

Liquidity Policy

Prudential Supervision Department
Document BS13

Issued: March 2011

A. INTRODUCTION

Liquidity policy and the Reserve Bank's objectives

1. This Liquidity Policy sets out the Reserve Bank of New Zealand's (Reserve Bank's) policy on the management of liquidity risk by registered banks.
2. The Reserve Bank has powers under Part 5 of the Reserve Bank of New Zealand Act 1989 (the Act) to register banks and undertake prudential supervision of registered banks.
3. Section 68 of the Act requires the powers under Part 5 of the Act to be exercised for the purposes of:
 - (a) promoting the maintenance of a sound and efficient financial system; or
 - (b) avoiding significant damage to the financial system that could result from the failure of a registered bank.
4. Section 68A of the Act requires that the Reserve Bank, when exercising its part 5 powers, must support Australian authorities in pursuit of Australian financial stability and where reasonably practicable avoid actions that might be detrimental to Australian financial stability.
5. Bank liquidity is essential to the functioning of the financial system. Liquidity problems at a registered bank can harm confidence and cause liquidity problems to spread through the financial system. In the case of minor disruptions, this could inhibit smooth operation of the financial system and make daily business more costly and less certain. Larger disruptions impose material costs on the wider economy as well as financial system participants, and could even give rise to the failure of other banks.
6. The objective of this Liquidity Policy is to contribute to the smooth functioning of the financial system by reducing the likelihood of liquidity problems affecting a registered bank, and promoting registered banks' capability to manage such problems.

Conditions of registration

7. Section 74 of the Act permits the Reserve Bank to impose conditions of registration that relate to, among other things, the matters referred to in the following sections of the Act:
 - (a) 73A;
 - (b) 73B; and
 - (c) 78(1)(f) and 78(1)(fa);
8. Those sections address, among other things, matters that can include the governance, management and execution of liquidity-risk management, and can also include the need for disclosure of information about liquidity risk management. They also allow the Reserve Bank to consider the implications of regulation, supervision and

disclosure in a foreign-owned registered bank's home jurisdiction for the regulation of its New Zealand operations.

Guidelines

9. Under Section 78(3) of the Act, the Reserve Bank may issue guidelines for the purpose of interpreting whether a bank is carrying on business in a prudent manner with regard to the matters identified in Section 78(1) of the Act. The matters in 78(1) that are of interest here are:
 - (f) internal controls and accounting systems or proposed internal controls and accounting systems; and
 - (fa) risk management systems and policies or proposed risk management systems and policies.

Disclosure to the public

10. Under section 81 of the Act, the Governor General may, on the advice of the Minister and in accordance with a recommendation by the Reserve Bank, prescribe information or data that registered banks must publish in disclosure statements.

Regulatory reporting

11. Under section 93 of the Act, the Reserve Bank may require a registered bank to provide information, data or forecasts to the Reserve Bank. A notice under section 93 may specify:
 - (a) the periods for which, and form in which, the information, data or forecasts must be supplied; and
 - (b) the time by which the information, data or forecasts must be supplied.

B. POLICY REQUIREMENTS

12. Under the Liquidity Policy, registered banks will in general be subject to conditions of registration as set out in Appendix 1 of this Liquidity Policy.
13. In addition, registered banks must report information on liquidity and liquidity risk to the Reserve Bank as set out in a notice given to registered banks under Section 93 of the Act (a sample notice is included as Appendix 2 of this Liquidity Policy). A summary of the reporting requirements is given in section E of this Liquidity Policy, and a template specifying the details of the standard reporting is available from the Reserve Bank.
14. The disclosure Orders in Council made under Section 81 of the Act include various disclosure requirements that relate to liquidity risk and liquidity-risk management. Appendix 3 of this Liquidity Policy summarises these requirements and also refers to the information on liquidity risk required in banks' financial statements under applicable financial reporting standards.

B.1 Application of conditions of registration

15. The Reserve Bank will generally seek to impose on all registered banks standard conditions of registration regarding liquidity-risk management. The only variation will normally be that for New Zealand-incorporated banks, the minimum ratio requirements

apply to the business of the New Zealand banking group on a consolidated basis, whereas for branches of overseas-incorporated banks, they apply to the business of the branch alone.

16. The Reserve Bank reserves the right to apply conditions of registration that differ in nature in other ways among banks or among classes of banks. However, variations will generally be considered only where there is a strong case for non-standard conditions of registration and where the varied treatment would be consistent with the Liquidity Policy's objectives.
17. In particular, the Reserve Bank might in certain cases consider alternative treatment for branches of foreign banks under the Liquidity Policy.
18. In considering whether to allow a branch to be subject to alternative quantitative or qualitative requirements, the Reserve Bank will take into account the following factors:
 - (a) whether the branch's presence in New Zealand qualifies as "large" (where "large" is as defined in the Reserve Bank of New Zealand document "Outsourcing Policy" (BS11) dated January 2006);
 - (b) whether the branch in any other way plays a significant role in the financial system;
 - (c) the nature of the branch's business;
 - (d) whether the activities of the branch are so immaterial that it would not be reasonably expected to have a treasury function or liquidity risk management in its own right;
 - (e) the robustness of the international banking group's policies for liquidity risk management and the extent to which they can be relied on to achieve liquidity-risk management for the New Zealand branch consistent with achieving the outcomes sought by this Liquidity Policy;
 - (f) the nature of the home-country supervision applying to the international banking group and whether its scope includes liquidity-risk management for the New Zealand branch;
 - (g) whether the branch has a related party operating in New Zealand as a New Zealand-incorporated registered bank, and if so, the potential for the branch to be used to subvert the effectiveness of the quantitative liquidity requirements applying to the New Zealand-incorporated bank;
 - (h) the arrangements for the branch to obtain liquidity from other parts of its banking group, and the degree of certainty of access they provide.
19. When intending to vary a bank's conditions of registration or impose new conditions, the Reserve Bank must give the bank a reasonable opportunity to make submissions on the proposed changes and must have regard to those submissions. This process will provide the opportunity for a registered bank that wishes to do so to discuss with

the Reserve Bank any variations to the standard conditions of registration for liquidity risk.

