24</td>
<td>3,178</td>
</tr>
<tr>
<td><strong>Cash Flows from Investing Activities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sources</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disposal of Available-for-sale Securities</td>
<td>513</td>
<td>291</td>
</tr>
<tr>
<td><strong>Total Sources of Cash Flows from Investing Activities</strong></td>
<td>513</td>
<td>291</td>
</tr>
<tr>
<td>Disbursements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchases of Available-for-sale Securities</td>
<td>601</td>
<td>444</td>
</tr>
<tr>
<td>Purchase of Property, Plant and Equipment and Intangible Assets</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td><strong>Total Disbursements of Cash Flows from Investing Activities</strong></td>
<td>606</td>
<td>451</td>
</tr>
<tr>
<td><strong>Net Cash Flows from Investing Activities</strong></td>
<td>(93)</td>
<td>(160)</td>
</tr>
</tbody>
</table>

The above statement is to be read in conjunction with the notes set out on pages 75 to 114.
# Consolidated Statement of Cash Flows (continued)

For the year ended 30 June

<table>
<thead>
<tr>
<th>Note</th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sources</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Issue of Circulating Currency</td>
<td>372</td>
<td>274</td>
</tr>
<tr>
<td>Issue of Local Currency Term Liabilities</td>
<td>700</td>
<td>100</td>
</tr>
<tr>
<td>Total Sources of Cash Flows from Financing Activities</td>
<td>1,072</td>
<td>374</td>
</tr>
<tr>
<td>Disbursements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Repayment of Foreign Currency Term Liabilities</td>
<td>640</td>
<td>151</td>
</tr>
<tr>
<td>Dividend Payments to the New Zealand Government</td>
<td>20</td>
<td>175</td>
</tr>
<tr>
<td>Total Disbursements of Cash Flows from Financing Activities</td>
<td>660</td>
<td>326</td>
</tr>
<tr>
<td>Net Cash Flows from Financing Activities</td>
<td>412</td>
<td>48</td>
</tr>
<tr>
<td>Net Cash Flows</td>
<td>3,497</td>
<td>(882)</td>
</tr>
<tr>
<td>Plus Foreign Exchange Rate Effect on Cash Balances at the Beginning of the Year</td>
<td>608</td>
<td>(428)</td>
</tr>
<tr>
<td>Net Cash Flows From All Activities</td>
<td>4,105</td>
<td>(1,310)</td>
</tr>
<tr>
<td>Cash Balances at the Beginning of the Year</td>
<td>2,637</td>
<td>3,947</td>
</tr>
<tr>
<td>Cash Balances at the End of the Year</td>
<td>6,742</td>
<td>2,637</td>
</tr>
</tbody>
</table>

The above statement is to be read in conjunction with the notes set out on pages 75 to 114.
Notes to be read as part of the Consolidated Financial Statements

1. Statement of Accounting Policies
a. Reporting Entity and Statutory Base
These are the consolidated financial statements of the Reserve Bank of New Zealand, a body corporate under the Reserve Bank of New Zealand Act 1989 (the Reserve Bank Act). These consolidated financial statements apply to the financial year ended 30 June 2015. They are prepared in accordance with Part VI of the Reserve Bank Act. The consolidated financial statements have been prepared in accordance with Tier 1 of the Public Benefit Entity International Public Sector Accounting Standards, issued by the New Zealand Accounting Standards Board, and comply with Generally Accepted Accounting Practice in New Zealand.

In these financial statements, the Reserve Bank of New Zealand is also referred to as the “Reserve Bank” or the “Bank”. The Bank’s controlling entity is the Government of New Zealand. The Bank is domiciled and operates in New Zealand.

The Governor and Deputy Governor of the Reserve Bank authorised these financial statements for issue on 25 August 2015.

b. Compliance with PBE Standards
Under XRB A1: Accounting Standards Framework, the Bank is classified as a Public Sector Public Benefit Entity (PBE). A PBE is a reporting entity whose primary objective is to provide goods and services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders. The consolidated financial statements have been prepared in accordance with Tier 1 Public Benefit Entity Accounting Standards as they apply to Public Sector PBEs (PBE Standards). These financial statements comply with PBE Standards and are the first financial statements presented in accordance with PBE Standards. The transition to PBE Standards has not resulted in significant changes to the amounts presented in the Bank’s financial statements. In addition, the adoption of the PBE IPSAS 1 Presentation of Financial Statements resulted in disclosures of budgeted operating expenses based on the Bank’s Statement of Intent relating to the period presented and based on its Funding Agreement with the New Zealand Government.

c. Basis of Preparation of Financial Statements
Measurement Basis
The consolidated financial statements have been prepared on a going concern basis and the accounting policies have been applied consistently throughout the period. These financial statements have been prepared using the general principles of historical cost accounting, modified by fair value accounting for available-for-sale financial assets, all derivative contracts, financial assets and liabilities that are held at fair value through profit or loss, land and buildings, and currency and artwork collections.

Changes in Accounting Policies
There have been no changes in accounting policies and all accounting policies have been applied consistently by the Bank for all the financial years presented (unless otherwise stated).

Standards Issued Not Yet Effective and Not Early Adopted
In October 2014, the PBE Standards were updated to incorporate requirements and guidance for not-for-profit entities. These updated standards apply to all PBEs, including the Bank, for periods beginning on or after 1 April 2015. The Bank will apply these updated PBE Standards in preparing the 30 June 2016 financial statements. The Bank expects no change in applying these Standards.

Basis of Consolidation
These consolidated financial statements are prepared using the acquisition method. All material inter-company balances and transactions are eliminated. Controlling entity financial statements are not produced because the difference between the controlling entity and economic entity is not material.

Trust and Custodial Activities
Assets held for third parties under custodial arrangements, and revenue arising thereon, are excluded from these financial statements, as they are not assets or revenue of the Bank (see Note 31).

Functional and Presentation Currency
The Bank’s financial statements are presented in New Zealand dollars, the Bank’s functional and presentation currency. Amounts in the financial statements are rounded to the nearest million dollars unless otherwise stated.

Foreign Currency Conversions
Transactions denominated in foreign currency are translated to New Zealand dollars using exchange rates applied on the trade date of the transaction. Foreign currency assets and liabilities are translated to New Zealand dollars at the relevant market bid or offer foreign exchange rate as at the reporting date. Foreign exchange gains and losses resulting from settlement of foreign currency transactions and from the translation at year-end exchange rates
of monetary assets and liabilities denominated in foreign currency are recognised in the Statement of Financial Performance, except where such gains and losses are deferred in equity as qualifying cash flow hedges. Where a gain or loss on a non-monetary item is recognised directly in equity, such as equity investments classified as financial assets that are available for sale, the related exchange gain or loss is also recognised in equity.

d. Financial Instruments

Classification and Measurement of Financial Instruments

Financial instruments are classified into various categories and are accounted for as shown in the table below. Classification of a financial instrument into a category occurs at the time of initial recognition.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair Value through Surplus/ (Deficit)</td>
<td>Assets • Investments • Securities Purchased under Agreements to Resell • Securities Lending • Derivatives</td>
<td>Fair Value</td>
<td>• Interest Revenue • Interest Expense • Gains/Losses from Fair Value Changes • Gains/Losses from Foreign Exchange Rate Changes</td>
<td></td>
</tr>
<tr>
<td>Available-for-sale Financial Assets</td>
<td>• New Zealand Government Securities (purchased for investment purposes) • Shareholding in Bank for International Settlements</td>
<td>Fair Value</td>
<td>• Interest Revenue • Dividend Revenue • Realised Gains/Losses from Fair Value and Foreign Exchange Rate Changes</td>
<td>Unrealised Gains/Losses from Fair Value Changes and Foreign Exchange Rate Changes are included in the Available-for-Sale Revaluation Reserve</td>
</tr>
<tr>
<td>Financial Instruments Designated as Cash Flow Hedge</td>
<td>• Cash Balances</td>
<td>Fair Value</td>
<td>• Interest Revenue • Expenses covered by the Cash Flow Hedge are recorded at hedged foreign exchange rates when they are settled</td>
<td>Changes in Foreign Currency Translation on Qualifying Cash Flow Hedges are included in the Cash Flow Hedge Reserve until the expenses covered by the Cash Flow Hedge are realised</td>
</tr>
<tr>
<td>Loans and Receivables</td>
<td>• Cash Balances • Receivable for Unsettled Sale of Securities • Fee Income Receivable</td>
<td>Amortised Cost</td>
<td>• Interest Revenue • Gains/Losses from Foreign Exchange Rate Changes (excluding Qualifying Cash Flow Hedges) • Changes in Impairment</td>
<td>Changes in Foreign Currency Translation on Qualifying Cash Flow Hedges are included in the Cash Flow Hedge Reserve</td>
</tr>
<tr>
<td>Financial Liabilities at Amortised Cost</td>
<td>• Deposits • Currency in Circulation • Short-Term Foreign Currency Liabilities • Payables for Unsettled Purchases of Securities • Other Local Currency Liabilities</td>
<td>Amortised Cost</td>
<td>• Interest Expense • Gains/Losses from Foreign Exchange Rate Changes</td>
<td></td>
</tr>
</tbody>
</table>
Fair Value through Surplus/(Deficit)
This category has two sub-categories: financial instruments designated as fair value through surplus/(deficit) at inception, and those that are held for trading. The Bank’s assets and liabilities that are designated as fair value through surplus/(deficit) are done so because compliance with the Bank’s investment mandates and performance of the Bank’s Foreign Reserves Management and Domestic Market Operations functions are assessed daily on the basis of the fair value of assets and related liabilities funding those assets. The Bank has active management portfolios, which are classified as held for trading.

Available-for-sale Financial Assets
Available-for-sale financial securities are those non-derivative financial assets that are designated as available for sale or that are not classified as financial assets at fair value through surplus/(deficit), or loans and receivables. Available-for-sale financial assets include the Bank’s holdings of New Zealand government bonds and its shareholding in the Bank for International Settlements. These assets are intended to be held either to maturity or for an indefinite period of time, and in the case of New Zealand government bonds, these may be sold in the course of the Bank’s operations. As part of its liquidity management operations, the Bank purchases New Zealand government securities generally up to six months before these securities mature. Government securities purchased for liquidity management operations are classified as financial assets at fair value through surplus/(deficit).

Loans and Receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides goods or services directly to a debtor with no intention of trading the receivable.

Financial Liabilities at Amortised Cost
Liabilities classified as financial liabilities at amortised cost include short-term liabilities with fixed or determinable payments that are not traded, such as unsettled purchases of securities, cash collateral held, and payables and accruals for services received. Notes and coins issued by the Bank that are either in circulation or demonetised are also classified as financial liabilities at amortised cost.

Additional Information on Recognition and Measurement of Financial Instruments
Purchases and disposals of financial instruments are recognised on trade date, the date on which the Bank commits to the purchase or disposal of the financial instrument. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all the risks and rewards of ownership. Financial liabilities are derecognised only when the obligation is discharged, cancelled or expired. The fair values of financial assets that are quoted in active markets are based on current bid prices and offer prices in the case of financial liabilities. In other cases, the Bank establishes fair value by using appropriate valuation techniques.

Interest revenue and income expense is calculated using the effective interest method and is recognised in the Statement of Financial Performance. Dividends on available-for-sale equity instruments are recognised in the Statement of Financial Performance when the right to receive payment is established.

Hedge Accounting on Qualifying Cash Flow Hedges
Hedge accounting is applied in respect of purchases of foreign currency cash that are effective in hedging the Bank’s exposure to foreign currency risk arising from operating expenditure, capital expenditure and purchases of bank notes and coins. Unrealised gains or losses due to the changes in foreign exchange rates on foreign currency cash purchased to hedge operating expenditure, capital expenditure and purchases of bank notes and coins are recognised in Other Comprehensive Revenue and Expense and are included in the Cash Flow Hedge Reserve. When hedged foreign currency-denominated operating expenditure, capital expenditure or purchases of bank notes and coins are settled, the relevant transaction is recorded at the foreign currency rate at which the foreign currency cash was purchased.

Offsetting of Financial Assets and Financial Liabilities
Financial assets and liabilities are offset and the net amount reported in the Statement of Financial Position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Additional Information on Specific Financial Assets and Financial Liabilities
Derivatives
Derivatives are initially recognised in the Statement of Financial Position at fair value on the date on
which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, or valuation techniques that use inputs observed in active markets, as appropriate. The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e., the fair value of the consideration given or received).

Derivative transactions, such as foreign currency swaps, and the payment and receipt of different currencies are stated in the Statement of Financial Position at the net of the fair value of receipts less the fair value of payments, both expressed in New Zealand dollars. The net fair value of each derivative contract is determined individually and carried as an asset if the net fair value is positive, and as a liability if that value is negative.

Gains and losses on all derivatives are recognised in the Statement of Financial Performance.

Securities Purchased under Agreements to Resell
Where the Bank purchases securities under agreements to resell (reverse-repurchase agreements), the Bank records as an asset the consideration receivable from the agreement to resell the security.

The consideration receivable under the agreement to resell is recorded at fair value. Movements in the fair value of reverse-repurchase agreements are reported in the Statement of Financial Performance.

Securities Lending Programme
The Bank operates a securities lending programme. Where securities are lent, the Bank receives collateral in the form of cash or other securities and the securities continue to be recorded as assets in the Bank’s Statement of Financial Position.

The Bank’s agent administers the securities lending programme and monitors the securities lending and related collateral against requirements agreed with the Bank.

The Bank records an asset being the market value of the securities lent and a liability for the same amount in respect of the collateral to be returned by the Bank at the conclusion of the loan.

The Bank records revenue from securities lending as it accrues. Changes in the value of the asset are reflected by a change in the corresponding liability.

Securities Sold under Agreements to Repurchase
Where the Bank sells securities under agreements to repurchase (repurchase agreements), the security continues to be included as an asset in the Bank’s Statement of Financial Position.

The consideration payable under the agreement to repurchase is recorded at fair value. Movements in the fair value of repurchase agreements are reported in the Statement of Financial Performance.

Short Sales of Investments
A short sale is a sale of a security that the Bank does not own. Securities that are sold short are recorded at fair value through surplus/(deficit) using quoted market offer prices.

Any gains or losses are recognised in the Statement of Financial Performance.

Currency in Circulation
Currency issued by the Bank represents a claim on the Bank in favour of the holder. The liability for currency in circulation is recorded at amortised cost in the Statement of Financial Position.

Demonetised Currency
The Bank has a liability for the face value of demonetised currency still in circulation. For currency demonetised before 1 July 2004, this is recognised as a contingent liability except for a provision retained in the Statement of Financial Position to cover expected redemptions. For currency demonetised from 1 July 2004, the Bank records a liability equal to the amortised cost of that currency still in circulation.

Collectors’ Currency
The Bank has a liability for the face value of collectors’ currency. The face value of collectors’ currency issued before 1 July 2004 is recognised as a contingent liability. For collectors’ currency issued from 1 July 2004, the Bank records a liability equal to the amortised cost of that currency.

e. Other Assets

Inventories
Inventories of currency on hand are recognised in the Statement of Financial Position at cost. Costs include bringing inventories to their present location and condition.

For the portion of inventories of currency on hand that relates to currency repatriated to the Bank through non-exchange transactions, this cost is measured at fair value, and is recorded by crediting currency issue expense and increasing the value of inventory recognised in the Statement of Financial Position.

When currency is issued, the value of inventory is reduced and an expense is recorded for currency issuance costs. Currency issuance cost is determined on a first-in, first-out (FIFO) basis.
Where inventories of currency on hand are obsolete, the cost of unissued currency, or the fair value of currency repatriated to the Bank through non-exchange transactions, is written down to net realisable value and an expense is recorded in the Statement of Financial Performance.

Property, Plant and Equipment

*Land and Buildings*
Land and buildings owned by the Bank are classified as Property, Plant and Equipment.

Land is recorded at fair value. Buildings are recorded at depreciated fair value. Surpluses of book value over historical cost for this class of asset are recorded in the Property Revaluation Reserve. Where the book value of this class of asset falls below historical cost, previous revaluations are reversed and any remaining balance is charged as an expense in the reporting period in which it occurs. Buildings are depreciated on a straight-line basis over 40 years.

The Bank obtains an independent valuation of land and buildings every three years. In the years between independent valuations, an annual assessment is made of whether there is likely to have been a material change in value. An independent valuation is obtained where a material change is likely to have occurred.

*Currency and Artwork Collections and Archives*
Items held in the Bank’s currency and artwork collections and archives that have a material commercial value are independently assessed to determine estimated fair values. Surpluses of book value over historical cost for this class of asset are recorded in the Currency and Artwork Collections and Archives Revaluation Reserve. Nominal values have been placed on items with no material commercial value. Collections are not depreciated. Additions are held at cost until subsequent revaluations.

*Other Property, Plant and Equipment*
Other property, plant and equipment is carried at cost less depreciation and impairment losses. The following assets held by the Bank are depreciated on a straight-line basis over the following terms:

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Useful Life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer Hardware</td>
<td>3-5 years</td>
</tr>
<tr>
<td>Plant and Equipment</td>
<td>5-10 years</td>
</tr>
<tr>
<td>Buildings</td>
<td>40 years</td>
</tr>
<tr>
<td>Property Improvements</td>
<td>8 years</td>
</tr>
</tbody>
</table>

Intangible Assets

Intangible assets comprise acquired and internally developed computer software and development costs incurred for the design of bank notes. Intangible assets are stated at cost less accumulated amortisation and impairment losses. Costs include all direct expenses incurred to acquire and bring to use the specific software and bank note designs.

