

# Reserve Bank of New Zealand

## *Statement of Intent*

*For the period 1 July 2012 to 30 June 2015*

### Contents

|  |    |
|--|----|
| Introduction   | 2  |
| What we do   | 2  |
| Vision and Values                                      | 2  |
| Foreword   | 3  |
| Reserve Bank Business Priorities for 2012-13           | 5  |
| Business Priorities over time                          | 6  |
| Planning and reporting framework                       | 8  |
| <br>   |    |
| <i>Governance and structure</i>                        |    |
| The Minister   | 9  |
| Board of Directors                                     | 9  |
| Management structure                                   | 10 |
| Reserve Bank organisational structure                  | 11 |
| <br>   |    |
| <i>Functions and operations</i>                        |    |
| Monetary policy formulation                            | 12 |
| Domestic market operations/Foreign reserves management | 14 |
| Macro-financial stability                              | 16 |
| Prudential supervision                                 | 18 |
| Currency operations                                    | 20 |
| Settlement services                                    | 21 |
| <br>   |    |
| <i>Organisational health and capabilities</i>          |    |
| Human resources  | 22 |
| Knowledge services                                     | 23 |
| Internal financial services                            | 24 |
| Communications   | 25 |
| Risk assessment and assurance                          | 26 |
| Property management/Security                           | 27 |
| Financial management                                   | 28 |
| Regulatory scanning and planning                       | 33 |
| Monitoring the Bank's performance                      | 33 |
| <br>   |    |
| Appendix: Key document references                      | 35 |

---

## Introduction

Under section 162A of the Reserve Bank of New Zealand Act 1989 (the Act), the Reserve Bank must, in each financial year, provide to the Minister a *Statement of Intent (SOI)* for the Bank for that financial year and at least the next two financial years. Section 162B requires the *SOI* to contain the following information for the full period to which it relates:

- a) key background information about the Bank and its operating environment;
- b) the nature and scope of the Bank's functions and its principal areas of operation;
- c) the specific impacts, outcomes, or objectives that the Bank seeks to achieve or contribute to;
- d) how the Bank intends to perform its functions and conduct its operations to achieve those impacts, outcomes, or objectives;
- da) if a direction has been given under section 68B, how the Bank has had regard to the direction;
- e) the proposed strategies for managing the organisational health and capability of the Bank;
- f) a statement of the projected income and expenditure for the first financial year in the period to which the *SOI* relates;
- g) a statement of the principles in accordance with which the Bank must determine the amount it recommends to the Minister as appropriately payable by the Bank to the Crown as an annual dividend;
- h) the main financial and non-financial measures and standards by which the future performance of the Bank may be judged;
- i) the matters on which the Bank will consult or notify the Minister before making a decision, the matters on which it will report to its Minister, and the frequency of reporting;
- j) any other matters that are reasonably necessary to achieve an understanding of the Bank's intentions and direction.

## What we do

The Reserve Bank of New Zealand is the nation's central bank, established by an Act of Parliament, the Reserve Bank of New Zealand Act. The Bank has three main functions, which are designed to promote a sound and dynamic monetary and financial system and meet the goal of improving New Zealand's economic performance. These functions are: (1) the management of monetary policy to maintain overall price stability; (2) the maintenance of a sound and efficient financial system; and (3) the supply of legal tender to meet the currency needs of the public.

The functions and operations that the Bank performs to achieve these objectives are described in the following pages. In performing them, the Bank ensures that it works effectively with Ministers, the Treasury, other relevant government departments and the private sector on all matters where there is a shared interest.

## Vision

We promote a sound and dynamic monetary and financial system.

## Values

**Integrity** – Being professional and exercising sound judgement

**Innovation** – Actively improving what we do

**Inclusion** – Working together for a more effective Bank

---

## Foreword

The global economic and financial landscape has become more complex, and is still vulnerable and unpredictable. The Reserve Bank is committed in several fields to supporting monetary and financial stability.

The inflation outlook is currently subdued. Domestic activity has been supported by strong farm incomes, dampened somewhat until recently by the elevated exchange rate. Housing sector activity has picked up, albeit from an historically very low base.

New Zealand's economic prospects will be heavily affected by developments in global funding markets; the demand for our exports in the US, Asia and Australia; and the pace of rebuild in Christchurch. The degree to which these developments impact on our key trading partners, and especially on commodity prices, will be of key importance to New Zealand.

The Bank will keep price stability as its primary goal in navigating through this new environment. However, we are aware that familiar landmarks may have shifted; landmarks such as potential growth, 'neutral' real interest rates, the sustainable level of the exchange rate, long-run unemployment levels, and private sector debt ratios. The Bank will explore this shifting territory and ensure that monetary and macro-prudential policies are calibrated accordingly.

We will also seek to understand the next business cycle in the context of earthquakes, fiscal consolidation and international developments.

Financial system stability in New Zealand has improved since late last year. Bank funding channels have been reassured and financial market sentiment has improved. However, the problems in Europe have not gone away and financial markets remain jittery. Banks continue to face higher funding costs and limited access to some sources of funding. While this slows credit and economic growth, there is a better chance it will be sustainable growth, as governments, businesses and households look to strengthen their balance sheets.

The interface between monetary and macro-financial policies has attracted a great deal of attention since the global financial crisis. Global experience in the use of macro-prudential instruments is still limited, and the Bank is continuing to develop a framework for implementing macro-prudential policy tools in New Zealand.

At the micro-prudential level, New Zealand banks all now have significant buffers above minimum core funding requirements and have met the vast majority of their 2012 funding needs. Their problem-loan levels have declined, improving profitability.

However, the global economic crises and Canterbury earthquakes have heightened risks to the balance sheets of financial institutions. The Bank is therefore progressing work to improve banks' capital requirements in line with Basel III; provide a legislative framework for covered bonds; and ensure banks are pre-positioned for Open Bank Resolution, which would provide for the prompt resolution of a failure.

The non-bank sectors are also now more closely regulated against the risks of failure. Non-bank deposit takers must now comply with new prudential standards and the Non-bank Deposit Takers Bill is expected to be passed in 2012, introducing further prudential requirements. All insurers are now required to be licensed and supervised by the Bank.

Should conditions deteriorate severely, the Bank is well placed to provide liquidity facilities for New Zealand banks. We will take the opportunity during 2012 to review access to, and the operation of, the Bank's domestic markets facilities, to ensure they meet policy objectives and the needs of the financial system in the new Basel III environment.

---

The Bank has established a market operations office in Auckland for both business-as-usual and business continuity purposes.

The Bank itself faces a wide range of risks, some general and others unique to central banks. The identification and management of these risks is key to maintaining a sound and dynamic monetary and financial system. We will implement a new operating model for our own risk management and assurance.

The Bank is funded by way of a five-year Funding Agreement with government, extending from 2010–11 to 2014–15. The Bank's budget for 2012–13 shows net operating expenditure of \$50.0 million, \$2.7 million less than the amount specified in the Bank's funding agreement for that year. This budget allows for continuation of the banknote upgrade and additional depreciation and support costs associated with new hardware for the payment systems.

A new Governor is due to be appointed to assume the role for a five-year term from 26 September 2012.



