

From: Bernard Hodgetts [Bernard.Hodgetts@rbnz.govt.nz]
Sent: Tuesday, 22 April 2008 9:32 a.m.
To: Geoff Lewis
Subject: Secondary objective re capital markets
Attachments: Secondary objective in capital market dev.doc

Geoff,

Ian Nield asked me to send this through to you.

Note that the final wording in the Statement of Intent now reads "Promote the development of capital markets in areas where the Bank has powers and responsibilities (i.e. in money, bond and FX markets)."

Regards
Bernard Hodgetts

MEMORANDUM FOR

FSO

COPIED TO

FROM

Financial Markets Department

DATE

4/04/2008

SUBJECT

A secondary objective for the RBNZ in promoting capital market development

FOR YOUR

Discussion/agreement

Background

1. In November 2007, a report to Ministers by Treasury suggested that the Reserve Bank could be given the subsidiary objective of promoting the development of capital markets in addition to its current responsibilities.¹ This suggestion was one of a broad range of options identified by a multi-agency taskforce headed by MED to help develop capital markets and encourage beneficial economic transformation. The Bank is now formally a part of this broader initiative (known as the Financial Markets Savings and Investment Initiative) along with the Treasury, MED and Inland Revenue.²
2. The Treasury proposal was first discussed at FSO Committee in January. Based on that initial FSO discussion, and further discussion within FMD, a number of points and issues have been established:
 - The Reserve Bank Act already has a requirement that the Bank *promote an efficient and sound financial system* across the Bank's various functions. Consequently, undertaking capital market initiatives would be consistent with this broader objective, provided that the promotion of efficiency and soundness was the guiding principle behind any initiatives in this area;
 - The Reserve Bank has undertaken initiatives to promote capital market development in the past (particularly in the area of the broader bond and money markets). However, there has been some uncertainty within the Bank as to how far this role should extend beyond the direct requirements of monetary policy implementation, prudential supervision, payment system oversight or liquidity management;
 - The discussion at FSO revealed a general concern that, if the Bank were to be given a secondary objective in the area of capital markets, any initiatives would need to be based on there being clear net benefits for the efficiency and soundness of markets. There was a strong reluctance that the Bank be involved in promoting capital market development for its own sake. The Bank would need to be satisfied that there was a clear market failure or other impediment to be addressed or that there was otherwise

¹ The report also suggested that the Debt Management Office also be given this secondary objective.

² Specifically, Grant Spencer is a member of the FMSI Sponsors Group (along with his counterparts from Treasury, MED and IRD), which will shortly convene a Private-Public engagement group to identify issues of relevance to capital markets. The Bank is also a member of the FMSI Working Group which oversees work being undertaken in this area across the various government agencies.

clearly demonstrable benefits to be had from promoting particular market initiatives. Rigorous cost-benefit analysis would be needed; and

- It was also felt that any initiatives promoted by the Bank would need to be restricted to those capital markets in which the Bank has clear expertise and/or a direct policy interest. This would tend to include areas such as the bond and money markets but exclude areas such as public or private equity markets or venture capital markets. In this regard, it was noted in discussion that many capital market issues, particularly as they relate to economic development, are likely to reside outside the Bank's sphere of responsibility.
- 3 On balance, providing the Bank with a secondary objective in this area is likely to constitute a relatively small change, which would make only a marginal difference to the overall development and functioning of the broader capital markets in New Zealand. Most directly, it could potentially influence the design of our monetary operations and standing financial facilities at times when we are looking to make changes for other (core business) reasons. It may also better guide the Bank in supporting market led initiatives. An example of this is the way the Bank assisted the development of the domestic Supranational bond market by allowing certain high-quality issuer's domestically issued debt to be used in the Bank's standing facilities.
- 4 As noted, it would be highly unlikely that this would address the multi-agency group's broader concerns (justified or not) in areas such as small and medium business capital raising. However, properly couched, we believe that the Bank can and should adopt the secondary objective as part of its contribution in this area.

The way forward

- 5 We do not believe that taking on this secondary objective warrants a further change to the Reserve Bank Act. Rather, we believe it could simply be couched as an additional 'issue' within the Bank's *Statement of Intent* under the broad heading of Financial system surveillance and policy. The specific issue could read something like:

Promote development initiatives or other changes in the capital markets in which we have expertise, if it can be shown that they will enhance the efficiency or soundness of the financial system.

- 6 Elsewhere in the SOI it would also be useful to recognise that the Bank is supporting the broader government-wide efforts in the area of capital market development and research.

Recommendation

- 7 It is recommended that FSO Committee:

- (i)** Agree that the Bank should add capital market development initiatives as an additional 'issue' in its *Statement of Intent* along the lines suggested in paragraph 5 of this paper.
- (ii)** Agree that we should acknowledge in the *SOI* our involvement in the broader government-wide efforts in the area of capital market development and research.