Costs incurred in bringing to use enhancements to an existing software programme are capitalised only if the enhancement will produce additional economic benefits exceeding costs over more than one year.

Capitalised software development costs are amortised on a straight-line basis over the estimated useful life of the software (3 to 7 years). Costs associated with maintaining computer software are recognised as expenses when incurred.

Capitalised bank note design and development costs are amortised over the estimated life of the relevant bank note series.

Impairment of Property, Plant and Equipment and Intangible Assets

*Cash-generating Assets*
The Bank does not hold any cash-generating assets. Assets are considered cash-generating where their primary objective is to generate a commercial return.

*Non-cash-Generating Assets*
Property, plant, and equipment and intangible assets held at cost that have a finite useful life are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset’s carrying amount exceeds its recoverable service amount. The recoverable service amount is the higher of an asset’s fair value less costs to sell and value in use.

If an asset’s carrying amount exceeds its recoverable service amount, the asset is regarded as impaired and the carrying amount is written down to the recoverable amount. The total impairment loss is recognised in the surplus or deficit.

The reversal of an impairment loss is recognised in the surplus or deficit.

f. Other Liabilities

**Employee Entitlements**

*Wages and Salaries, Annual and Sick Leave*
Liabilities for wages and salaries, including non-monetary benefits and annual leave, are recognised in Other Liabilities in respect of employees’ services and are measured at the amounts expected to be paid when liabilities are settled.

*Retirement Gratuity*
Retirement gratuities and post-retirement benefits apply to staff members who joined the Bank before 1 October 1991. These gratuities and benefits
are recognised in Other Liabilities in respect of employees’ services and are measured at the present value of future payments expected to be made in respect of services provided by employees up to the reporting date. This is calculated by an independent actuary using a discounted cash flow model. Expected future payments are discounted to their net present value using market yields at the reporting date on government bonds with terms that match as closely as possible the estimated timing of future cash flows.

Changes in the value of the liability for retirement gratuities and post-retirement benefits are included within the Statement of Financial Performance in staff expenses within Operating Expenses.

Superannuation Obligations
Obligations for contributions to defined benefit superannuation schemes are recognised as an expense in the Statement of Financial Performance as incurred.

A liability is recognised in the Statement of Financial Position where the present value of defined benefit obligations exceeds the fair value of the scheme’s assets (as adjusted for unrecognised past-service costs).

An asset is recognised in the Statement of Financial Position where the present value of defined benefit obligations is less than the fair value of the scheme’s assets (as adjusted for unrecognised past-service costs). Any net asset recognised in the Statement of Financial Position is limited to the estimated present value of reductions in future employer contributions to the defined benefit scheme.

The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of New Zealand government bonds that have terms to maturity approximating the terms of the related superannuation liability. The calculation is performed annually by an independent qualified actuary using the projected unit credit method.

Staff expenses within Operating Expenses in the Statement of Financial Performance include the current-service cost, past-service cost, an interest cost and an expected return for the defined benefit superannuation scheme. The actuarial gain or loss on the defined benefit superannuation scheme is included as a separate item within Operating Expenses.

Revenue and Expenses Allocated to Functions
The Reserve Bank Act requires the Bank to account for revenue and expenses by reference to the functions the Bank performs. Each function receives revenue and incurs expenses relating directly to the assets and liabilities used exclusively by that function. Earnings from the investment of the Bank’s equity are allocated to each function based on the estimated amount of equity required for each function.

Revenue and expense flows are attached to the notional funding for each function. The Bank operates notional balance sheets to calculate the notional revenue and expense for each of the Bank’s functions as though each function operates autonomously. The Bank also has systems to allocate operating costs to functions. Operating costs are allocated as closely as possible to reflect their consumption. Direct operating costs are assigned directly to functions. Indirect operating costs are allocated to functions based on predetermined cost drivers and related activity or usage information. These structures enable each function to report more accurately the financial outcome of the services provided.

Income Tax
Section CW38 of the Income Tax Act 2007 exempts the Bank from income tax. Accordingly, no provisions are raised for current or deferred income taxes.

h. Cash Flows
For the purposes of the Statement of Cash Flows, cash and cash equivalents include balances with other central banks and amounts available at call with other financial institutions.

Certain cash flows have been netted to provide more meaningful disclosure. Netting of cash flows occurs where cash receipts and payments on behalf of customers reflect the activities of the customer rather than the Bank, or where cash receipts or payments are for items in which turnover is quick, amounts are large, and maturities are short.

i. Significant Accounting Estimates and Judgements in Applying Accounting Policies
The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.
Fair Value of Financial Instruments

Financial instruments classified as held for trading or designated at fair value through surplus/(deficit), and financial assets classified as available for sale, are recognised in the financial statements at fair value. All derivatives are measured and recognised at fair value.

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Financial instruments are priced either with reference to a quoted market price for that instrument or by using a valuation model. Where the fair value is calculated using financial market pricing models, the methodology used is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to the present value. These models use as their basis independently-sourced market parameters including, for example, interest rate yield curves and currency rates. Most market parameters are either observable directly or are implied from instrument prices.

Judgement is applied also in assessing the extent of impairment of financial and other assets.

Superannuation and Post-retirement Obligations

The Bank has obligations under the defined benefit superannuation plan and for certain post-retirement obligations as described on page 79 and 80. The carrying amount of these obligations is based on actuarial valuations, which in turn depend on a series of assumptions. Key valuation assumptions include price inflation, earnings growth, employee retirement dates, and investment returns. Valuations are performed on the basis that the scheme will not be wound up.

Valuation of Land and Buildings

The fair value of the Bank’s land and buildings is assessed by an independent registered property valuer. Estimated fair value is arrived at by the valuer, based on a number of assumptions, principally with respect to market rates of rental and market capitalisation rates.

2. Nature and Extent of Activities

The Reserve Bank’s role as a central bank determines the nature and extent of its activities with respect to financial instruments. This role is defined by the Reserve Bank Act.

a. Local Currency Activities

The Bank provides exchange settlement account facilities to financial institutions and to the New Zealand Government. The Bank manages the aggregate level of liquidity held by financial institutions in their exchange settlement accounts.

The financial instruments used to inject funds into the banking system include local currency reverse-repurchase transactions, outright purchases of New Zealand government securities shortly before maturity, and foreign currency swaps. The Bank uses its holdings of New Zealand government securities in repurchase transactions and issues Reserve Bank bills to withdraw funds from the banking system for liquidity management purposes.

Balances in exchange settlement accounts are repayable on demand and the Bank pays interest on overnight balances. From time to time, the Bank may also hold small trading positions in New Zealand government securities or registered bank securities as part of market test activities.

The Bank issues notes and coins to registered banks to meet the currency needs of the public. When currency is issued to a registered bank, that bank’s settlement account is debited with the face value of currency issued.

The Bank also operates the NZClear System. This includes carrying out securities registry and paying agent responsibilities.

b. Foreign Currency Activities

The Bank’s foreign currency activities arise mainly from:

— holding foreign currency assets for crisis management purposes;
— the investment of proceeds of foreign currency swaps entered into for managing the aggregate level of liquidity of the New Zealand banking system; and
— the purchase or sale of foreign currency in support of monetary policy objectives.

Foreign reserve assets held for crisis management purposes are funded by a combination of foreign currency and local currency loans from the Treasury, which are made on arm’s length terms, and New Zealand dollar-denominated liabilities, including currency in circulation and deposits placed with the Bank by financial institutions. Cross-currency basis swaps are used to convert New Zealand dollar funding into foreign currency and to manage a significant portion of foreign currency risk. A proportion of foreign currency assets held for crisis management purposes are maintained without hedging their foreign currency risk. The hedged/unhedged position will vary over time as the Bank determines appropriate.

The Bank routinely injects and withdraws New Zealand dollars into and from the New Zealand banking system.
as part of its liquidity management operations. The injection of New Zealand dollars entails the Bank entering into foreign currency swap transactions for a finite term. The swap entails the Bank paying New Zealand dollars to the counterparty and receiving foreign currency for the term of the swap. The foreign currency received from a swap is invested in foreign currency-denominated securities for a term coinciding with the term of the swap. Proceeds received on maturity of the foreign currency investment are used by the Bank to repay the foreign currency at the end of the term of the foreign currency swap transaction and the counterparty repays the New Zealand dollars together with any interest.

Foreign currency purchased or sold when the Bank intervenes in the foreign exchange market to support monetary policy objectives would usually entail the Bank borrowing or lending New Zealand currency to finance the foreign currency transaction.

Financial instruments held within foreign currency portfolios consist mainly of sovereign securities, securities issued by quasi-government entities or highly rated supranational institutions, securities held under reverse-repurchase transactions, or balances held with other central banks. Liquidity and credit risk are key criteria in determining the type of instruments held.

The Bank manages the foreign currency exposure arising from certain operating and capital expenditure commitments denominated in foreign currency. The Bank will purchase foreign currency cover for those foreign currency-denominated commitments that will fall due during the following financial year.

For further information on the risk management policies relating to financial instruments, see Notes 13 to 20.

c. Foreign Exchange Dealing

Section 16 of the Reserve Bank Act gives the Bank the power to deal in foreign currency for the purpose of carrying out its functions and powers. All dealings in foreign currency assets and liabilities occur under that section, except for transactions that occur at the direction of the Minister of Finance.

Sections 17 and 18 of the Reserve Bank Act provide for the Minister of Finance to direct the Bank to deal in foreign exchange, or for the Minister of Finance to fix the foreign exchange rates for foreign exchange dealing by the Bank. Section 21 of the Reserve Bank Act requires the Bank to either pay any foreign currency exchange gains to the Crown, or be reimbursed for any foreign exchange losses, as a result of dealing in foreign exchange under sections 17 or 18 of the Reserve Bank Act. For the year ended 30 June 2015, there have been no directions from the Minister under section 17 or 18 and there have been no payments to or from the Crown under section 21 of the Reserve Bank Act (2014: nil).

Under section 24 of the Reserve Bank Act, the Minister, in consultation with the Bank, determines the level or range of foreign reserve assets that must be maintained by the Bank.

d. Derivatives

The Bank’s involvement in derivatives includes primarily foreign currency swaps, bond and interest rate futures, interest rate swaps and cross-currency basis swaps.

Foreign currency swaps are used to manage transactions for foreign exchange for both Domestic Market Operations and Foreign Reserves Management. The arrangements are described in more detail above in (b) Foreign Currency Activities.

Bond and interest rate futures and interest rate swaps are used to enhance expected returns on foreign currency assets and, from time to time, to manage interest rate and foreign exchange risks.

e. Title to Assets

As part of its foreign currency operations, the Bank enters into security repurchase transactions. These foreign currency securities sold by the Bank under repurchase agreements are recorded as an asset within Investments in the Bank’s Statement of Financial Position. These foreign currency-denominated transactions are also recognised as a liability within Securities Sold under Agreements to Repurchase in the Bank’s Statement of Financial Position.

The Bank enters into security repurchase transactions as part of its liquidity management operations and market testing activities. These local currency-denominated securities sold by the Bank under repurchase agreements are recorded as an asset in New Zealand Government Securities in the Bank’s Statement of Financial Position.

The Bank also purchases securities under reverse-repurchase agreements in both its foreign currency and local currency operations. These transactions are recognised as Securities Purchased under Agreements to Resell in the Bank’s Statement of Financial Position.

The Bank can be required to deliver collateral under swap arrangements. Any securities delivered by the Bank as collateral remain in the Statement of Financial Position.

Note 3 gives details of the collateral taken or provided as at balance date.

**Foreign Currency Investments**

Foreign Currency Investments of $13,727 million (2014: $11,771 million) comprise fixed interest securities issued by foreign governments, foreign near-government entities and supranational organisations. Further details, such as the credit rating and the country in which the issuer is resident, are provided in Note 15 in respect of all financial assets including Foreign Currency Investments.

**Analysis of Financial Assets and Liabilities by Measurement Basis**

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies describes how the classes of financial instruments are measured, and how revenue and expenses, including fair value gains and losses, are recognised. The following table analyses the financial assets and liabilities in the Statement of Financial Position by class and by category as defined by Public Benefit Entity International Public Sector Accounting Standard 29 Financial Instruments: Recognition and Measurement (PBE IPSAS 29).

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
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<td></td>
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<tr>
<td>Cash Balances</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>66</td>
<td>6,676</td>
<td>-</td>
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<tr>
<td>Securities Purchased under Agreements to Resell</td>
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<td>4,436</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
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<tr>
<td>Investments</td>
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<td>13,292</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>435</td>
<td>-</td>
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<tr>
<td>Derivative Assets</td>
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<td>347</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Other Foreign Currency Assets</td>
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<td>-</td>
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<td><strong>Total Foreign Currency Financial Assets</strong></td>
<td>25,406</td>
<td>17,728</td>
<td>347</td>
<td>153</td>
<td>66</td>
<td>7,112</td>
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<td>Local Currency Financial Assets</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>New Zealand Government Securities</td>
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<td>-</td>
<td>-</td>
<td>3,117</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Other Local Currency Financial Assets</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>496</td>
<td>-</td>
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<td><strong>Total Local Currency Financial Assets</strong></td>
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<td>-</td>
<td>3,117</td>
<td>-</td>
<td>496</td>
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<td><strong>Total Financial Assets</strong></td>
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<td>17,728</td>
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<td>3,270</td>
<td>66</td>
<td>7,608</td>
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<td><strong>Liabilities</strong></td>
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<tr>
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<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Short-term Foreign Currency Financial Liabilities</td>
<td>101</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>101</td>
<td>-</td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>704</td>
<td>704</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Derivative Liabilities</td>
<td>1,739</td>
<td>-</td>
<td>1,739</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Term Liabilities</td>
<td>1,127</td>
<td>1,127</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td><strong>Total Foreign Currency Financial Liabilities</strong></td>
<td>3,671</td>
<td>1,831</td>
<td>1,739</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Local Currency Financial Liabilities</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits</td>
<td>14,538</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>14,538</td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>1,096</td>
<td>1,096</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Reserve Bank Bills</td>
<td>309</td>
<td>309</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Currency in Circulation</td>
<td>5,255</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Other Local Currency Financial Liabilities</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<td>125</td>
</tr>
<tr>
<td>Term Liabilities</td>
<td>800</td>
<td>800</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td><strong>Total Local Currency Financial Liabilities</strong></td>
<td>22,123</td>
<td>2,205</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>19,918</td>
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<tr>
<td><strong>Total Financial Liabilities</strong></td>
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<td>4,036</td>
<td>1,739</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>20,019</td>
</tr>
</tbody>
</table>
## Financial Statements

**RBNZ Annual Report 2015**

### Financial Statements

**As at 30 June 2014**

<table>
<thead>
<tr>
<th>Assets Type</th>
<th>Total $M</th>
<th>Fair Value through Surplus/(Deficit) $M</th>
<th>Derivatives Deemed Held for Trading $M</th>
<th>Available for-sale Financial Assets $M</th>
<th>Financial Instruments Designated as Cash Flow Hedge $M</th>
<th>Loans and Receivables $M</th>
<th>Financial Liabilities at Amortised Cost $M</th>
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<tbody>
<tr>
<td><strong>Foreign Currency Financial Assets</strong></td>
<td></td>
<td></td>
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<tr>
<td>Derivative Assets</td>
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<td>- 1,358 - - - -</td>
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<td>-</td>
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<tr>
<td>Other Foreign Currency Assets</td>
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<td>- 126 - 6 -</td>
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<td>- - - - 2</td>
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</tr>
<tr>
<td><strong>Total Local Currency Financial Assets</strong></td>
<td>3,093</td>
<td>200 2,891 - 2</td>
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<td><strong>Total Financial Assets</strong></td>
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<td>Short-term Foreign Currency Financial Liabilities</td>
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<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>437</td>
<td>437 - - - -</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Derivative Liabilities</td>
<td>228</td>
<td>- 228 - - - -</td>
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<td>-</td>
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<td>Other Local Currency Financial Liabilities</td>
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<td>Term Liabilities</td>
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<td><strong>Total Local Currency Financial Liabilities</strong></td>
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<td>-</td>
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</tbody>
</table>
Fair Value of Financial Assets and Liabilities

All financial assets and liabilities are recorded at fair value based on either quoted market prices or prices derived from market yield curves, as described in the Bank’s accounting policies, except as detailed below. Refer below for details of the classification by valuation hierarchy of financial assets and financial liabilities carried at fair value.

a. Unsettled Transactions
The reported value of unsettled sales and purchases is considered to approximate their fair value due to the very short period between balance date and the settlement date.

b. Cash Balances and Short-term Deposits
The carrying value of cash balances and short-term deposits is considered to approximate their fair value, as they are payable on demand.

c. Currency in Circulation
Currency in Circulation is reported at its face value, as currency in circulation is payable on demand. PBE IPSAS 29 requires that the fair value cannot be less than the face value.

d. Cash Collateral Assets and Liabilities
Collateral received or paid under two-way Credit Support Annex agreements is recorded within Investments and Other Local Currency Financial Assets and in Short-Term Foreign Currency Financial Liabilities. The carrying value is considered to approximate the fair value of these financial assets and liabilities due to the short-term nature of the margin calls.

e. Dividend Receivable and Accounts Payable
The dividend receivable from the Bank for International Settlements is recorded in Other Foreign Currency Assets. Accounts payable are recorded in Other Local Currency Financial Liabilities. The carrying values are considered to approximate the fair values due to the short period between balance date and the receipt or payment of these financial assets and liabilities.

f. Demonetised Currency
The Bank has a liability for currency in circulation that has been demonetised but not returned to the Bank. The liability is recorded in Other Local Currency Financial Liabilities and is reported at its face value as demonetised currency is payable on demand.