B.2 Application of reporting and disclosure requirements

20. The Reserve Bank will generally seek to impose on all registered banks standard liquidity risk *reporting requirements*.
21. The Reserve Bank reserves the right to apply reporting requirements that differ in nature among banks or among classes of banks. However, variations will be considered only where there is a strong case for non-standard reporting and where the varied reporting would be consistent with the Liquidity Policy's objectives.
22. The Reserve Bank generally expects to vary reporting requirements less commonly than it varies conditions of registration for liquidity, and the hurdle will be particularly high for locally-incorporated banks.
23. In considering whether to allow a branch to be subject to alternative reporting requirements, the Reserve Bank will take into account the factors listed in paragraph 18 above, and in addition the following factors:
 - (a) whether reporting on the basis of the branch alone would give a meaningful picture of the liquidity risk facing the branch; and
 - (b) whether regulatory reporting and public disclosure applying to the banking group in other jurisdictions are available to the Reserve Bank and give an adequate picture of the liquidity risk position of the New Zealand branch.
24. *Disclosure requirements* in general for registered banks are set out in two Orders in Council, one for branches and one for New Zealand incorporated banks. With respect to liquidity risk specifically, these contain some minor differences between the disclosure requirements for branches and for locally-incorporated banks. When the Reserve Bank adds additional disclosure on liquidity risk in due course, as planned, it may continue to vary the approach between branches and locally-incorporated banks, as appropriate.
25. The rest of this document:
 - sets out the method of calculation for the quantitative requirements;
 - sets out the standard conditions of registration under this Liquidity Policy and related background material;
 - provides guidelines on how a registered bank could apply the qualitative requirements to its operations;
 - summarises the nature of the required public disclosures and directors' attestations under the Liquidity Policy; and
 - summarises the nature of required reporting to the Reserve Bank.

C. QUANTITATIVE REQUIREMENTS

26. The specific application of the Liquidity Policy's quantitative requirements to a registered bank will be set out in a registered bank's conditions of registration. The standard Conditions of Registration are set out in Appendix 1 of this Liquidity Policy.

The Reserve Bank will, from time to time, review the levels of the standard minimum requirements to ensure that they remain appropriate as long-run, through-the-cycle minimum requirements. Where necessary the Reserve Bank will discuss with banks the outcomes of such reviews.

27. Under the Reserve Bank's disclosure requirements, directors of a registered bank, and the New Zealand Chief Executive Officer for a registered bank incorporated overseas, must attest that the registered bank has, at the reporting date and over the accounting period, complied with the registered bank's conditions of registration including the quantitative liquidity requirements set out here.
28. A registered bank must also report data to the Reserve Bank that includes information about the registered bank's performance against the quantitative requirements. The nature of the reporting requirements is set out in section E.2 of this Liquidity Policy.
29. Except where a registered bank's conditions of registration state otherwise, the registered bank must calculate its position against the Liquidity Policy's quantitative requirements by the approach set out in the remainder of Section C. The definitions and "haircuts" to be used in the calculations are defined in Section C.4. However, the registered bank may adopt any reasonable simplifying assumption in its method of calculation of any of the three quantitative ratios that has the effect (if any) of decreasing the value of that ratio. The conditions of registration specify the scope of consolidation to be used in the calculations.

C.1 One-week mismatch ratio

30. The registered bank must maintain its one-week mismatch ratio at not less than the minimum specified in its conditions of registration, at the end of each business day. The standard minimum is zero per cent.
31. The one-week mismatch dollar amount for the purposes of calculating the one-week mismatch ratio is defined as follows, with the components defined in section C.4.

One-week mismatch dollar amount =

	primary liquid assets after accounting for haircuts
<i>plus</i>	contractual inflows due within one week
<i>plus</i>	75 per cent of undrawn committed lines granted to the registered bank available within one week, up to a maximum amount from any one provider of 3 per cent of the bank's total funding, and a maximum amount from all providers together of 9 per cent of the bank's total funding
<i>minus</i>	100 per cent of market funding withdrawable at sight or with residual contractual term within one week
<i>minus</i>	non-market funding that is withdrawable at sight or with residual contractual term within one week, applying the percentages in Table 1 to such funding falling within each size band
<i>minus</i>	other contractual outflows due within one week
<i>minus</i>	15 per cent of the undrawn balance of committed lines, other than revolving retail facilities, granted by the bank drawable within one week

Table 1: percentages of non-market funding in each size band to be included as outflows (negative sign) in the mismatch ratio calculations

Size band	Up to \$5mn	\$5mn to \$10mn	\$10mn to \$20mn	\$20mn to \$50mn	Over \$50mn
Percentage to be included	5%	20%	40%	60%	80%

32. The one-week mismatch ratio is defined as follows, with the components defined in section C.4.

$$\text{One-week mismatch ratio} = 100 \times (\text{One-week mismatch dollar amount} / \text{Total funding})$$

C.2 One-month mismatch ratio

33. The registered bank must maintain its one-month mismatch ratio at not less than the minimum specified in its conditions of registration, at the end of each business day. The standard minimum is zero per cent.
34. The one-month mismatch dollar amount for the purposes of calculating the one-month mismatch ratio is defined as follows, with the components defined in section C.4.

$$\begin{aligned} \text{One-month mismatch dollar amount} = & \\ & \text{primary liquid assets after accounting for haircuts} \\ & \textit{plus} \text{ secondary liquid assets after accounting for haircuts} \\ & \textit{plus} \text{ contractual inflows due within one month} \\ & \textit{plus} \text{ 75 per cent of undrawn committed lines granted to the} \\ & \text{registered bank available within one month, up to a} \\ & \text{maximum amount from any one provider of 3 per cent} \\ & \text{of the bank's total funding, and a maximum amount} \\ & \text{from all providers together of 9 per cent of the bank's} \\ & \text{total funding} \\ & \textit{minus} \text{ 100 per cent of market funding withdrawable at sight or} \\ & \text{with residual contractual term within one month} \\ & \textit{minus} \text{ non-market funding that is withdrawable at sight or with} \\ & \text{residual contractual term within one month, applying} \\ & \text{the percentages in Table 1 to such funding falling within} \\ & \text{each size band} \\ & \textit{minus} \text{ other contractual outflows due within one month} \\ & \textit{minus} \text{ 15 per cent of the undrawn balance of committed lines,} \\ & \text{other than revolving retail facilities, granted by the bank} \\ & \text{drawable within one month} \end{aligned}$$

35. The one-month mismatch ratio is defined as follows, with the components defined in section C.4.

$$\text{One-month mismatch ratio} = 100 \times (\text{One-month mismatch dollar amount} / \text{Total funding})$$

36. Liquid assets and committed funding lines are held to support a bank's ongoing ability to meet obligations in the event of stress. Should a bank need to liquefy such assets or

draw down such lines in order to meet its obligations, then the Reserve Bank recognises that this should be done even where doing so would breach the minimum regulatory requirements.