Alan Bollard  
Governor



Grant Spencer  
Deputy Governor

22 May 2012

## Reserve Bank Business Priorities for 2012-13

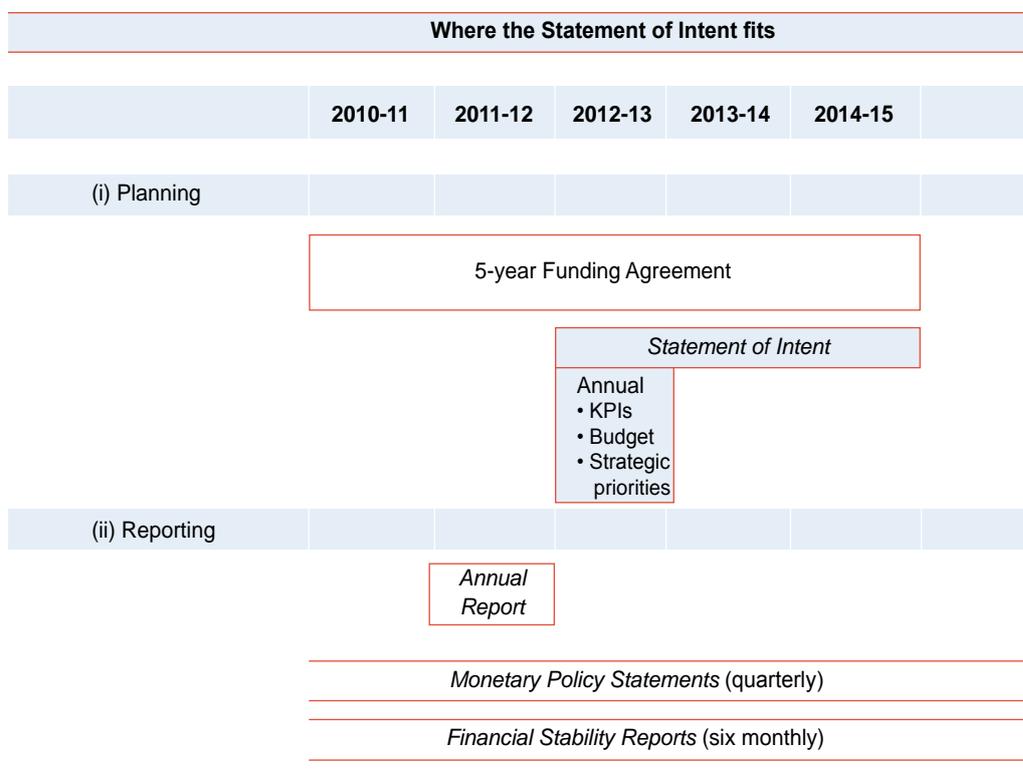
| Priority | Explanation   | Department                                  |
|----------|---|---|
| 1        | Ensure monetary and financial stability policies are appropriate in light of recent structural changes in the economic and financial environment. | Economics                                   |
| 2        | All relevant banks to have pre-positioned IT and operating systems to enable Open Bank Resolution (OBR).  | Prudential Supervision                      |
| 3        | Implementation of the Basel III capital adequacy requirements for banks.  | Prudential Supervision<br>Financial Markets |
| 4        | Determination of the detailed specifications for the new series of banknotes.   | Currency                                    |
| 5        | Implementation of a new operating model for risk management and assurance.  | Risk Assessment & Assurance<br>Bank-wide    |

## Business Priorities over time

| THEME                                  | 2007–08  | 2008–09  | 2009–10  |
|--|--|--|--|
| <b>MONETARY POLICY</b>                 | Macroeconomic policy framework: Assess how to maintain price stability while avoiding unnecessary damage to the external sector. |  | Support effective monetary policy for inflation targeting in a world of volatile financial and economic conditions.  |
| <b>ECONOMIC MODELLING</b>              | Model redevelopment: Upgrade the current policy and forecasting model.   | Economic model construction and implementation: Introduce a state-of-the-art model into the policy and forecasting process.  |  |
| <b>STATISTICS</b>                      |  | Financial Sector Information System (FSIS) development: Design and build an integrated computer application.   | Implement our Financial Sector Information System (FSIS), significantly improving the management of statistics and enabling new prudential data collections. |
| <b>BANK LIQUIDITY</b>                  |  | Prudential liquidity policy: Develop and implement a prudential liquidity policy for registered banks.   | Ensure the banking system has sufficient liquidity to meet its ongoing funding needs.  |
| <b>FOREIGN RESERVES MANAGEMENT</b>     |  |  |  |
| <b>MACRO-PRUDENTIAL POLICY</b>         |  |  |  |
| <b>BANK REGULATION</b>                 | Basel II implementation: Develop and implement policy on bank capital requirements under Basel II.                               |  | Ensure that the registered banks maintain adequate capital, through close monitoring of asset quality and prompt supervisory responses.                      |
| <b>NON-BANK DEPOSIT TAKERS</b>         | Financial sector regulatory arrangements: Help develop and implement new non-bank regulatory arrangements.                       | Extended prudential regulatory regime: Implement new regulatory arrangements for non-bank deposit takers and develop a prudential regime for the insurance sector. | Introduce a prudential regime for the insurance sector, and implement new regulatory arrangements for non-bank deposit takers.                               |
| <b>INSURANCE</b>                       |  |  |  |
| <b>CURRENCY</b>                        |  |  |  |
| <b>HUMAN RESOURCE DEVELOPMENT</b>      | Management: Enable managers to continually develop leadership and management competencies.                                       | Support management in further developing their values-based leadership competencies.   | Engage and develop staff to meet the challenges of a volatile financial and economic environment.  |
| <b>BUSINESS CONTINUITY</b>             |  |  | Improve business continuity and disaster-recovery capability through the establishment of a business support office in Auckland.                             |
| <b>RISK MANAGEMENT &amp; ASSURANCE</b> |  |  |  |

| 2010–11  | 2011–12  | 2012–13  |
|--|--|--|
| Begin unwinding special financial system support and monetary policy stimulus.<br>[See also Macro-prudential Policy.]            | Assess the impact of the Canterbury earthquakes and the implications for the Bank's monetary policy.   | Ensure monetary and financial stability policies are appropriate in light of recent structural changes in the economic and financial environment.  |
|  |  |  |
|  |  |  |
|  |  |  |
|  | Implement a new asset allocation and performance benchmarking framework for foreign reserves.  |  |
| Investigate the potential for macro-prudential policy tools for New Zealand.<br>[See also Monetary Policy.]                      | Develop an implementation framework for macro-prudential policy tools in New Zealand and consider the inter-relationship with monetary policy.             | [See Monetary Policy Priority.]  |
| Identify any appropriate changes to the bank supervision regime, including those based on international regulatory reforms.      | Develop a plan for the implementation of Basel III prudential requirements for banks, suitably adapted for New Zealand conditions.                         | <ul style="list-style-type: none"> <li>All relevant banks to have pre-positioned IT and operating systems to enable Open Bank Resolution (OBR).</li> <li>Implementation of the Basel III capital adequacy requirements for banks.</li> </ul> |
| Advance the implementation of the new non-bank deposit taker regime.   |  |  |
| Develop and implement the new prudential regime for Insurance.   | Ensure that insurers are on the path to obtaining a full licence by September 2013, meeting at least the provisional licensing requirements by March 2012. |  |
|  | Undertake initial planning and consultation for a new (Series 7) issue of banknotes.   | Determination of the detailed specifications for the new series of banknotes.  |
| Engage, develop and support staff to meet the challenges of the Bank's evolving responsibilities.                                | Develop cross-functional capabilities among our staff to support the Bank's wider range of responsibilities.   |  |
| Improve business continuity and disaster recovery capability through the establishment of a business support centre in Auckland. |  |  |
|  |  | Implementation of a new operating model for risk management and assurance.   |

# Planning and reporting framework



Our *SOI*, which traverses three years, is set in the context of our longer-term planning and funding. The Bank is funded through a five-year funding agreement between the Governor and the Minister of Finance, which is ratified by Parliament. The funding agreement specifies how much of the Bank's income can be retained by the Bank to meet its operating costs.

This *SOI* covers three years of the Funding Agreement, 2012/13–2014/15.

---

## Governance and structure

### The Minister

The Reserve Bank Act provides considerable 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 (via the Finance and Expenditure Committee) all have formal roles. Transparency is an important feature of the overall framework.