Determination of Fair Value of Financial Instruments Carried at Fair Value

Each financial instrument carried at fair value is categorised within the hierarchy based on the lowest-level input that is significant to the fair value measurement of the whole instrument. Fair values are determined according to the following hierarchy:

a. Quoted Market Price
Financial instruments with quoted prices for identical instruments in active markets (level 1).

b. Valuation Technique Using Observable Inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets, and financial instruments valued using models where all significant inputs are observable (level 2).

The determination of what constitutes ‘observable’ requires significant judgement by the Bank. The Bank considers observable data to be that market data that is available readily, distributed or updated regularly, reliable and verifiable, not proprietary, and provided by independent sources that are involved actively in the relevant market. Judgement is required to be exercised also in determining appropriate margins to representative forward prices and interest rate yield curves in order to model more accurately the market price of the specific instrument that is being valued.

Where necessary, valuation models include estimated future cash flows and discount rates that are calculated using forward prices and interest rate yield curves. Forward prices and interest rate yield curves are sourced from the relevant published market observable exchange rates and interest rates applicable to the remaining life of the instrument at the valuation date. Also, where necessary, margin adjustments are made to representative prices and interest rate yield curves in order to allow for features of the instrument that would be taken into account in valuing a financial instrument, where those features are not included or priced into representative forward prices and interest rate yield curves.

c. Valuation Technique with Significant Non-observable Inputs
Financial instruments valued using models where one or more significant inputs are not observable (level 3).
### Valuation Techniques:

<table>
<thead>
<tr>
<th></th>
<th>Total $M</th>
<th>Quoted Market $M</th>
<th>Using Observable Inputs $M</th>
<th>With Significant Non-observable Inputs $M</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Financial Assets</td>
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<td></td>
<td></td>
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<tr>
<td>Securities Purchased under Agreements to Resell</td>
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<tr>
<td>Other Foreign Currency Assets</td>
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<td>153</td>
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<tr>
<td><strong>Total Foreign Currency Financial Assets Carried at Fair Value</strong></td>
<td>18,228</td>
<td>6,115</td>
<td>11,960</td>
<td>153</td>
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<tr>
<td>Local Currency Financial Assets</td>
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</tr>
<tr>
<td>New Zealand Government Securities</td>
<td>3,117</td>
<td>3,117</td>
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<td><strong>Total Local Currency Financial Assets Carried at Fair Value</strong></td>
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<td><strong>Total Financial Assets Carried at Fair Value</strong></td>
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<td>9,232</td>
<td>11,960</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Financial Liabilities</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
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<td>Derivative Liabilities</td>
<td>1,739</td>
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<tr>
<td>Term Liabilities</td>
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<td><strong>Total Foreign Currency Financial Liabilities Carried at Fair Value</strong></td>
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<td>-</td>
<td>3,570</td>
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<tr>
<td>Local Currency Financial Liabilities</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
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<td>-</td>
<td>1,096</td>
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<tr>
<td>Reserve Bank Bills</td>
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<td><strong>Total Local Currency Financial Liabilities Carried at Fair Value</strong></td>
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<td>-</td>
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<td><strong>Total Financial Liabilities Carried at Fair Value</strong></td>
<td>5,775</td>
<td>-</td>
<td>5,775</td>
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### Financial Statements

#### Celebrating 80 years

<table>
<thead>
<tr>
<th></th>
<th>Total $M</th>
<th>Quoted Market Price $M</th>
<th>Using Observable Inputs $M</th>
<th>With Significant Non-observable Inputs $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>** Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td><strong>Foreign Currency Financial Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities Purchased under Agreements to Resell</td>
<td>3,388</td>
<td>-</td>
<td>3,388</td>
<td>-</td>
</tr>
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<td>Investments</td>
<td>11,771</td>
<td>5,797</td>
<td>5,974</td>
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<td>1,358</td>
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<td>Other Foreign Currency Assets</td>
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<td>16,643</td>
<td>5,797</td>
<td>10,720</td>
<td>126</td>
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<tr>
<td>Securities Purchased under Agreements to Resell</td>
<td>200</td>
<td>-</td>
<td>200</td>
<td>-</td>
</tr>
<tr>
<td>New Zealand Government Securities</td>
<td>2,891</td>
<td>2,891</td>
<td>-</td>
<td>-</td>
</tr>
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<td><strong>Total Local Currency Financial Assets Carried at Fair Value</strong></td>
<td>3,091</td>
<td>2,891</td>
<td>200</td>
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<td><strong>Total Financial Assets Carried at Fair Value</strong></td>
<td>19,734</td>
<td>8,688</td>
<td>10,920</td>
<td>126</td>
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<tr>
<td><strong>Foreign Currency Financial Liabilities</strong></td>
<td></td>
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<td></td>
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<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>437</td>
<td>-</td>
<td>437</td>
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<tr>
<td>Derivative Liabilities</td>
<td>228</td>
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<td>228</td>
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<tr>
<td>Term Liabilities</td>
<td>1,541</td>
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<td>1,541</td>
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<tr>
<td><strong>Total Foreign Currency Financial Liabilities Carried at Fair Value</strong></td>
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<td>-</td>
<td>2,206</td>
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<tr>
<td><strong>Local Currency Financial Liabilities</strong></td>
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<td></td>
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<tr>
<td>Term Liabilities</td>
<td>101</td>
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<td><strong>Total Local Currency Financial Liabilities Carried at Fair Value</strong></td>
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<td>2,307</td>
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</tbody>
</table>
Collateral Pledged
The carrying amount of securities pledged as collateral for liabilities comprising Securities Sold under Agreements to Repurchase was $1,096 million (2014: $nil) and the fair value of collateral pledged was $1,096 million (2014: $nil). Cash collateral of $928 million was provided (2014: $nil).

Collateral Received
Investments
The Bank has entered into reverse-repurchase agreements in respect of New Zealand dollar-denominated and foreign currency-denominated marketable securities. The table below shows the principal amount subject to reverse-repurchase agreements and the fair value of collateral received. The Bank may sell or repledge that collateral even if the counterparty is not in default of its obligations.

<table>
<thead>
<tr>
<th></th>
<th>NZ Dollar-Denominated Investments</th>
<th>Foreign Currency Denominated Investments</th>
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<tr>
<td>Principal Amount Subject to Reverse-Repurchase Agreements</td>
<td>- 200</td>
<td>3,733</td>
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<tr>
<td>Fair Value of Collateral Received</td>
<td>- 211</td>
<td>3,811</td>
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</tbody>
</table>

Other Collateral Received
In addition, cash collateral received was $43 million (2014: $987 million). Cash collateral received is recorded in the Statement of Financial Position within Short-term Foreign Currency Financial Liabilities.

Under the Bank’s securities lending programme, the Bank has lent securities with a fair value of $704 million (2014: $437 million). The Bank has accepted securities with a fair value of $718 million (2014: $446 million) as collateral for the securities lent under this programme.

These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse-repurchase agreements.

Additional Information for Financial Liabilities
The carrying amount as at balance date of financial liabilities designated at fair value through surplus/(deficit), excluding derivatives, was $3 million less (2014: $3 million less) than the contractual amount at maturity.

Interest rates used as observable inputs in determining the fair value of financial liabilities will inherently include a component for credit risk. However, given the Bank’s status as a sovereign issuer, it is difficult to isolate and accurately measure the change in interest rates and the resulting change in fair value of financial liabilities directly attributable to credit risk.

Collateral has been pledged for all Securities Sold under Agreements to Repurchase. All other liabilities of the Bank are unsecured and rank equally in the event that the Bank ceases to trade.
4. Derivatives

The Bank’s involvement in derivatives includes interest rate futures, cross-currency basis swaps and foreign exchange swaps.

Refer to page 82 for a description of the Bank’s use of derivatives.

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<th>deriv type</th>
<th>2015 Carrying Value $M</th>
<th>2015 Notional Principal $M</th>
<th>2014 Carrying Value $M</th>
<th>2014 Notional Principal $M</th>
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<td>Interest Rate Futures</td>
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<tr>
<td>Assets</td>
<td>-</td>
<td>163</td>
<td>-</td>
<td>82</td>
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<tr>
<td>Liabilities</td>
<td>-</td>
<td>178</td>
<td>-</td>
<td>108</td>
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<td>Net Interest Rate Futures Position</td>
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<td>341</td>
<td>-</td>
<td>190</td>
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<tr>
<td>Cross-Currency Basis Swaps</td>
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<td>Foreign Exchange Swaps</td>
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<tr>
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<td>(30)</td>
<td>3,161</td>
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<td>Net Foreign Exchange Swaps Position</td>
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<td>86</td>
<td>9,655</td>
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<tr>
<td>Total Derivative Assets</td>
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</tr>
<tr>
<td>Total Derivative Liabilities</td>
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<td>(228)</td>
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<td>Net Derivatives Recognised in the Statement of Financial Position</td>
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<td>1,130</td>
<td>17,903</td>
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</table>

As at 30 June 2015, the Bank had 1,471 open Interest Rate Futures contracts (2014: 903).

5. Other Foreign Currency Financial Assets

<table>
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<th>asset type</th>
<th>2015 $M</th>
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<tr>
<td>Dividend Receivable</td>
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<td>Receivable for Unsettled Sales of Securities</td>
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<tr>
<td></td>
<td>154</td>
<td>132</td>
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</tbody>
</table>

As at 30 June 2015, the Bank owned 3,211 shares (2014: 3,211 shares) issued by the Bank for International Settlements (BIS). This represents approximately 0.6 percent of all shares on issue. The shares have a par value of SDR 5,000 each and are paid up to SDR 1,250 each. The Bank’s investment in shares issued by the BIS is valued at fair value, which is determined as being 70 percent of the Bank’s interest in the BIS’s net asset value.

6. Other Assets

<table>
<thead>
<tr>
<th>asset type</th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, Plant and Equipment</td>
<td>69</td>
<td>57</td>
</tr>
<tr>
<td>Intangible Assets</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Inventory</td>
<td>16</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td>88</td>
<td>82</td>
</tr>
</tbody>
</table>

The Bank obtains an independent valuation of land and buildings every three years. The most recent valuation of land and buildings, dated 30 June 2015, was prepared by Jones, Lang LaSalle Limited, an independent registered valuer. The valuation was prepared by discounting rental and nominal rental flows at current market capitalisation rates. The valuation report included details of recent sales of broadly comparable premises. The capitalisation rate applied in valuing the property was a weighted average of 7.7 percent per annum. The aggregate market value of land and buildings was $53.8 million. The original cost was $10 million.
7. **Short-term Foreign Currency Financial Liabilities**

<table>
<thead>
<tr>
<th></th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payable for Unsettled Purchases of Securities</td>
<td>58</td>
<td>-</td>
</tr>
<tr>
<td>Short-term Deposits</td>
<td>43</td>
<td>987</td>
</tr>
<tr>
<td></td>
<td><strong>101</strong></td>
<td><strong>987</strong></td>
</tr>
</tbody>
</table>

Cash collateral received in respect of reverse-repurchase agreements is recorded as Short-term Deposits.

8. **Deposits**

<table>
<thead>
<tr>
<th></th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Zealand Government Deposits</td>
<td><strong>6,112</strong></td>
<td>3,529</td>
</tr>
<tr>
<td>Settlement Bank Deposits</td>
<td>8,321</td>
<td>8,112</td>
</tr>
<tr>
<td>Central Bank Deposits</td>
<td>47</td>
<td>26</td>
</tr>
<tr>
<td>International Monetary Fund Deposits</td>
<td>58</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td><strong>14,538</strong></td>
<td><strong>11,673</strong></td>
</tr>
</tbody>
</table>

**New Zealand Government Deposits**

The Bank provides the Crown Settlement Account for the Government. This account serves as the Crown’s central ‘disbursement account’, although one of the registered banks provides actual cheque processing and other transactional banking services for the Government. The balances with this bank are ‘cleared’ to the Crown Settlement Account at the Reserve Bank each day.

**Settlement Bank Deposits**

The Bank provides exchange settlement account facilities to financial institutions and to the New Zealand Government. Balances in exchange settlement accounts are repayable on demand and the Bank pays interest on overnight balances.

**Central Bank Deposits and International Monetary Fund Deposits**

The Bank provides New Zealand dollar transactional banking services for other central banks and the International Monetary Fund. Balances in these accounts are repayable on demand and the Bank pays no interest on overnight balances.

9. **Other Local Currency Financial Liabilities**

<table>
<thead>
<tr>
<th></th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>Payable for Unsettled Purchase of Securities</td>
<td>37</td>
<td>-</td>
</tr>
<tr>
<td>Demonetised Currency</td>
<td>81</td>
<td>82</td>
</tr>
<tr>
<td></td>
<td><strong>125</strong></td>
<td><strong>85</strong></td>
</tr>
</tbody>
</table>

10. **Other Liabilities**

<table>
<thead>
<tr>
<th></th>
<th>Note</th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend Payable to the New Zealand Government</td>
<td>11</td>
<td>510</td>
<td>20</td>
</tr>
<tr>
<td>Accrued Salaries and Holiday Pay</td>
<td>2</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Accrued Retirement Gratuities</td>
<td>2</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Superannuation Liability</td>
<td>26</td>
<td>-</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td><strong>514</strong></td>
<td>27</td>
<td></td>
</tr>
</tbody>
</table>

No provision is made for non-vesting sick leave, as the pattern of sick leave taken indicates that no additional liability will arise for non-vesting sick leave.
11. Management of the Bank’s Capital and Dividend or Similar Distributions

The Bank is not subject to any regulatory capital requirements.

The Bank’s capital management objective is to ensure that the Bank has sufficient equity to perform its functions. Specifically, the Bank employs an economic capital framework which ensures that the Bank is unlikely, within a 99.9 percent confidence level, to suffer a financial loss through credit, market or operational risks that would result in negative equity.

The Bank uses market and credit risk models using both standard and stressed value at risk (VaR) models, and applies these to its traded, and non-traded, portfolios to model the Bank’s capital requirement. An allowance for operational risk is also added. Modelling uses assumptions and judgement. Key inputs in capital modelling include interest rate and foreign currency positions and limits, foreign and local currency investments, counterparty credit exposures, as well as the probability of loss with respect to each of these factors. Based on a 99.9 percent confidence level, the Bank’s modelled capital requirement is assessed as being $2,300 million (2014: $2,300 million).

The calculation of required capital is assessed by the Bank’s Asset and Liability Committee and the Governing Committee. In making that assessment, consideration is given to whether a capital buffer needs to be retained for hypothetical events such as an extreme economic shock or foreign currency market event. No additional capital buffers are required as at the reporting date (2014: nil). The Board and Minister review the Bank’s assessment of required capital when considering the Bank's annual dividend recommendation.

Dividends

The Bank is required to recommend to the Minister the amount of a dividend in respect of each financial year ended 30 June. The Bank must determine the dividend recommendation in accordance with the dividend principles set out in the Statement of Intent. These principles are:

— The Bank should maintain sufficient equity for the financial risks associated with performing its functions. Equity in excess of that required to cover those risks will be distributed to the Crown.

— In general, unrealised gains should be retained by the Bank until they are realised in New Zealand dollars. However, the Bank may recommend the distribution of unrealised gains where the Bank believes that the probability of the gain being realised is high.

For 2015, the Bank has recommended that a dividend of $510 million be paid. The Board supported that recommendation and the Minister has determined that a dividend of $510 million be paid for 2015. In 2014, a dividend of $20 million was paid.