37. In such circumstances the bank should inform the Reserve Bank of a forthcoming or actual breach, and the Reserve Bank would then discuss the process for returning to compliance with the ongoing minimum quantitative requirements. Such a path might be set out in conditions of registration. The Reserve Bank would also discuss what information might be disclosed about the breach, the reasons for the breach, and the path to re-attaining compliance.

C.3 One-year core funding ratio

38. The registered bank must maintain its one-year core funding ratio at not less than the minimum specified in its conditions of registration, at the end of each business day. The standard minimum has been set at 65 per cent on initial implementation of this policy, although the Reserve Bank intends to increase the minimum to 75 per cent in stages over time, subject to a review process in line with paragraph 26.
39. The core funding dollar amount for the purposes of calculating the one-year core funding ratio is defined as follows, with the components defined in section C.4.

One year core funding dollar amount =

- all funding with residual maturity longer than one year, including subordinated debt and related party funding
- plus* 50 per cent of any tradable debt securities issued by the bank with original maturity of two years or more and with residual maturity at the reporting date of more than six months and not more than one year
- plus* non-market funding that is withdrawable at sight or with residual maturity less than or equal to one year, applying the percentages in Table 2 to such funding falling within each size band
- plus* Tier 1 capital

Table 2: percentages of non-market funding up to one year in each size band to be included in core funding

Size band	Up to \$5mn	\$5mn to \$10mn	\$10mn to \$20mn	\$20mn to \$50mn	Over \$50mn
Percentage to be included in core funding	90%	80%	60%	40%	20%

40. The one-year core funding ratio is defined as follows, with the components defined in section C.4.

One-year core funding ratio =

$$100 \times (\text{One year core funding dollar amount} / \text{total loans and advances})$$

C.4 Definitions: components of the quantitative ratio requirements

41. Section C.4 defines the variables that are to be used in the calculation of the quantitative requirements under this Liquidity Policy. Unless otherwise specifically stated, each term is defined in relation to the scope of consolidation for the calculation that is specified in the conditions of registration, that is, normally the banking group or registered bank as applicable. For instance, “primary liquid assets” can mean such assets held on the consolidated balance sheet of a banking group, or on the balance sheet of a branch, depending on the scope of the ratio calculations. Where the term “bank” is used, it refers to either banking group or registered bank, as applicable.
42. The list of **Primary liquid assets** and **Secondary liquid assets**, along with their associated haircuts and limits on the eligibility of certain classes of liquid asset, is set out in the current version of Reserve Bank of New Zealand Document “Liquidity Policy Annex: Liquid Assets” (BS13A).
43. The value of a liquid asset to be included in the calculation (before applying the haircut) will be its current mark-to-market value. If such a value is not available, then another fair value measurement approach can be used (as allowed by NZ IAS 39). If no such measurement approach is applicable to the asset, it should not be treated as a liquid asset.
44. Wherever possible, the Reserve Bank will endeavour to give reasonable notice when making changes to BS13A. Advice of such changes will be provided to registered banks and posted on the Reserve Bank’s website.
45. It should be noted that there is no one-to-one correspondence between the lists set out in BS13A and the Reserve Bank’s list of securities acceptable in its Domestic Markets Operations. Changes in one list will not automatically result in changes in the other.
46. **Due within one week** means payable by close of business on the day one calendar week after the business day at which the limit applies: for instance, when the ratio is being calculated as at close of business on a Monday, payments due within one week are all those payable by close of business on the following Monday.
47. **Due within one month** means payable by close of business on the day one calendar month after the business day at which the limit applies.
48. **Contractual inflows due within one week / one month** is defined as amounts of principal and interest due, and payments contractually due on derivative contracts, within the specified period, but excluding the following:
- (a) any amount contractually repayable within the period from outstanding credit card balances and from amounts drawn down under retail overdraft facilities;
 - (b) any interest payment due from any borrower within the period that will be debited directly to an account held by the borrower with the bank;
 - (c) demand balances held at other banks and ESAS balances at the Reserve Bank (these are treated separately as primary liquid assets);
 - (d) any repayment of principal due on any other asset which is separately included in the calculation of the ratio as a primary or secondary liquid asset;

- (e) principal or interest payments which the bank assesses that it is unlikely to receive because the borrower is facing repayment difficulties;
 - (f) any other amounts of principal or interest due within the period that the bank chooses to exclude from the calculation of the mismatch ratios; and
 - (g) amounts due from receipt of fees and commissions.
49. **Other contractual outflows due within one week / one month** is defined as amounts due to be paid out within the specified period arising from interest payments, lending due to be drawn down where the draw-down date and principal amount are certain, and payments contractually due on derivative contracts. It excludes the following:
- (a) any interest payment due to any depositor within the period that will be credited directly to an account held by the depositor with the bank; and
 - (b) amounts due to be paid in fees and commissions.
50. A **Committed line granted to the registered bank** is defined as any line that meets the following conditions:
- (a) its provider has an investment grade credit rating that is, a credit rating of BBB- or Baa3 or better, or its equivalent;
 - (b) it is legally binding;
 - (c) its commitment agreement will remain valid for at least the period of the relevant mismatch requirement (i.e. one week for the one-week ratio; and one month for the one-month ratio);
 - (d) it is not unconditionally cancellable; and
 - (e) the bank judges that no covenants or material adverse change clauses in the commitment agreement are likely to be breached.
51. For the purpose of the limits on the amounts that can be included in the calculations, committed lines from entities that are related to one another must be treated as committed lines from a single provider. Committed lines from related parties of the registered bank (outside the scope of consolidation of the calculation) can be included in the calculation, subject to the above conditions and subject to the 3% limit on any one provider. The limits apply to the amounts of undrawn committed lines after applying the 75% factor.
52. **Committed lines granted by the bank** are defined as committed credit limits that the bank has granted to customers. Irrevocable offers of residential mortgage lending which the customer has not yet drawn down should also be treated as committed lines. Revolving retail facilities including credit card limits, retail overdrafts, and revolving mortgage facilities are excluded from the calculations.
53. **Market funding** is defined as the total of:

- (a) deposits/ debt securities of the bank held by financial institutions or related parties of financial institutions;
 - (b) tradable debt securities issued by the bank not already included in (a) above;
 - (c) any funding received from related parties of the bank not already included in (a) or (b) above; and
 - (d) any funding that the registered bank is unable to, or chooses not to allocate between market and non-market funding.
54. For the purpose of defining market funding, **financial institution** means an entity falling within the subdivision K62 “finance” of the Australian and New Zealand Standard Industrial Classification (ANZSIC) 2006.
55. For the purpose of this liquidity policy, **tradable debt security** means any debt security (as defined in section 2 of the Securities Act 1978) which can be freely bought, sold or traded, except that the registered bank may opt to exclude from this category any debt security which it can identify as meeting one of the following conditions:
- (a) it is issued to, or becomes held by, a natural person or natural persons resident in New Zealand;
 - (b) it is issued to, or becomes held by, a nominee company on behalf of a natural person or natural persons resident in New Zealand;
 - (c) it is issued to, or becomes held by, a trust whose beneficiary(ies) are a natural person or natural persons resident in New Zealand; or
 - (d) it is issued to, or becomes held by, a Loss Attributing Qualifying Company in which a natural person or natural persons resident in New Zealand hold the majority of shares.
56. For the purpose of these definitions **related** has the same meaning as in section 2(3) of the Companies Act 1993, but with the meaning of subsidiary modified as in section 2(1) of the Financial Reporting Act 1993.
57. **Non-market funding** means total deposits/debt securities issued by the bank not falling within the definition of market funding.
58. The bank must use one of the two methods described below to allocate total non-market funding as at the end of each business day to different size bands. The bank may adopt any reasonable simplifying assumption in its method of allocation which has the effect (if any) of re-allocating amounts of funding that would otherwise have fallen into a given size band into a higher size band (or bands).
59. **Under either method**, on each relevant date as required by the method chosen, the registered bank must determine which persons fall in to each of the size bands listed in Table 3 below by allocating each person that is a provider of non-market funding to the bank to the size band corresponding to that person’s total assets held at the bank on that date, except that:

- (a) in the case where the person is a body corporate other than a Crown or government organisation, the registered bank must not allocate that person and each of its related parties individually to size bands, but must instead treat that person and all of its related parties as if they were a single person and must allocate that single person to a size band according to the total assets which it holds at the bank;
- (b) in the case where the person holds a deposit at the bank as a trustee of a trust for which the registered bank or another member of the banking group is settlor, the bank must exclude that person from the allocation to size bands, and must instead allocate each individual beneficiary of that trust to a size band according to the amount of that beneficiary's beneficial interest in that deposit and any other assets which that beneficiary holds at the bank; and
- (c) in the case where a person owns a deposit at the bank which is under the control of a third party who has the right to withdraw the deposit without reference to the owner of the deposit, that deposit should be treated as if it were owned by the third party and aggregated with all other deposits at the bank owned by that party. If the third party is classified as a financial institution, all those deposits should be treated as market funding.

Table 3: Definitions of Size Bands

Total assets	Not more than NZ\$5,000,000	More than NZ\$5,000,000 and not more than NZ\$10,000,000	More than NZ\$10,000,000 and not more than NZ\$20,000,000	More than NZ\$20,000,000 and not more than NZ\$50,000,000	More than NZ\$50,000,000
Size band	Up to \$5mn	\$5mn to \$10mn	\$10mn to \$20mn	\$20mn to \$50mn	Over \$50mn

60. **Under the first method**, the registered bank updates its size categorisation of each relevant person, in accordance with paragraph 59 above, with the following frequency:
- (a) at least at the balance date of each accounting period and each interim accounting period; or
- (b) at more frequent regular dates, but still including the dates specified in (a) above, if it chooses; and,
- (c) in respect of new customers of the relevant types, on the date that the customer first places funds with the bank.
61. **Non-market funding in each size band on each reporting date** is then the total of non-market funding provided by all persons that the registered bank has allocated to that size band at the most recent update of that size categorisation.

62. **Under the second method**, the registered bank determines, at least monthly and at more frequent regular intervals if it chooses, what percentage of non-market funding falls into each size band, on the basis of the total dollar amounts of non-market funding provided by all persons falling into that size band at that date, determined in accordance with paragraph 59 above.
63. **Non-market funding in each size band on each reporting date** is then total non-market funding at that date, multiplied by the percentage share of that size band as at the most recent date that the bank has determined those percentages.
64. Under the second method, the registered bank may apply the approach separately to two or more sub-categories of non-market funding that make up the total of non-market funding, so that total non-market funding in a given size band on each reporting date is the sum of non-market funding that falls into that size band across all sub-categories.
65. **Total funding** is the sum of market funding and non-market funding in all size bands.
66. **Total loans and advances** is the figure for loans and advances included in the bank's balance sheet in its most recent published disclosure statements.
67. For the purpose of calculating the one year core funding ratio, any funding raised by means of securitisation of assets of the bank may be included in the calculation, treated in the prescribed manner given its maturity and other characteristics, provided that if the securitisation results in derecognition of an amount that would otherwise be included in total loans and advances on the bank's reported balance sheet, that amount should be added to total loans and advances in the denominator of the ratio.
68. **Tier One capital** is the banking group's Tier One capital as most recently calculated for the Reserve Bank's capital adequacy requirements framework if applicable, or the equivalent branch equity for branches of overseas-incorporated banks.