The Minister of Finance has responsibility for: agreeing with the Governor on the monetary policy target; agreeing on changes to the scope of the supervisory regime; approval of any decision to place a failing bank into statutory management or to give directions to a registered bank; and approval of Orders-in-Council in relation to bank, non-bank deposit taker and insurance regulation. The Minister can also direct the Bank to intervene in the foreign exchange market or to impose, for a limited period, an alternative monetary policy target. In these cases, transparent procedures are set out in the Act.

The Bank keeps the Minister regularly informed on its thinking on significant policy developments, especially where Cabinet decisions and legislation may be required. This includes timely notification of any cases where the Minister of Finance may need to exercise his powers and of the regulatory impact of proposed policy developments. In terms of the 2012-15 SOI, this would also include information on financial stability policy developments, such as the Open Bank Resolution policy and trans-Tasman crisis management, Basel III, covered bonds legislation, macro-prudential policy governance arrangements, and the insurance sector supervision and prudential regime.

### Board of Directors

The Reserve Bank has a Board of Directors whose primary function is to review the performance of the Governor and the Bank. The Board holds regular meetings at which it receives extensive briefings on the Bank's activities, decisions and policies. At these meetings, the Board also provides advice to the Governor on a range of Bank functions.

The Board, through its 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.

When required, the Board makes recommendations to the Minister on the appointment or reappointment of the Governor – as is the case in 2012, following the current Governor's decision not to seek a third term. The Minister can only appoint 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 in any one of various respects. The Board appoints the Deputy Governor on the Governor's recommendation.

The Board typically meets formally nine times a year, with provision for additional meetings. At the time of writing, there are six non-executive directors, following Mr Fletcher's retirement on 9 June. The current Board members are Dr Arthur Grimes (Chair); Ms Sue Sheldon CNZM (Deputy Chair); Mr Keith Taylor (Chair of the Board's Audit Committee); Dr Chris Eichbaum; Professor Neil Quigley; Ms Kerrin Vautier CMG; and Dr Alan Bollard (Governor). Board members are appointed for five-year terms and are eligible for reappointment.

---

## Management structure

Under the Act, the Governor – who is also the Bank’s Chief Executive – is accountable for the Bank’s actions. In monetary policy, and in many other matters, decision-making authority resides with the Governor alone, although in practice he receives widespread advice, and takes monetary policy decisions based on the formal advice of the Official Cash Rate Advisory Group.<sup>1</sup> The Governor is appointed for a five-year term and can also be reappointed for further terms of up to five years. The Act sets specific procedures for the appointment, reappointment and dismissal of the Governor.

The Reserve Bank’s senior management team is made up of the Governor, the Deputy Governor/Deputy Chief Executive, two Assistant Governors and the heads of the Bank’s various departments, as outlined below. The positions of Governor and Deputy Governor are required, and their roles defined, by statute. Currently, the Deputy Governor is also the Head of Financial Stability. The two current Assistant Governors are the Head of Operations and the Head of Economics. The Governor receives advice from a number of internal committees within the Bank.

---

<sup>1</sup> This group includes key economic advisers within the Bank and two external monetary policy advisers.

# Reserve Bank organisational structure

| Governors  | Department/Heads   | Functions   | Internal services   |
|--|--|---|---|
| Assistant Governor/<br>Head of Economics<br><i>John McDermott</i>          | Economics  | Monetary policy<br>formulation  |   |
| Deputy Governor/<br>Head of Financial<br>Stability<br><i>Grant Spencer</i> | Financial markets<br><i>Vacant*</i>                          | Domestic market<br>operations<br>Foreign reserves<br>management<br>Macro-financial<br>stability |   |
|  | Prudential<br>supervision<br><i>Toby Fiennes</i>             | Financial system<br>surveillance and<br>policy  |   |
|  |  |   |   |
| Governor<br><i>Alan Bollard</i>  | Currency, Property<br>and Security<br><i>Alan Boaden</i>     | Currency operations   | Property<br>management<br>Security  |
|  | Financial<br>services<br><i>Mike Wolyncewicz</i>             | Settlement services   | Accounting services<br>Treasury services  |
|  | Knowledge<br>services<br><i>Tanya Harris</i>                 |   | Library services<br>Technology services<br>Project<br>management<br>Web publishing          |
|  | Assistant Governor/<br>Head of Operations<br><i>Don Abel</i> | Human<br>resources<br><i>Lindsay Jenkin</i>   | Human resources<br>strategy and<br>services   |
|  |  | Communications/<br>Board secretary<br><i>Mike Hannah</i>  | Communications<br>strategy and<br>services<br>Reputation<br>management<br>Board secretariat |
|  |  | Risk assessment<br>and assurance<br><i>Steve Gordon</i>   | Risk assessment<br>and assurance<br>Audit services<br>Legal services                        |
|  |  |   |   |

\* To be filled, following departure of Simon Tyler on 15 June 2012.

---

## Functions and operations

### Monetary policy formulation

#### Outcome

Stability in the general level of prices.

#### Objective statement

To achieve and maintain stability in the general level of prices. The current Policy Targets Agreement (PTA)<sup>2</sup> requires that the Bank “keep future CPI inflation outcomes between 1 and 3 percent on average over the medium term”. 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.”

#### Environment

- The New Zealand economy has expanded modestly over the past year, while underlying inflation pressure has remained subdued. Strong primary sector incomes have supported domestic activity, although dampened until recently by the elevated exchange rate. Housing market activity has picked up from an historically very low level.
- These positive factors have been partially offset by ongoing global challenges. Debt concerns in European economies have resulted in significant volatility in financial markets. Addressing these conditions is likely to weigh on European economic activity over the medium term. There has also been a softening in Asia-Pacific economic activity, while US growth has remained moderate.
- Although export commodity prices have declined recently, domestic growth is expected to accelerate over the next few years, due to reconstruction activity in Canterbury, and a projected pick-up in underlying investment. This will absorb existing spare capacity, so increasing inflationary pressures.

#### Scope of operations

- Setting an Official Cash Rate (OCR) eight times a year, or as required, with the aim of keeping inflation within the target band.
- Publishing the Bank’s quarterly *Monetary Policy Statements (MPSs)* at the same time as four of the OCR decisions. The *MPSs* set out the Bank’s views on the economy and inflationary pressures, and the basis for the OCR decision.
- Announcing the other four OCR decisions approximately halfway between each *MPS*.
- Intervening, where appropriate and feasible, in the foreign exchange market to influence the level of the exchange rate, consistent with the objectives of the PTA.

#### Issues

- Familiar landmarks may have shifted, such as potential growth, ‘neutral’ real interest rates, the sustainable level of the exchange rate, long-run unemployment levels, and private sector debt ratios.
- There remains considerable uncertainty and risk around the global economic outlook and its impact on the domestic economy. Risk appetite and global economic prospects will continue to influence New Zealand’s commodity prices and exchange rate, and funding costs for New Zealand’s banks.

---

<sup>2</sup> The PTA specifies the monetary policy target agreed by the Governor and the Minister of Finance.

- 
- Reconstruction activity associated with the Canterbury earthquakes will have pronounced effects on the New Zealand economy for many years. The timing, size and pace of reconstruction activity are highly uncertain.
  - In New Zealand and many other countries, households and governments are looking to increase savings and reduce debt. The consequent reduced demand and inflationary pressure will have implications for monetary policy.
  - Global and domestic crises have challenged policy frameworks, both the objectives and the choice of policy instruments. The Bank will continue to learn from international experience, to ensure that monetary and macro-prudential policies are framed appropriately.

## Initiatives and strategies

- Explore changes in the environment, and undertake research to develop better tools and analytical frameworks, to improve future monetary and macro-prudential policies.
- Understand the next business cycle in the context of earthquakes, fiscal consolidation and international developments.
- Publish high-quality, credible analysis underpinning monetary policy decisions.
- Develop and publish quality statistics on New Zealand's economy and financial sector that inform decision making and policy advice.
- Develop and implement a modelling and forecasting framework that is robust and flexible.