The following table shows the components of equity, including the amount of unrealised gains, and sets out how equity excluding unrealised gains is compared with required equity, to arrive at the recommended dividend.
Net Assets/Equity comprises:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Net Assets/Equity</strong></td>
<td></td>
<td><strong>Total Net Assets/Equity</strong></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>$M</td>
<td>2014</td>
<td>$M</td>
</tr>
<tr>
<td>Net Assets/Equity</td>
<td>1,213</td>
<td>-</td>
<td>997</td>
</tr>
<tr>
<td>Unrealised Gains</td>
<td>997</td>
<td>-</td>
<td>997</td>
</tr>
<tr>
<td><strong>Changes in the Fair Value of Financial Instruments not yet Realised</strong></td>
<td></td>
<td><strong>Changes in the Fair Value of Financial Instruments not yet Realised</strong></td>
<td></td>
</tr>
<tr>
<td>Foreign Exchange Losses not yet Realised in New Zealand Dollars</td>
<td>90</td>
<td>-</td>
<td>(276)</td>
</tr>
<tr>
<td><strong>Total Accumulated Comprehensive Revenue and Expense before Provision for Dividend excluding Revaluation Reserves</strong></td>
<td>1,396</td>
<td>1,213</td>
<td>183</td>
</tr>
<tr>
<td>Available-for-sale Revaluation Reserve</td>
<td>241</td>
<td>-</td>
<td>241</td>
</tr>
<tr>
<td>Property Revaluation Reserve</td>
<td>54</td>
<td>-</td>
<td>54</td>
</tr>
<tr>
<td>Cash Flow Hedge Reserve</td>
<td>13</td>
<td>-</td>
<td>13</td>
</tr>
<tr>
<td>Currency and Artwork Collections and Archives Revaluation Reserve</td>
<td>5</td>
<td>-</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total Accumulated Comprehensive Revenue and Expense and Revaluation Reserves before Provision for Dividend</strong></td>
<td>1,709</td>
<td>1,213</td>
<td>496</td>
</tr>
<tr>
<td>Capital contributed by the New Zealand Government</td>
<td>1,600</td>
<td>-</td>
<td>1,600</td>
</tr>
<tr>
<td>Less Provision for Dividend</td>
<td>(510)</td>
<td>-</td>
<td>(20)</td>
</tr>
<tr>
<td><strong>Total Net Assets/Equity after Provision for Dividend</strong></td>
<td>2,799</td>
<td>2,303</td>
<td>496</td>
</tr>
</tbody>
</table>

To ensure that unrealised gains are not distributed, after a provision for dividend is made, Net Assets/Equity Excluding Unrealised Gains should not be less than required capital. For 2015, after providing for a dividend of $510 million, Net Assets/Equity Excluding Unrealised Gains was $2,303 million against required equity of $2,300 million.

For 2014, after providing for a dividend of $20 million, Net Assets/Equity Excluding Unrealised Gains was $2,300 million against required equity of $2,300 million.
12. Concentrations of Funding

<table>
<thead>
<tr>
<th>Financial Liabilities</th>
<th>Total 2015 $M</th>
<th>New Zealand Government $M</th>
<th>New Zealand Public $M</th>
<th>New Zealand Financial Institutions $M</th>
<th>Overseas Financial Institutions $M</th>
<th>Other $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Currency Term Liabilities</td>
<td>1,127</td>
<td>1,127</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>1,800</td>
<td>-</td>
<td>-</td>
<td>1,080</td>
<td>720</td>
<td>-</td>
</tr>
<tr>
<td>Deposits</td>
<td>14,538</td>
<td>6,112</td>
<td>-</td>
<td>6,630</td>
<td>1,765</td>
<td>31</td>
</tr>
<tr>
<td>Local Currency Term Liabilities</td>
<td>800</td>
<td>-</td>
<td>800</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Reserve Bank Bills</td>
<td>309</td>
<td>-</td>
<td>309</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Currency in Circulation</td>
<td>5,255</td>
<td>-</td>
<td>5,255</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>1,965</td>
<td>-</td>
<td>81</td>
<td>664</td>
<td>1,213</td>
<td>7</td>
</tr>
<tr>
<td><strong>Total Financial Liabilities</strong></td>
<td><strong>25,794</strong></td>
<td><strong>8,039</strong></td>
<td><strong>5,336</strong></td>
<td><strong>8,683</strong></td>
<td><strong>3,698</strong></td>
<td><strong>38</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financial Liabilities</th>
<th>Total 2014 $M</th>
<th>New Zealand Government $M</th>
<th>New Zealand Public $M</th>
<th>New Zealand Financial Institutions $M</th>
<th>Overseas Financial Institutions $M</th>
<th>Other $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Currency Term Liabilities</td>
<td>1,541</td>
<td>1,541</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>437</td>
<td>-</td>
<td>-</td>
<td>437</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Deposits</td>
<td>11,673</td>
<td>3,529</td>
<td>-</td>
<td>6,292</td>
<td>1,797</td>
<td>55</td>
</tr>
<tr>
<td>Local Currency Term Liabilities</td>
<td>101</td>
<td>101</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Currency in Circulation</td>
<td>4,883</td>
<td>-</td>
<td>4,883</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>1,300</td>
<td>-</td>
<td>82</td>
<td>547</td>
<td>668</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total Financial Liabilities</strong></td>
<td><strong>19,935</strong></td>
<td><strong>5,171</strong></td>
<td><strong>4,965</strong></td>
<td><strong>6,839</strong></td>
<td><strong>2,902</strong></td>
<td><strong>58</strong></td>
</tr>
</tbody>
</table>

All figures are stated at carrying values in the Statement of Financial Position.
13. Risk Management

The Reserve Bank is involved in policy-oriented activities. Therefore, elements of the Bank’s risk management framework might differ from the risk management frameworks for most other financial institutions. The main financial risks to which the Bank is exposed include credit risk, foreign currency risk, and interest rate risk on both foreign and local currency assets. In the management of foreign reserves, minimising liquidity risk is a major consideration to maintain an effective foreign exchange intervention capability. Policies for managing credit, interest rate, foreign currency, and liquidity risks are outlined in Notes 15 to 19. As for other financial institutions, the nature of the Bank’s operations creates exposure to a broad range of enterprise risks, including operational and reputational risks.

The Bank seeks to ensure that strong and effective risk management and control systems identify, assess, monitor, and manage risk exposures. An Asset and Liability Committee (ALCO), comprising the governors and senior management, is responsible for advising the Governing Committee with respect to all balance sheet-related activities, including the appropriateness of risk-return trade-offs underlying the Bank’s strategy. Specialist staff conduct the Bank’s local currency, foreign currency reserves management, and foreign exchange-dealing operations in accordance with a clearly defined risk management framework, including delegated authorities and limits set by the Governing Committee. The risk management framework is subject to regular review by ALCO. The overall risk management framework is designed to promote the sound and prudent management of the Bank’s risks.

The majority of the Bank’s financial risks arise from the Foreign Reserves Management and Domestic Market Operations units of the Bank’s Financial Markets department. Within this department, a separate risk management team is responsible for maintaining the Bank’s financial risk management framework and operating independent risk reporting systems that monitor and report compliance with various risk limits and policies.

The Risk Assessment and Assurance department (which includes an internal audit unit) is responsible for an enterprise-wide risk management system and reports on internal audit, enterprise-wide risk management and related issues to the Governing Committee. A risk-based framework, which evaluates key business risks and internal controls, determines the extent and frequency of internal audits conducted. All Bank departments are subject to periodic internal audit review. The Head of Risk Assessment and Assurance, and the Manager, Internal Audit, have direct and independent access to the Audit Committee of the Board of Directors, comprising three of the Bank’s non-executive directors. Summary information on the outcomes of internal audits is reported to the Audit Committee.

The Bank is subject to an annual external audit by the Auditor-General under the Public Audit Act 2001. Auditing arrangements are overseen by the Audit Committee of the Board of Directors, which meets regularly to monitor the financial reporting, risk and audit functions within the Bank. The committee reviews the internal audit function and has direct access to the external auditor. The Audit Committee reports to the Board of Directors on its activities. The Board of Directors monitors the Bank’s management of risk as part of its role of keeping the Bank’s performance and use of resources under constant review.

The Bank continues to self-insure all property, plant and equipment, including the Bank’s Wellington building.

14. Operational Risk

Operational risk is the risk of loss, in both financial and non-financial terms, resulting from human error and the failure of processes and systems.

The Bank has a broad range of functions spanning policy, financial stability, payments systems and internal corporate support, all of which are exposed to operational risk. Managing operational risk in the Bank is an integral part of day-to-day operations and management, which includes explicit consideration of both the opportunities and the risks of all business activities. Operational risk management includes Bank-wide corporate policies that describe the standard of conduct required of staff, a number of mandated requirements (e.g., a proactive problem management process whereby problems and incidents are reported and analysed for potential risk management improvements), an active internal audit function, and specific internal control systems designed around the particular characteristics of various Bank activities.

The above policies and procedures for managing operational risk are reinforced by the requirements of section 165 of the Reserve Bank Act. The Reserve Bank Act requires that the financial statements of the Bank include a statement signed by the Governor and Deputy Chief Executive accepting responsibility for, among other things, the establishment and maintenance of a system of effective internal control within the Bank.
15. Credit Risk
Credit risk is the risk of loss due to a borrower or counterparty failing to meet their financial obligations in accordance with agreed terms.

Within the Bank, credit risk arises principally through the investment of funds through Foreign Reserves Management and Domestic Market Operations functions. The Bank faces counterparty risk to the extent that derivative contracts are utilised by these two functions as part of normal operations.

a. Foreign Reserves Management Credit Risk Management
Credit risk for Foreign Reserves Management is monitored and managed daily. Exposures are controlled through comprehensive individual counterparty and issuer credit limits. Individual credit limits are set taking into account the credit profile of the counterparty or issuer. Individual credit exposures are also aggregated and managed against cumulative limits, such as country exposure limits.

As part of the arrangements for using financial instruments, credit risk is mitigated by receiving collateral. Collateral usually takes the form of cash or government securities. The value of collateral held is required to be within a prescribed range of the value of the exposure to the counterparty. Valuations are updated daily and, as a result, additional collateral may be called for or excess collateral returned to the counterparty.

b. Domestic Market Operations Credit Risk Management
Repurchase and reverse-repurchase transactions generated by the Domestic Market Operations function also give rise to credit risk. The Bank accepts a wide range of pre-approved securities for reverse-repurchase transactions. Where funds are advanced by reverse-repurchase agreements, the amount advanced is subject to specified discounts depending upon the type of security so as to ensure that the value of security held exceeds the amount advanced. The value of security held is monitored daily and calls are made for additional collateral to be requested from, or excess collateral returned to, the counterparty as required.

c. Concentrations of Credit Exposure
The following table presents the Bank’s financial assets based on end-of-year concentrations of credit exposure, classified by the country in which the issuer is resident. For this table, where collateral is held for reverse-repurchase agreements, the exposure measured is that to the issuer of the collateral, as opposed to the counterparty to the reverse-repurchase agreement.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>11,765</td>
<td>11,435</td>
<td>330</td>
<td>7,026</td>
<td>6,693</td>
<td>333</td>
</tr>
<tr>
<td>New Zealand</td>
<td>3,665</td>
<td>3,117</td>
<td>548</td>
<td>3,630</td>
<td>3,091</td>
<td>539</td>
</tr>
<tr>
<td>Germany</td>
<td>2,666</td>
<td>697</td>
<td>1,969</td>
<td>3,252</td>
<td>732</td>
<td>2,520</td>
</tr>
<tr>
<td>Supranational</td>
<td>2,114</td>
<td>-</td>
<td>2,114</td>
<td>1,207</td>
<td>-</td>
<td>1,207</td>
</tr>
<tr>
<td>France</td>
<td>2,094</td>
<td>1,399</td>
<td>695</td>
<td>1,942</td>
<td>782</td>
<td>1,160</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2,070</td>
<td>792</td>
<td>1,278</td>
<td>407</td>
<td>44</td>
<td>363</td>
</tr>
<tr>
<td>Japan</td>
<td>1,599</td>
<td>1,599</td>
<td>-</td>
<td>1,552</td>
<td>1,551</td>
<td>1</td>
</tr>
<tr>
<td>Australia</td>
<td>598</td>
<td>487</td>
<td>111</td>
<td>580</td>
<td>363</td>
<td>217</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>549</td>
<td>549</td>
<td>-</td>
<td>831</td>
<td>809</td>
<td>22</td>
</tr>
<tr>
<td>Sweden</td>
<td>532</td>
<td>-</td>
<td>532</td>
<td>525</td>
<td>-</td>
<td>525</td>
</tr>
<tr>
<td>Denmark</td>
<td>347</td>
<td>-</td>
<td>347</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Canada</td>
<td>328</td>
<td>324</td>
<td>4</td>
<td>865</td>
<td>838</td>
<td>27</td>
</tr>
<tr>
<td>Other Non-European</td>
<td>227</td>
<td>-</td>
<td>227</td>
<td>111</td>
<td>-</td>
<td>111</td>
</tr>
<tr>
<td>Asian Bond Funds</td>
<td>186</td>
<td>-</td>
<td>186</td>
<td>143</td>
<td>-</td>
<td>143</td>
</tr>
<tr>
<td>China</td>
<td>156</td>
<td>156</td>
<td>-</td>
<td>58</td>
<td>58</td>
<td>-</td>
</tr>
<tr>
<td>Austria</td>
<td>123</td>
<td>-</td>
<td>123</td>
<td>228</td>
<td>-</td>
<td>228</td>
</tr>
<tr>
<td>Switzerland</td>
<td>-</td>
<td>-</td>
<td>22</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Financial Assets</td>
<td>29,019</td>
<td>20,555</td>
<td>8,464</td>
<td>22,379</td>
<td>14,961</td>
<td>7,418</td>
</tr>
</tbody>
</table>
The following table presents the Bank’s financial assets based on end-of-year concentrations of credit exposure, classified by the country in which the counterparty is resident. For this table, any collateral held is not included in determining exposures.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>8,033</td>
<td>6,999</td>
<td>1,034</td>
<td>4,389</td>
<td>3,720</td>
<td>669</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>4,281</td>
<td>549</td>
<td>3,732</td>
<td>3,400</td>
<td>809</td>
<td>2,591</td>
</tr>
<tr>
<td>New Zealand</td>
<td>3,665</td>
<td>3,117</td>
<td>548</td>
<td>3,630</td>
<td>2,891</td>
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<td>700</td>
<td>1,966</td>
<td>2,875</td>
<td>317</td>
<td>2,558</td>
</tr>
<tr>
<td>Supranational</td>
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<td>-</td>
<td>2,114</td>
<td>1,207</td>
<td>-</td>
<td>1,207</td>
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<tr>
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<td>792</td>
<td>1,278</td>
<td>407</td>
<td>44</td>
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<tr>
<td>Japan</td>
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<td>1,599</td>
<td>-</td>
<td>1,552</td>
<td>1,551</td>
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<td>487</td>
<td>111</td>
<td>580</td>
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<td>532</td>
<td>-</td>
<td>532</td>
<td>525</td>
<td>-</td>
<td>525</td>
</tr>
<tr>
<td>Denmark</td>
<td>347</td>
<td>-</td>
<td>347</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Canada</td>
<td>328</td>
<td>324</td>
<td>4</td>
<td>865</td>
<td>838</td>
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<td>-</td>
<td>227</td>
<td>111</td>
<td>-</td>
<td>111</td>
</tr>
<tr>
<td>Asian Bond Funds</td>
<td>186</td>
<td>-</td>
<td>186</td>
<td>143</td>
<td>-</td>
<td>143</td>
</tr>
<tr>
<td>China</td>
<td>156</td>
<td>156</td>
<td>-</td>
<td>58</td>
<td>58</td>
<td>-</td>
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<tr>
<td>Austria</td>
<td>123</td>
<td>-</td>
<td>123</td>
<td>228</td>
<td>-</td>
<td>228</td>
</tr>
<tr>
<td>Switzerland</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>51</td>
<td>-</td>
<td>51</td>
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<tr>
<td><strong>Total Financial Assets</strong></td>
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<td><strong>16,122</strong></td>
<td><strong>12,897</strong></td>
<td><strong>22,379</strong></td>
<td><strong>11,373</strong></td>
<td><strong>11,006</strong></td>
</tr>
</tbody>
</table>

16. The differences between amounts disclosed by issuer and by counterparty relate to Securities Purchased under Agreements to Resell.
d. **Credit Exposure by Credit Rating**

The following table presents the Bank’s financial assets based on Standard & Poor’s credit rating of the issuer. AAA is the highest-quality rating possible and indicates the entity has an extremely strong capacity to pay interest and principal. AA is a high-grade rating, indicating a very strong capacity, and A is an upper-medium grade, indicating a strong capacity to pay interest and principal. BBB is the lowest investment-grade rating, indicating a medium capacity to pay interest and principal. Ratings lower than AAA can be modified by + or - signs to indicate relative standing within the major categories. N/R indicates the entity has not been rated by Standard & Poor’s.

For this table, where collateral is held for reverse-repurchase agreements, the credit rating is that for the issuer of the collateral and not the credit rating for the counterparty to the reverse-repurchase agreement.

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
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</tr>
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<tr>
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<td>3,665 - 3,662 - 3</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>2,666 2,665 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supranational</td>
<td>2,114 1,581 - 533</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>2,094 - 2,035 59 -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>2,070 - 2,070 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>1,599 - 1,599 - 1</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>598 487 111 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>United Kingdom</td>
<td>549 549 - 1</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>532 532 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>347 347 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>328 324 3 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Non-European</td>
<td>227 - 227 -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asian Bond Funds</td>
<td>186 - 186 -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>156 - 156 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td>123 - 123 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Financial Assets</strong></td>
<td>29,019 6,485 21,270 384 342 538</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>7,026 - 6,713 311 - 2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>3,630 - 3,628 - 2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>3,252 3,251 - 1</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>1,942 - 1,845 97 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Japan</td>
<td>1,552 - 1,551 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supranational</td>
<td>1,207 343 - 864</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>865 839 24 2</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>831 809 - 22 2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>580 363 217 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>525 525 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>407 44 363 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td>228 - 228 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asian Bond Funds</td>
<td>143 - 143 -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Non-European</td>
<td>111 - 111 -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>58 - 58 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Switzerland</td>
<td>22 - 22 - 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Financial Assets</strong></td>
<td>22,379 6,174 14,680 454 201 870</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

17. Exposures to Supranational that do not have a credit rating are exposures to the Bank for International Settlements.
16. Market Risk

Market risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market prices and rates. In respect of the Bank, market risk comprises interest rate risk and foreign currency risk.