D. QUALITATIVE REQUIREMENTS AND GUIDELINES

69. Standard conditions of registration require that a registered bank must have an internal process for liquidity-risk management that meets the Reserve Bank's qualitative requirements for liquidity-risk management. This section sets out the Conditions of Registration and associated guidelines.
70. Under the Reserve Bank's disclosure requirements, directors of a registered bank, and the New Zealand Chief Executive Officer for a registered bank incorporated overseas, must attest that the registered bank has, at the reporting date and over the accounting period, complied with the registered bank's conditions of registration including the qualitative requirements set out here.
- ### **D.1 Qualitative requirements**
71. Except where a registered bank's conditions of registration provide otherwise, the registered bank's internal framework for liquidity-risk management must be adequate in the registered bank's view for managing the bank's liquidity risk at a prudent level, and must, in particular:

- (a) be clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;
- (b) identify responsibility for approval, oversight and implementation of the framework and policies for liquidity-risk management;
- (c) identify the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and
- (d) consider the material sources of stress that the bank might face, and prepare the bank to manage stress through a contingency funding plan.

D.2 Guidelines

- 72. Guidelines follow, issued under Section 78(3) of the Act, on factors that a registered bank should consider when deciding how to meet the requirements set out in section D.1.
- 73. Subject to complying with the requirements set out in the registered bank's conditions of registration, a registered bank may determine the detailed nature of its arrangements for liquidity-risk management. The directors should satisfy themselves that the detailed arrangements both comply with the requirements of the Liquidity Policy and are appropriate to the nature of the bank's business and risks.
- 74. In determining the detailed nature of a registered bank's arrangements for liquidity risk management, the registered bank should act in a manner consistent with the objectives of the guidelines provided by this Liquidity Policy and with the implications of the particular nature of the registered bank's business and risks.

D.2.1 Organisational structure for liquidity-risk management

- 75. Where relevant to the bank, given its nature and risks, the bank should apply the guidelines given in Section D.2.1 when devising the organisational structure for managing liquidity risk.
- 76. The overall framework and structure should be approved by the Board of the bank (for a New Zealand-incorporated bank) or by the Board and the New Zealand Chief Executive Officer (for a branch of a foreign-incorporated bank).
- 77. The principal elements in the organisational structure for liquidity-risk management are:
 - (a) the application of the framework through the organisation; and
 - (b) the arrangements for governance, oversight and implementation of the framework.

(a) *Application through the organisation*

- 78. The registered bank's policies should address all parts of the business that have a material influence on the registered bank's liquidity position and liquidity risk. For a New Zealand incorporated bank, this may include subsidiaries of the registered bank.

The policies should be communicated to all those with responsibility for managing liquidity and liquidity risk.

79. Where relevant to the registered bank's business structure, the policies should address the terms on which liquidity or liquidity risk may be transferred across business lines or with other members of the banking group. Where appropriate, this should address the appropriate pricing of any liquidity or risk transferred.

(b) *Roles and responsibilities in liquidity-risk management*

80. The framework should identify where responsibility lies in the registered bank for oversight, control and implementation of liquidity-risk management.
81. The framework should identify the necessary process for approval of the registered bank's policies for liquidity risk management, and for any changes to or exceptions to those policies.
82. The framework should identify the nature, recipients and frequency of the main internal reporting on liquidity risk and on the management of liquidity risk.
83. The bank should have an independent function with the authority to challenge those responsible for implementing liquidity management and for executing funding plans.
84. Provision should be included for periodic review, by internal audit or by an external independent party, of liquidity management and of the liquidity-risk management framework.
85. The Board should take responsibility for ensuring that the registered bank has and implements an effective structure and liquidity-risk management framework for the bank, including contingency planning, so as to be able to achieve the bank's objectives for liquidity-risk management in normal times and in periods of stress.
86. Senior management should take responsibility for the operational implementation of the registered bank's liquidity-risk management framework, including contingency planning, and of the structures, strategy, policies and practices that comprise the framework.

D.2.2 Methods for measuring, monitoring and controlling liquidity risk

87. Where relevant to the bank, given its nature and risks, the bank should apply the guidelines given in Section D.2.2 when devising and applying the analytical framework and tools for liquidity-risk management.

(a) *Internal strategy and communication of the strategy*

88. The bank should identify its risk tolerance and objectives for liquidity risk management. In general, the bank's risk tolerance and objectives should reflect:
- the nature of the bank's business;
 - potential demands from off the bank's balance sheet and from business with connected parties, where applicable;
 - the environment and markets in which the bank operates; and
 - the nature of the bank's relationship with the owner or with related parties.

89. The strategy for liquidity-risk management should identify how the bank will manage liquidity risk in line with its risk tolerance and with any other stated objectives. This should include identification of the analytical framework and tools that the bank will use to measure, monitor and control liquidity risk.
90. The analytical framework and tools should be documented and communicated clearly to all those in the bank who are required to carry out the measurement, monitoring, control and management of liquidity risk.

(b) Coverage of the bank's operations

91. The bank's approach to measuring, monitoring and controlling liquidity risk should enable the bank to meet demands for liquidity, in the form of cash outflows in a given period, with a margin of certainty consistent with the bank's risk tolerance. The approach should address liquidity risk and liquidity positions over a range of time horizons, from intra-day payment and settlement needs in Real-Time Gross Settlement systems out to the long term, and for all material sources of liquidity risk.
92. The processes and systems for measuring, monitoring and controlling liquidity risk should apply both to transactions with third parties and, where appropriate to the registered bank's business structure, to activity within the bank or its group. They should also address risk stemming from off the balance sheet and from contingent exposures.
93. All elements of the bank's framework for measurement, monitoring, and control of liquidity risk and for management of liquidity should take account of cashflows in all currencies. Where the bank does not consider there to be material risk to the convertibility of a currency, positions in that currency may be converted into a home currency or principal currency of analysis for the purposes of analysing and managing liquidity risk.
94. Those in the bank undertaking activities that affect the bank's liquidity and liquidity risk should face controls and incentives reflecting their contributions to liquidity and liquidity risk.