## Key performance indicators

- Reserve Bank forecasts of CPI inflation should be comfortably within the target range in the second half of our forecast horizon.
- Measures of underlying inflation should generally remain within the target range.
- Unnecessary instability in output, interest rates and the exchange rate should be avoided.
- *MPSs* assess the Bank's performance in meeting the objectives of the PTA.

---

# Domestic market operations

## Foreign reserves management

### Outcomes

- 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.

### Objective statement

To support the implementation of monetary policy; to assist in the efficient functioning of the New Zealand 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.

### Environment

- Turbulent global financial markets, particularly in Europe, have made it difficult and expensive for banks to raise term funds over the past year.
- Credit ratings for some sovereigns and many financial institutions have been lowered, and financial prices remain volatile.
- Market conditions have required the Bank to use a wide range of tools to manage domestic liquidity.
- Relatively low interest rates in major markets are reducing the earnings on the Bank's foreign reserves.
- Global regulatory standards are changing with the move to the new Basel III bank liquidity and capital regime.

### Scope of operations

- Providing advice on financial market developments and issues for the formulation of monetary policy.
- Managing official foreign reserves for use in times of financial distress or when foreign exchange intervention is needed for monetary policy purposes.
- Implementing monetary policy through market operations that ensure market interest rates are consistent with the OCR.
- Managing liquidity in the banking system.
- Providing and managing the Crown Settlement Account.
- Acting as lender of last resort to the financial system if necessary, as well as assisting in the resolution of any financial market or banking crisis.

### Issues

- It is likely that international market uncertainty and volatility will persist. However, the Bank is well placed to provide liquidity facilities for New Zealand banks, if conditions deteriorate severely.
- Returns on the Bank's foreign reserves are likely to remain volatile as the New Zealand dollar ebbs and flows with bouts of international risk seeking/risk aversion.
- The international downgrading of counterparties affects the Bank's investment strategies.

---

## Initiatives and strategies

- During 2012, the Bank will review access to and the operation of its domestic markets facilities, to ensure they meet its policy objectives and the needs of the financial system in the new Basel III environment.
- The Bank is implementing a new foreign reserves asset allocation and management approach, including independent performance benchmarks for the foreign reserves portfolio.
- The Bank has established a market operations office in Auckland for both business-as-usual and business continuity purposes.

## Key performance indicators

- 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 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

### Outcomes

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

### Objective statement

To promote a sound and efficient financial system that facilitates the effective performance of the economy; where possible, to reduce or manage risks to the financial system arising from extremes in the credit cycle or developments in liquidity conditions and global funding markets; to analyse and report on the soundness and efficiency of the financial system.

### Environment

- New Zealand's financial system is heavily reliant on the four major Australian banking groups.
- Volatile global credit markets continue to affect the cost and availability of offshore funding and the market for domestic deposits.
- Global growth remains weak, with imbalances evident in key engines of world economic growth.
- Private sector credit growth is subdued as households, businesses and farms continue to reduce their debt. Credit supply is tighter than prior to the financial crisis.
- New Zealand's net financial liabilities remain high by international standards, reflecting a sustained period of current account deficits, financed by borrowing primarily through the banking system.

### Scope of operations

- Monitoring and reporting on the risks facing the financial system, including those arising from the credit cycle, high indebtedness or external sector imbalances.
- Publishing regular *Financial Stability Reports (FSRs)* assessing the soundness and efficiency of the New Zealand financial system.
- Conducting research into the effectiveness of macro-prudential instruments and their associated costs and benefits and developing frameworks for the implementation of these instruments.
- Advising on the deployment or adjustment of macro-prudential instruments and the macro-financial implications of other Reserve Bank policies.

### Issues

- Banks continue to face higher funding costs and limited access to some sources of funding.
- Changes in household and business financial behaviours and the operating environment for the financial sector have implications for the conduct and interaction of monetary and financial policies.
- Experience in the use of macro-prudential instruments is limited.
- The global financial crisis has led to a re-examination of macroeconomic stabilisation policy and how prudential policy may support and interact with monetary policy.
- Credit or insurance availability and regulatory or technical issues could affect the Canterbury rebuild, with broader economic implications.

---

## Initiatives and strategies

- Continue to develop the implementation framework for macro-prudential policy tools in New Zealand, including a system of indicators of financial risks and imbalances to support decision making in this area.
- Monitor bank funding conditions and assess any implications for Reserve Bank policies.
- Assess the implications of changes in household and business sector behaviour and financial sector operating conditions for the conduct and interaction of monetary and financial stability policies.

## Key performance indicators

- The Bank maintains, publishes and monitors a comprehensive set of indicators to assess vulnerability and stress in the financial system.
- Any measures taken to reduce financial system risks, including the use of macro-prudential instruments, are explained in the *FSR*, and their net benefits for financial system stability are assessed.

---

## Prudential supervision

### Outcomes

- A sound and efficient financial system in New Zealand.
- International and local confidence in New Zealand's financial system.

### Objective statement

To register and supervise banks, license and supervise insurers, regulate non-bank deposit takers, oversee payment and settlement systems, and undertake policy development in all these areas. The Bank takes these actions to promote a sound and efficient financial system, and to limit damage to the system that could arise from institutional failure or other financial system distress. Actions will be relevant to New Zealand, with a cost-effective balance between regulatory requirements and self- and market discipline.

### Environment

- The global economy and Canterbury earthquakes have heightened risks to the balance sheets of banks, non-bank deposit takers, and insurers.
- Governments and international regulators are seeking prompt resolution frameworks that prevent failing financial institutions from destabilising the financial system and exposing the taxpayer to risk of loss.
- International regulators are strengthening financial market infrastructure through revised standards.
- Bank supervisors are initiating Basel III capital reforms.
- Non-bank deposit takers must comply with the prudential requirements.
- The Non-bank Deposit Takers Bill is expected to be passed in 2012, introducing licensing and further prudential requirements.
- All insurers are now required to be licensed and are therefore subject to the Bank's regulatory and supervisory regime.
- The Bank is gauging readiness of financial institutions it will supervise prior to full implementation of the anti-money laundering and countering the financing of terrorism (AML/CFT) statutory requirements.

### Scope of operations

- Setting and applying prudential criteria for bank registration.
- Monitoring banks' adherence to prudential standards.
- Strengthening the Bank's capacity to respond in times of financial crisis with the implementation of the Open Bank Resolution (OBR) policy.
- Setting and overseeing criteria for designation of payment and settlement systems.
- Implementing the prudential regulatory framework for non-bank deposit takers and insurers, throughout 2012 and 2013.
- Undertaking further development of the AML/CFT supervisory framework, throughout 2012 and 2013.
- Setting a framework for undertaking enforcement action in the event of identified non-compliance.

---

## Issues

- A heightened awareness of financial risks has promoted the development of prudential standards, as well as policies to strengthen capital and funding requirements, and failure resolution policies.
- The Bank and supervised institutions are adjusting to these policies and standards as they are developed and implemented.
- The global financial crisis has led to a re-examination of macroeconomic stabilisation policy and how prudential policy may support and interact with monetary policy.
- The Bank needs to continue to coordinate with other AML/CFT supervisors to ensure consistency in approach and guidance during implementation of the regime.