The Bank uses a range of position size, delta, and stop-loss limits, together with Value at Risk (VaR) to measure and manage market risk.

Interest Rate Risk and Limits
Interest rate risk is the risk that the fair value of a financial instrument will fluctuate due to changes in interest rates. Interest rate deltas measure the change in fair value of a financial instrument due to a 0.01 percent increase in interest rates. Interest rate delta limits are established for the aggregate balance sheet as well as individual portfolios.

Foreign Currency Risk and Limits
Foreign currency risk is the risk that the fair value of financial instruments will fluctuate due to a change in foreign exchange rates. Foreign exchange position limits are established for the aggregate net foreign currency position that may be taken, together with limits for the net exposure to individual foreign currency positions.

VaR and VaR Limits
VaR estimates financial loss potential, based on historical observations of market rate and price movement. The Bank’s VaR models test Bank portfolios against various periods of historical data, including the most recently recorded data, and data recorded during stressed market conditions (such as those recorded during 2008). The Bank’s primary VaR model captures the potential financial loss over one day, at 99 percent confidence, referencing the most recent 250 days of price data. A 99 percent confidence interval suggests that the Bank may incur losses greater than those predicted by VaR once every 100 trading days, or 2.5 times a year.

VaR limits are utilised to manage market risk arising from the Bank’s actively managed portfolios.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>VaR As at 30 June</td>
<td>43</td>
<td>25</td>
<td>5</td>
<td>4</td>
<td>43</td>
<td>25</td>
</tr>
<tr>
<td>Peak over the Year</td>
<td>43</td>
<td>29</td>
<td>6</td>
<td>6</td>
<td>43</td>
<td>30</td>
</tr>
<tr>
<td>Low over the Year</td>
<td>22</td>
<td>24</td>
<td>4</td>
<td>4</td>
<td>22</td>
<td>25</td>
</tr>
<tr>
<td>Average over the Year</td>
<td>30</td>
<td>28</td>
<td>5</td>
<td>5</td>
<td>30</td>
<td>28</td>
</tr>
</tbody>
</table>

Total Market Risk is the sum of Foreign Currency Risk and Interest Rate Risk and also includes a deduction for correlation benefits.

Stop-loss Limits
Stop-loss limits are set to control losses that may arise in the Bank’s actively traded portfolios. Should market risk losses exceed the stop-loss limit, the associated positions are closed.
Sensitivity to Interest Rate Risk and Foreign Currency Risk

The sensitivity of the fair value of the Bank’s financial assets and liabilities to assumed across-the-board changes in interest rates and the exchange rate is shown below.

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A rise of 10 percent in the value of the New Zealand dollar</td>
<td>(322)</td>
<td>(308)</td>
<td>(14)</td>
<td>(228)</td>
<td>(217)</td>
<td>(11)</td>
</tr>
<tr>
<td>A fall of 10 percent in the value of the New Zealand dollar</td>
<td>394</td>
<td>377</td>
<td>17</td>
<td>279</td>
<td>265</td>
<td>14</td>
</tr>
<tr>
<td>A rise of one percentage point in the local currency yield curve</td>
<td>(184)</td>
<td>(19)</td>
<td>(165)</td>
<td>(164)</td>
<td>(16)</td>
<td>(148)</td>
</tr>
<tr>
<td>A fall of one percentage point in the local currency yield curve</td>
<td>200</td>
<td>19</td>
<td>181</td>
<td>178</td>
<td>16</td>
<td>162</td>
</tr>
<tr>
<td>A rise of one percentage point in the yield curve for all foreign currencies</td>
<td>(19)</td>
<td>(19)</td>
<td>-</td>
<td>(39)</td>
<td>(39)</td>
<td>-</td>
</tr>
<tr>
<td>A fall of one percentage point in the yield curve for all foreign currencies</td>
<td>19</td>
<td>19</td>
<td>-</td>
<td>39</td>
<td>39</td>
<td>-</td>
</tr>
</tbody>
</table>

The Bank’s exposures to foreign currency risk and interest rate risk can change materially over time, depending on the Bank’s policy objectives and economic conditions.

17. Interest Rate Risk

Interest rate risk is the risk that the fair value of a financial instrument will fluctuate due to changes in interest rates.

Foreign Reserves Management Interest Rate Risk Management

The Bank holds an open foreign currency position, effectively financing a portion of its foreign currency assets using New Zealand dollar funding. This exposes the Bank to the risk of changes in the relative interest rates between New Zealand and overseas currencies. Interest rate risk also arises as a result of mismatches between the maturity, or interest rate resets, of assets and liabilities where the assets and liabilities are denominated in the same currency. The Bank utilises risk limits to cap the amount of interest rate risk the Bank manages actively.

Domestic Market Operations Interest Rate Risk Management

The Bank’s exposure to interest rate risk that arises from domestic market operations is also constrained through interest rate risk limits.

The average duration of the Bank’s holding of New Zealand government securities in its investment portfolio (which excludes outright purchases of government securities for liquidity management purposes) as at 30 June 2015 was 71 years (2014: 5.6 years). Interest rate risk on New Zealand government securities is not dynamically managed and it is intended that these securities be held to maturity.
Assets and liabilities will mature or reprice within the following periods:

<table>
<thead>
<tr>
<th>Period</th>
<th>Total 2015 $M</th>
<th>Non-interest Sensitive $M</th>
<th>Overnight $M</th>
<th>3 Months or Less $M</th>
<th>Between 3 and 12 Months $M</th>
<th>Between 1 and 2 Years $M</th>
<th>Between 2 and 5 Years $M</th>
<th>More Than 5 Years $M</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Investments</td>
<td>13,727</td>
<td>-</td>
<td>419</td>
<td>9,136</td>
<td>1,263</td>
<td>1,476</td>
<td>1,091</td>
<td>342</td>
</tr>
<tr>
<td>Securities Purchased under Agreements to Resell</td>
<td>4,436</td>
<td>-</td>
<td>-</td>
<td>4,436</td>
<td>-</td>
<td>-</td>
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<td>-</td>
</tr>
<tr>
<td>New Zealand Government Securities</td>
<td>3,117</td>
<td>-</td>
<td>-</td>
<td>955</td>
<td>-</td>
<td>-</td>
<td>1,137</td>
<td>1,025</td>
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<td>Other Financial Assets</td>
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<td>7,192</td>
<td>389</td>
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<tr>
<td>Other Assets</td>
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<td>88</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>29,107</td>
<td>246</td>
<td>7,611</td>
<td>14,916</td>
<td>1,263</td>
<td>1,476</td>
<td>2,228</td>
<td>1,367</td>
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<tr>
<td><strong>Liabilities</strong></td>
<td></td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>Foreign Currency Term Liabilities</td>
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<td>-</td>
<td>-</td>
<td>1,127</td>
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<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Local Currency Term Liabilities</td>
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<td>-</td>
<td>800</td>
<td>-</td>
<td>-</td>
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<td>-</td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
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<td>1,800</td>
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<td>Deposits</td>
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<td>14,434</td>
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<td>309</td>
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<td>Currency in Circulation</td>
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<td>5,255</td>
<td>-</td>
<td>-</td>
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<td>-</td>
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<tr>
<td>Other Financial Liabilities</td>
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<td>183</td>
<td>84</td>
<td>1,693</td>
<td>5</td>
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<tr>
<td>Other Liabilities</td>
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<td>-</td>
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<td>-</td>
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<tr>
<td><strong>Net Assets/Equity</strong></td>
<td>2,799</td>
<td>2,799</td>
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<td>-</td>
<td>-</td>
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<tr>
<td><strong>Total Liabilities and Equity</strong></td>
<td>29,107</td>
<td>8,855</td>
<td>14,518</td>
<td>5,729</td>
<td>5</td>
<td>-</td>
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<td>-</td>
</tr>
<tr>
<td><strong>Interest Rate Sensitivity Gap excluding Futures Contracts</strong></td>
<td>-</td>
<td>(8,609)</td>
<td>(6,907)</td>
<td>9,187</td>
<td>1,258</td>
<td>1,476</td>
<td>2,228</td>
<td>1,367</td>
</tr>
<tr>
<td>Futures Contracts</td>
<td>(300)</td>
<td>-</td>
<td>-</td>
<td>10</td>
<td>-</td>
<td>(305)</td>
<td>(5)</td>
<td>-</td>
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<tr>
<td><strong>Total Interest Rate Sensitivity Gap</strong></td>
<td>(300)</td>
<td>(8,609)</td>
<td>(6,907)</td>
<td>9,197</td>
<td>1,258</td>
<td>1,171</td>
<td>2,223</td>
<td>1,367</td>
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</table>

**Interest Rate Sensitivity Gap by Currency:**

<table>
<thead>
<tr>
<th>Currency</th>
<th>(3,536)</th>
<th>(8,699)</th>
<th>(13,980)</th>
<th>16,676</th>
<th>305</th>
<th>-</th>
<th>1,137</th>
<th>1,025</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Zealand dollar</td>
<td>(5,336)</td>
<td>(8,699)</td>
<td>(13,980)</td>
<td>16,676</td>
<td>305</td>
<td>-</td>
<td>1,137</td>
<td>1,025</td>
</tr>
<tr>
<td>United States dollar</td>
<td>690</td>
<td>(2)</td>
<td>5,182</td>
<td>(5,489)</td>
<td>366</td>
<td>417</td>
<td>149</td>
<td>67</td>
</tr>
<tr>
<td>Euro</td>
<td>747</td>
<td>60</td>
<td>793</td>
<td>(670)</td>
<td>206</td>
<td>358</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>193</td>
<td>15</td>
<td>1,059</td>
<td>(1,320)</td>
<td>299</td>
<td>61</td>
<td>79</td>
<td>-</td>
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<tr>
<td>British pound</td>
<td>520</td>
<td>17</td>
<td>30</td>
<td>-</td>
<td>-</td>
<td>68</td>
<td>405</td>
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<tr>
<td>Australian dollar</td>
<td>487</td>
<td>-</td>
<td>2</td>
<td>-</td>
<td>82</td>
<td>49</td>
<td>354</td>
<td>-</td>
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<tr>
<td>Canadian dollar</td>
<td>324</td>
<td>-</td>
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<td>-</td>
<td>-</td>
<td>218</td>
<td>99</td>
<td>-</td>
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<tr>
<td>Chinese renminbi</td>
<td>156</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>156</td>
<td>-</td>
</tr>
<tr>
<td>Other</td>
<td>119</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>119</td>
<td>-</td>
</tr>
</tbody>
</table>

New Zealand Government Inflation-Indexed Bonds, with a market value of $958 million, are included in the three months or less category. These bonds have an earnings rate that is linked to the Consumer Price Index and are reset each quarter.

18. The Interest Rate Sensitivity Gap by Currency differs from the open foreign exchange position by the notional principal on open futures contracts.
### Financial Statements

#### Celebrating 80 years

<table>
<thead>
<tr>
<th></th>
<th>Total 2014 $M</th>
<th>Non-interest Sensitive $M</th>
<th>Overnight $M</th>
<th>3 Months or Less $M</th>
<th>Between 3 and 12 Months $M</th>
<th>Between 1 and 2 Years $M</th>
<th>Between 2 and 5 Years $M</th>
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<tr>
<td>Investments</td>
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<td>-</td>
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<td>1,756</td>
<td>1,571</td>
<td>658</td>
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<td>New Zealand Government Securities</td>
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<td>944</td>
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<td>2,633</td>
<td>1,360</td>
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<td>Other Assets</td>
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<td>-</td>
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<tr>
<td><strong>Total Assets</strong></td>
<td>22,461</td>
<td>216</td>
<td>2,633</td>
<td>13,133</td>
<td>2,240</td>
<td>1,571</td>
<td>1,523</td>
<td>1,145</td>
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<td>Local Currency Term Liabilities</td>
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<td>-</td>
<td>101</td>
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<td>-</td>
<td>-</td>
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<tr>
<td>Securities Sold under Agreements to Repurchase</td>
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<td>-</td>
<td>437</td>
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<td>982</td>
<td>233</td>
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<td>-</td>
<td>-</td>
<td>-</td>
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<td>Other Liabilities</td>
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<td>-</td>
<td>-</td>
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<td><strong>Net Assets/Equity</strong></td>
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<td>2,499</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<td><strong>Total Liabilities and Equity</strong></td>
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<td>7,526</td>
<td>12,623</td>
<td>2,312</td>
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<td>-</td>
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<tr>
<td><strong>Interest Rate Sensitivity Gap excluding Futures Contracts</strong></td>
<td>-</td>
<td>(7,310)</td>
<td>(9,990)</td>
<td>10,821</td>
<td>2,240</td>
<td>1,571</td>
<td>1,523</td>
<td>1,145</td>
</tr>
<tr>
<td>Futures Contracts</td>
<td>(184)</td>
<td>-</td>
<td>-</td>
<td>3</td>
<td>-</td>
<td>(136)</td>
<td>(14)</td>
<td>(37)</td>
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<tr>
<td><strong>Total Interest Rate Sensitivity Gap</strong></td>
<td>(184)</td>
<td>(7,310)</td>
<td>(9,990)</td>
<td>10,824</td>
<td>2,240</td>
<td>1,435</td>
<td>1,509</td>
<td>1,108</td>
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<td><strong>Interest Rate Sensitivity Gap by Currency:</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Zealand dollar</td>
<td>(2,510)</td>
<td>(7,445)</td>
<td>(11,641)</td>
<td>14,089</td>
<td>678</td>
<td>-</td>
<td>865</td>
<td>944</td>
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<tr>
<td>United States dollar</td>
<td>507</td>
<td>62</td>
<td>899</td>
<td>(1,818)</td>
<td>753</td>
<td>302</td>
<td>260</td>
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<tr>
<td>Euro</td>
<td>524</td>
<td>48</td>
<td>44</td>
<td>185</td>
<td>-</td>
<td>247</td>
<td>-</td>
<td>-</td>
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<td>Japanese yen</td>
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<td>10</td>
<td>630</td>
<td>(1,331)</td>
<td>282</td>
<td>375</td>
<td>151</td>
<td>(36)</td>
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<tr>
<td>British pound</td>
<td>357</td>
<td>14</td>
<td>20</td>
<td>(191)</td>
<td>281</td>
<td>233</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Australian dollar</td>
<td>474</td>
<td>1</td>
<td>19</td>
<td>109</td>
<td>58</td>
<td>134</td>
<td>153</td>
<td>-</td>
</tr>
<tr>
<td>Canadian dollar</td>
<td>232</td>
<td>-</td>
<td>39</td>
<td>(219)</td>
<td>188</td>
<td>144</td>
<td>80</td>
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<td>Chinese renminbi</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>58</td>
</tr>
<tr>
<td>Other</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>93</td>
</tr>
<tr>
<td><strong>Total Interest Rate Sensitivity Gap by Currency:</strong></td>
<td>(184)</td>
<td>(7,310)</td>
<td>(9,990)</td>
<td>10,824</td>
<td>2,240</td>
<td>1,435</td>
<td>1,509</td>
<td>1,108</td>
</tr>
</tbody>
</table>
18. Foreign Currency Risk

Foreign currency risk is the risk that the fair value of a financial instrument will fluctuate due to a change in foreign exchange rates.

Foreign exchange risk arises from:
— maintenance of a portion of foreign currency reserves on an unhedged basis for crisis management purposes;
— currency intervention to meet monetary policy objectives; and
— active management undertaken in trading portfolios.

The Bank intends to hold some of its reserves on an unhedged basis through most of the exchange rate cycle. The Bank has a policy of maintaining a passive ‘benchmark’ open foreign exchange position of SDR 1 billion ($NZ 2.075 billion), but can vary the actual open position, and thus the amount of unhedged reserves, around that benchmark level, depending on the behaviour of the exchange rate and foreign exchange markets. This variation might be significant.

For non-trading portfolios, foreign currency risk is managed by way of open position limits, target open-currency composition weights and deviation bands. Additionally, the Bank monitors VaR and stressed-VaR outcomes for these portfolios.

Stop-loss and VaR limits are also used to help manage the Bank’s trading portfolios, which account for a minor proportion of the Bank’s total open foreign exchange position.