(c) Cashflow management and liquid-asset stocks

95. The bank should have a method for projecting cashflows and positions under both normal conditions and stress scenarios. This analysis should be performed both for the bank as a whole and, where relevant, for business units that contribute significantly to liquidity or liquidity risk. The flows considered should include flows driven by correspondent relationships and off-balance-sheet business.
96. Internal cashflow projections should take account of the expected behaviour of assets and liabilities, making appropriate assumptions where contractual maturities are unlikely to be a useful guide. The bank should also consider the risk of calls for support from off-balance sheet vehicles, from requirements to post additional collateral in derivatives positions, or from other contingent demands on liquidity.
97. Assumed behaviour of cashflows and available liquidity should take account of any material practical obstacles to obtaining needed funds and realising liquidity.
98. In the event of stress, an important way of meeting funding gaps can be through the sale or pledging of a stock of liquid assets held as a backstop against such events.

However, such a stock should be treated as backstop for difficult conditions rather than as the usual primary means of meeting net outflows. The holding of liquid assets is addressed in further detail below in Section D.2.2 (h) on management of funding and liquid assets.

(d) *Internal limits and targets*

99. Based on its analysis of liquidity and liquidity risk, and to provide for operation in line with the bank's risk tolerance and other objectives, the bank should set internal limits and targets for use in the day-to-day management of liquidity and liquidity risk. Where needed to ensure effective liquidity-risk management, these should be set in addition to the Reserve Bank's quantitative requirements set out in Section C of this Liquidity Policy.
100. Limits and targets should be set for the bank as a whole. Where appropriate, they should also be set for individual business lines and in line with the comments above in Section D.2.2 (b) should address risks from positions and flows in all currencies.

(e) *Breaches of internal limits and targets*

101. Clear procedures should be implemented for reporting on and responding to breaches of internal limits and targets, or of regulatory requirements. Any allowance of exceptions to internal limits and targets, or approval of breaches after the event, should be approved at an appropriate level in the organisation.
102. Any breaches of internal limits or targets, and of regulatory requirements, should be reported to an appropriate level in the bank. A remedial plan should then be identified, and regular reports provided on progress until such time as the remedial action is satisfactorily completed and the bank has returned to a position consistent with its risk tolerance and other objectives.

(f) *Scenario analysis*

103. To support the bank's understanding of its liquidity risk and position, the bank should regularly undertake analysis of its liquidity position under a range of scenarios that are appropriate to the bank's business and risks. This should entail, at least, analysis of the bank's cashflow position and ability to meet outflows over a range of time horizons. A bank should not rely solely on compliance with the Reserve Bank's quantitative requirements to ensure robustness to a range of relevant scenarios.
104. The outcomes of such scenario analysis should inform the bank's management of liquidity and liquidity-risk, and any deficiencies indicated by the analysis should be addressed promptly. As noted below (Section D.2.3), the scenarios analysed should also be reflected in the bank's planning for contingency management.

(g) *Analysis of other types of risk*

105. Liquidity risk can be exacerbated by and contribute to the manifestation of other types of risk to which banks are exposed, e.g. credit risk, operational risk, and other types of risk can contribute to or be exacerbated by liquidity problems. Analysis of risk should thus take account of the interaction of liquidity risk with other types of risk, including those risks coming from off the bank's balance sheet.

(h) *Management of funding and liquid assets*

106. Consistent with the bank's risk tolerance, objectives and internal analysis of liquidity risk, the bank's liquidity-risk management framework should identify the approach to

managing the composition and nature of the bank's funding and its liquid assets. This should include a funding plan. There should be associated internal targets and limits.

107. The composition of funding and liquid assets should reflect the bank's liquidity needs. Equally, the bank's business should not be allowed to develop in ways that cannot be prudently supported by its funding and its liquid-asset holdings.
108. Consistent with Section D.2.2 (b) above, decisions on the composition of funding and liquid assets should address risks from positions and flows in all currencies.

Managing the composition of funding

109. The composition of funding should reflect the bank's liquidity needs and risks. Two important dimensions of funding composition are: the diversity (of the source and form) of funding; and the term of funding. The bank should have policies, including internal targets and limits, to ensure that the diversity and term of funding are prudent for the bank's needs.
110. The bank's funding position and policy should be one of the important inputs to the bank's analysis of liquidity risk and to scenario analysis.
111. Where funding sources are diverse in source and form – so that their risks are not highly correlated – there is a lesser chance that the bank will face a reduction in access to, or increase in demands to repay, a number of sources at the same time. Important elements of diversity can include, though are not necessarily limited to: the identity or characteristics of the provider, including whether the funding is wholesale or retail in nature; the currency of denomination; the jurisdiction of origin; the markets through which funding is raised; and the legal structure of the funding instrument. Diversity is important for promoting the continued provision and renewal of funding, the issuance of new funding, and the mobility of funds within the bank or within the group of which the bank is a part.
112. The term of funding determines the point in time at which, under normal conditions, the bank will face the requirement to renew funding or obtain funding from another source. If the term of funding and of the assets funded is more closely matched, there will be less risk of difficulties in obtaining funding to support those assets or in realising inflows from the assets to repay funding.
113. It is important not to allow excessive concentrations in the term of funding. Such concentrations can be a source of difficulty when large quantities of funding of a given term need to be renewed within a short space of time. The bank is responsible for adopting policies that ensure adequate diversity in the term of funding, and should not rely solely on compliance with the Reserve Bank's quantitative requirements (set out in Section C, above).

Management and monitoring of market access

114. The bank should actively monitor and promote its access to its important funding sources. The bank should also have a way of assessing its funding capacity both in normal times and in stressed circumstances.

Buffer of liquid assets

115. Effective management of the bank's mismatch position and balance sheet composition should be the principle means of avoiding shortfalls in liquidity. Nonetheless, as a

backstop measure the bank should hold a buffer of high-quality liquid assets against the risk of liquidity shortfalls. This buffer should both allow the bank to meet the Reserve Bank's quantitative requirements of liquid-asset holdings and take account of the full range of risks and liquidity demands facing the bank.