## Initiatives and strategies

- Enhance the Bank's monitoring of risks to bank balance sheets and profitability.
- Ensure all relevant banks have pre-positioned IT and operating systems to enable Open Bank Resolution.
- Continue to monitor funding market conditions with a view to raise the Core Funding Ratio to 75 percent on 1 January 2013.
- Continue implementing regulations for the non-bank deposit taker sector, and review the effectiveness of these by the end of the financial year.
- Initiate the licensing process for non-bank deposit takers (assuming enactment of the Non-Bank Deposit Takers Bill in 2012).
- Finalise the Bank's Basel III capital adequacy standards and oversee the implementation of these standards by locally incorporated New Zealand banks.
- Further refine our crisis preparedness, focusing on coordination with other, particularly trans-Tasman, financial regulators.
- Monitor the financial soundness of all insurers as they move from provisional to full licensing by September 2013, and Canterbury earthquake claims develop and are settled.
- Develop and implement the AML/CFT supervisory regime.

## Key performance indicators

- 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 prudential oversight function for banks, non-bank deposit takers, insurance companies and payment systems shows: vigilance in its monitoring activities; it is capable of identifying emerging financial stresses in a timely manner; and it 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 FSRs provide a comprehensive assessment of the health of the New Zealand financial system.

---

# Currency operations

## Outcomes

Legal tender that meets the currency needs of the public.

## Objective statement

To meet the currency needs of the public by ensuring, as the sole issuer of currency, the supply and integrity of banknotes and coins.

## Environment

- Demand for notes and coins continues to grow each year. Cash remains an important means of making payments in New Zealand.
- There is a constant need to ensure the efficiency and security of the Bank's cash operations.
- Given rapid innovation in copying and printing technologies, the Bank is developing a new series of banknotes with upgraded security features to offset counterfeiting risks.
- Quality issues relating to \$5 notes in circulation are being addressed and will be monitored.
- Natural disasters in recent years, together with the planned development of a new banknote series, have made it timely to review the levels and locations of contingency reserves.

## Scope of operations

- Procuring, storing, processing and issuing banknotes and coins to the banking system.
- Maintaining the quality, and verifying the authenticity, of currency in circulation.
- Issuing legal tender collectors' currency through an outsourcing arrangement.

## Issues

- Systems are required to enable more effective management of cash-handling operations.
- The current polymer banknote series is 13 years old and the security features are due for modernisation.

## Initiatives and strategies

- Further develop and fully utilise the new Currency Management System for the efficient and secure management of currency operations.
- Continue planning for the development of a new banknote series.
- Review and implement any changes to the levels and location of contingency currency reserves.

## Key performance indicators

- 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.

---

## Settlement services

### Outcomes

An efficient, reliable and secure payments system that supports the smooth functioning of the economy.

### Objective statement

To ensure that payments system infrastructure services support the functioning of the economy, are provided efficiently and reliably, and meet international standards.

### Environment

International standards for system performance and resilience are being lifted.

### Scope of operations

- Operating the Exchange Settlement Account System (ESAS) and the New Zealand central securities depository system (NZClear). This includes operating the infrastructure required for settlement of interbank payments (Settlement Before Interchange) and that required for foreign exchange transactions through Continuous Linked Settlement Bank.

### Issues

- Enhancing ESAS and NZClear system functionality and capability.
- Improving business continuity planning and disaster recovery capabilities.
- Responding to higher international operating standards.

### Initiatives and strategies

- Continue to enhance NZClear and ESAS as agreed with industry, including replacement of the hardware.
- Working together with industry participants to improve the operation of New Zealand's clearing and settlement infrastructure.

### Key performance indicators

- Availability of ESAS/NZClear during core hours is at least 99.95 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 (CPSS and IOSCO)<sup>3</sup> are complied with, subject to variations for local New Zealand conditions.

---

<sup>3</sup> Committee on Payment and Settlement Systems; and the International Organisation of Securities Commissions.

---

# Organisational health and capabilities

## Human resources

### Objective statement

To provide strategic human resource advice and support services.

### Environment

The Bank's expanded prudential role is now in place. Knowledge and skills, and an alignment of staff's objectives to the Bank's Business Priorities, are critical to the Bank's overall success in fulfilling its full range of functions. Cross-skilling, rotations and staff development are being explored to support Bank-wide staff performance.

### Scope of operations

- Providing strategic human resource advice and support to senior management.
- Organising specific Bank-wide training and development programmes, key-role risk planning, succession planning and secondment arrangements.
- Assisting departments with change management, recruitment, employee development, contract negotiation, employment relations, legislative advice and terminations.
- Facilitating the annual remuneration review and performance management programme.

### Issues

- The opportunity for staff to develop as the Bank adjusts to its new range of functions.
- Identifying areas where skills can be enhanced and developed to meet current and future business requirements.

### Initiatives and strategies

- Develop our staff capability across the Bank's full range of responsibilities.
- Support management to enhance their leadership competencies.
- Continue an annual review of key-role risk within the Bank and mitigation strategies.
- Enrich the Bank's training and development programme.
- Provide a supportive environment for staff to perform at their best.
- Ensure the Bank Values of integrity, innovation and inclusion are central to all staff initiatives.

---

## Knowledge services

### Objective statement

To provide knowledge management and information technology services, direction and support.

### Environment

To perform its functions effectively, the Bank requires technology platforms that provide a high level of uninterrupted service, functionality and security, as well as easy access to a broad range of relevant information sources. Rapid changes in technology, affecting how the Bank works and communicates, require the Bank to continually review and evolve its operations.

### Scope of operations

- Developing and maintaining the Bank's technology infrastructure.
- Providing payments systems network support.
- Providing business analysis tools and applications development.
- Delivering help desk and web support.
- Maintaining library, museum, information and records management services.
- Providing project and programme management, and business continuity planning services.

### Issues

Managing capital expenditure to:

- maintain and upgrade information technology, information management and applications;
- enhance data management and reporting systems; and
- improve business continuity.

### Initiatives and strategies

- Continue the implementation of the Financial Sector Information System project integrating the Bank's statistical data.
- Implement a common platform to support supervisory functions across the insurance, non-bank deposit taker and banking sectors, and for the Reserve Bank's role across these sectors in anti-money laundering and countering the financing of terrorism.
- Enhance the Bank's business continuity infrastructure for critical functions.
- Provide an innovative and flexible IT environment.
- Ensure the Bank's IT security systems are maintained at industry best practice and are capable to respond to an increasing threat from external sources.
- Enhance the electronic delivery of information to the Bank through collaborative tools.
- Refresh the Bank's website to better meet the needs of users.
- Improve management and archival processes around document, email, network drive files and physical records in accordance with the Public Records Act.
- Develop and update museum services as part of a wider public education programme.

---

## Internal financial services

### Objective statement

To provide financial control for the Bank's activities. Services provided include financial reporting and management reporting; compliance with corporate governance and accountability responsibilities; settlement operations; and treasury accounting and compliance reporting.

### Environment

The Bank's financial systems and processes must be of a high standard to enable management of a very large and complex balance sheet.

### Scope of operations

- Settling transactions, treasury accounting and compliance reporting in support of the Bank's domestic market operations, foreign reserves functions and currency operations.
- Preparing financial statements and monthly management and Board reports.
- Facilitating the Bank's planning and annual budgeting processes.
- Delivering financial support services and balance sheet management advice.
- Liaising with external auditors.

### Issues

- Ensuring systems are developed to meet developments in the Bank's financial operations and environment.
- Maximising efficiency through process and systems improvements.

### Initiatives and strategies

- Continue to enhance workflows, reports and processes for financial operations, currency operations and securities transactions, including reporting on foreign reserves management performance against agreed benchmarks.

---

## Communications

### Objective statement

To provide strategic advice and management for the Bank's external and internal communications and for the maintenance of its reputation and credibility.

### Environment

- The Bank's messages and actions across its policy functions require broad public understanding, to be most effective.
- The Bank will need to communicate clearly a diverse range of policy developments.
- The Bank's wider responsibilities are attracting more public scrutiny.
- The economic and financial environment places a premium on financial literacy.
- Social media provide opportunities as well as risks that require management.