As at 30 June 2015, the Bank’s net exposure to major currencies, in New Zealand dollar terms, was:

<table>
<thead>
<tr>
<th>Currency</th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australian dollar</td>
<td>487</td>
<td>474</td>
</tr>
<tr>
<td>British pound</td>
<td>520</td>
<td>357</td>
</tr>
<tr>
<td>Canadian dollar</td>
<td>324</td>
<td>232</td>
</tr>
<tr>
<td>Chinese renminbi</td>
<td>156</td>
<td>58</td>
</tr>
<tr>
<td>Euro</td>
<td>884</td>
<td>594</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>193</td>
<td>117</td>
</tr>
<tr>
<td>United States dollar</td>
<td>863</td>
<td>588</td>
</tr>
<tr>
<td>Various currencies (Asian Bond Fund 2)</td>
<td>119</td>
<td>93</td>
</tr>
<tr>
<td><strong>Total Net Open Foreign Exchange Position</strong></td>
<td><strong>3,546</strong></td>
<td><strong>2,513</strong></td>
</tr>
</tbody>
</table>

At 30 June 2015, the net open foreign exchange position was SDR 1,709 million (2014: SDR 1,420 million). The quantum of the open position varies over time to the level the Bank determines is warranted by its policy objectives (specified in SDR terms) and economic conditions. The largest net open foreign exchange position (measured in SDR terms) during the 12 months ended 30 June 2015 was SDR 1,743 million (2014: SDR 1,448 million). The smallest net open foreign exchange position (measured in SDR terms) during the 12 months ended 30 June 2015 was SDR 1,420 million (2014: SDR 1,354 million). The largest net open foreign exchange position (measured in NZD terms) during the 12 months ended 30 June 2015 was $3,553 million (2014: $2,656 million). The smallest net open foreign exchange position (measured in NZD terms) during the 12 months ended 30 June 2015 was $2,500 million (2014: $2,482 million).
19. Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting financial obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk also includes the risk that the Bank may have to sell a financial asset quickly at less than its fair value.

The objectives of the Bank’s liquidity policy are to:
— ensure that all financial obligations are met when due;
— ensure that foreign reserves assets held for currency intervention purposes are able to be liquidated in an orderly fashion, within agreed timeframes; and
— ensure that the Bank manages the aggregate level of New Zealand dollar liquidity in the New Zealand banking system so as to, in turn, ensure that interest rates in inter-bank markets are consistent with monetary policy settings, and to facilitate the smooth operation of the inter-bank payment system.

a. Foreign Currency Activities

Liquidity is a key criterion in determining the composition of the Bank’s foreign currency assets. This reflects the potential requirement to liquidate foreign reserves for intervention purposes, should the need arise. Accordingly, the Bank employs a number of controls that aim to ensure quick access to funds. These controls include a required composition of portfolios based on the liquidity characteristics of securities, with defined minimum levels, duration, and limits on the minimum and maximum proportion of reserves that may be held in any one currency.

At 30 June 2015, foreign currency assets valued at $24,027 million were classified as being able to be settled within two business days of being liquidated (30 June 2014: $16,682 million).

The Bank also manages refinancing risk on foreign reserves funded from borrowing by applying limits on the amount of borrowing maturing in any 12-month period.

b. Local Currency Activities

The Bank’s management of its own New Zealand dollar liquidity risk is a function of the Bank’s management of the daily aggregate liquidity that is available within the New Zealand banking system.

The Bank manages its own New Zealand dollar cash flows by advancing funds to, and withdrawing funds from, the New Zealand banking system. This is achieved through a range of financial transactions, including entering into foreign exchange swap and basis swap transactions and asset repurchase and reverse-repurchase agreements, and by issuing Reserve Bank bills. As New Zealand’s central bank, the Bank is able to create New Zealand dollar liquidity through its daily market operations. Therefore, the Bank is not required to maintain liquid assets to meet its New Zealand dollar obligations.

20. Cash Flows by Remaining Contractual Maturities

The following table sets out the maturity profile of the Bank’s financial assets and liabilities. The table discloses the contractual principal receivable or due at the maturity date, together with interest receivable or payable for the period to the maturity date based on interest rates and foreign exchange rates prevailing as at balance date. Financial liabilities payable on demand includes currency in circulation. However, historical experience has shown such balances provide a stable source of long-term funding for the Bank.

Deposits, which are on-demand liabilities, are managed taking into account the Bank’s ability to create New Zealand dollar liquidity through its daily market operations. In all other respects, the Bank manages liquidity on a contractual maturity basis, which is consistent with the expected maturities of financial instruments.

The balances in this table do not equate with the balances in the Consolidated Statement of Financial Position, as the table incorporates all cash flows on an undiscounted basis.

Contractual maturities exclude the following assets, which have no fixed maturity dates: Asian Bond Fund 1, Asian Bond Fund 2, Bank for International Settlements Investment Pool Sovereign China (BISIP CNY), and shares in the Bank for International Settlements. The aggregate carrying value of these assets at 30 June 2015 was $494 million (2014: $326 million). Dividend outflows of $510 million (2014: $20 million) are also excluded from the table.
### Foreign Currency Financial Assets

<table>
<thead>
<tr>
<th></th>
<th>Total 2015 $M</th>
<th>On Demand $M</th>
<th>3 Months or Less $M</th>
<th>3 to 12 Months $M</th>
<th>1 to 2 Years $M</th>
<th>2 to 5 Years $M</th>
<th>More Than 5 Years $M</th>
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</thead>
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<td>Cash Balances</td>
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<tr>
<td>Securities Purchased under Agreements to Resell</td>
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<td>-</td>
<td>4,436</td>
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<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Investments</td>
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<td>9,142</td>
<td>1,285</td>
<td>1,492</td>
<td>1,371</td>
<td>-</td>
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<td>Other Foreign Currency Financial Assets</td>
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<td>435</td>
<td>2</td>
<td>-</td>
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<td>-</td>
<td>-</td>
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<tr>
<td></td>
<td>24,905</td>
<td>7,177</td>
<td>13,580</td>
<td>1,285</td>
<td>1,492</td>
<td>1,371</td>
<td>-</td>
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</table>

### Foreign Currency Financial Liabilities

<table>
<thead>
<tr>
<th></th>
<th>Total 2015 $M</th>
<th>On Demand $M</th>
<th>3 Months or Less $M</th>
<th>3 to 12 Months $M</th>
<th>1 to 2 Years $M</th>
<th>2 to 5 Years $M</th>
<th>More Than 5 Years $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term Foreign Currency Financial Liabilities</td>
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<td>43</td>
<td>58</td>
<td>-</td>
<td>-</td>
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<td>-</td>
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<tr>
<td>Securities Sold under Agreements to Repurchase</td>
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<td>-</td>
<td>704</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<td>Term Liabilities</td>
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<td>1,031</td>
<td>-</td>
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<td></td>
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<td>43</td>
<td>760</td>
<td>102</td>
<td>-</td>
<td>1,031</td>
<td>-</td>
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</table>

### Foreign Currency Derivatives

<table>
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<tr>
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<th>Total 2015 $M</th>
<th>On Demand $M</th>
<th>3 Months or Less $M</th>
<th>3 to 12 Months $M</th>
<th>1 to 2 Years $M</th>
<th>2 to 5 Years $M</th>
<th>More Than 5 Years $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contractual Inflows</td>
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<td>-</td>
<td>2,632</td>
<td>192</td>
<td>377</td>
<td>476</td>
<td>-</td>
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<td>Contractual Outflows</td>
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<td>-</td>
<td>(14,744)</td>
<td>(1,786)</td>
<td>(2,002)</td>
<td>(2,225)</td>
<td>(3,242)</td>
</tr>
<tr>
<td></td>
<td>(20,322)</td>
<td>-</td>
<td>(12,112)</td>
<td>(1,594)</td>
<td>(1,625)</td>
<td>(1,749)</td>
<td>(3,242)</td>
</tr>
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</table>

### Foreign Currency Net Gap in Contractual Maturities

<table>
<thead>
<tr>
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<th>Total 2015 $M</th>
<th>On Demand $M</th>
<th>3 Months or Less $M</th>
<th>3 to 12 Months $M</th>
<th>1 to 2 Years $M</th>
<th>2 to 5 Years $M</th>
<th>More Than 5 Years $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Zealand Government Securities</td>
<td>3,669</td>
<td>-</td>
<td>13</td>
<td>110</td>
<td>123</td>
<td>1,355</td>
<td>2,068</td>
</tr>
<tr>
<td></td>
<td>3,669</td>
<td>-</td>
<td>13</td>
<td>110</td>
<td>123</td>
<td>1,355</td>
<td>2,068</td>
</tr>
</tbody>
</table>

### Local Currency Financial Assets

<table>
<thead>
<tr>
<th></th>
<th>Total 2015 $M</th>
<th>On Demand $M</th>
<th>3 Months or Less $M</th>
<th>3 to 12 Months $M</th>
<th>1 to 2 Years $M</th>
<th>2 to 5 Years $M</th>
<th>More Than 5 Years $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposits</td>
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<td>14,538</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>1,096</td>
<td>-</td>
<td>1,096</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Reserve Bank Bills</td>
<td>309</td>
<td>-</td>
<td>309</td>
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<tr>
<td>Currency in Circulation</td>
<td>5,255</td>
<td>5,255</td>
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<td>-</td>
<td>-</td>
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<tr>
<td>Term Liabilities</td>
<td>932</td>
<td>-</td>
<td>6</td>
<td>15</td>
<td>21</td>
<td>459</td>
<td>431</td>
</tr>
<tr>
<td>Other Local Currency Financial Liabilities</td>
<td>125</td>
<td>81</td>
<td>44</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>22,255</td>
<td>19,874</td>
<td>1,455</td>
<td>15</td>
<td>21</td>
<td>459</td>
<td>431</td>
</tr>
</tbody>
</table>

### Local Currency Derivatives

<table>
<thead>
<tr>
<th></th>
<th>Total 2015 $M</th>
<th>On Demand $M</th>
<th>3 Months or Less $M</th>
<th>3 to 12 Months $M</th>
<th>1 to 2 Years $M</th>
<th>2 to 5 Years $M</th>
<th>More Than 5 Years $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contractual Inflows</td>
<td>20,023</td>
<td>-</td>
<td>11,435</td>
<td>1,769</td>
<td>1,869</td>
<td>1,828</td>
<td>3,122</td>
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<tr>
<td>Contractual Outflows</td>
<td>(506)</td>
<td>-</td>
<td>(4)</td>
<td>(11)</td>
<td>(384)</td>
<td>(107)</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>19,517</td>
<td>-</td>
<td>11,431</td>
<td>1,758</td>
<td>1,485</td>
<td>1,721</td>
<td>3,122</td>
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### Local Currency Net Gap in Contractual Maturities

<table>
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<th></th>
<th>Total 2015 $M</th>
<th>On Demand $M</th>
<th>3 Months or Less $M</th>
<th>3 to 12 Months $M</th>
<th>1 to 2 Years $M</th>
<th>2 to 5 Years $M</th>
<th>More Than 5 Years $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>931 (19,874)</td>
<td>9,989</td>
<td>1,853</td>
<td>1,587</td>
<td>2,617</td>
<td>4,759</td>
<td></td>
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</table>

### Total Net Gap in Contractual Maturities

<table>
<thead>
<tr>
<th></th>
<th>Total 2015 $M</th>
<th>On Demand $M</th>
<th>3 Months or Less $M</th>
<th>3 to 12 Months $M</th>
<th>1 to 2 Years $M</th>
<th>2 to 5 Years $M</th>
<th>More Than 5 Years $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,578 (12,740)</td>
<td>10,697</td>
<td>1,442</td>
<td>1,454</td>
<td>1,208</td>
<td>1,517</td>
<td></td>
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</table>
## Financial Statements

Celebrating 80 years

<table>
<thead>
<tr>
<th></th>
<th>Total 2014 $M</th>
<th>On Demand $M</th>
<th>3 Months or Less $M</th>
<th>3 to 12 Months $M</th>
<th>1 to 2 Years $M</th>
<th>2 to 5 Years $M</th>
<th>More Than 5 Years $M</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Foreign Currency Financial Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Balances</td>
<td>2,637</td>
<td>2,637</td>
<td>-</td>
<td>-</td>
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<td>-</td>
</tr>
<tr>
<td>Securities Purchased under Agreements to Resell</td>
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<td>3,388</td>
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<td>Investments</td>
<td>11,492</td>
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<td>7,487</td>
<td>1,781</td>
<td>1,573</td>
<td>651</td>
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<tr>
<td>Other Foreign Currency Financial Assets</td>
<td>7</td>
<td>-</td>
<td>7</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td></td>
<td>17,524</td>
<td>2,637</td>
<td>10,882</td>
<td>1,781</td>
<td>1,573</td>
<td>651</td>
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<tr>
<td><strong>Foreign Currency Financial Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term Foreign Currency Financial Liabilities</td>
<td>987</td>
<td>987</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>437</td>
<td>-</td>
<td>437</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Term Liabilities</td>
<td>1,548</td>
<td>-</td>
<td>(2)</td>
<td>602</td>
<td>76</td>
<td>87</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>2,972</td>
<td>987</td>
<td>435</td>
<td>602</td>
<td>76</td>
<td>87</td>
<td>-</td>
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<tr>
<td><strong>Foreign Currency Derivatives</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contractual Inflows</td>
<td>3,352</td>
<td>-</td>
<td>2,844</td>
<td>3</td>
<td>146</td>
<td>359</td>
<td>-</td>
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<tr>
<td>Contractual Outflows</td>
<td>(16,322)</td>
<td>-</td>
<td>(9,597)</td>
<td>(782)</td>
<td>(1,340)</td>
<td>(2,600)</td>
<td>(2,003)</td>
</tr>
<tr>
<td></td>
<td>(12,970)</td>
<td>-</td>
<td>(6,753)</td>
<td>(779)</td>
<td>(1,194)</td>
<td>(2,241)</td>
<td>(2,003)</td>
</tr>
<tr>
<td><strong>Foreign Currency Net Gap in Contractual Maturities</strong></td>
<td>1,582</td>
<td>1,650</td>
<td>3,694</td>
<td>400</td>
<td>303</td>
<td>(2,462)</td>
<td>(2,003)</td>
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<tr>
<td><strong>Local Currency Financial Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities Purchased under Agreements to Resell</td>
<td>200</td>
<td>-</td>
<td>200</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>New Zealand Government Securities</td>
<td>3,637</td>
<td>-</td>
<td>11</td>
<td>588</td>
<td>105</td>
<td>1,083</td>
<td>1,850</td>
</tr>
<tr>
<td></td>
<td>3,837</td>
<td>-</td>
<td>211</td>
<td>588</td>
<td>105</td>
<td>1,083</td>
<td>1,850</td>
</tr>
<tr>
<td><strong>Local Currency Financial Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits</td>
<td>11,673</td>
<td>11,673</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<td>-</td>
</tr>
<tr>
<td>Currency in Circulation</td>
<td>4,883</td>
<td>4,883</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Term Liabilities</td>
<td>130</td>
<td>-</td>
<td>1</td>
<td>3</td>
<td>4</td>
<td>13</td>
<td>109</td>
</tr>
<tr>
<td>Other Local Currency Financial Liabilities</td>
<td>85</td>
<td>81</td>
<td>4</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>16,771</td>
<td>16,637</td>
<td>5</td>
<td>3</td>
<td>4</td>
<td>13</td>
<td>109</td>
</tr>
<tr>
<td><strong>Local Currency Derivatives</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contractual Inflows</td>
<td>15,718</td>
<td>-</td>
<td>7,052</td>
<td>1,048</td>
<td>1,776</td>
<td>3,229</td>
<td>2,613</td>
</tr>
<tr>
<td>Contractual Outflows</td>
<td>(638)</td>
<td>-</td>
<td>(105)</td>
<td>(14)</td>
<td>(21)</td>
<td>(498)</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>15,080</td>
<td>-</td>
<td>6,947</td>
<td>1,034</td>
<td>1,755</td>
<td>2,731</td>
<td>2,613</td>
</tr>
<tr>
<td><strong>Local Currency Net Gap in Contractual Maturities</strong></td>
<td>2,146 (16,637)</td>
<td>7,153</td>
<td>1,619</td>
<td>1,856</td>
<td>3,801</td>
<td>4,354</td>
<td></td>
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<tr>
<td>Total Net Gap in Contractual Maturities</td>
<td>3,728 (14,987)</td>
<td>10,847</td>
<td>2,019</td>
<td>2,159</td>
<td>1,339</td>
<td>2,351</td>
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</tbody>
</table>
21. Net Investment Revenue

Net Investment Revenue includes:

<table>
<thead>
<tr>
<th></th>
<th>Total 2015 $M</th>
<th>Foreign Currency $M</th>
<th>Local Currency $M</th>
<th>Total 2014 $M</th>
<th>Foreign Currency $M</th>
<th>Local Currency $M</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Interest Revenue</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Balances</td>
<td>2</td>
<td>2</td>
<td>-</td>
<td>2</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Securities Purchased under Agreements to Resell</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>6</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Investments</td>
<td>35</td>
<td>35</td>
<td>-</td>
<td>34</td>
<td>34</td>
<td>-</td>
</tr>
<tr>
<td>Derivatives</td>
<td>506</td>
<td>(14)</td>
<td>520</td>
<td>338</td>
<td>(17)</td>
<td>355</td>
</tr>
<tr>
<td>New Zealand Government Securities</td>
<td>156</td>
<td>-</td>
<td>156</td>
<td>140</td>
<td>-</td>
<td>140</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
<td>-</td>
<td>2</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Interest Revenue</strong></td>
<td>704</td>
<td>24</td>
<td>680</td>
<td>520</td>
<td>20</td>
<td>500</td>
</tr>
<tr>
<td><strong>Interest Expense</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities Sold under Agreements to Repurchase</td>
<td>14</td>
<td>-</td>
<td>14</td>
<td>6</td>
<td>-</td>
<td>6</td>
</tr>
<tr>
<td>Term Liabilities(^a)</td>
<td>6</td>
<td>(8)</td>
<td>14</td>
<td>(6)</td>
<td>(7)</td>
<td>1</td>
</tr>
<tr>
<td>New Zealand Government Deposits</td>
<td>120</td>
<td>-</td>
<td>120</td>
<td>69</td>
<td>-</td>
<td>69</td>
</tr>
<tr>
<td>Settlement Bank Deposits</td>
<td>277</td>
<td>-</td>
<td>277</td>
<td>193</td>
<td>-</td>
<td>193</td>
</tr>
<tr>
<td>Reserve Bank Bills</td>
<td>16</td>
<td>-</td>
<td>16</td>
<td>4</td>
<td>-</td>
<td>4</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Interest Expense</strong></td>
<td>433</td>
<td>(8)</td>
<td>441</td>
<td>267</td>
<td>(6)</td>
<td>273</td>
</tr>
<tr>
<td><strong>Net Interest Revenue</strong></td>
<td>271</td>
<td>32</td>
<td>239</td>
<td>253</td>
<td>26</td>
<td>227</td>
</tr>
<tr>
<td><strong>Net Gains/(Losses) from Fair Value Changes</strong></td>
<td>30</td>
<td>47</td>
<td>(17)</td>
<td>49</td>
<td>22</td>
<td>27</td>
</tr>
<tr>
<td><strong>Net Gains/(Losses) from Foreign Exchange Rate Changes</strong></td>
<td>379</td>
<td>379</td>
<td>-</td>
<td>(198)</td>
<td>(198)</td>
<td>-</td>
</tr>
<tr>
<td>Dividend Revenue</td>
<td>1</td>
<td>1</td>
<td>-</td>
<td>1</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Net Investment Revenue/(Expense)</strong></td>
<td>681</td>
<td>459</td>
<td>222</td>
<td>105</td>
<td>(149)</td>
<td>254</td>
</tr>
</tbody>
</table>

Interest Revenue from the New Zealand Government (including entities controlled by the New Zealand Government) comprised 22% (2014: 27%) of total interest received.