116. These liquid assets should be available permanently and should be eligible for realisation by sale or pledging even in stressed circumstances. The composition and quantum held in the portfolio should be appropriately diversified by source and term in light of the bank's risk tolerance, the bank's potential liquidity needs under a range of relevant scenarios, and the available facilities for realising the liquidity value of the assets. Among the demands to be considered are the intra-day needs for collateral stemming from the bank's operation in payment and settlement systems.
117. Practical factors influencing the bank's needs and ability to realise liquidity value should also be considered when structuring the portfolio, including the currency of denomination and location in which assets are held.
118. It is important that the bank should not excessively concentrate its liquid assets in particular asset classes simply for reasons such as minimising the cost of holding liquid assets. Because liquid assets are held as a buffer against the risk of unforeseen events, the portfolio composition should take account of the risk to the liquidity of each asset type in the kinds of circumstances in which the bank might need to liquify the portfolio.

D.2.3 Planning for contingency management

119. Where relevant to the bank, given its nature and risks, the bank should apply the guidelines given in Section D.2.3 when preparing, maintaining and implementing plans for contingency management.
120. The bank should be prepared to respond promptly and decisively to periods of liquidity stress. As part of such preparedness, the bank must establish a contingency funding plan. The contingency funding plan should be documented and communicated to those who would be affected by its execution.
121. The contingency funding plan should seek to achieve operation within the bank's risk tolerance where that is possible. In the event of stress and the invocation of the contingency funding plan, the plan should be designed to return the bank to a robust position, in line with its risk tolerance, as quickly as possible.
122. A contingency funding plan should include policies, procedures and plans for responding to disruptions to the bank's ability to meet its funding needs, enabling prompt and effective decision-making and execution of contingency measures.
123. The plan should address all of the bank's business lines, and take account of any off balance sheet and contingent risks that exist. The plan should reflect the nature of the risks that the bank faces and the bank's liquidity-risk tolerance. The scenarios considered by the contingency funding plan, and the assumptions therein, should relate to the bank's scenario analysis and take account of the lessons from scenario analysis.
124. The contingency funding plan should be consistent with any wider business continuity plan (BCP) of the bank.

125. The contingency funding plan should identify clear triggers – quantitative and qualitative as appropriate – and procedures for invocation of the plan, and for escalation of the level of alert. There should be scope for the plan to be invoked and escalation initiated based on judgement about risk, even if none of the identified triggers has been hit.
126. To support internal control of liquidity risk, the bank should be capable of producing, analysing and responding to additional information during periods of stress. This must include the ability to meet the requirements for additional reporting to the Reserve Bank (see Section E). The bank should be able to quickly assess its position and available liquidity sources, taking account of any practical matters involved in realising liquidity. The plan should also consider means of prioritising payments and controlling outflows where possible.
127. The contingency funding plan should include consideration of how to manage both internal and external communications to promote the markets' and the wider public's confidence in the bank.
128. The plan should be tested for effectiveness and operational feasibility.

E. REQUIREMENTS FOR PUBLIC DISCLOSURE AND REGULATORY REPORTING

E.1 Public disclosure

129. A registered bank must comply with the Reserve Bank's requirements for public disclosure and for regular reporting to the Reserve Bank about liquidity. Further, directors of a registered bank, and the New Zealand Chief Executive Officer for a registered bank incorporated overseas, must attest in disclosure statements that the registered bank has, at the reporting date and over the accounting period, complied with the requirements set out in the bank's conditions of registration.
130. The Reserve Bank's precise requirements for public disclosure are set out in the disclosure Orders in Council. New Zealand financial reporting standards also require substantial disclosure relating to liquidity risk. Appendix 3 of this Liquidity Policy summarises the liquidity-related disclosure requirements applying to registered banks.

E.2 Reporting to the Reserve Bank

131. A registered bank must report monthly to the Reserve Bank on its liquidity position and risk. The Reserve Bank imposes this requirement by issuing a notice to the bank under Section 93 of the Act: a sample notice is included as Appendix 2 of this Liquidity Policy. The registered bank must also be able to provide the same information weekly should the Reserve Bank request such reporting.
132. The details of the required reporting for each registered bank are set out in an Excel workbook provided to the bank following on from the Section 93 notice. In general, the reporting details and definitions are standardised for all registered banks. These standard requirements are summarised below, with each sub-paragraph summarising one worksheet in the Excel workbook:

- (a) Mismatch and core funding: a summary of the three key ratios, and the dollar amounts of their components. Figures are reported as at end-month, intra-month maximum and minimum, and average over the month.
- (b) Primary liquidity assets: a breakdown of assets held that qualify as primary liquid assets for the calculation of the mismatch ratios.
- (c) Secondary liquidity assets: a breakdown of assets qualifying as secondary liquid assets for the calculation of the one month mismatch ratio
- (d) Funding profile (face value): all funding, broken down into columns according to the remaining time to maturity of the funding, and into rows according to whether the funding is domestic or offshore, NZ dollar or other currency, over or under 2 years' original maturity, and from related or unrelated parties.
- (e) Non-market funding at face value, by size band: a further breakdown of the non-market funding included in the previous worksheet, showing the amounts falling within the different depositor size bands as specified in this policy.
- (f) Reconciliation to SSR (Standard Statistical Return): because they are prepared on different bases, there will not normally be an exact match between the various funding subtotals used in the calculation of the liquidity ratios, and the corresponding values reported for the purposes of monetary aggregates in the SSR. This worksheet shows the differences between the two sets of figures.
- (g) Contractual cash flows: a breakdown by residual contractual maturity of all other cash inflows and outflows not included above that are needed to complete the calculation of the mismatch ratios and the core funding ratio.
- (h) New issues at face value: this shows new funds invested into the bank during the month, broken down by investment term, excluding amounts invested for less than one month. Amounts include funds already invested in the bank that are rolled over.
- (i) Average cost of new issues, weighted by face value: this reports the weighted average cost of new funds raised over the month, in each maturity band and category of funding. For market funding raised via debt issuance programmes, the cost is reported relative to the three-month bank bill rate. For other funding it is reported relative to the NZ dollar swap rate.