### Scope of operations

- Supporting the Bank's functions with communication and relationship strategies.
- Editing and publishing Bank statements and documents.
- Sponsoring financial literacy and education initiatives.
- Coordinating responses to Official Information Act requests, ministerial correspondence, parliamentary questions and public inquiries.
- Providing Board secretariat and administrative services.

### Issues

- Ensuring the Bank's messages are informed, easily understood, timely and delivered to target audiences through the most appropriate channels.
- Growing specialist and social media interest in the Bank's activities.
- Maintaining the Bank's preparedness by monitoring developments, news and commentaries, and liaising with other agencies.
- Improving New Zealanders' financial literacy.

### Initiatives and strategies

- Ensure in a rapidly-changing communications environment that the Bank's communications services are delivered to a high standard and efficiently.
- Provide timely information and strategies, and maintain communication relationships, to ensure the Bank's key messages are delivered and understood, and address credibility risks and opportunities.
- Enhance financial literacy through support for relevant programmes.

---

## Risk assessment and assurance

### Objective statement

To assist in the identification of risk, and the maintenance of effective and efficient risk management; to provide assurance over operations, procedures and internal control systems; and to provide legal advice.

### Environment

The Bank faces a wide range of risks, some general and others unique to central banks. The identification, management and monitoring of these risks is key to maintaining a sound and dynamic monetary financial system.

In addition, there have been significant changes in the global environment within which the Bank operates and within the Bank in terms of projects under way and recently acquired functions. These all introduce new risks that need to be effectively managed.

### Scope of operations

- Assisting management to identify and analyse sources of risk.
- Assisting management to design risk management systems and processes.
- Monitoring risk management implementation and providing risk management advice to Governors and the Board.
- Providing ongoing internal audit review and evaluation of the Bank's operations and control systems.
- Providing legal advice and services.

### Issues

- Ensuring risks are being identified and managed in a proactive, coordinated, prioritised and cost-effective manner.
- Embedding enterprise risk management across all areas of the Bank.
- Enhancing workflow and audit processes to maximise resource effectiveness.
- Identifying and managing the increased exposure to implementation risks from the expanded prudential regulatory regimes.

### Initiatives and strategies

- Implement a new operating model for risk management and assurance.
- Further mature the Bank's approach to risk management, utilising the enterprise-wide risk map and embedding enterprise risk management.
- Refresh the internal audit programme to provide comprehensive risk-focused assurance on the Bank's control environment.
- Ensure legal advice and services are appropriately matched to the needs of the Bank.

---

## Property Security

### Objective statement

To provide appropriate accommodation for the Bank to ensure that all functions, including cash operations, can be conducted unimpeded in a safe and secure environment.

### Environment

- The infrastructure of the properties used by the Bank must be maintained at a level that promotes efficiency, soundness, effectiveness and security.
- For security reasons, the Bank operates and maintains modern, reliable security access and control systems.
- For efficiency and environmental reasons, the Bank needs to maintain and extend energy-saving and recycling programmes.

### Scope of operations

- Maintaining the Bank-owned building at 2 The Terrace, and managing leases on eight of the 14 floors.
- Maintaining a secure working environment and the safe custody of currency reserves.
- Operating and maintaining a satellite site in Auckland.

### Issues

- Maintaining a regular review of security systems in view of technology developments.

### Initiatives and strategies

- Complete the renovation of the lifts and domestic boilers at 2 The Terrace.
- Implement cost-effective measures to further enhance energy efficiency at 2 The Terrace.
- Complete the replacement of ceiling tiles and services at 2 The Terrace.
- Review the Bank's security systems.

---

## Financial management

### Financial structure

#### *Balance sheet overview and funding of the Bank's operations*

The Reserve Bank is both a statutory agency and a financial institution. It receives no direct funding through the central government budgetary 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 impacting on its balance sheet are described in the *Annual Report 2010–2011* (pages 74–75). Foreign reserves management, New Zealand dollar liquidity management and currency operations materially impact the size and structure of the Bank's balance sheet.

Under the Reserve Bank Act, the Minister and the Governor are required to enter into a funding agreement to specify the amount of the Bank's income that may be used to meet operating expenses in each financial year. The funding agreement comes into force only after it is ratified by Parliament. The Act provides for each funding agreement to apply for a period of five consecutive financial years. The Bank's funding arrangements are designed to strike an appropriate balance between providing a high degree of operational independence, and providing strong incentives for effective management of operating expenditure, while ensuring accountability for use of resources. Capital expenditure is funded by the Bank, with depreciation of fixed assets included in annual operating expenses. The funding agreement requires that the Bank include in its annual report a comparison of expenditure against the specified amount of net operating expenses for each year, together with a comparison of cumulative expenditure against the cumulative specified amount of net operating expenses for the term of the agreement.

### Annual distributions paid by the Bank

Under the Reserve Bank of New Zealand Amendment Act, the Bank's annual dividend is determined using the principles set out in the Statement of Intent. Each August, the Bank applies these dividend principles and makes a recommendation to the Minister of Finance of the amount to be paid. The Minister then decides how much should be paid having regard for the recommendation of the Bank, the views of the Board of the Bank and any other relevant matters.

#### **Statement of dividend principles**

The Bank should maintain sufficient equity for the financial risks of 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 current Funding Agreement, signed by the Governor and the Minister of Finance in 2010, covers the five-year period ending 30 June 2015. The agreement provides for \$47.8 million in the first year (2010–11) increasing to \$56.4 million in year five (2014–15).

The agreement focuses on extending capacity in new regulatory and supervision areas and upgrading information technology, business continuity and building infrastructure, in particular, establishing the Auckland office.

The new agreement was developed in an environment where central government expected its agencies to have strong expenditure control and to minimise growth in operating costs. The Bank has carefully prioritised its expenditure proposals and minimised increases in costs, without undermining the ability to deliver on the Bank's existing and new responsibilities over the term of the new Funding Agreement.

The introduction of a new series of bank notes is potentially a large project for the Funding Agreement, with a considerable cost attached to it. However, at this stage, much of the cost will fall into the subsequent five-year funding agreement period (i.e., from 1 July 2015 onwards).

## Drivers of the Bank's financial performance and financial position

The principal drivers of the Bank's financial performance and financial position are:

- *The value of currency in circulation.*

Currency in circulation is a non-interest-bearing liability. Trading banks are charged for currency issued to them and the Bank earns interest, known as seigniorage, on investment of these amounts paid by trading banks.

At 30 April 2012, currency in circulation was \$4.42 billion.

- *The size of the Bank's open foreign exchange position and related changes in foreign exchange rates.*

The Bank has a policy of holding some of its foreign currency reserves on an unhedged basis. This allows it to deliver a more effective response in the event of a crisis affecting the country's foreign exchange market and to smooth more extreme exchange rate movements.

The Bank has a benchmark holding of SDR 1.0 billion unhedged foreign currency reserves with the ability to hold more or less than the benchmark over the exchange rate cycle. The unhedged foreign reserves position is held in six currencies – US dollars, euro, Japanese yen, British pounds, Australian dollars and Canadian dollars.

Holding unhedged foreign reserves means that the Bank's net equity will fluctuate with changes in the exchange rate: foreign exchanges losses may be incurred when the New Zealand dollar is strong, and gains may be recorded when the New Zealand dollar is weak. The unhedged position increases volatility in the Bank's financial performance and financial position.

At 30 April 2012, the Bank held an open foreign exchange position of SDR 1.15 billion (NZD 2.17 billion), down from SDR 1.15 billion (NZD 2.23 billion) at 30 June 2011.

- 
- *Interest rates earned on the Bank's investment in government securities and other securities.*

Under the New Zealand equivalents to International Financial Reporting Standards (NZ IFRS), the Bank's holdings of New Zealand government securities are valued at market value, with unrealised gains and losses on those holdings booked to Equity. Interest income is recognised in the Bank's Income Statement.