Components of Net Investment Revenue from Financial Instruments

Net Investment Revenue includes net revenue/(expense) arising from:

<table>
<thead>
<tr>
<th></th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Assets and Financial Liabilities Classified as Fair Value through Surplus/(Deficit) upon Initial Recognition</td>
<td>430</td>
<td>(126)</td>
</tr>
<tr>
<td>Derivatives Deemed to be Classified as Held for Trading</td>
<td>506</td>
<td>338</td>
</tr>
<tr>
<td>Financial Assets and Financial Liabilities Classified as Held for Trading</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Interest and Dividend Revenue from Available-for-sale Financial Assets</td>
<td>135</td>
<td>141</td>
</tr>
<tr>
<td>Realised Gains on Disposal of Available-for-sale Financial Assets</td>
<td>4</td>
<td>11</td>
</tr>
<tr>
<td>Financial Assets Classified as Loans and Receivables</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Financial Liabilities Classified as Financial Liabilities at Amortised Cost</td>
<td>(397)</td>
<td>(263)</td>
</tr>
<tr>
<td><strong>Total Net Investment Revenue</strong></td>
<td>681</td>
<td>105</td>
</tr>
</tbody>
</table>

19. Interest rates on foreign currency Term Liabilities with the New Zealand Government are re-set every quarter, based on market reference rates less a margin agreed at the inception of the loans. During 2015, with market interest rates at very low levels, interest was received by the Bank after the fixed margin was applied.
## 22. Revenue and Expenses by Function

The following table sets out operating revenue and operating expenses for each of the Bank’s main functions.

<table>
<thead>
<tr>
<th>Functions</th>
<th>Operating Revenue 2015 $M</th>
<th>Attribution of Earnings on Investments Funded by Net Assets/Equity 2015 $M</th>
<th>Operating Expenses 2015 $M</th>
<th>Surplus/ (Deficit) 2015 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monetary Policy Formulation</td>
<td>20</td>
<td>23</td>
<td>5</td>
<td>38</td>
</tr>
<tr>
<td>Domestic Market Operations</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prudential Supervision</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Macro-financial Stability</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Currency Operations</td>
<td>214</td>
<td>-</td>
<td>22</td>
<td>192</td>
</tr>
<tr>
<td>Foreign Reserves Management</td>
<td>359</td>
<td>65</td>
<td>6</td>
<td>418</td>
</tr>
<tr>
<td>Settlement Services</td>
<td>13</td>
<td>-</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total for Bank before Earnings on Investments Funded by Net Assets/Equity</strong></td>
<td><strong>606</strong></td>
<td><strong>88</strong></td>
<td><strong>70</strong></td>
<td><strong>624</strong></td>
</tr>
<tr>
<td>Earnings not Allocated to Functions:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earnings on Investments Funded by Net Assets/Equity</td>
<td><strong>88</strong></td>
<td>(88)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total for Bank</strong></td>
<td><strong>694</strong></td>
<td>-</td>
<td><strong>70</strong></td>
<td><strong>624</strong></td>
</tr>
</tbody>
</table>

Operating income for each function includes allocations of notional interest income and expenditure on New Zealand dollar funding provided by (or provided to) the function through internal lending and borrowing. Notional interest rates take into account the estimated term of the funding and the associated external interest earned or incurred. Earnings on net assets/equity are not allocated to individual functions. The total operating expenses for each function include internal transfers between functions.
### 23. Operating Expenses

<table>
<thead>
<tr>
<th>Note</th>
<th>2015 $M</th>
<th>2015 $M</th>
<th>2014 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff Expenses</td>
<td>35</td>
<td>35</td>
<td>32</td>
<td>33</td>
</tr>
<tr>
<td>Net Currency-issued Expenses</td>
<td>13</td>
<td>7</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>Asset Management Expenses</td>
<td>7</td>
<td>7</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Other Operating Expenses</td>
<td>18</td>
<td>20</td>
<td>19</td>
<td>18</td>
</tr>
<tr>
<td><strong>Total Operating Expenses excluding Actuarial Gain on Defined Benefit Superannuation Scheme</strong></td>
<td>73</td>
<td>69</td>
<td>64</td>
<td>63</td>
</tr>
<tr>
<td>Actuarial Gain on Defined Benefit Superannuation Scheme</td>
<td>26</td>
<td>(3)</td>
<td>-</td>
<td>(4)</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>70</td>
<td>69</td>
<td>60</td>
<td>63</td>
</tr>
</tbody>
</table>

The budgets for 2015 and 2014 are the annual budgets prepared by the management of the Bank and are published in the *Statement of Intent*.

#### Net Currency-issued Expenses includes:

- **Write-down of inventories to net realisable value**: 6,663

#### Asset Management Expenses includes:

- **Depreciation of Property, Plant and Equipment**: 3,613
- **Amortisation of Intangible Assets**: 1,356
- **Impairment Charges for Property, Plant and Equipment**: -
- **Impairment Charges for Intangible Assets**: -

#### Other Operating Expenses includes:

- **Restructuring costs**: 960
- **Bad Debt Expenses**: -
- **Rental and Lease Expenses**: 131
- **Auditor’s Remuneration:**
  - **Statutory Audit**: 251
  - **Payment Systems Assurance**: 76
  - **Advisory Services**: 4

The Statutory Audit expense comprises the fee for the audit of the annual financial statements of the Bank.

The Payment Systems Audits expense comprises fees paid for the contractual assurance engagements of the NZClear depository system and the Exchange Settlement Account System.

The Advisory Services expense comprises fees for high-level advice in relation to the potential disposal of NZClear. These advisory services were approved in accordance with the Bank’s External Auditor Independence Policy, which requires that prior to engaging the external auditor for any of these services, the advice of the Chair of the Audit Committee must be sought and approval must be given by the Governor or Deputy Governor.
Funding Agreement

A Funding Agreement is agreed between the Bank and the Government for periods of five years. The Funding Agreement sets out the expectations of the levels of operating expenses net of certain items of income within which the Bank should manage its operations. The table below sets out net operating expenses for 2014, 2015 and cumulatively over the five years as specified in the Funding Agreement for the five years ended 30 June 2015.

<table>
<thead>
<tr>
<th></th>
<th>2015 $M</th>
<th>Cumulative 5 Year Funding Agreement $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Operating Expenses</td>
<td>60.5</td>
<td>255.9</td>
<td>53.3</td>
</tr>
<tr>
<td>Net Operating Expenses Specified in Funding Agreement</td>
<td>56.4</td>
<td>262.3</td>
<td>55.2</td>
</tr>
</tbody>
</table>

Key Management Personnel

Key management personnel comprise the Governor, two Deputy Governors and the Assistant Governor. Because non-executive Board members are not responsible for decision-making by the Bank, and their statutory role is to monitor the performance of the Bank, they are not considered to be key management personnel as defined in Public Benefit Entity International Public Sector Accounting Standard 20 Related Party Disclosures (PBE IPSAS 20). For the year ended 30 June, aggregate compensation paid to key management personnel comprised:

<table>
<thead>
<tr>
<th></th>
<th>2015 $000</th>
<th>2014 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries, Superannuation Contributions and Other Short-term Benefits</td>
<td>2,082</td>
<td>1,995</td>
</tr>
<tr>
<td><strong>Total Key Management Personnel Compensation</strong></td>
<td><strong>2,082</strong></td>
<td><strong>1,995</strong></td>
</tr>
</tbody>
</table>

This table includes all compensation paid to key management personnel.
### 24. Reconciliation of Net Cash Flows from Operating Activities with Surplus for the Year

<table>
<thead>
<tr>
<th>Surplus for the Year</th>
<th>$M</th>
<th>$M</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>624</td>
<td>56</td>
</tr>
<tr>
<td>2014</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Add/(Subtract) Items included in Surplus relating to cash flows from changes in Operating Asset and Operating Liability Balances, Investing and Financing Activities:**

<table>
<thead>
<tr>
<th>Item</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Exchange (Gains)/Losses(^{20})</td>
<td>(379)</td>
<td>198</td>
</tr>
<tr>
<td>Market Value Changes</td>
<td>(30)</td>
<td>(49)</td>
</tr>
</tbody>
</table>

**Add/(Subtract) Non-cash Items:**

<table>
<thead>
<tr>
<th>Item</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation and Amortisation</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Amortisation of Premium/Discount on Financial Instruments</td>
<td>(28)</td>
<td>17</td>
</tr>
<tr>
<td>Net Movement in Repatriated Currency Revenue and Expense</td>
<td>3</td>
<td>(1)</td>
</tr>
</tbody>
</table>

Total: (429) 170

**Movements in Other Working Capital Items**

<table>
<thead>
<tr>
<th>Increase/(Decrease) in Current Assets:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Movement in Accounts Receivable</td>
</tr>
<tr>
<td>Movement in Inventories</td>
</tr>
<tr>
<td>Movement in Interest Receivable</td>
</tr>
</tbody>
</table>

Total: (6) (14)

<table>
<thead>
<tr>
<th>Increase/(Decrease) in Current Liabilities:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Movement in Miscellaneous Liabilities</td>
</tr>
<tr>
<td>Movement in Interest Payable</td>
</tr>
</tbody>
</table>

Total: 1 (4)

**Net Movements in Other Working Capital Items**

<table>
<thead>
<tr>
<th>Item</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Cash Flows from Revenue and Expenses</td>
<td>190</td>
<td>208</td>
</tr>
<tr>
<td>Cash Flows from Changes in Operating Asset and Operating Liability Balances</td>
<td>2,988</td>
<td>(978)</td>
</tr>
<tr>
<td>Net Cash Flows from Operating Activities</td>
<td>3,178</td>
<td>(770)</td>
</tr>
</tbody>
</table>

---

20. Foreign Exchange (Gains)/Losses include the Foreign Exchange Rate Effect on Cash Balances at the Beginning of the Year in the Consolidated Statement of Cash Flows on page 74.
25. Statement of Commitments

a. Provision of Funding to the New Zealand Financial System
   As New Zealand’s central bank, the Bank is able to create New Zealand dollar liquidity through its liquidity management operations, which include the daily open market operations. The Bank’s open market operations include providing New Zealand dollar liquidity facilities to eligible borrowers on terms stipulated by the Bank, including the provision of approved collateral.

b. Reciprocal Funding Arrangements with Foreign Central Banks
   On 24 April 2014, the People’s Bank of China (PBOC) and the Bank renewed a reciprocal currency arrangement (swap line) to support the settlement of trade and investment transactions between New Zealand and Chinese businesses in circumstances where it might otherwise be difficult to settle obligations in Chinese renminbi (RMB). The swap facility provides for the PBOC and the Bank to enter into foreign exchange swap transactions that have a total value at any point of up to RMB 25 billion (NZD 5 billion), with the terms of the foreign exchange swaps to be agreed at the time the swaps are entered into. The swap line is for a term of three years, which may be extended if both parties agree. No drawings have been made under this arrangement in the year ended 30 June 2015 (2014: nil).

   The Bank also has a reciprocal arrangement with the Hong Kong Monetary Authority, which allows either party to enter into repurchase agreements with the other to raise up to USD 250 million, secured by US government securities. The existing arrangement expires on 31 March 2016, but may be extended by mutual agreement. No drawings have been made under this arrangement in the year ended 30 June 2015 (2014: nil).

c. Commitments to the New Zealand Government
   The Bank has agreed to make foreign currency available to the New Zealand Government on arm’s length terms so that the Government may meet any calls made by the International Monetary Fund (IMF) under two standby loan facilities.

   The two standby loan facilities entered into by the Government are:
   — to provide loans to the IMF up to SDR 624.34 million if the IMF makes a call on the New Zealand Government in respect of the Government’s commitment under the IMF’s “New Arrangements to Borrow” facility; and
   — to provide loans to the IMF of up to USD 1 billion if the IMF makes a call on the New Zealand Government in respect of the Government’s commitment under the IMF’s “2012 Borrowing Arrangements” facility.

   During the year ended 30 June 2015, no funds were made available to the Government under these arrangements (2014: nil).

d. Commitments for Capital Expenditure and Purchase of Inventories
   At reporting date, the Bank had commitments for capital expenditure and purchase of inventories totalling $74.32 million (2014: $73.53 million).
26. Superannuation Commitments

The Bank has a superannuation fund for staff. The superannuation fund includes both a defined contribution scheme and a defined benefit scheme. Contributions, as specified in the rules of the respective schemes, are made by the Bank as required. Statutory actuarial valuations of the schemes are undertaken every three years, with the last statutory valuation being undertaken as at 31 March 2015. The statutory valuation as at 31 March 2015 had not been finalised at the date that these Financial Statements were signed. There have been no material changes to the fund’s financial position between 31 March 2015 and 30 June 2015. Contributions to the defined benefit scheme are at a rate, reviewed annually, sufficient to keep the scheme solvent, based on actuarial assessments. The defined benefit scheme was closed to new members in 1991.

Defined Benefit Scheme

The following information is provided in respect of the defined benefit scheme.

<table>
<thead>
<tr>
<th>As at 31 March</th>
<th>2015 $000</th>
<th>2014 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Superannuation Asset/Superannuation Liability Recognised in the Statement of Financial Position</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Present Value of Wholly or Partly Funded Obligations</td>
<td>33,751</td>
<td>36,702</td>
</tr>
<tr>
<td>Fair Value of Plan Assets</td>
<td>35,069</td>
<td>34,004</td>
</tr>
<tr>
<td>Present Value of Net (Assets)/Obligations</td>
<td>(1,318)</td>
<td>2,698</td>
</tr>
<tr>
<td>Actuarial Gains Not Recognised in the Statement of Financial Position</td>
<td>896</td>
<td>-</td>
</tr>
<tr>
<td>Net (Asset)/Liability Recognised in the Statement of Financial Position</td>
<td>(422)</td>
<td>2,698</td>
</tr>
</tbody>
</table>

The net asset (if any) recognised at the end of the year is limited to the estimated present value of reductions in future employer contributions to the defined benefit plan. The value of net assets of the defined benefit superannuation scheme not recognised as an asset of the Bank was $896,000 (2014: nil).

The primary actuarial assumptions used in the above calculations, expressed as weighted averages, are as follows:

<table>
<thead>
<tr>
<th></th>
<th>2015 %</th>
<th>2014 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount Rate at the Beginning of the Year</td>
<td>3.72</td>
<td>3.29</td>
</tr>
<tr>
<td>Expected Rate of Return on Plan Assets at the Beginning of the Year</td>
<td>4.50</td>
<td>4.50</td>
</tr>
<tr>
<td>Future Salary Increases</td>
<td>3.50</td>
<td>3.50</td>
</tr>
<tr>
<td>Other Material Actuarial Assumptions - Pension Increases</td>
<td>2.50</td>
<td>2.50</td>
</tr>
</tbody>
</table>

For the year ended 30 June 2015, in accordance with the accounting policies of the Treasury of the New Zealand Government, the method of valuation of the Bank’s Net Liability Recognised in the Statement of Financial Position has changed from using a post-tax discount rate to a pre-tax discount rate. The impact of this change is a decrease in the valuation of the Net Liability Recognised in the Statement of Financial Position of $4.205 million.