Appendix 1 – Standard conditions of registration

In general, registered banks will be subject to the following conditions of registration. The quantitative requirements will normally apply at banking group level for New Zealand-incorporated banks, and at registered bank level for New Zealand branches of overseas-incorporated banks.

1. That the [banking group]/[registered bank] complies with the following quantitative requirements for liquidity-risk management:
 - (a) the one-week mismatch ratio of the [banking group]/[registered bank] is not less than zero per cent at the end of each business day;
 - (b) the one-month mismatch ratio of the [banking group]/[registered bank] is not less than zero per cent at the end of each business day; and
 - (c) the one-year core funding ratio of the [banking group]/[registered bank] is not less than [65 per cent] at the end of each business day.

For the purposes of these requirements, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled “Liquidity Policy” (BS13) dated [month year] and “Liquidity Policy Annex: Liquid Assets” (BS13A) dated [month year].

2. That the registered bank has an internal framework for liquidity-risk management that is adequate in the registered bank’s view for managing the bank’s liquidity risk at a prudent level, and that, in particular:
 - (a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;
 - (b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity-risk management;
 - (c) identifies the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and
 - (d) considers the material sources of stress that the bank might face, and prepares the bank to manage stress through a contingency funding plan.

Appendix 2 – Sample Section 93 notice setting out reporting requirements

SECTION 93 NOTICE issued to [name of registered bank]

With effect from [date], the Reserve Bank of New Zealand requires [name of bank] to provide monthly information on its liquidity risk. Details of the required information and the form in which it must be supplied are specified in an Excel workbook which is to be sent to a nominated officer of [name of bank].

The required information must be sent to the Reserve Bank of New Zealand no later than 15 working days after the end of the month to which the information relates, via the Reserve Bank's secure upload facility <https://sup.rbnz.govt.nz/>.

This notice is issued pursuant to Section 93 of the Reserve Bank of New Zealand Act 1989.

Head of Financial Stability
Reserve Bank of New Zealand

Appendix 3 – Summary of disclosure requirements

- 1 This Appendix summarises the requirements applying to registered banks for disclosure of quantitative and qualitative material relating to liquidity risk. The complete disclosure requirements are contained in the disclosure Orders in Council (“the Orders”) and in applicable financial reporting standards.
- 2 A registered bank is required to include a copy of its conditions of registration, including any conditions relating to liquidity risk, in its disclosure statement for the full year period. Disclosure statements for other periods must describe any changes to the conditions of registration that have occurred over the period. The bank’s directors (and, for a branch, its New Zealand chief executive officer) must state in every disclosure statement whether they believe that the bank has complied with all conditions of registration that applied during the relevant period. If the registered bank has not complied with all conditions of registration, it must give a description of the nature and extent of each case of non-compliance.
- 3 A registered bank’s disclosure statement for the full year accounting period must be accompanied by the financial statements of the registered bank and the banking group. Current applicable financial reporting standards require disclosure of various information, both quantitative and qualitative, relating to liquidity risk.

Quantitative disclosure

- 4 Any requirements to maintain liquidity ratio limits are imposed by the Reserve Bank in conditions of registration. Those conditions, and any breaches of them, must be disclosed as noted above.
- 5 Banks’ financial statements included in their full year disclosure statement are required to include extensive financial information on liquidity risk. Relevant financial reporting standards that currently apply include the following paragraphs of NZ IFRS 7: 31-32, 34-35, 39(a) and (b), and B10A-B11F.
- 6 The Orders require some additional information on liquidity risk on top of that required by financial reporting standards (see Schedules 4, 5 and 6 of both Orders, “Additional financial disclosures”). The combined effect is that a bank must publish a maturity analysis of financial assets and financial liabilities, including an “on demand” time band, in its half year as well as its full year disclosure statement. A bank must also publish every quarter an analysis of financial assets it holds for the purpose of managing liquidity risk. Full year disclosure is on both a banking group and a parent bank basis, while disclosure for other periods is on the basis of the banking group only.
- 7 The Reserve Bank intends in due course to require banks to add additional detail to their quantitative disclosure of liquidity risk.

Qualitative disclosure

- 8 The Reserve Bank imposes standard conditions of registration on registered banks setting out requirements for liquidity risk management. Those conditions, and any breaches of them, must be disclosed as described above.

- 9 A registered bank's disclosure statement must include a statement by its directors as to whether each director believes, after due enquiry, that, over the relevant period, the registered bank had systems in place to monitor and control adequately the banking group's material risks including liquidity risk, and that those systems were being properly applied.
- 10 Banks' financial statements are required to include descriptive information on liquidity risk and how it is managed. Relevant financial reporting standards that currently apply include the following paragraphs of NZ IFRS 7: 31-33, 39(c) and IG15-IG17.
- 11 The Order applying to locally-incorporated registered banks requires each bank to disclose the following information in its disclosure statement for the full year, in respect of liquidity risk among other risks:
- (1) A general description of the banking group's risk management objectives, policies, strategies and processes, to the extent not otherwise disclosed to comply with paragraph 33 of NZ IFRS 7.
 - (2) The following information in respect of each of the categories of risk [specified, including liquidity risk], to the extent not otherwise disclosed to comply with paragraph 33 of NZ IFRS 7:
 - (a) an explanation of the nature of the risk and the activities of the banking group which give rise to that risk:
 - (b) an explanation of the structure and organisation of the relevant risk management function:
 - (c) a general description of the relevant processes for identifying, measuring and monitoring exposure to the risk, including the frequency with which exposures are monitored and reported:
 - (d) a general description of the systems and procedures for controlling the risk, including (if applicable)—
 - (i) whether exposure limits are employed; and
 - (ii) any policies with respect to collateral or other security; and
 - (iii) any policies on the use of financial instruments to mitigate or hedge risks; and
 - (iv) strategies and processes for monitoring the continuing effectiveness of hedges and other mitigants.
 - (3) A statement as to—
 - (a) the nature and frequency of any reviews conducted in respect of the banking group's risk management systems; and
 - (b) whether any such reviews were conducted by a party external to the banking group, ultimate parent bank, or ultimate holding company.
- 12 Similar but slightly reduced requirements apply to branches of overseas banks for the full year accounting period.