- *The size and performance of the Bank's foreign reserve management and market operations functions.*

The Bank holds foreign reserves that can be liquidated at short notice to support its functions, including monetary policy objectives and the maintenance of orderly markets. At 30 April 2012, the Bank had foreign reserve assets equivalent in value to NZD 21.56 billion, which provided the Bank with foreign currency intervention capacity.

- *New Zealand government deposits held at the Bank.*

The Bank provides a settlement account facility to the New Zealand government. The size of New Zealand government deposits held in the Crown Settlement Account (CSA) is a big driver of the Bank's balance sheet. Larger CSA deposits are swapped into foreign currency and invested by the Bank offshore. While the CSA balance is a big driver of the Bank's balance sheet, net earnings are not materially impacted by this activity.

At 30 April 2012, the Bank held New Zealand government deposits of NZD 6.57 billion.

- *Operating expenditure incurred by the Bank.*

As noted in the previous section, the five year Funding Agreement specifies the amount of the Bank's income that may be used to meet operating expenses in each financial year.

- *The level of equity available for investment and the dividend paid by the Bank.*

The Bank requires equity to absorb any losses that may arise from carrying out its functions and equity is reviewed annually to assist in determining the Bank's annual dividend.

The dividend for the 2010–11 year was \$210 million.

## Principal financial risk management considerations

As a financial institution with more than \$25 billion in assets, the Bank faces a wide range of financial risks. These arise mainly because of the Bank's operations in the domestic financial system and because of the Bank's holdings of foreign exchange reserves. The risks include:

- credit risks and market risks associated with day-to-day dealings with financial institutions, in the process of managing liquidity in the financial system;
- risks associated with the Bank's holdings of foreign currency reserves, including credit risk, liquidity risk, interest rate risk and exchange rate risk; and
- operational risks in the transactions and processing areas of the Bank.

More detailed information on the Bank's approach to managing these risks is outlined on pages 87–99 in the *Annual Report 2010–2011*.

---

## Financial projections

The following table outlines the Bank's budgeted income and expenditure for 2012–13. The budgeted income and expenditure have been prepared using the accounting policies used in the preparation of the Bank's financial statements for the year ended 30 June 2011.

The key assumptions underlying the budget for the year ended 30 June 2013 are that:

- the Bank's current functions will continue;
- there are no material changes to the structure of the Bank's balance sheet between 29 February 2012 and 30 June 2013;
- projected interest and exchange rates will be those advised by the Treasury for the purposes of preparing the government's budget for 2012–13;
- there will be no change in the credit worthiness of the Bank's counterparties; and
- there will be no material changes to the Bank's liquidity management operations.

The following table sets out projected income and expenditure for the Bank for the year ending 30 June 2013.<sup>4</sup>

## Projected financial performance 2012 – 2013

|                                    | <b>Budget</b>  |
|------------------------------------|----------------|
| <i>For the year ending 30 June</i> | <b>2012-13</b> |
|                                    | <b>\$m</b>     |
| <b>Operating income:</b>           |                |
| Net investment income              | 288.7          |
| Other income                       | 7.9            |
| <b>Total operating income</b>      | <b>296.6</b>   |
| <b>Operating expenses:</b>         |                |
| Personnel                          | 30.4           |
| Asset management                   | 6.9            |
| Net currency issued                | 5.4            |
| Other                              | 15.2           |
| <b>Total operating expenses</b>    | <b>57.9</b>    |
| <b>Operating surplus</b>           | <b>238.7</b>   |

The budget is based on the key assumptions outlined above. It is important to note that the Bank's assets and liabilities are sensitive to changes in interest rates and exchange rates, and that actual financial results could differ materially from those budgeted.

---

<sup>4</sup> The Bank's accounting policies are disclosed in its *Annual Report 2010–2011* on pages 67–73.

At 29 February 2012, a 10 percent appreciation in the value of the New Zealand dollar would reduce the Bank's comprehensive income<sup>5</sup> by \$212 million, and conversely a 10 percent depreciation in the value of the New Zealand dollar would add \$235 million to comprehensive income. A 1 percent across-the-board increase in interest rates would reduce comprehensive income by about \$138 million, and a 1 percent across-the-board reduction in interest rates would increase comprehensive income by about \$146 million.

## Net expenditure by function

| <i>For the year ending 30 June</i>                    | <b>Net Expenditure<sup>6</sup></b> |
|---|------------------------------------|
|   | <b>Budget</b>                      |
|   | <b>2012-13</b>                     |
|   | <b>\$000s</b>                      |
| <b>Functions:</b>                                     |                                    |
| Monetary Policy Formulation                           | 11,613                             |
| Domestic Market Operations                            | 5,329                              |
| Macro-Financial Stability                             | 4,010                              |
| Prudential Supervision                                | 12,092                             |
| Foreign Reserves Management                           | 6,505                              |
| Settlement Services                                   | (671)                              |
| Currency Operations                                   | 11,136                             |
| <br>  |                                    |
| Net expenditure                                       | 50,014                             |
| Net expenditure provided for in the Funding Agreement | 52,700                             |
| Funding Agreement Under-Expenditure                   | 2,686                              |

<sup>5</sup> Comprehensive income includes earnings booked to the Bank's Income Statement and also changes booked directly to Equity. The majority of sensitivity to changes in foreign exchange rates is booked to the Income Statement, whereas the majority of interest rate sensitivity arises on the Bank's portfolio of New Zealand government securities and is booked directly to Equity. Refer to page 92 of the Bank's Annual Report 2010-2011 for a detailed sensitivity analysis as at 30 June 2011.

<sup>6</sup> Net Expenditure comprises operating expenses less income earned from certain Bank operations as specified in the Funding Agreement.

---

## Regulatory scanning and planning

The Bank carries out a scan of its existing stock of regulation each year to identify any items that should be repealed or updated. No issues have been identified that need attention in the current period.

In addition and in line with other public agencies, the Bank prepares an annual regulatory plan to help it prioritise its regulatory work. The plan is prepared in accordance with the overarching framework set out in the document 'Government Statement on Regulation: Better Regulation, Less Regulation' and other relevant Treasury guidance and submitted to the Treasury, the Minister for Regulatory Reform and the Minister of Finance. It sets out the regulatory instruments that the Bank intends to introduce, amend or repeal in the coming year.

With regards to banks, this year's regulatory plan focuses on implementing Basel III capital requirements as promulgated by the Basel Committee on Banking Supervision, Open Bank Resolution, a legislative framework for covered bonds and liquidity requirements for branches of overseas-registered banks. For non-bank deposit takers and insurers, the plan includes the second Non-Bank Deposit Takers Bill and the Insurance (Prudential Supervision) Amendment Bill

## Monitoring the Bank's performance

The Bank has been, and will continue to strive to be, a world leader in the openness and transparency of its processes and policies. Transparency assists the Bank to achieve its policy and operational goals effectively and efficiently, while allowing others to scrutinise the Bank's performance and to provide feedback, so helping the Bank improve the way it works.

The principal mechanisms for externally communicating the Bank's views each year include:

- eight OCR decisions, four of them in the quarterly *MPSs*;
- two *FSRs*;
- the Bank's *Statement of Intent*, *Annual Report* and financial statements;
- four *Bulletins*;
- the Bank's website ([www.rbnz.govt.nz](http://www.rbnz.govt.nz));
- addresses given by the Governor and other senior Bank staff; and
- occasional publications and issue-specific books and brochures.

The Bank formally assesses its performance or is externally assessed in the following ways.