27. Controlled Entity

The Bank has a wholly-owned New Zealand-incorporated controlled entity, New Zealand Central Securities Depository Limited (NZCSD).

NZCSD is a non-trading company, incorporated solely for the purpose of acting as a custodian trustee. It holds assets on behalf of the participants in the NZClear System, as described in Note 31.
28. Related Parties

In the normal course of its operations, the Bank enters into transactions with related parties. Related parties include the Crown, various government departments, and Crown entities. Unless stated otherwise, all transactions with related parties take place at arm’s length.

Transactions entered into include:
— banking services;
— foreign exchange transactions;
— funding from the Treasury as part of the Foreign Reserves Management operations; and
— purchases and disposals of New Zealand government securities.

Material transactions with entities controlled by the Crown and balances with entities controlled by the Crown were:

<table>
<thead>
<tr>
<th></th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receipts of Revenue from Entities Controlled by the New Zealand Government</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Revenue</td>
<td>156</td>
<td>140</td>
</tr>
<tr>
<td>Rental Revenue</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Receipts of a Capital Nature from Entities Controlled by the New Zealand Government</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds on Disposal of New Zealand Government Securities - Available for Sale</td>
<td>513</td>
<td>291</td>
</tr>
<tr>
<td>Proceeds on Maturity of New Zealand Government Securities - Fair Value through Surplus/(Deficit)</td>
<td>2,174</td>
<td>-</td>
</tr>
<tr>
<td>Issuance of Local Currency Term Liability to the New Zealand Government</td>
<td>700</td>
<td>100</td>
</tr>
<tr>
<td>Payments of Expenses to Entities Controlled by the New Zealand Government</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Expense</td>
<td>141</td>
<td>69</td>
</tr>
<tr>
<td>Payments of Capital to Entities Controlled by the New Zealand Government</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Decrease/(Increase) in Deposits</td>
<td>(2,620)</td>
<td>1,111</td>
</tr>
<tr>
<td>Repayment of Foreign Currency Term Liabilities</td>
<td>640</td>
<td>151</td>
</tr>
<tr>
<td>Payment for Purchase of New Zealand Government Securities</td>
<td>601</td>
<td>444</td>
</tr>
</tbody>
</table>

As at 30 June

<table>
<thead>
<tr>
<th></th>
<th>2015 $M</th>
<th>2014 $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balances with Entities Controlled by the New Zealand Government</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets that Comprise Claims on Entities Controlled by the New Zealand Government</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Zealand Government Securities</td>
<td>3,117</td>
<td>2,891</td>
</tr>
<tr>
<td>Liabilities that Comprise Claims by Entities Controlled by the New Zealand Government</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits</td>
<td>6,502</td>
<td>3,882</td>
</tr>
<tr>
<td>Term Liabilities</td>
<td>1,927</td>
<td>1,642</td>
</tr>
</tbody>
</table>

In addition, during the year, as part of the Bank’s domestic market operations, the Bank entered into securities reverse-repurchase agreements with Crown-owned entities on standard commercial terms. Except as noted above, all amounts advanced under these agreements have been repaid. The table above also includes interest revenue received by the Bank from this activity.
29. Contingent Liabilities

a. In terms of a Trust Deed dated 16 May 1980, the Reserve Bank has a contingent liability to maintain the actuarial soundness of the Reserve Bank of New Zealand Staff Superannuation and Provident Fund (the Fund).

The Actuary carried out a review of the financial position of the Fund as at 31 March 2015.

The Fund’s Trust Deed provides for the Defined Benefit division of the Fund to be wound up in the event that the Bank is wound up or by resolution of the Bank’s directors. In the event that the Fund is wound up, the Fund is required to purchase annuities having values equal to the actuarial value of benefits payable by the Fund. The Actuary reported that, based on current estimates of the cost of annuities, in the event the Defined Benefit division of the Fund is wound up, the purchase cost of annuities would exceed the value of Defined Benefit assets of the Fund. On winding up, the Bank is required by the Trust Deed to make good any shortfall. The Bank considers that the likelihood of the Fund being wound up is remote.

b. The Bank has a contingent liability for currency in circulation that has been demonetised but not returned to the Bank, but only to the extent that the Bank has not recognised an actual liability. The total face value of demonetised currency as at 30 June 2015 was $104.4 million (2014: $104.4 million). Of the total face value of demonetised currency, $81.4 million (2014: $81.4 million) is recognised as a liability in the Statement of Financial Position.

c. The Bank has a liability for the face value of collectors’ currency. However, it is most unlikely that significant amounts of collectors’ currency will be returned for redemption at face value. The face value of collectors’ currency issued before 1 July 2004 and that is not recognised as a liability is $9.8 million (2014: $9.8 million).


30. Income Tax

Section CW38 of the Income Tax Act 2007 exempts the Bank from income tax. The Bank incurs and meets liabilities for goods and services tax, fringe benefit tax and other withholding tax.

31. Custodial Activities

The Bank operates the NZClear System, which is a securities clearing and settlement system. It holds assets, on behalf of the participants, in the name of New Zealand Central Securities Depository Limited (NZCSD), which it has appointed as custodian trustee in terms of the Trustee Act 1956.

NZCSD is a wholly-owned New Zealand-incorporated subsidiary of the Bank, which, in terms of a Deed of Appointment between the Bank and NZCSD, is incorporated solely to act as a custodian trustee. The Bank undertakes to accept liability for all costs and debts of NZCSD as a means of reinforcing that role. NZCSD is a non-trading company, but has legal ownership of securities beneficially owned by members of the NZClear System. With the exception of the local currency securities owned by the Bank and held through NZCSD, the Bank has no beneficial interest in the securities that NZCSD holds, or any management obligations apart from safekeeping or acting as paying agent in certain circumstances.

The total value of securities held by NZCSD as at 30 June 2015 was $203.4 billion (2014: $187.7 billion). Under the NZClear System Rules, the Bank’s and NZCSD’s liability to any member of NZClear, arising out of, or in connection with, the system, is limited to direct losses, up to an aggregate of $5 million for any one event.

On 2 June 2015, the Bank announced it intended to seek a buyer for the NZClear business. The Bank requested that potential buyers submit an Expression of Interest by 23 June 2015. The Bank will send an Information Memorandum to a short-list of potential buyers who will be asked to submit indicative bids.

32. Significant Post-Reporting Date Events

There have been no significant post-reporting date events.
# Five-year Historical Financial Information

## Five-year Financial Position

<table>
<thead>
<tr>
<th></th>
<th>NZ IFRS PBE</th>
<th>NZ IFRS PBE</th>
<th>NZ IFRS PBE</th>
<th>PBE Standards Audited</th>
<th>PBE Standards Audited</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>As at 30 June</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Financial</td>
<td>24,647</td>
<td>21,971</td>
<td>21,163</td>
<td>19,286</td>
<td>25,406</td>
</tr>
<tr>
<td>Local Currency Financial</td>
<td>6,360</td>
<td>4,695</td>
<td>2,844</td>
<td>3,093</td>
<td>3,613</td>
</tr>
<tr>
<td>Other Assets</td>
<td>83</td>
<td>78</td>
<td>75</td>
<td>82</td>
<td>88</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>31,090</td>
<td>26,744</td>
<td>24,082</td>
<td>22,461</td>
<td>29,107</td>
</tr>
<tr>
<td><strong>Liabilities and Equity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Financial</td>
<td>4,481</td>
<td>4,129</td>
<td>3,657</td>
<td>3,193</td>
<td>3,671</td>
</tr>
<tr>
<td>Local Currency Financial</td>
<td>23,884</td>
<td>19,841</td>
<td>17,667</td>
<td>16,742</td>
<td>22,123</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>216</td>
<td>172</td>
<td>186</td>
<td>27</td>
<td>514</td>
</tr>
<tr>
<td>Net Assets/Equity</td>
<td>2,509</td>
<td>2,602</td>
<td>2,572</td>
<td>2,499</td>
<td>2,799</td>
</tr>
<tr>
<td><strong>Total Liabilities and Net Assets/Equity</strong></td>
<td>31,090</td>
<td>26,744</td>
<td>24,082</td>
<td>22,461</td>
<td>29,107</td>
</tr>
</tbody>
</table>

## Five-year Financial Performance

<table>
<thead>
<tr>
<th></th>
<th>NZ IFRS PBE</th>
<th>NZ IFRS PBE</th>
<th>NZ IFRS PBE</th>
<th>PBE Standards Audited</th>
<th>PBE Standards Audited</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For the year ended 30 June</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Operating Revenue</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Investment Revenue</td>
<td>191</td>
<td>171</td>
<td>356</td>
<td>105</td>
<td>681</td>
</tr>
<tr>
<td>Other Revenue</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>11</td>
<td>13</td>
</tr>
<tr>
<td><strong>Total Operating Revenue</strong></td>
<td>199</td>
<td>179</td>
<td>365</td>
<td>116</td>
<td>694</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff Expenses</td>
<td>27</td>
<td>28</td>
<td>30</td>
<td>32</td>
<td>35</td>
</tr>
<tr>
<td>Currency-issued Expenses</td>
<td>7</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>13</td>
</tr>
<tr>
<td>Asset Management Expenses</td>
<td>7</td>
<td>7</td>
<td>6</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Other Operating Expenses</td>
<td>14</td>
<td>15</td>
<td>16</td>
<td>19</td>
<td>18</td>
</tr>
<tr>
<td><strong>Total Operating Expenses excluding Actuarial Loss/(Gain) on Defined Benefit Superannuation Scheme</strong></td>
<td>55</td>
<td>55</td>
<td>58</td>
<td>64</td>
<td>73</td>
</tr>
<tr>
<td>Actuarial Loss/(Gain) on Defined Benefit Superannuation Scheme</td>
<td>-</td>
<td>6</td>
<td>(1)</td>
<td>(4)</td>
<td>(3)</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>55</td>
<td>61</td>
<td>57</td>
<td>60</td>
<td>70</td>
</tr>
<tr>
<td><strong>Surplus for the Year</strong></td>
<td>144</td>
<td>118</td>
<td>308</td>
<td>56</td>
<td>624</td>
</tr>
</tbody>
</table>

## Five-year Outcomes under the Funding Agreement

<table>
<thead>
<tr>
<th></th>
<th>NZ IFRS PBE</th>
<th>NZ IFRS PBE</th>
<th>NZ IFRS PBE</th>
<th>PBE Standards Audited</th>
<th>PBE Standards Audited</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For the year ended 30 June</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actual Net Expenses under the Funding Agreement</td>
<td>46.8</td>
<td>47.0</td>
<td>48.3</td>
<td>53.3</td>
<td>60.5</td>
</tr>
<tr>
<td>Net Expenditure Specified under the Funding Agreement</td>
<td>47.8</td>
<td>50.2</td>
<td>52.7</td>
<td>55.2</td>
<td>56.4</td>
</tr>
<tr>
<td><strong>Funding Agreement Under-expenditure/(Over-expenditure)</strong></td>
<td>1.0</td>
<td>3.2</td>
<td>4.4</td>
<td>1.9</td>
<td>(4.1)</td>
</tr>
</tbody>
</table>

## Five-year Dividends Paid to the New Zealand Government

<table>
<thead>
<tr>
<th></th>
<th>NZ IFRS PBE</th>
<th>NZ IFRS PBE</th>
<th>NZ IFRS PBE</th>
<th>PBE Standards Audited</th>
<th>PBE Standards Audited</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For the year ended 30 June</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends Paid to the New Zealand Government</td>
<td>210</td>
<td>160</td>
<td>175</td>
<td>20</td>
<td>510</td>
</tr>
</tbody>
</table>

No adjustments to the financial information prepared under NZ IFRS (PBE) were made on transition to PBE Standards. No adjustments would be necessary to make the historical financial information presented under NZ IFRS (PBE) comply with PBE Standards.
Glossary

(The) Act
The Reserve Bank Act 1989

AML/CFT
Anti-Money Laundering and Countering the Financing of Terrorism

Under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009, the Reserve Bank is one of three supervisors tasked with ensuring firms comply with new obligations designed to help deter and detect money laundering and terrorist financing.

Banking Forum
The Banking Forum is a sub-committee of the Council of Financial Regulators, and was established in 2014 to coordinate the work of government agencies that regulate banks. Forum members are Reserve Bank, The Treasury, Financial Markets Authority and Ministry of Business, Innovation and Employment. Associate members are Ministry of Justice and Inland Revenue Department. The Forum meets quarterly to discuss regulatory initiatives and identify possible areas for cooperation and coordination.

Basel III
Global regulatory standards on bank capital adequacy and liquidity, published by the Basel Committee on Banking Supervision in December 2012.

BIS
Bank for International Settlements
An international financial institution based in Switzerland, owned by about 50 central banks and providing a range of financial services to central banks, international financial institutions and governments.

CFR
Core Funding Ratio
The ratio of a registered bank’s total core funding to its total loans and advances. Core funding is the sum of all funding with more than one year remaining to maturity, plus varying percentages of shorter-term funding.

CLS system
An international system run by CLS Bank International intended to reduce foreign exchange settlement risk (Herstatt risk). The CLS system does this by ensuring payment of both currencies in a foreign exchange transaction to be made simultaneously and irrevocably. The Reserve Bank is a member of the international CLS Oversight Committee.

CPI
Consumers Price Index
The All Groups Consumers Price Index published by Statistics New Zealand. The CPI measures the rate of price change of goods and services purchased by New Zealand households.

CPMI
Committee on Payments and Market Infrastructures
A forum for central banks to monitor and analyse developments in domestic payment, settlement and clearing systems as well as in cross-border and multicurrency settlement schemes. CPMI is a global standard setter. It has 25 central bank members. It has relationships with many other central banks to strengthen payment systems globally, including the Reserve Bank of New Zealand. CPMI’s Secretariat is hosted by the Bank for International Settlements.

EMEAP
Executive Meeting of East Asian and Pacific central banks and monetary authorities
A cooperative organisation of central banks and monetary authorities in the East Asia and Pacific region, comprising Australia, China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, New Zealand, Philippines, Singapore and Thailand.

ESAS
Exchange Settlement Account System
The Reserve Bank’s banking service for certain qualifying institutions that need to make regular high-value payments with each other. All the current account holders are registered banks.

FSR
Financial Stability Report
A six-monthly report assessing the soundness and efficiency of the New Zealand financial system.

ISL
Interchange and Settlement Limited
A non-real time switch system that enables the settlement of transactions between banks from the processing of cheques, direct debit, direct credits, automatic payments and EFTPOS.

LVR
Loan-to-value ratio restrictions
A measure of how much a bank lends against residential property compared to the property’s value. Borrowers with LVRs of more than 80 percent, for example, have borrowed more than 80 percent of the property’s value (less than 20 percent deposit). LVR restrictions limit the amount of high-LVR lending a bank can do.

MPR
Monetary Policy Statement
A quarterly assessment, accompanying an OCR Review, of how the Bank proposes to achieve its monetary policy target (see PTA); how it proposes to formulate and implement monetary policy during the next five years; and how monetary policy has been implemented since the last MPS.

NBDTs
Non-bank deposit takers
Finance companies, building societies and credit unions, which take deposits from the investing public and which are not registered banks under the Act.

NZClear
A real-time settlement system providing the financial markets with clearing and settlement services for high-value debt securities and equities.

OCR
Official Cash Rate
The interest rate set by the Bank to meet the inflation target specified in the PTA.

PTA
Policy Targets Agreement
A contract, negotiated between the Government and the Governor of the Reserve Bank, defining the Bank’s price stability target.

SDR
Special Drawing Right
Unit of account of international reserve assets created by the International Monetary Fund (IMF) to supplement the reserves of IMF member countries. Its value is based on a basket of key international currencies.

SBI
Settlement Before Interchange
The process, operated under Payments New Zealand Ltd’s rules, by which any two banks prepare and process files containing details of their customers’ bilateral transactions. The net value of the transactions is settled by one bank making a payment from its ESAS account to the other bank’s ESAS account. Once settled, the file containing details of the customers’ transactions is delivered to the destination bank, which will then update its customers’ records.

TWI
Trade-Weighted Index
A measure of the value of the New Zealand dollar relative to the currencies of New Zealand’s major trading partners.
Image credits

P4: Māori bargaining with a Pākehā, 1845 or 1846. Drawing by John Williams, d 1905. Alexander Turnbull Library, A-079-017
P8: An early BNZ branch at Māori Point in Otago, 1863. Alexander Turnbull Library, 1/1-000594-F
P14: Detail from a £50 note issued by the Reserve Bank in 1934. RBNZ Collection.
P20: Detail from a poster promoting DC day. RBNZ Collection.
P24: Construction of the Reserve Bank building on The Terrace. RBNZ Collection.
P48: Early RBNZ computer mainframe. RBNZ Collection.
P52: RBNZ’s coat of arms. RBNZ Collection.
In 2014, the Reserve Bank of New Zealand turned 80. To mark this, you'll notice an historic timeline running through this year’s Annual Report. We’ve dug into the archives and chosen nine stories that highlight key moments in our history.

This year our Annual Report is also available online at annualreport.rbnz.govt.nz