The Board reviews the Bank's performance and the discharge of its statutory obligations. In addition to providing the Governor with ongoing advice and feedback, the Board is also required to report annually on the Bank's performance. The Board's report is published with the Bank's Annual Report.<sup>7</sup>

The Audit Committee of the Board reviews the Bank's financial statements and provides advice to the Governor before the Governor and Deputy Governor sign the related management statements. It also monitors the Bank's external and internal audit functions.

The Bank publishes its *SOI* at the commencement of each financial year. The *SOI* sets out the Bank's principal functions, objectives, strategies and key performance indicators for the next three years; comments on strategies for managing organisational health and capability; sets out initiatives and projected income

---

<sup>7</sup> For example, see pages 6–10 in the *Annual Report 2010–2011*.

---

and expenditure for the first year of that three-year period; includes a statement of principles determining the annual dividend payable to the Minister; and outlines the Bank's Regulatory Plan for the year.

The *Annual Report* includes both the financial statements and an assessment of the performance of the Bank's various functions, in terms of both the day-to-day responsibilities and progress against priorities and key performance indicators published in the *SOI*. It is tabled in Parliament.

Parliament's Finance and Expenditure Committee reviews the quarterly *MPS*, the six-monthly *FSR* and the Bank's *Annual Report*, and can ask the Bank to appear before it on request.

Under section 167 of the Act, the Minister may, from time to time, initiate an assessment of the Bank's performance and how it has exercised its powers under the Act.

The Bank is subject to Cabinet's Regulatory Impact Analysis requirements, ensuring that proposals involving regulatory options are subject to careful and robust regulatory analysis, and that the Bank demonstrates that a regulatory solution is required in the public interest. The Bank undertakes extensive consultation on proposed legislation and regulation.

The Bank's financial statements are audited by external auditors, who are the agent of the Controller and Auditor-General. The critical payment systems operated by the Bank are subject to review by external auditors quarterly in respect of the NZClear depository system, and annually in respect of ESAS. An annual report is presented to NZClear members.

From time to time, the Bank engages experts to assess the Bank's processes, research and technical performance. In the past, assessments have been provided in the fields of monetary policy development; financial system policy; forecasting processes; bank-failure management; computer systems and network security; management; and leadership assessment and development. The Bank funds a Professorial Fellowship in Monetary and Financial Economics at Victoria University of Wellington. Also, two external advisers assist in the provision of advice to the Governor regarding his interest rate decisions. Prior to the release of the *MPS*, these two advisers participate in the deliberations leading to the formulation of the *MPS*.

The Bank's performance is also subject to international scrutiny. Every 12 to 18 months, the International Monetary Fund (IMF) undertakes an 'Article IV' assessment of the New Zealand economy, which includes sections on monetary policy and financial system stability. The resultant report is made public. Likewise, every two years, the Organisation for Economic Co-operation and Development undertakes a similar assessment, which is also published. The IMF is expected to undertake a Financial Sector Assessment Programme investigation every six or seven years; the last was in 2003.

## Appendix A

### Key document references

| Title  | Purpose  | Location  |
|--|--|---|
| Policy Targets Agreement   | Agreement between the Governor and the Minister of Finance required under s9 of the Act, specifying the monetary policy target in detail                                       | <a href="http://www.rbnz.govt.nz/monpol/pta/index.html">http://www.rbnz.govt.nz/monpol/pta/index.html</a>   |
| <i>Monetary Policy Statement*</i>  | Quarterly publication of the Bank's view of how it proposes to meet its monetary policy targets, including extensive economic projections, required under s15 of the Act       | <a href="http://www.rbnz.govt.nz/monpol/statements/">http://www.rbnz.govt.nz/monpol/statements/</a>   |
| <i>Financial Stability Report*</i>   | Six-monthly publication of the Bank's view on the soundness and efficiency of the New Zealand financial system, required under s165A of the Act                                | <a href="http://www.rbnz.govt.nz/finstab/fsreport/index.html">http://www.rbnz.govt.nz/finstab/fsreport/index.html</a>   |
| <i>Annual Report*</i>  | Key accountability document, plus presentation of financial statements, required under ss163-165 of the Act  | <a href="http://www.rbnz.govt.nz/about/whatwedo/0094054.html">http://www.rbnz.govt.nz/about/whatwedo/0094054.html</a>   |
| Board of Directors' Annual Report  | Board of Directors' report on the Bank's performance required under s53A of the Act  | Reproduced in the <a href="#">Bank's Annual Report</a><br><a href="http://www.rbnz.govt.nz/about/whatwedo/0094054.html">http://www.rbnz.govt.nz/about/whatwedo/0094054.html</a> |
| Briefing on the Reserve Bank of New Zealand*   | Description of the role and functions of the Reserve Bank, prepared for an incoming government   | <a href="http://www.rbnz.govt.nz/about/whatwedo/0122541.html">http://www.rbnz.govt.nz/about/whatwedo/0122541.html</a>   |
| Reserve Bank of New Zealand Act 1989   | Reserve Bank's statutory authority   | <a href="http://www.rbnz.govt.nz/about/ourlegislation/">www.rbnz.govt.nz/about/ourlegislation/</a>  |
| Funding Agreement  | Basis of Bank's funding, setting how much of the Bank's revenues can be retained by the Bank, in accordance with ss159-161 of the Act  | <a href="http://www.rbnz.govt.nz/about/whatwedo/1845734.html">http://www.rbnz.govt.nz/about/whatwedo/1845734.html</a>   |
| <i>Statement of Intent*</i>  | A statement of what the Bank intends to achieve over the next three years, with forecast income and expenditure for one financial year, in accordance with ss162A-E of the Act | <a href="http://www.rbnz.govt.nz/about/whatwedo/1764296.html">http://www.rbnz.govt.nz/about/whatwedo/1764296.html</a>   |
| Letter to Minister of Finance on foreign exchange market intervention policy         | Description of how the Bank may intervene in the foreign exchange market under section 16 of the Act to influence the exchange rate  | <a href="http://www.rbnz.govt.nz/finmarkets/foreignreserves/intervention/0148214.html">http://www.rbnz.govt.nz/finmarkets/foreignreserves/intervention/0148214.html</a>         |
| Memorandum from the Minister of Finance to the Bank on foreign exchange intervention | Provision of delegated authority for the Bank to intervene in the foreign exchange market under section 17 of the Act, should that market become dysfunctional                 | <a href="http://www.rbnz.govt.nz/finmarkets/foreignreserves/intervention/0148293.html">http://www.rbnz.govt.nz/finmarkets/foreignreserves/intervention/0148293.html</a>         |
| Reserve Bank <i>Bulletin*</i>  | Quarterly publication of articles relevant to central banking in New Zealand   | <a href="http://www.rbnz.govt.nz/research/bulletin/">http://www.rbnz.govt.nz/research/bulletin/</a>   |
| Statement of Principles  | Explanation of the Reserve Bank's approach to bank registration and supervision under s75 of the Act   | <a href="http://www.rbnz.govt.nz/finstab/banking/regulation/0094291.html">http://www.rbnz.govt.nz/finstab/banking/regulation/0094291.html</a>                                   |
| Annual Report for the NZClear NZ System  | Accountability document on the performance of the NZClear NZ system  | <a href="http://www.rbnz.govt.nz/payment/nzclear/index.html">http://www.rbnz.govt.nz/payment/nzclear/index.html</a>   |
| Vision Statement and Values  | Expression of the Bank's vision and culture  | Inside front cover of <i>Annual Report</i><br><a href="http://www.rbnz.govt.nz/about/whatwedo/0094054.html">http://www.rbnz.govt.nz/about/whatwedo/0094054.html</a>             |

\* Also available in print from: the Knowledge Centre, Reserve Bank of New Zealand, PO Box 2498, Wellington, New Zealand 6140. [knowledge@rbnz.govt.nz](mailto:knowledge@rbnz.govt.nz), [www.rbnz.govt.nz](http://www.rbnz.govt.nz)